

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – II

PAPER – 5: ADVANCED MANAGEMENT ACCOUNTING

Question No. 1 is compulsory

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

Time Allowed – 3 Hours

Maximum Marks – 100

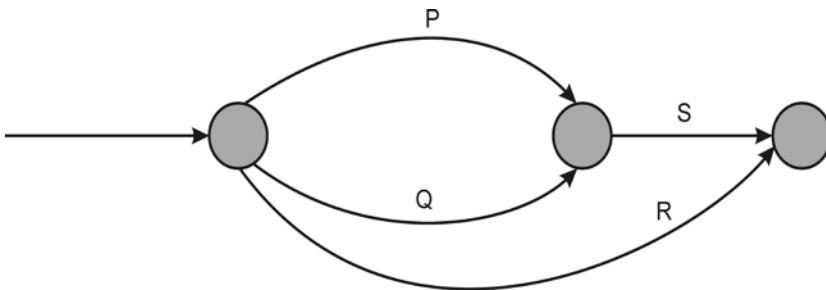
1. (a) A Pharmaceutical company produces formulations having a shelf life of one year. The company has an opening stock of 30,000 boxes on 1st January, 2005 and expected to produce 1,30,000 boxes as was in the just ended year of 2004. Expected sale would be 1,50,000 boxes. Costing department has worked out escalation in cost by 25% on variable cost and 10% on fixed cost. Fixed cost for the year 2004 is ₹40 per unit. New price announced for 2005 is ₹100 per box. Variable cost on opening stock is ₹40 per box. You are required to compute breakeven volume for the year 2005. (5 Marks)
- (b) Determine the selling price per unit to earn a return of 12% net on capital employed (net of Tax @ 40%).

The cost of production and sales of 80,000 units per annum are:

Material	₹ 4,80,000	Labour	₹ 1,60,000
Variable Overhead	₹ 3,20,000	Fixed overhead	₹ 5,00,000

The fixed portion of capital employed is ₹12 lacs and the varying portion is 50% of sales turnover. (5 Marks)

- (c) The following is a part of a network.



What are activities P and Q called? How would you rectify the situation? (5 Marks)

- (d) Answer the following independent situations relating to an assignment problem with a minimization objective:
- Just after row and column minimum operations, we find that a particular row has 2 zeroes. Does this imply that the 2 corresponding numbers in the original matrix before any operation were equal? Why?
 - Under the usual notation, where a_{32} means the element at the intersection of the 3rd row and 2nd column, we have, in a 4×4 assignment problem, a_{24} and a_{32} figuring in the optimal solution. What can you conclude about the remaining assignments? Why? (5 Marks)

2. (a) Global Bank is in the process of formulating a loan policy that involves a maximum of ₹ 25 lakhs. The following table provides the pertinent data about available types of loans.

Type of Loan	Interest Rate	Bad-Debt Ratio
Personal	0.135	0.09
Credit Card	0.145	0.12
Home	0.115	0.02
Farm	0.120	0.04
Commercial	0.105	0.01

Competition with other financial institution requires that the bank allocate at least 30% of the funds to farm and commercial loans. To assist the housing industry in the region, home loans must equal at least 50% of the personal, credit card and home loans. The bank also has a stated policy of not allowing the overall ratio of bad debts on all loans to exceed 5%. Formulate this as a Linear Programming Problem. (8 Marks)

- (b) A company following standard marginal costing system has the following interim trading statement for the quarter ending 30th June, 2013, which reveals a loss of ₹ 17,000, detailed below:

	₹
Sales	4,99,200
Closing Stock	18,000
Direct Material	1,68,000
Direct Labour	1,05,000
Variable Factory Overhead	42,000
Fixed Factory Overhead	1,20,000

Fixed Administration Overhead	40,000
Variable Distribution Overhead	19,200
Fixed Selling Overhead	40,000
Loss	17,000

Additional information is as follows:

- (i) Sales for the quarter were 1,200 units. Production was 1,400 units, of which 100 units were scrapped after complete manufacture. The factory capacity is estimated at 2,000 units.
- (ii) Because of low production, labour efficiency during the quarter is estimated to be 20% below normal level.
- (iii) Variable Factory Overhead Cost is driven by the number of units produced.

You are required to analyse the above and report to the management giving the reasons for the loss. (8 Marks)

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

Overheads cost variance = ₹ 2,800 (A)

Overheads volume variance = ₹ 2,000 (A)

Budgeted overheads = ₹ 12,000

Actual overhead recovery rate = ₹ 8 per hour

Budgeted hours for the period = 2,400 hours

You are required to compute the following:

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

(8 Marks)

- (b) Fox Ltd has Division A and Division B. The Division A produces Components which it sells to 'outside' customers and also transfers to the Division B. The Division B produces a product called the 'Zoom' which incorporates a Fox component in its design.

Details of the production and operating costs for the next year are forecasted to be as follows.

Division A	Division B
Annual Fixed Costs - ₹ 15,00,000	Annual Fixed Costs - ₹ 25,000
Variable Cost - ₹ 175 (per component)	Variable Cost per 'Zoom' - ₹ 350 (excludes transfer costs)

Both Divisions have surplus capacity. Market analysis has indicated that the demand from 'outside' customers for Fox Ltd's products is as follows:

- (i) 4,500 components are sold at a unit selling price of ₹ 350; sales change by an average of 5 components for each ₹ 1 change in the selling price, per component;
- (ii) 500 'Zoom' are sold at a unit selling price of ₹ 1,100; sales change by an average of 125 'Zoom' for each ₹ 75 changes in the selling price per 'Zoom'. It is an established practice for the Division A to transfer components to the Division B at 'market selling price'.

You are required to calculate the, Unit selling price of a 'Zoom' that should be set in order to maximize Fox Ltd's profit. Selling price should also be exact to the nearest paisa. [Note: If $P = a - bQ$ then $MR = a - 2bQ$]

(4 Marks)

- (c) Examine the validity of following statements along with the reasons:
 - (i) The concepts, tools and techniques of value chain analysis apply only to all those organizations which produce and sell a product.
 - (ii) Procurement activities are included in the Primary activities as classified by Porter under value chain analysis concept.
 - (iii) As per Porter's five forces model, bargaining power of buyers does influence the profitability of an industry or market.
 - (iv) Value chain analysis in the strategic framework consists of single cost driver concept.

(4 Marks)

4. (a) MFG Ltd. is producing a component called 'KDK'. Estimated costs are:

	Fixed Cost per year (₹ '000)	Variable Cost per 'KDK' (₹)
Production	32,000	3,600
Distribution	2,000	200

Direct labour costs are 40% of the variable production costs. In the production department machining and assembling of 'KDK', 90 men work 8 hours per day for 300 days in a year. Each worker can machine and assemble 1 'KDK' per uninterrupted 180 minutes time frame. In each 8 hours working day, 20 minutes are

allowed for coffee-break, 30 minutes on an average for training and 22 minutes for supervisory instructions. Besides 10% of each day is booked as idle time to cover checking in and checking out changing operations, getting materials and other miscellaneous matters.

MFG Ltd. has been facing industrial relations problem as the workers of company have a very strong union. Company is faced with the possibility of a strike by direct production workers engaged on the assembly of 'KDK'. The trade union is demanding an increase of 15%, back-dated from the beginning of financial year, but the company expects that if a strike does take place, it will last 25 Days after which the union will settle for an increase of 10% similarly back-dated. The only product of the company is being sold at ₹6,000.

If the strike takes place, Sales of 1,300 'KDK' would be lost. The balance that would ordinarily have been produced during the strike period could, however be sold, but these 'KDK' would have to be made up in overtime working which would be at an efficiency rate of 90% of normal. This would entail additional fixed cost of ₹1,00,000 and wage payments at time and one-half.

You are required to state, whether you would advise the management to allow the strike to go ahead, rather than to the union's demand. (8 Marks)

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

Activity	Predecessors	Time (in Days)	Probability
A	---	6	0.50
		8	0.50
B	---	4	0.30
		5	0.20
		6	0.50
C	A	8	0.50
		16	0.50
D	A, B	8	0.30
		10	0.70
E	C, D	2	0.20
		4	0.80

Required:

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

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

Determine the critical path and the project duration for each trial. (8 Marks)

5. (a) Jigyasa India Ltd. (JIL) has 30 retail stores of uniform sizes 'Fruity & Sweety Retailers' across the country. Mainly three products namely 'Butter Jelly', 'Fruits & Nuts' and 'Icy Cool' are sold through these retail stores. JIL maintains stocks for all retail stores in a centralised warehouse. Goods are released from the warehouse to the retail stores as per requisition raised by the stores. Goods are transported to the stores through two types of vans i.e. normal and refrigerated. These vans are to be hired by the JIL.

Costs per month of JIL are as follows:

	(₹)
Warehouse Costs:	
Labour & Staff Costs	27,000
Refrigeration Costs	1,52,000
Material Handling Costs	28,000
Total	2,07,000
Head Office Cost:	
Salary & Wages to Head Office Staff	50,000
Office Administration Costs	1,27,000
Total	1,77,000
Retail Stores Costs:	
Labour Related Costs	33,000
Refrigeration Costs	1,09,000
Other Costs	47,000
Total	1,89,000

Average transportation cost of JIL per trip to any retail stores are as follows:

Normal Van	₹3,200
Refrigerated Van	₹4,900

The Chief Financial Manager asked his Finance managers to calculate profitability based on three products sold through Fruity & Sweety retail stores rather than traditional method of calculating profitability.

The following information regarding retail stores are gathered:

	Butter Jelly	Fruits & Nuts	Icy Cool
No. of Cartons <i>per cubic metre</i> (m ³)	42	28	40
No. of Items <i>per cartons</i> (units)	300	144	72
Sales <i>per month</i> (units)	18,000	4,608	1,152
Time in Warehouse (in months)	1	1.5	0.5
Time in Retail Stores (in months)	1	2	1
Selling Price <i>per unit</i> (₹)	84	42	26
Purchase Price <i>per unit</i> (₹)	76	34	22

Butter Jelly and Icy-Cool are required to be kept under refrigerated conditions.

Additional information:

Total Volume of All Goods Sold <i>per month</i>	40,000 m ³
Total Volume of Refrigerated Goods Sold <i>per month</i>	25,000 m ³
Carrying Volume of <i>each van</i>	64 m ³

Required:

Calculate the Profit *per unit* using Direct Product Profitability (DPP) method.

(12 Marks)

- (b) State whether the learning curve theory can be applied to the following independent situations briefly justifying your decision:
- A labour intensive sculpted product is carved from the metal provided to the staff. The metal is sourced from different suppliers since it is scarce. The alloy composition of the input metal is quite different among the suppliers.
 - Pieces of hand-made furniture are assembled by the company in a far off location. The labourers do not know anything about the final product which utilizes their work. As a matter of further precaution, rotation of labour is done frequently.
 - Skilled workers have been employed for a long time. The company has adequate market for the craft pieces done by these experts.

(iv) A company finds that it always has an adverse usage of indirect material. It wants to apply learning curve theory to improve the way standards have been set. (4 Marks)

6. (a) SK Roadways Services Pvt. Ltd. is planning to run a fleet of 15 buses in Birpur City on a fixed route. Company has estimated a total of 2,51,85,000 passenger kilometers per annum. It is estimated buses to have 100% load factor. Buses are purchased at a price of ₹ 40,00,000 per unit whose scrape value at the end of 5 years life is ₹ 5,00,000. Seating capacity of a bus excluding a Driver's seat is 42. Each bus can give a mileage of 5 kmpl. Average cost of fuel is ₹ 60 per liter. Cost of Lubricants & Sundries per 1,000 km would be ₹ 3,000. Company will pay ₹ 25,000 per month to Driver and two attendants for each bus.

Other annual charges per bus: Insurance ₹ 50,000, Garage Charges ₹ 30,000, Repairs & Maintenance ₹ 50,000. Route Permit Charges upto 20,000 km is ₹ 5,000 and ₹ 2,000 for every additional 5,000 km or part Thereof.

(i) You are required to calculate a suggested fare per passenger/km taking into account markup on cost @20% to cover general overheads and sufficient profit.

(ii) The Transport Sector of Birpur is highly regulated. The Government has fixed the fare @ ₹ 1.20 for next 2 years. Comment on the two year's profitability taking into consideration the inflation rate of 8%.

Note: Route permit charges is not subject to Inflation. (8 Marks)

(b) SamKum Telecom Ltd. is a leading cellular service provider having a global presence. It aims to be the most innovative and trusted telecom company in the world. To achieve this aim, it is constantly working on its overall functioning. It is trying to adopt best managements practices in the world. Following are some information related to the company's performance for a particular period:

Particulars	Current Year	Base Year	Target
Operating Ratio	60%	54%	Reduce it to 50%
Average Revenue per User	₹ 225	₹ 210	Increase it to ₹250
Unresolved consumer complaints	27,500	25,000	Reduce it by 20%
Customer Relationship Centres	280	200	Take the total to 250
Employee coverage under Training Programme	10%	8%	At least 15%

Evaluate the performance of the company using Balance Scorecard approach.

(8 Marks)

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

(a) Discuss briefly two methods of costing in the service sector and give examples.

(4 Marks)

(b) ABC Ltd. is planning to introduce Kaizen Costing approach in its manufacturing plant. State whether and why the following are valid or not in respect of Kaizen Costing.

(i) VP(Finance) is of the view that company has to make a huge initial investment to bring a large scale modification in production process.

(ii) Head (Personnel) has made a point that introduction of Kaizen Costing does not eliminate the training requirement of employees.

(iii) General Manager (Manufacturing) firmly believes that only shop floor employees and workers' involvement is prerequisite of Kaizen Costing approach.

(iv) Manager (Operations) has concerns about creation of confusion among employees and workers regarding their roles and degradation in quality of production.

(4 Marks)

(c) Define the following terms in relation to a transportation problem:

(i) Degeneracy

(ii) Prohibited routes

(4 Marks)

(d) State the type of cost in the following cases:

(i) Cost associated with the acquisition and conversion of material into finished product.

(ii) Cost arising from a prior decision which cannot be changed in the short run.

(iii) Increase in cost resulting from selection of one alternative instead of another.

(iv) Accountant of a cloth factory paid ₹25,000 for water that has been used for washing clothes before they go for final drying process.

(4 Marks)

(e) In each of the following independent situations, state with a brief reason whether 'Zero Base Budgeting' (ZBB) or 'Traditional Budgeting' (TB) would be more appropriate for year II.

(i) A company producing a certain product has done extensive ZBB exercise in year I. The activity level is expected to marginally increase in year II.

- (ii) The sales manager of a company selling three products has the intuitive feeling that in year II, sales will increase for one product and decrease for the other two. His expectation cannot be substantiated with figures.
- (iii) The top management would like to delegate responsibility to the functional managers for their results during year II.
- (iv) Resources are heavily constrained and allocation for budget requirements is very strict.

(4 Marks)

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – II

PAPER – 5: ADVANCED MANAGEMENT ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) Shelf life is one year hence opening stock of 30,000 boxes is to be sold first. Contribution on these boxes is Rs.18,00,000 [30,000 boxes × (Rs.100 – Rs.40)].

In the question production of 2004 is same as in 2005. Hence fixed cost for the year 2004 is Rs.52,00,000 (1,30,000 boxes × Rs.40). Therefore fixed cost for the year 2005 is Rs.57, 20,000 (Rs.52, 00,000 + 10% of Rs.52,00,000).

Variable Cost for the year 2005, Rs.50 per unit (Rs.40 + 25% of Rs.40).

Hence Contribution per unit during 2005 is Rs.50 (Rs.100 – Rs.50).

Break even volume is the volume to meet the fixed cost i.e. fixed cost equals to contribution. Therefore, remaining fixed cost of Rs.39,20,000 (Rs.57, 20,000 – Rs.18, 00,000) to be recovered from production during 2005.

Production in 2005 to reach BEP, 78,400 units (Rs.39,20,000 / Rs.50).

Therefore BEP for the year 2005 is 1,08,400 boxes (30,000 boxes + 78,400 boxes)

- (b) Return of 12% Net (after tax of 40%) on Capital Employed is equivalent to 20% (Gross) [12% ÷ (1 – 0.4)] on Capital Employed.

Let Selling Price *per unit* to be 'K'

Since Total Sales = Total Cost + Profit

$$80,000 K = 14,60,000 + 20\% (12,00,000 + 0.5 \times 80,000K)$$

$$\text{Or, } 80,000 K = 14,60,000 + 2,40,000 + 8,000K$$

$$\text{Or, } 72,000 K = 17,00,000$$

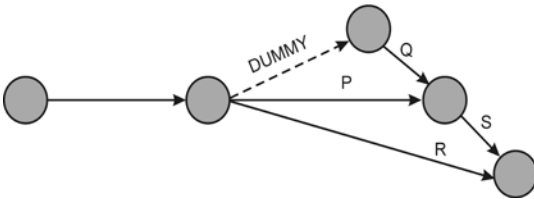
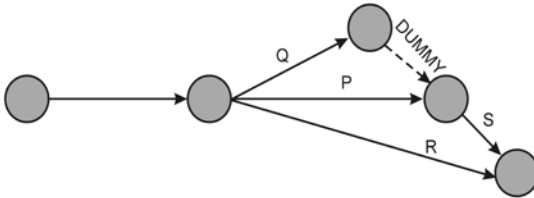
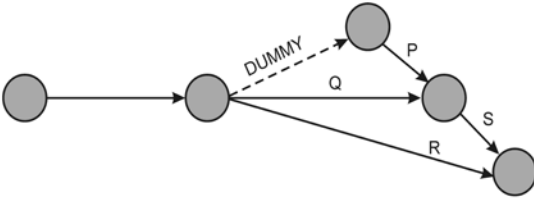
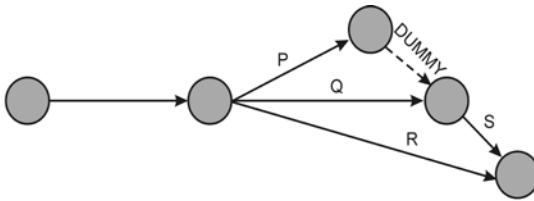
$$\text{Or, } 'K' = \frac{17,00,000}{72,000}$$

$$= \text{Rs.23.61}$$

Hence Selling Price *per unit* will be Rs.23.61.

- (c) Activities P and Q are called duplicate activities (or parallel activities) since they have the same head and tail events. The situation may be rectified by introducing a dummy either between P and S or between Q and S or before P or before Q (i.e. introduce the dummy before the tail event and after the duplicate activity or

Introduce the dummy activity between the head event and the duplicate activity). Possible situations are given below:



- (d) (i) Under the Hungarian Assignment Method, the prerequisite to assign any job is that each row and column must have a zero value in its corresponding cells. If any row or column does not have any zero value then to obtain zero value, each cell values in the row or column is subtracted by the corresponding minimum cell value of respective rows or columns by performing row or column operation. This means *if any row or column have two or more cells having same minimum value then these row or column will have more than one zero.* However, having two zeros does not necessarily imply two equal values in the original assignment matrix just before row and column operations. Two zeroes in a same row can also be possible by two different operations i.e. one zero from row operation and one zero from column operation.

(ii) The order of matrix in the assignment problem is 4×4 . The total assignment (allocations) will be four. In the assignment problem when any allocation is made in any cell then the corresponding row and column become unavailable for further allocation. Hence, these corresponding row and column are crossed mark to show unavailability. In the given assignment matrix two allocations have been made in a_{24} (2nd row and 4th column) and a_{32} (3rd row and 2nd column). This implies that 2nd and 3rd row and 4th and 2nd column are unavailable for further allocation.

Therefore, the other allocations are at either at a_{11} and a_{43} or at a_{13} and a_{41} .

2. (a) Let

$$\left. \begin{array}{l} y_1 = \text{Personal Loan} \\ y_2 = \text{Credit Card Loan} \\ y_3 = \text{Home Loan} \\ y_4 = \text{Farm Loan} \\ y_5 = \text{Commercial Loan} \end{array} \right\} \text{ (in Lakhs Rs.)}$$

Objective function:

$$\text{Total Interest} = 0.135 \times 0.91 \times y_1 + 0.145 \times 0.88 \times y_2 + 0.115 \times 0.98 \times y_3 + 0.120 \times 0.96 \times y_4 + 0.105 \times 0.99 \times y_5$$

$$= 0.1229y_1 + 0.1276y_2 + 0.1127y_3 + 0.1152y_4 + 0.1040y_5$$

$$\text{Bad Debts} = 0.09y_1 + 0.12y_2 + 0.02y_3 + 0.04y_4 + 0.01y_5$$

$$\text{Maximize } Z = \text{Total Interest} - \text{Bad Debt}$$

$$= 0.1229y_1 + 0.1276y_2 + 0.1127y_3 + 0.1152y_4 + 0.1040y_5 - (0.09y_1 + 0.12y_2 + 0.02y_3 + 0.04y_4 + 0.01y_5)$$

$$= 0.0329y_1 + 0.0076y_2 + 0.0927y_3 + 0.0752y_4 + 0.094y_5$$

Condition-1:

Total fund should not exceed Rs. 25 Lakhs.

$$y_1 + y_2 + y_3 + y_4 + y_5 \leq 25$$

Condition-2:

Farm and commercial loans equal at least 30% of all loans.

$$y_4 + y_5 \geq 0.30 \times (y_1 + y_2 + y_3 + y_4 + y_5)$$

Or
$$0.30y_1 + 0.30y_2 + 0.30y_3 - 0.70y_4 - 0.70y_5 \leq 0$$

Condition-3:

Home loans should equal at least 50% of personal, credit card and home loans.

$$y_3 \geq 0.50 \times (y_1 + y_2 + y_3)$$

Or

$$0.50y_1 + 0.50y_2 - 0.50y_3 \leq 0$$

Condition-4:

Bad Debts should not exceed 5% of all loans.

$$0.09y_1 + 0.12y_2 + 0.02y_3 + 0.04y_4 + 0.01y_5 \leq 0.05 (y_1 + y_2 + y_3 + y_4 + y_5)$$

Or $0.04y_1 + 0.07y_2 - 0.03y_3 - 0.01y_4 - 0.04y_5 \leq 0$

The linear programming model can be formulated as follows:

Maximize

$$Z = 0.0329y_1 + 0.0076y_2 + 0.0927y_3 + 0.0752y_4 + 0.094y_5$$

Subject to the Constraints-

$$y_1 + y_2 + y_3 + y_4 + y_5 \leq 25$$

$$0.30y_1 + 0.30y_2 + 0.30y_3 - 0.70y_4 - 0.70y_5 \leq 0$$

$$0.50y_1 + 0.50y_2 - 0.50y_3 \leq 0$$

$$0.04y_1 + 0.07y_2 - 0.03y_3 - 0.01y_4 - 0.04y_5 \leq 0$$

$$y_1, y_2, y_3, y_4, y_5 \geq 0$$

(b) Working Note

Details	Working	Amount (Rs.)
Selling Price	$\frac{\text{₹}4,99,200}{1,200\text{units}}$	416
Raw Materials	$\frac{\text{₹}1,68,000}{1,400\text{units}}$	120
Labour	$\frac{\text{₹}1,05,000}{1,750\text{units}^*}$	60
Variable Overhead	$\frac{\text{₹}42,000}{1,400\text{units}}$	30
Manufacturing Cost (Variable)		210
Distribution Overhead	$\frac{\text{₹}19,200}{1,200\text{units}}$	16
Total Variable Cost		226
Contribution		190

Fixed Cost		
Factory	Rs. 1,20,000	
Administration	Rs. 40,000	
Selling	Rs. 40,000	2,00,000

*Equivalent units (1,400 units / 80%)

Standard Profit for 1,200 Units Sold

Details	Working	Amount (Rs.)
Contribution	1,200 units × Rs. 190	2,28,000
Less: Fixed Costs		2,00,000
Profit		28,000

Reconciliation between Budgeted and Actual Profit

Details	Working	Amount (Rs.)
Budgeted Profit	(2,000 units × Rs. 190 – Rs. 2,00,000)	1,80,000
Less: Volume Variance	(800 units × Rs.190)	1,52,000
Standard Profit		28,000
<i>Factors causing loss:</i>		
Units Scrapped	(100 units × Rs.210)	21,000
Labour Inefficiency	(350 units × Rs.60)	21,000
Undervaluation of Closing Stock	{100 units × (Rs.210 – Rs.180)}	3,000
Actual Profit		(-)17,000

3. (a) Basic Workings

Overheads Cost Variance	=	Rs. 2,800 (A)
Overheads Volume Variance	=	Rs. 2,000 (A)
Budgeted Overheads	=	Rs. 12,000
Actual Overhead Recovery Rate	=	Rs. 8 per hour
Budgeted Hours <i>for the period</i>	=	2,400 hours

Computation of Requirements

Overheads expenditure variance:

$$\begin{aligned}\text{Overheads Expenditure Variance} &= \text{Overheads Cost Variance (-) Overheads Volume Variance} \\ &= \text{Rs. 2,800 (A) - Rs. 2,000 (A)} \\ &= \text{Rs. 800 (A)}\end{aligned}$$

Actual incurred overheads:

$$\begin{aligned}\text{Overheads Expenditure Variance} &= \text{Budgeted Overheads (-) Actual Overheads} \\ \Rightarrow \text{Rs. 800(A)} &= \text{Rs. 12,000 (-) Actual Overheads} \\ \text{Therefore, Actual Overheads} &= \text{Rs. 12,800}\end{aligned}$$

Actual hours for actual production:

$$\begin{aligned}\text{Actual hours for actual production} &= \frac{\text{Actual Overheads}}{\text{Actual Overhead Recovery Rate Per Hour}} \\ &= \frac{\text{₹ 12,800}}{\text{₹ 8}} \\ &= 1,600 \text{ hours}\end{aligned}$$

Overheads capacity variance:

$$\begin{aligned}\text{Overheads Capacity Variance} &= \text{Budgeted Overheads for Actual Hours (-) Budgeted Overheads} \\ &= \text{Rs. 5} \times \text{1,600 hrs. - Rs. 12,000} \\ &= \text{Rs. 8,000 - Rs. 12,000} \\ &= \text{Rs. 4,000 (A)}\end{aligned}$$

Overheads efficiency variance:

$$\begin{aligned}\text{Overheads Efficiency Variance} &= \text{Absorbed Overheads (-) Budgeted Overheads for Actual Hours} \\ &= \text{Rs. 10,000 - Rs. 5} \times \text{1,600 hours} \\ &= \text{Rs. 2,000 (F)}\end{aligned}$$

Standard hours for actual production:

$$\begin{aligned}\text{Standard hours for actual output} &= \frac{\text{Absorbed Overheads}}{\text{Standard Overhead Rate per hour}} \\ &= \frac{\text{₹ 10,000}}{\text{₹ 5}} \\ &= 2,000 \text{ hours}\end{aligned}$$

Working Note

$$\begin{aligned}\text{Overhead Cost Variance} &= \text{Absorbed Overheads (-) Actual Overheads} \\ \Rightarrow \text{Rs. 2,800 (A)} &= \text{Absorbed Overheads (-) Rs. 12,800} \\ \Rightarrow \text{Absorbed Overheads} &= \text{Rs. 10,000} \\ \text{Standard Overhead Rate per hour} &= \frac{\text{Budgeted Overheads}}{\text{Budgeted Hours}} \\ &= \frac{\text{₹ 12,000}}{2,400 \text{ hours}} \\ &= \text{Rs. 5}\end{aligned}$$

(b) Assumed Selling Price 'P', Quantity 'Q'

The Marginal Cost of a 'Zoom' is Rs. 525 i.e. (Rs.175 + Rs.350)

Demand Function for 'Zoom'

$$\begin{aligned}P &= 1,400 - (75/125) \times Q \text{ [Refer to Working Note]} \\ \text{Revenue (R)} &= Q \times [1,400 - 3/5 \times Q] \\ \text{Marginal Revenue (MR)} &= 1,400 - (6/5) \times Q \\ \text{Marginal Cost (MC)} &= 525\end{aligned}$$

Profit is Maximum where Marginal Revenue (MR) equals to Marginal Cost (MC)

$$\begin{aligned}1,400 - (6/5) \times Q &= 525 \\ Q &= 729.17 \text{ Units} \\ P &= 962.50\end{aligned}$$

Unit Selling Price should be Rs.962.50 to get *maximum profit*.

Working Note

Price at which,

$$\begin{aligned}\text{There will be no Sale} &= 1,100 + \{(75/125) \times 500\} \\ &= \text{Rs. 1,400}\end{aligned}$$

(c) (i) Invalid

The concepts, tools and techniques of value chain analysis apply to organizations which produce and sell a product and also to organizations which provide a service.

(ii) Invalid

Procurement activities are included in the support activities rather than primary activities.

(iii) Valid

Bargaining power of buyers is one of the factor or force that influences the profitability of a market or industry. More the bargaining power buyers have, more the pressure on the industry to not increase the price of product or service. They may even have to reduce the price sometimes.

(iv) Invalid

Value chain analysis in the strategic framework consists of multiple cost drivers concept. In value chain analysis, a set of unique cost drivers is identified for each value activity instead of single cost driver application at the overall firm level. Multiple cost drivers may be classified into Structural drivers and Executional drivers.

4. (a) Alternative-1 with No Strike: (Refer W.N.-2, 3)

Cost of Settlement is 15% Increase i.e. Rs.216 per unit

Annual Cost of Settlement

$$= 54,000 \text{ units} \times \text{Rs.}216$$

$$= \text{Rs.}1,16,64,000$$

Alternative 2 i.e. if Strike Goes Ahead: (Refer W.N.-1, 2, 3)

Extra Cost	(Rs.)
Annual Incremental Labour Cost (Ex. Strike Days Production) [(54,000 units – (25Days × 180 units per Day)) × Rs.144.00]	71,28,000
Loss of Contribution <i>due to loss of sales</i> [1,300 units × Rs. 2,200]	28,60,000
Incremental Labour Cost for Balance 3,200 units [(25 Days × 180 units per Day) – 1,300 units] × Rs.144.00]	4,60,800
Overtime Premium [3,200 units × 1,584 × 0.5]	25,34,400
Payment for Efficiency [3,200 units × 1/9 × 1,584 × 1.5]	8,44,800
Additional Fixed Cost	1,00,000
	1,39,28,000

If there is no strike, it will yield a financial benefit of Rs.22,64,000 (Rs.1,39,28,000 – Rs. 1,16,64,000). Management should accept union's demand.

Working Note

(1) Statement Showing Contribution *per unit* of 'KDK':

	(Rs.)
Selling Price	6,000
<i>Less: Variable Costs:</i>	
Labour Cost	1,440
Production Ex. Wages (Rs.3,600 – Rs.1,440)	2,160
Distribution	200
Contribution	2,200

(2) Calculation of Labour Cost:

Direct Labour (40% of production costs of Rs.3,600) = Rs.1,440 *per unit*

With 15% Increase, Revised Labour Cost (Rs.1,440 + Rs.216) = Rs.1,656

With 10% Increase, Revised Labour Cost (Rs.1,440 + Rs.144) = Rs.1,584

(3) Statement Showing Budgeted Production:

Total Time in a Day: (8hrs. × 60 minutes) = 480 minutes

Less: Idle Time = 48 minutes

 Coffee Break = 20 minutes

 Instructions = 22 minutes

 Training = 30 minutes

Productive Time *per day* = 360 minutes

Therefore, 'KDK' to be produced per man per day: $(360/180 \times 1)$

= 2 units

Since 'KDK' are produced at the rate of 2 'KDK' per man day, so total yearly production will be 54,000 units (2 units × 90 men × 300 days) of 'KDK'



This question has been solved by comparing 'Existing Situation' with both 'Alternatives (Strike or Non-Strike)' *independently*. However this question can also be solved by comparing 'Alternatives (Strike or Non-Strike)' *only* and final answer would be the same.

(b) Random Numbers Allocation for *each activity*:

Activity	Time (in Days)	Probability	Cumulative Probability	Allocated Random Number
A	6	0.50	0.50	00-49
	8	0.50	1.00	50-99
B	4	0.30	0.30	00-29
	5	0.20	0.50	30-49
	6	0.50	1.00	50-99
C	8	0.50	0.50	00-49
	16	0.50	1.00	50-99
D	8	0.30	0.30	00-29
	10	0.70	1.00	30-99
E	2	0.20	0.20	00-19
	4	0.80	1.00	20-99

Simulation Table:

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

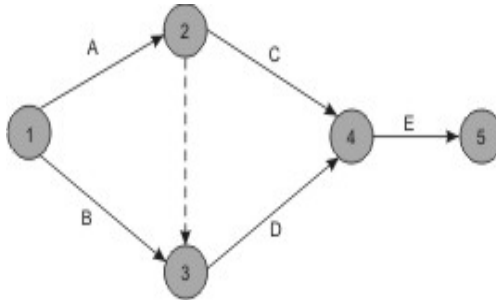
Determination of Critical Path and Project Duration for *each trial*:

Trial	Project Duration			Critical Path
	1-2-4-5 (A-C-E)	1-2-3-4-5 (A-D-E)	1-3-4-5 (B-D-E)	
1	18	20	18	1-2-3-4-5 (A-D-E)
2	20	22	20	1-2-3-4-5 (A-D-E)

3	28	20	16	1-2-4-5 (A-C-E)
4	26	20	17	1-2-4-5 (A-C-E)

Working Note

The Network for the given problem:



5. (a) Direct Product Profitability (DPP) Statement

(Amount in Rs.)

	Butter Jelly	Fruits & Nuts	Icy Cool
Selling Price <i>per unit</i>	84.00	42.00	26.00
<i>Less: Purchase Price per unit</i>	76.00	34.00	22.00
Gross Profit (A)	8.00	8.00	4.00
Direct Product Costs:			
Warehouse Costs <i>per m³</i> [W.N.-1]	7.46	2.07	3.73
Retail Stores Costs <i>per m³</i> [W.N.-2]	6.36	4.00	6.36
Transportation Costs [W.N.-3]	76.56	50.00	76.56
Total DPP costs <i>per m³</i>	90.38	56.07	86.65
Items <i>per m³</i> [W.N.-4]	12,600	4,032	2,880
Cost <i>per item</i> (B)	0.007	0.014	0.030
Direct Product Profit (A) - (B)	7.993	7.986	3.97

Working Notes

(1) Warehouse Related Costs

	General Costs (Rs.)	Cost Related with Refrigerated Goods (Rs.)
Labour & Staff Costs	27,000	---
Refrigeration Costs	---	1,52,000
Material Handling Costs	28,000	---
Total	55,000	1,52,000
Volume of Goods Sold	40,000 m ³	25,000 m ³
Cost per m ³ per month	1.38	6.08

Products	Time in Warehouse	Cost per m ³ per month (Rs.)	Total Cost (Rs.)
Butter Jelly	1 Month	7.46 (1.38 + 6.08)	7.46
Fruits & Nuts	1.5 Months	1.38	2.07
Icy-cool	0.5 Months	7.46 (1.38 + 6.08)	3.73

(2) Retail Stores Related Costs

	General Costs (Rs.)	Cost Related with Refrigerated Goods (Rs.)
Labour Related Costs	33,000	---
Refrigeration Costs	---	1,09,000
Other Costs	47,000	---
Total	80,000	1,09,000
Volume of Goods Sold	40,000 m ³	25,000 m ³
Cost per m ³ per month	2.00	4.36

Products	Time in Retail Stores	Cost <i>per m³</i> <i>per month</i>	Total Cost
Butter Jelly	1 Month	Rs.6.36 (Rs.2.00 + Rs.4.36)	Rs.6.36
Fruits & Nuts	2 Months	Rs.2.00	Rs.4.00
Icy-Cool	1 Month	Rs.6.36 (Rs.2.00 +Rs.4.36)	Rs.6.36

(3) Transportation Costs

	Normal Van Costs	Refrigerated Van Costs
Cost <i>per trip</i>	Rs.3,200	Rs.4,900
Volume of Van	64 m ³	64 m ³
Cost <i>per m³</i> <i>per trip</i>	Rs.50.00	Rs.76.56

(4) No. of Items *per m³*

Products	No. of Cartons (m ³)	No. of Items <i>per</i> <i>Cartons</i> (units)	No. of Items <i>per m³</i>
Butter Jelly	42	300	12,600 (42 × 300)
Fruits & Nuts	28	144	4,032 (28 × 144)
Icy - Cool	40	72	2,880 (40 × 72)

- (b) (i) 'Learning Curve Theory' will not be applicable as alloy combination of the input metal is quite different among the suppliers hence learning experience with one type of metal may not be beneficial for the workers to deal with other metal with separate alloy composition.
- (ii) 'Learning Curve Theory' will not be applicable as in this situation rotation of labour is done frequently, labours will not be able to get the benefit of learning and apply their learning. Hence, learning curve theory can not be applied.
- (iii) 'Learning Curve Theory' will not be applicable as in this situation as workers are skilled and employed for a long time, they have already achieved maximum level of expertise by taking advantage of learning. Hence, at this point of time learning curve theory can not be applied.
- (iv) 'Learning Curve Theory' will not be applicable as indirect materials are the

materials which are not used directly in the production (not directly proportionate with volume of output) and usually used machines (e.g. lubricants, spares parts etc.) with less human interactions. Adverse usage of indirect materials can be controlled through proper monitoring and appropriate standard settings and not from applying learning curve theory.

6. (a) (i) Statement Suggesting Fare *per passenger – km* (Each Bus)

Particulars	Cost per annum (Rs.)
Fixed Expenses:	
Insurance	50,000.00
Garage Charges	30,000.00
Depreciation	7,00,000.00
Running Expenses:	
Repair and Maintenance	50,000.00
Cost of Lubricants and Sundries	1,25,925.00
Fuel Cost	5,03,700.00
Salary of Driver and Two Attendants	3,00,000.00
Route Permit Charges	15,000.00
Total Cost <i>per annum</i>	17,74,625
Add: Markup @ 20% of Total Cost or 16.67% of Total Revenue	3,54,925
Total Revenue	21,29,550

Rate *per passenger- km* equals to Rs.1.268

Workings

Total Passenger Kms = 2,51,85,000

Total Buses = 15

Passenger Kms *per bus* = 16,79,000 (2,51,85,000 Kms / 15)

Total Passenger Capacity *per bus* = 42 – 2 = 40

Annual Distance Covered *by a bus* = 41,975 Kms (16,79,000Kms / 40)

(ii) Regulated Fare *per passenger km* is Rs.1.20

Profitability Statement for *Each Bus*

Particulars	Year 1 (Rs.)	Year 2 (Rs.)
Fixed Expenses:		
Insurance	54,000.00	58,320.00
Garage Charges	32,400.00	34,992.00
Depreciation	7,00,000.00	7,00,000.00
Running Expenses:		
Repair and Maintenance	54,000.00	58,320.00
Cost of Lubricants and Sundries	1,35,999.00	1,46,879.00
Fuel Cost	5,43,996.00	5,87,516.00
Salary of Driver and Two Attendants	3,24,000.00	3,49,920.00
Route Permit Charges	15,000.00	15,000.00
Total Cost ...[A]	18,59,395.00	19,50,947.00
Total Revenue (Regulated) ...[B]	20,14,800.00	20,14,800.00
Profit ...[B] – [A]	1,55,405.00	63,853.00
Profit to Total Revenue	7.71%	3.17%

The gross margin is showing a downward trend because the cost components have taken into the effect of inflation hence increasing year by year but the total revenue has remained stagnant due to Government regulations which resulted in reduction in gross margin per bus.

The company's gross margin to total revenue ratio has come out to be 7.71% and 3.17% in first and second year respectively but initially the company's desired gross margin to total revenue ratio is 16.67% to cover general overheads and sufficient profit. Though the amount of general overheads is not given but we can safely assume that they may also subject to inflation i.e. increase year by year then in such case the company needs to maintain or increase its gross margin per bus to maintain its net profit after general overheads which is not possible in regulated environment. The information about regulated fare in the given case is regarding first two years only but if this regulated fare scenario persists for further years then the project may not be viable for the company.

- (b) The balanced scorecard is a method which displays organisation's performance into four dimensions namely financial, customer, internal and innovation. The four

dimensions acknowledge the interest of shareholders, customers and employees taking into account of both long-term and short-term goals. The detailed analysis of performance of the company using Balance Scorecard approach as follows:

(i) Financial Perspective

Operating ratio and average revenue will be covered in this prospective.

Company is unable to achieve its target of reducing operating ratio to 50% instead it has increased to 60%. Company is required to take appropriate steps to control and manage its operating expenses. Average revenue per user has increased from Rs. 210 to Rs. 225 but remains short of targeted Rs. 250. This is also one of the reasons of swelled operating ratio. Company can boost up its average revenue per user either by increasing the price of its services or by providing more paid value added services.

(ii) Customer Perspective

Service complaints will be covered under this perspective. The company had set a target of reducing unresolved complaints by 20% instead unresolved complaints have risen by 10% $[(27,500-25,000)/(25,000) \times 100]$. It shows dissatisfaction is increasing among the consumers which would adversely impact the consumer's general perception about the company and company may lose its consumers in long run.

(iii) Internal Business Perspective

Establishing customer relationship centres will be covered under this perspective. Company has established 80 relationship centres in the current period exceeding its target of 50 (250-200) to cater to the needs of existing consumers as well as soliciting new consumers. This shows the seriousness of the company towards the consumer satisfaction and would help them in the long run.

(iv) Learning and Growth Perspective

Employee training programmes are covered under this perspective.

Company had set a target to cover at least 15% employee under its training programmes but covered only 10%. This could hurt capabilities of the employees which are needed for long term growth of the organisation necessary to achieve the objectives set in the previous three perspectives. People or the human resource of the company is one of the three principle sources where organisational learning and growth comes.

7. (a) Methods of Costing in the service sector are as follows:

- (i) **Job costing method:** In job costing method the cost of a particular service is obtained by assigning costs to a distinct identifiable service. In service sector like Accounting firm, Advertising campaigns etc. job costing method is used. For assigning indirect costs (overheads) models such as Activity Based Costing may be used.
- (ii) **Process costing method:** In process costing system the cost of a service is obtained by assigning costs to masses of similar unit and then computing unit cost on an average basis. Retail banking, Postal delivery, Credit card etc. uses process costing method.
- (iii) **Hybrid costing method:** Many companies uses a method of costing which is neither job costing nor process costing method. They in fact uses a hybrid costing method which combines elements of both job costing and process costing methods.

(b) (i) Invalid

Kaizen costing is the system of cost reduction procedures which involves making small and continuous improvements to the production processes rather than innovations or large-scale investment.

(ii) Valid

The training of employees is very much a long-term and ongoing process in the Kaizen costing approach. Training enhances the abilities of employees.

(iii) Invalid

Kaizen Costing approach involves everyone from top management level to the shop floor employees. Every employee's active participation is a must requirement.

(iv) Invalid

Though the aim of Kaizen Costing is to reduce the cost but at the same time it also aims to maintain the quality. Kaizen costing also aims to bring the clarity in roles and responsibilities for all employees.

(c) (i) **Degeneracy:** When the number of positive allocations at any stage of the feasible solution is less than the required number (rows + columns -1), the solution is said to be *degenerate solution*. Such a situation is handled by introducing an infinitesimally small allocation 'e' in the least cost and independent cell. If the number of occupied cells $< m+n-1$ by one, then only one 'e' needs to be introduced. If the number of occupied cells is less by more than one, to the extent of shortage, 'e's will have to be introduced till the condition that number of occupied cells = $m+n-1$.

(ii) **Prohibited Routes:** Sometimes in a given transportation problem, some routes may not be available. There could be several reasons for this such as bad road conditions or strike etc. In such situations, there is a restriction on the route available for transportation. To handle such type of a situation, a very large cost (or a negative profit for the maximization problem) represented by ∞ or 'M' is assigned to each of such routes which are not available. Due to assignment of very large cost, such routes would automatically be eliminated in the final solution. The problem is solved in its usual way.

(d)

Cases		Type of Cost
(i)	Cost associated with the acquisition and conversion of material into finished product.	Product Cost
(ii)	Cost arising from a prior decision which cannot be changed in the short run.	Committed Cost
(iii)	Increase in cost resulting from selection of one alternative instead of another.	Differential/Incremental Cost
(iv)	Accountant of a cloth factory paid Rs.25,000 for water that has been used for washing clothes before they go for final drying process.	Direct Cost

- (e) (i) The company has done extensive exercise in year-I that can be used as a basis for budgeting in year-II by incorporating increase in costs / revenue at expected activity level. Hence, **Traditional Budgeting** would be more appropriate for the company in year-II.
- (ii) In **Traditional Budgeting** system budgets are prepared on the basis of previous year's budget figures with expected change in activity level and corresponding adjustment in the cost and prices. But under **Zero Base Budgeting (ZBB)** the estimations or projections are converted into figures. Since, sales manager is unable to substantiate his expectations into figures so **Traditional Budgeting** would be preferred against **Zero Base Budgeting**.
- (iii) **Zero Base Budgeting** would be appropriate as ZBB allows top-level strategic goals to be implemented into the budgeting process by tying them to specific functional areas of the organization, where costs can be first grouped, then measured against previous results and current expectations.
- (iv) **Zero Base Budgeting** allocates resources based on order of priority up to the spending cut-off level (maximum level upto which spending can be made). In an organisation where resources are constrained and budget is allocated on requirement basis, **Zero Base Budgeting** is more appropriate method of budgeting.

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – II

PAPER – 6: INFORMATION SYSTEMS CONTROL & AUDIT

Question No. 1 is compulsory.

Attempt any five questions from the remaining six Questions.

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) ASK International proposes to launch a new subsidiary to provide e-consultancy services for organizations throughout the world, to assist them in system development, strategic planning and e-governance areas. The fundamental guidelines, programme modules and draft agreements are all preserved and administered in e-form only.

The company intends to utilize the services of a professional analyst to conduct a preliminary investigation and present a report on smooth implementation of the ideas of the new subsidiary. Based on the report submitted by the analyst, the company decides to proceed further with three specific objectives - reduce operational risk, increase business efficiency and ensure that information security is being rationally applied. The company has been advised to adopt ISO 27001 for achieving the same.
 - (i) What are the two primary methods through which the analyst would have collected the data ? (8 Marks)
 - (ii) To retain their e-documents for specified period, what are the conditions laid down in Section 7, Chapter III of Information Technology Act, 2000? (4 Marks)
- (b) What do you understand by Financial Controls? Explain major financial control techniques in brief. (8 Marks)
2. (a) What do mean by Expert Systems? What are the need and benefits of Expert systems? (6 Marks)
- (b) Discuss major tasks performed by Operating System? (6 Marks)
- (c) Discuss various dimensions under which the phase 'Feasibility Study' of SDLC is evaluated. (4 Marks)
3. (a) What are the objectives and goals of Business Continuity Planning(BCP)? (6 Marks)
- (b) Differentiate between Black Box Testing and White Box Testing. (6 Marks)
- (c) Discuss the advantages of Cloud Computing. (4 Marks)

4. (a) Discuss computer crime exposures in brief. (6 Marks)
- (b) Discuss in brief various steps involved in Information Systems Audit. (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) What do you understand by the term "Corporate Governance"? (4 Marks)
6. (a) Discuss objectives and goals of Business Continuity Planning? (6 Marks)
- (b) Discuss the impact of Information Systems audit on organizations. (6 Marks)
- (c) Discuss Office Automation System. (4 Marks)
7. Write short notes on any **four** of the following:
- (a) Key governance practices for evaluating risk management.
- (b) Impact of technology on Internal Controls.
- (c) SA 402.
- (d) Platform as a Service in Cloud Computing.
- (e) Strength of Agile model. (4 × 4 = 16 Marks)

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – II

PAPER – 6: INFORMATION SYSTEMS CONTROL & AUDIT

SUGGESTED ANSWERS/HINTS

1. (a) (i) Two primary methods through which the analyst would have collected the data are given as follows:
- **Reviewing Internal Documents:** The analyst first tries to learn about the organization involved in or affected by the project. For example, the subsidiary's activities based on its business and operation plans. S/he will also examine proposed organization charts and functions of positions mentioned in it.
 - **Conducting Interviews:** Written documents tell the analyst 'how the system should operate' but they may not include enough details to allow a decision to be made about the merits of a system proposal nor do they present users' views about current operations. To learn these details, analysts use interviews. Preliminary investigation interviews involve only management and supervisory personnel. The analyst may conduct interviews with persons who are scheduled to occupy various positions in the subsidiary.
- (ii) Section 7, Chapter III of Information Technology Act, 2000 provides that the documents, records or information which is to be retained for any specified period shall be deemed to have been retained if the same is retained in the electronic form provided the following conditions are satisfied:
- (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, –
- (a) the information contained therein remains accessible so as 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.

E.g. Company may include clause in its contracts with customers that electronic documents and correspondence will be considered valid; Electronic documents will have to be preserved till the contract and all liabilities are discharged; Documents may be digitally signed with hash values to assure that they have not been altered; All correspondence with clients may be saved with dates of transmission / receipt; In case the company changes / upgrades its email or other systems, the new system should be able to read the old data and retain all data without change etc.

- (b) **Financial Controls:** These controls are generally defined as the procedures exercised by the system user personnel over source, or transactions origination, documents before system input. These areas exercise control over transactions processing using reports generated by the computer applications to reflect un-posted items, non-monetary changes, item counts and amounts of transactions for settlement of transactions processed and reconciliation of the applications (subsystem) to general ledger.

Major financial control techniques are given as follows:

- **Authorization:** This entails obtaining the authority to perform some act typically accessing such assets as accounting or application entries.
- **Budgets:** These are estimates of the amount of time or money expected to be spent during a particular period, project, or event. The budget alone is not an effective control. Budgets must be compared with the actual performance, including isolating differences and researching them for a cause and possible resolution.
- **Cancellation of documents:** This marks a document in such a way to prevent its reuse. This is a typical control over invoices marking them with a "paid" or "processed" stamp or punching a hole in the document.
- **Documentation:** This includes written or typed explanations of actions taken on specific transactions; it also refers to written or typed instructions, which explain the performance of tasks.
- **Dual control:** This entails having two people simultaneously access an asset. For example, the depositories of banks' 24-hour teller machines should be accessed and emptied with two people present, many people confuse dual control with dual access, but these are distinct and different. Dual access divides the access function between two people: once access is achieved, only one person handles the asset. With teller-machines, for example, two tellers would open the depository vault door together, but only one would retrieve the deposit envelopes.

- **Input/output verification:** This entails comparing the information provided by a computer system with the input documents. This is an expensive control that tends to be over recommended by auditors.
- **Safekeeping:** This entails physically securing assets, such as computer disks, under lock and key, in a desk drawer, file cabinet storeroom, or vault.
- **Sequentially numbered documents:** These are working documents with preprinted sequential numbers, which enables the detection of missing documents.
- **Supervisory review:** This refers to review of specific work by a supervisor but this control requires a sign-off on the documents by the supervisor, in order to provide evidence that the supervisor at least handled them. This is an extremely difficult control to test after the fact because the auditor cannot judge the quality of the review unless he or she witnesses it, and, even then, the auditor cannot attest to what the supervisor did when the auditor was not watching.

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

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

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

Benefits of Expert Systems – The key benefit of Expert Systems are given as follows:

- Expert Systems preserve knowledge that might be lost through retirement, resignation or death of an acknowledged company expert.
- Expert Systems put information into an active-form so it can be summoned almost as a real-life expert might be summoned.
- Expert Systems assist novices in thinking the way experienced professional do.

- Expert Systems are not subjected to such human fallings as fatigue, being too busy, or being emotional.
- Expert Systems can be effectively used as a strategic tool in the areas of marketing products, cutting costs and improving products.

(b) Operating system performs the following major tasks:

- **Scheduling Jobs:** They can determine the sequence in which jobs are executed, using priorities established.
- **Managing Hardware and Software Resources:** They can first cause the user's application program to be executed by loading it into primary storage and then cause the various hardware units to perform as specified by the application.
- **Maintaining System Security:** They may require users to enter a password - a group of characters that identifies users as being authorized to have access to the system.
- **Enabling Multiple User Resource Sharing:** They can handle the scheduling and execution of the application programs for many users at the same time, a feature called multiprogramming.
- **Handling Interrupts:** An interrupt is a technique used by the operating system to temporarily suspend the processing of one program in order to allow another program to be executed. Interrupts are issued when a program requests an operation that does not require the CPU, such as input or output, or when the program exceeds some predetermined time limit.
- **Maintaining Usage Records:** They can keep track of the amount of time used by each user for each system unit - the CPU, secondary storage, and input and output devices. Such information is usually maintained for the purpose of charging users' departments for their use of the organization's computing resources.

(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) 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. 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 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) **Black Box Testing:** Black Box Testing takes an external perspective of the test object, to derive test cases. These tests can be functional or non- functional, though usually functional. The test designer selects typical inputs including simple, knowledge of the test object's internal structure. This method of test design is applicable to all levels of software testing i.e. unit, integration, functional testing, system and acceptance. The higher the level, hence the bigger and more complex the box, the more one is forced to use black box testing to simplify. While this method can uncover unimplemented parts of the specification, one cannot be sure that all existent paths are tested. If a module performs a function, which is not supposed to, the black box test does not identify it.

White Box Testing: It uses an internal perspective of the system to design test cases based on internal structure. It requires programming skills to identify all paths through

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

(c) Major advantages of Cloud Computing are given as follows:

- **Cost Efficiency:** Cloud computing is probably the most cost efficient method to use, maintain and upgrade. Traditional desktop software costs companies a lot in terms of finance. Adding up the licensing fees for multiple users can prove to be very expensive for the establishment concerned. The cloud, on the other hand, is available at much cheaper rates and hence, can significantly lower the company's IT expenses. Besides, there are many one-time-payments, pay-as-you-go and other scalable options available, which make it very reasonable for the company.
- **Almost Unlimited Storage:** Storing information in the cloud gives us almost unlimited storage capacity. Hence, one no more need to worry about running out of storage space or increasing the current storage space availability.
- **Backup and Recovery:** Since all the data is stored in the cloud, backing it up and restoring the same is relatively much easier than storing the same on a physical device. Furthermore, most cloud service providers are usually competent enough to handle recovery of information. Hence, this makes the entire process of backup and recovery much simpler than other traditional methods of data storage.
- **Automatic Software Integration:** In the cloud, software integration is usually something that occurs automatically. This means that we do not need to take additional efforts to customize and integrate the applications as per our preferences. This aspect usually takes care of itself. Not only that, cloud computing allows us to customize the options with great ease. Hence, one can handpick just those services and software applications that s/he thinks will best suit his/her particular enterprise.
- **Easy Access to Information:** Once registered in the cloud, one can access the information from anywhere, where there is an Internet connection. This convenient feature lets one move beyond time zone and geographic location issues.
- **Quick Deployment:** Lastly and most importantly, cloud computing gives us the advantage of quick deployment. Once we opt for this method of functioning, the entire system can be fully functional in a matter of a few minutes. Of course, the amount of time taken here will depend on the exact kind of technology that we

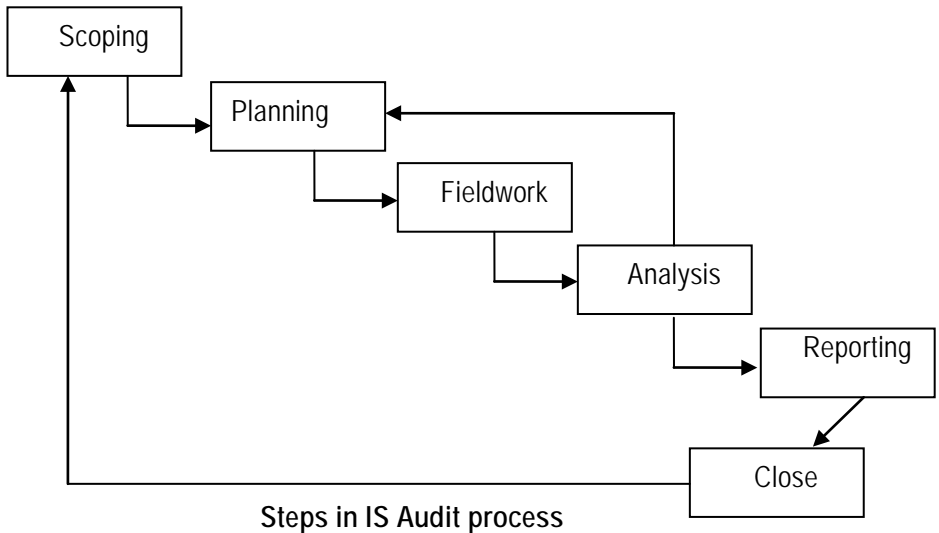
need for your business.

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:

- (i) **Financial Loss:** Financial losses may be direct like loss of electronic funds or indirect like expenditure towards repair of damaged electronic components.
- (ii) **Legal Repercussions:** An organization has to 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.
- (iii) **Loss of Credibility or Competitive Edge:** In order 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.
- (iv) **Blackmail/Industrial Espionage:** By knowing the confidential information, the perpetrator can obtain money from the organization by threatening and exploiting the security violation.
- (v) **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.
- (vi) **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.

(b) Steps in Information System Audit are depicted in the figure.



- (i) **Scoping and pre-audit survey:** Auditors determine the main area/s of focus and any areas that are explicitly out-of-scope, based on the scope-definitions agreed with management. Information sources at this stage include background reading and web browsing, previous audit reports, pre audit interview, observations and, sometimes, subjective impressions that simply deserve further investigation.
- (ii) **Planning and preparation:** During which the scope is broken down into greater levels of detail, usually involving the generation of an audit work plan or risk-control-matrix.
- (iii) **Fieldwork:** Gathering evidence by interviewing staff and managers, reviewing documents, and observing processes etc.
- (iv) **Analysis:** This step involves desperately sorting out, reviewing and trying to make sense of all that evidence gathered earlier. SWOT (Strengths, Weaknesses, Opportunities, Threats) or PEST (Political, Economic, Social, Technological) techniques can be used for analysis.
- (v) **Reporting:** Reporting to the management is done after analysis of evidence gathered and analyzed
- (vi) **Closure:** Closure involves preparing notes for future audits and follow up with management to complete the actions they promised after previous audits.
- (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 behaviour 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 Behaviour** 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 DSS** – The key characteristics of DSS are given 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 particular manager and ready to change according to 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) **Corporate Governance:** Corporate governance is defined as the system by which a company or enterprise is directed and controlled to achieve the objective of increasing shareholder value by enhancing economic performance. Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, Board of Directors, the controlling shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital. It is about doing good business to protect shareholders' interest.

6. (a) The primary objective of a business continuity plan 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. In order 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 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) Impact of Information Systems audit on organizations are as below:

- **Organisational Costs of Data Loss:** Data is a critical resource of an organisation for its present and future process and its ability to adapt and survive in a changing environment.
- **Incorrect Decision Making:** Management and operational controls taken by managers involve detection, investigations and correction of the processes. These high level decisions require accurate data to make quality decision rules.
- **Costs of Computer Abuse:** Unauthorised access to computer systems, malwares, unauthorised physical access to computer facilities and unauthorised copies of sensitive data can lead to destruction of assets (hardware, software, data, information etc.)
- **Value of Computer Hardware, Software and Personnel:** These are critical resources of an organisation, which has a credible impact on its infrastructure and business competitiveness.
- **High Costs of Computer Error:** In a computerised enterprise environment where many critical business processes are performed, a data error during entry or process would cause great damage.
- **Maintenance of Privacy:** Today, data collected in a business process contains private information about an individual too. These data were also collected before computers but now, there is a fear that privacy has eroded beyond acceptable levels.
- **Controlled evolution of computer Use:** Use of Technology and reliability of complex computer systems cannot be guaranteed and the consequences of using unreliable systems can be destructive.
- **Information Systems Auditing:** It is the process of attesting objectives (those of the external auditor) that focus on asset safeguarding and data integrity, and management objectives (those of the internal auditor) that include effectiveness and efficiency both.

- **Asset Safeguarding Objectives:** The information system assets (hardware, software, data information etc.) must be protected by a system of internal controls from unauthorised access.
 - **Data Integrity Objectives:** It is a fundamental attribute of IS Auditing. The importance to maintain integrity of data of an organisation requires all the time. It is also important from the business perspective of the decision maker, competition and the market environment.
 - **System Effectiveness Objectives:** Effectiveness of a system is evaluated by auditing the characteristics and objective of the system to meet business and user requirements.
 - **System Efficiency Objectives:** To optimize the use of various information system resources (machine time, peripherals, system software and labour) along with the impact on its computing environment.
- (c) **Office Automation Systems (OAS)** – It is most rapidly expanding computer based information systems. Different office activities can be broadly grouped into the following types of operations:

- **Document Capture** – Documents originating from outside sources like incoming mails, notes, handouts, charts, graphs etc. need to be preserved.
- **Document Creation** – This consists of preparation of documents, dictation, editing of texts etc. and takes up major part of the secretary's time.
- **Receipts and Distribution** – This basically includes distribution of correspondence to designated recipients.
- **Filling, Search, Retrieval and Follow up** – This is related to filling, indexing, searching of documents, which takes up significant time.
- **Calculations** – These include the usual calculator functions like routine arithmetic, operations for bill passing, interest calculations, working out the percentages and the like.
- **Recording Utilization of Resources** – This includes, where necessary, record keeping in respect to specific resources utilized by office personnel.

All the activities mentioned have been made very simple, efficient and effective by the use of computers. The application of computers to handle the office activities is also termed as office automation.

7. (a) The key governance practices for evaluating risk management are given as follows:
- **Evaluate Risk Management:** Continually examine and make judgment on the effect of risk on the current and future use of IT in the enterprise. Consider whether the enterprise's risk appetite is appropriate and that risks to enterprise value related to the use of IT are identified and managed;

- **Direct Risk Management:** Direct the establishment of risk management practices to provide reasonable assurance that IT risk management practices are appropriate to ensure that the actual IT risk does not exceed the board's risk appetite; and
- **Monitor Risk Management:** Monitor the key goals and metrics of the risk management processes and establish how deviations or problems will be identified, tracked and reported on for remediation.

(b) **Impact of Technology on Internal Controls are as follows:**

- **Personnel:** Personnel should have proper skill and knowledge to discharge their duties.
- **Segregation of duties:** Within an IT environment, the staff in the IT department of an enterprise will have a detailed knowledge of the interrelationship between the source of data, how it is processed and distribution and use of output. IT staff may also be in a position to alter transaction data or even the financial applications which process the transactions.
- **Authorization procedures:** In some on-line transaction systems, written evidence of individual data entry authorization, e.g. a supervisor's signature, may be replaced by computerized authorization controls such as automated controls written into the computer programs (e.g. programmed credit limit approvals)
- **Record keeping:** There are various controls over the protection and storage of documents, transaction details, and audit trails etc.
- **Access to assets and records:** A client's financial data and computer programs are vulnerable to unauthorized amendment in the computer or from remote locations. The use of wide area networks, including the Internet, has increased the risk of unauthorized access.
- **Management supervision and review:** Management's supervision and review helps to deter and detect both errors and fraud.
- **Concentration of programs and data:** Transaction and master file data (e.g. pay rates, approved suppliers lists etc.) may be stored in a computer readable form on one computer installation or on a number of distributed installations. Therefore, in the absence of appropriate controls over these programs and utilities, there is an increased risk of unauthorized access and alteration of financial data.

(c) **SA402:** Audit Considerations Relating to an Entity using Service Organization, SA 402 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 24, "Audit Considerations Relating to Entities Using Service Organizations" issued by the ICAI in 2002. The revised Standard deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organizations. SA 402 also deals with the

aspects like obtaining an understanding of the services provided by a service organization, including internal control, responding to the assessed risks of material misstatement, Type 1 and Type 2 reports, fraud, non-compliance with laws and regulations and uncorrected misstatements in relation to activities at the service organization and reporting by the user auditor. This SA is effective for audits of financial statements w.e.f. April 1, 2010.

- (d) **Platform as a Service (PaaS):** in Cloud Computing Cloud providers deliver a computing platform including operating system, programming language execution environment, database, and web server. Application developers can develop and run their software solutions on a cloud platform without the cost and complexity of acquiring and managing the underlying hardware /software layers. In PaaS, one can make applications and software's on other's database. Thus, it gives us the platform to create, edit, run and manage the application programs we want. All the development tools are provided. Some of examples of PaaS include: AWS Elastic Beanstalk, Cloud Foundry, Heroku, Force.com, EngineYard etc.
- (e) **Strength of Agile Model:** Some of the strengths identified by the experts and practitioners include the following:
- Agile methodology has the concept of an adaptive team, which enables to respond to the changing requirements.
 - The team does not have to invest time and efforts and finally find that by the time they delivered the product, the requirement of the customer has changed.
 - Face to face communication and continuous inputs from customer representative leaves a little space for guesswork.
 - The documentation is crisp and to the point to save time.
 - The end result is generally the high quality software in least possible time duration and satisfied customer.

MOCK TEST PAPER – 2
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) Piyush, an employee with M/s Premium Solutions Ltd., provides the following information relating to his income for the financial year 2013-14:
- (i) He received salary Rs. 25,000 per month including conveyance allowance @ Rs. 2,500 per month for official purposes.
 - (ii) He deposited Rs. 2,500 per month in his account under a pension scheme notified by the Central Government.
 - (iii) He paid a sum of Rs. 60,000 during the year as interest on loan taken in April, 2008 from bank for higher studies of his daughter.
 - (iv) He paid health insurance premium for himself and for his family members Rs. 8,500 in cash and Rs. 9,000 by credit card.
 - (v) He invested Rs. 40,000 in notified bonds issued by NABARD in July, 2013.
 - (vi) Equity shares having fair market price of Rs. 1,00,000 (on the date of exercise of option) were allotted to him by the company at a concessional price of Rs. 20,000 on 30.5.2013, which were sold by him for Rs. 1,80,000 on 28.2.2014.

Compute the total income of Piyush for assessment year 2014-15 and give reasons for treatment to each of the items. (10 Marks)

- (b) Shradha Constructions Ltd. furnishes the following particulars of its wealth for the valuation date as on 31.3.2014:

		Rs. (in lacs)
(i)	Land in urban area (held as stock in trade since 2000).	81
(ii)	Motor cars (including one imported car, worth Rs. 18 lacs used for hiring)	38
(iii)	250 acres agricultural land acquired at Greater Noida Township on 27.8.2013 for construction of residential flats/commercial complex. However, Greater Noida Authority has reserved 25 acres land as green belt.	250

(iv)	Residential flats of 1500 sq feet each provided to 3 employees (salary of one employee exceeded Rs. 10 lacs per annum)	36
(v)	Farm house of 5 acre at a remote village beyond 25 kms from the local limits of Municipality	9
(vi)	Cash in hand as per cash book	3
	Liabilities:	
(i)	Loan for purchase of land at Urban area	30
(ii)	Loan for purchase of land at Greater Noida	120
(iii)	Wealth-tax liability for Assessment year 2013-14	12
(iv)	Loan for construction of residential flats	9

Compute the net wealth of the company as on valuation date 31.03.2014.

(10 Marks)

2. The Profit & Loss Account of Sunshine Private Limited for the year ended 31st March, 2014 shows a profit of Rs. 75 lakhs after debiting the following items:
- (i) Rs. 2 lakhs contributed to Employees' Welfare Trust.
 - (ii) Rs. 12 lakhs paid towards course fee and hostel expenses for MBA course of a close relative of a director. The relative is not in employment with the company.
 - (iii) Rs. 3.50 lakhs, being expenses incurred on installation of a traffic signal, so as to facilitate its employees coming to office to overcome traffic jam and save office time.
 - (iv) Rs. 3 lakhs spent on gift items distributed to various dealers under the company's sales incentive scheme.
 - (v) Rs. 6 lakhs, being expenses incurred on the travelling of the wife of MD, who accompanied him on tour to Singapore on invitation of Trade and Commerce Chamber, Singapore.
 - (vi) Rs. 3 lakhs, being amount paid in March 2014 consequent upon change in currency rate due to exchange fluctuation in excess of the amount due to the supplier of machinery. Machinery was put to use in July 2013.
 - (vii) Rs. 18,000 and Rs. 9,000 paid in cash on 25th October, 2013 by two separate vouchers to a contractor who carried out certain repair work in the office premises.
 - (viii) Interest of Rs. 2 lakhs was paid in March, 2014 to a company on a loan taken from a company. Tax deducted at source from such interest was deposited in July, 2014.

Additional Information:

- (a) Provision for audit fee of Rs. 6 lakhs was made in the books for the year ended 31st March, 2013 without deducting tax at source. Such fee was paid to the auditors in September, 2013 after deducting tax under section 194J and the tax so deducted was deposited on 7th October, 2013.
- (b) During the year, the company purchased 10,000 shares of Best Private Limited at Rs. 40 per share. The fair market value of such shares on the date of transaction was Rs. 60 per share.

Compute total income of Sunshine Private Limited for Assessment Year 2014-15 and tax payable on such income indicating reasons for treatment of each item. Ignore the provisions relating to minimum alternate tax. (16 Marks)

3. (a) Brown Ltd. has two industrial undertakings. Unit I is engaged in the production of television sets and Unit II is engaged in the production of refrigerators. The company has, as part of its restructuring program, decided to sell Unit II as a going concern by way of slump sale for Rs. 260 lacs to a new company called Heat Ltd., in which it holds 85% equity shares. The following is the extract of the balance sheet of Brown Ltd. as on 31st March, 2014:

	Rs. (in lacs)	
	Unit – I	Unit – II
Fixed Assets	112	158
Debtors	88	67
Inventories	60	23
Liabilities	33	45

	Rs. (in lacs)
Paid-up share capital	231
General Reserve	160
Share Premium	39
Revaluation Reserve	105

The company set up Unit II on 1st April, 2009. The written down value of the block of assets for tax purpose as on 31st March, 2014 is Rs. 150 lacs of which Rs. 60 lacs are attributable to Unit II.

- (i) Determine what would be the tax liability of Brown Ltd. on account of Slump sale;
- (ii) How can the restructuring plan of Brown Ltd. be modified, without changing the amount of consideration, in order to make it more tax efficient? (8 Marks)

- (b) A private limited company has share capital in the form of equity share capital. The shares were held up till 31st March, 2012 by four members Ashok, Vikash, Chetan and Dhruv equally. The company made losses/profits for the past three assessment years as follows:

Assessment Year	Business Loss Rs.	Unabsorbed Depreciation Rs.	Total Rs.
2010-2011	Nil	15,00,000	15,00,000
2011-2012	Nil	12,00,000	12,00,000
2012-2013	9,00,000	9,00,000	18,00,000
Total	9,00,000	36,00,000	45,00,000

The above figures have been accepted by the tax department.

During the previous year ended 31.3.2013, Ashok sold his shares to Suraj and during the previous year ended 31.3.2014, Vikas sold his shares to Raj. The profits for the past two previous years are as follows:

31.3.2013 Rs. 18,00,000 (before charging depreciation of Rs. 9,00,000)

31.3.2014 Rs. 45,00,000 (before charging depreciation of Rs. 7,50,000)

Compute taxable income for A.Y.2014-15. Workings must form part of your answer.

(8 Marks)

4. (a) Govind Public Charitable Trust (Registered under section 12A of the Income-tax Act, 1961) furnishes the following data for the financial year ending 31.3.2014.

S. No.	Particulars	Rs. (in Lacs)
(i)	Income from Engineering College (Gross receipts Rs. 100 Lacs)	10
(ii)	Income from properties held in trust (out of his Rs. 2 Lacs was not received during the year and Rs. 2 Lacs was received only on the last day of the year)	26
(iii)	Net income from business held under trust (As incidental to the main objects) as per books	2
(iv)	Amount spent on free scholarship, free meals and free medical relief	9
(v)	Repayment of loan taken for construction of Health Care Centre	3

You are required to:

- (i) Compute the taxable income of the Trust for the assessment year, 2014-15. Assume that option is exercised under explanation to section 11(1) of the Act.
 - (ii) Advise how the taxability on the computed income could be minimized or reduced. *(8 Marks)*
- (b) A piece of land owned by Mr. Kalra located on Jaipur-Delhi highway was acquired by NHAI in the F.Y.2008-09, but the award ordered in F.Y. 2009-10 was paid in the F.Y. 2013-14. This land was purchased by him on 2.4.1978 for Rs. 10,000. The fair market value of the land as on 1.4.1981 was Rs. 9,000. Compensation paid was Rs. 15 lacs.

The other piece of land located in Chennai purchased in April, 2004 for Rs. 25 lacs was also sold by him in February, 2014 for Rs. 35 lacs, but sale deed thereof could not be executed by 31.3.2014. The value for the purpose of stamp duty to be applied by the stamp valuation authority was Rs. 40 lacs.

Compute the income chargeable to tax arising as a result of these transactions in the A.Y.2014-15. The CILs for the F.Y: 2004-05, 2008-09, 2009-10 and 2013-14 are 480, 582, 632 and 939 respectively. *(8 Marks)*

5. Attempt any four questions out of the following questions:

- (a) A company engaged in textile manufacturing, debited to its Profit & Loss Account a sum of Rs. 6,00,000, being the interest on loan of Rs. 60,00,000 taken for financing its expansion scheme. The plant and machinery purchased for the project with the loan were not received during the year and those were still in transit at the end of the year. A sum of Rs. 60,000 was paid to a broker who arranged the loan. Discuss the admissibility or otherwise of the interest and brokerage on borrowing.
- (b) Girdhar purchased a residential flat from Dev in December 2013. However, the deed of conveyance has not been registered in the name of Girdhar till 31.03.2014. Girdhar has let out the flat at a monthly rent of Rs. 25,000 to Rakesh.

Girdhar claims that rent received is not chargeable under the head "Income from house property", but the same is chargeable under the head "Income from other sources" and he can claim deduction for expenses on repair and insurance premium on actual basis and also depreciation. Examine the correctness of Girdhar's claim.

- (c) Mr. Chawla, a leading advocate on corporate law, decided to reduce his practice and to accept briefs only for paying his taxes and making charities with the fees received on such briefs. In a particular case, he agreed to appear to defend one company in the Supreme Court on the condition that he would be provided with Rs. 5 lacs for a public charitable trust that he would create. He defended the company and was paid the sum by the company. He created a trust of that sum by executing

a trust deed. Decide whether the amount received by Mr. Chawla is assessable in his hands as income from profession.

- (d) Neeraj is a fashion designer having lucrative business. His wife is a model. Neeraj pays her monthly salary of Rs. 10,000. The Assessing Officer while admitting that the salary is an admissible deduction, in computing the total income of Neeraj had applied the provisions of section 64(1), and had clubbed the income (salary) of his wife in Neeraj hands. Discuss the correctness of the action of the Assessing Officer.
- (e) Rajan carrying on a business as sole proprietor, died on 31st March, 2013. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2013, a determined business loss of Rs. 5 lacs is to be carried forward under the Income-tax Act, 1961.

Does the firm consisting of all legal heirs of Mr. Rajan, get a right to have this loss adjusted against its current income? (4×4=16 Marks)

6. (a) Mr. Goswami sought voluntary retirement from a Government of India Undertaking and received compensation of Rs. 40 Lacs on 31st January, 2014. He is planning to use the money as capital for a business dealership in electronic goods. The manufacturer of the product requires a security deposit of Rs. 15 Lacs, which would carry interest at 8% p.a. Goswami's wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of Rs. 5 Lacs. Mr. Goswami would like to draw a monthly remuneration of Rs. 40,000 and also interest @10% p.a. on his capital in the business. Mr. Goswami has approached you for a tax efficient structure of the business.

Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required. (6 Marks)

- (b) Mr. Bajaj, a resident Indian and aged 67 years, has derived the following income during the previous year 2013-14:

		Rs.
(i)	Income from business in India	2,50,000
(ii)	Commission (Gross) from a company in Hong Kong (Tax paid in Hong Kong Rs. 60,000)	3,00,000
(iii)	Dividend (Gross) from a company in Hong Kong (Tax paid in Hong Kong Rs. 18,000)	90,000
(iv)	Interest on fixed deposit with banks in India	2,00,000

India has no double tax avoidance agreement with Hong Kong. Compute the income and tax payable by Mr. Bajaj for assessment year 2014-15. (6 Marks)

(c) Mr. Sujit, an individual whose total sales in the business of food grains for the year ending 31.3.2014 was Rs. 105 lacs, did not maintain books of account. The Assessing Officer levied penalty under section 271A for non-maintenance of books of account and section 271B for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty under section 271B? *(4 Marks)*

7. (a) Surya Motors Ltd., an Indian company declared income of Rs. 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2014:

- (i) 10,000 cars sold to Thin Ltd. which holds 30% shares in Surya Motors Ltd. at a price which is less by \$ 200 each car than the price charged from Shingto Ltd.
- (ii) Royalty of \$ 1,20,00,000 was paid to Kyoto Ltd. for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for \$ 90,00,000.
- (iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2014. The total book value of assets of Surya Motors Ltd. on the date was Rs. 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2014-15 keeping in mind that the value of 1\$ and of 1 EURO was Rs. 63 and Rs. 84, respectively, throughout the year. *(8 Marks)*

(b) Explain the applicability of the provision relating to the deduction of tax at source in the following transactions:

- (i) Tall Limited pays Rs. 1 lac to Short Limited, a resident contractor who, under the contract dated 15th October, 2013, manufactures a product according to specification of Tall Limited by using materials purchased from Short Limited.
- (ii) A company operating a television channel makes payment of Rs. 5 lacs to a former cricketer for making running commentary of a one-day cricket match.
- (iii) SN Ltd., a foreign company, pays outside India, salary to its employee, Mr. David, a foreign national and a non-resident, for services rendered in India.
- (iv) TPO Ltd., the employer, credited salary due for the financial year 2013-14 amounting to Rs. 2,40,000 to the account of Dinesh, an employee, in its books of account on 31.3.2014. Dinesh has not furnished any information about his income/loss from any other head or proof of investments/payments qualifying for deduction under section 80C. *(8 Marks)*

MOCK TEST PAPER – 2

FINAL: GROUP – II

PAPER – 7 : DIRECT TAX LAWS

SUGGESTED ANSWERS/HINTS

1. (a) Computation of total income of Mr. Piyush for the Assessment Year 2014-15

Particulars	Rs.	Rs.
Salaries		
Gross salary received	3,00,000	
<i>Add:</i> Shares allotted at concessional price – fair market value less the amount recovered from the employee [Section 17(2)(vi)] (i.e. Rs. 1,00,000 minus Rs. 20,000)	80,000	
	3,80,000	
<i>Less:</i> Conveyance allowance exempt under section 10(14)	30,000	3,50,000
Capital gains		
Sale consideration of equity shares sold on 28.02.2014	1,80,000	
<i>Less:</i> Fair Market Value of shares on the date of exercise of option (i.e., 30.5.2013)	1,00,000	80,000
Gross Total Income		4,30,000
Less: Deduction under Chapter VIA		
Under section 80C		
For investment in notified bonds of NABARD	40,000	
Under section 80CCD		
For deposit in pension scheme notified by Central Government [Rs. 30,000 but restricted to 10% of salary i.e. 10% of Rs. 2,70,000]	27,000	
Under section 80D		
For payment of health insurance premium by credit card	9,000	
Under section 80E		
For payment of interest on loan taken from bank for higher studies of daughter	60,000	1,36,000
Total Income		2,94,000

Notes:

- (i) Conveyance allowance received for official duties is fully exempt under section 10(14). It is assumed that such amount is actually incurred by the employee for official purpose.
- (ii) Section 80CCD provides for deduction of employee's and employer's contribution to pension scheme notified by the Central Government. This deduction has been extended also to individuals employed by any other employer on or after 1.1.2004. However, if the amount contributed exceeds 10% of salary, then, the deduction would be restricted to 10% of salary. [As per *Explanation* to section 80CCD, salary for this purpose would include dearness allowance if the terms of employment so provide, but excludes all other allowances and perquisites]. Therefore, "salary" for the purpose of section 80CCD would be Rs. 2,70,000 (Rs. 3,00,000 – Rs. 30,000).
- (iii) The deduction under section 80E available to an individual in respect of interest on loan taken for his higher education has been extended to include interest on such loan taken for higher education of his relative i.e. his or her spouse and children. Hence, interest on loan taken by Mr. Piyush from bank for the higher studies of his daughter is eligible for deduction under section 80E.
- (iv) For claiming deduction under section 80D, the payment of medical insurance premium has to be made by any mode other than cash. Hence, payment of Rs. 8,500 made in cash will not qualify for deduction under section 80D.
- (v) Subscription to notified bonds issued by NABARD will qualify for deduction under section 80C(2)(xxii).
- (vi) The value of any specified security or sweat equity shares allotted or transferred by the employer, free of cost or at a concessional rate to the employee would be treated as a perquisite in the hands of the employee. The value would be the fair market value of the specified security or sweat equity shares on the date on which the option is exercised by the employee as reduced by the amount actually paid by, or recovered from the employee in respect of such security or shares.

Consequently, section 49(2AA) provides that for the purpose of computing capital gains in the hands of the employee at the time of sale of such securities/shares by the employee, the cost of acquisition shall be the fair market value which has been taken into account for the purpose of computing the perquisite value in the hands of the employee.

(b) Computation of Net Wealth of M/s Shradha Constructions Ltd. as on valuation date 31.03.2014

Particulars	Rs. (in lacs)	Rs. (in lacs)
Assets [as per the definition of assets under section 2(ea)]		
(i) Land in urban area (held as stock in trade since 2000) – taxable since it is held as stock-in-trade for more than 10 years		81
(ii) Motor cars (excluding imported car not being an asset since it is used for hiring) [Rs. 38 Lacs – Rs. 18 Lacs]		20
(iii) Agricultural land acquired for construction of residential and commercial complex (is a stock-in-trade in the hands of a construction company – hence, not an asset)		Nil
(iv) (a) Residential flats provided to 2 employees drawing salary less than Rs. 10 lacs per annum – not an asset		Nil
(b) Residential flat provided to one employee drawing salary exceeding Rs. 10 lacs per annum is an asset [36 × 1/3]		12
(v) Farm house - not an asset		Nil
(vi) Cash in hand as per cash book is not an asset since it represents cash recorded in the books		Nil
		113
Less: Liabilities		
(i) Loan for purchase of land in urban area – deductible, since it is incurred in relation to land in urban area, which is an asset chargeable to wealth-tax.	30	
(ii) Loan for purchase of agricultural land - not deductible, since land is not an asset	Nil	
(iii) Wealth tax liability for Assessment year 2013-14 – wealth tax liability is not deductible	Nil	
(iv) Loan for construction of residential flats - the portion relating to taxable asset (1/3) is deductible i.e. $\frac{1}{3} \times 9$ lacs	<u>3</u>	<u>33</u>
Net Wealth		80

2. Computation of total income of Sunshine Private Ltd. for the A.Y.2014-15

Particulars	Rs.
Profits and gains of business or profession	
Net profit for the year as per profit and loss account	75,00,000
Add: Expenses debited to profit and loss account but not allowable	
(i) Contribution to Employees Welfare Trust disallowed under section 40A(9)	2,00,000
(ii) Expenses on course fee and hostel expenses for MBA course of a close relative of a director, who is not in employment of Sunshine Private Ltd., is not deductible under section 37 [Enkay (India) Rubber Co. Pvt. Ltd v. CIT (2003) 263 ITR 521 (Del)]. Such expenditure is not incurred wholly and exclusively for the purposes of business. Hence, it should be added back to compute business income.	12,00,000
(iii) Expenses on installation of traffic signal, to facilitate its employees to overcome traffic jam and be on time, is in the interest of the business so that the work gets completed on time, and is hence, an allowable expense under section 37(1).	--
(iv) Expenses on distribution of gift items to dealers under sales incentive scheme would promote goodwill and is made in the interest of business. Such gifts are prompted by commercial expediency and hence, the expenditure is allowable under section 37(1) [CIT v. Avery Cycle Industries Ltd. (2008) 298 ITR 239 / 296 ITR 393 (Punjab & Haryana)].	--
(v) Expenses on travelling to Singapore of the wife of Managing Director on the invitation of Trade and Commerce Chamber, Singapore, is an allowable expense on the grounds of commercial expediency and business considerations.	--
(vi) Increase in liability due to change in currency rate and paid to the suppliers of machinery is to be added to cost of the asset irrespective of the method of accounting as per section 43A. Hence, it should be added back to compute business income.	3,00,000
(vii) Payments to a contractor for repair work in a day by two separate vouchers in cash, is not an allowable expense as per section 40A(3), since the aggregate payment in a day exceeds the limit of Rs. 20,000.	27,000
(viii) Interest of Rs. 2 lakhs paid in March, 2014, on which tax	-

deducted at source was remitted to the Government before the due date of filing of return (i.e., before 30 th September, 2014), is allowable as per section 40(a)(ia).		
		92,27,000
Less: Expenditure allowable as deduction but not debited to profit and loss account		
Provision for audit fees for the year ended 31.3.2013 for which tax was not deducted in the F.Y. 2012-13 but was deducted and paid in F.Y. 2013-14 is allowable as deduction in the A.Y.2014-15, as per the proviso to section 40(a)(ia).	6,00,000	
Depreciation on the amount of Rs. 3 lakhs added in cost of machinery @ 15% for the year, since the machinery was put to use for more than 180 days (See Note below)	<u>45,000</u>	6,45,000
		85,82,000
Income from other sources		
Difference between the aggregate fair market value of shares of a closely held company and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company under section 56(2)(viiia).		
Since the difference exceeds Rs. 50,000, the entire sum is taxable.		2,00,000
Total income		87,82,000

Computation of tax liability of Sunshine Private Ltd. for A.Y.2014-15

Particulars	Rs.
Tax on Rs. 87,82,000 @ 30%	26,34,600
Add: Education cess @ 2%	52,692
Secondary and higher education cess @ 1%	<u>26,346</u>
Total Tax Payable	<u>27,13,638</u>

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

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed

to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Ascertainment of tax liability of Brown Ltd. from slump sale of Unit II

Particulars	Rs.
Slump sale consideration	2,60,00,000
Less : Cost of acquisition (net worth) [See Working Note below]	<u>1,05,00,000</u>
Long-term capital gain (as Unit II is held for more than 36 months)	<u>1,55,00,000</u>
Calculation of tax liability	
Income tax @ 20% (Being long term capital gain under section 112)	31,00,000
Surcharge @ 5%	<u>1,55,000</u>
	32,55,000
Education cess @ 2% and Secondary and higher education cess@1%	<u>97,650</u>
Total tax liability	<u>33,52,650</u>

Working Note: Net worth of Unit II

Particulars	Rs.
WDV of block of assets	60,00,000
Debtors	67,00,000
Inventories	<u>23,00,000</u>
	1,50,00,000
Less : Liabilities	<u>45,00,000</u>
Net worth	<u>1,05,00,000</u>

(ii) Tax Advice

- (i) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempted from tax under section 47(iv). Therefore, if it is possible for Brown Ltd. should try to acquire the entire shareholding of Heat Ltd. and thereafter make a slump sale, then the resultant capital gain shall not attract tax liability. However, in such case also, Brown Ltd. should not transfer any shares in Heat Ltd. for 8 years from the date of slump sale.
- (ii) Alternatively, if acquisition of 15% share is not feasible, Brown Ltd. may think about demerger plan of Unit-II to get benefit of section 47(vib) of the Income-tax Act, 1961.

- (b) Ashok, Vikash, Chetan and Dhruv are the four shareholders of a private limited company. The shareholding pattern of the company in the last three financial years are given below:

As on 31 st day of March	Ashok	Vikas	Chetan	Dhruv	Suraj	Raj
	%	%	%	%	%	%
2012	25	25	25	25	-	-
2013	-	25	25	25	25	-
2014	-	-	25	25	25	25

Section 79 provides that, in case of a closely held company, no loss incurred in the previous year shall be carried forward and set off against the income of the subsequent previous year unless the shares carrying at least 51% of the voting power of the company are beneficially held on the last day of the previous year in which the loss is sought to be set off, by the same shareholders, who beneficially held the shares carrying at least 51% of the voting power on the last day of the previous year in which the loss was incurred.

Since shareholders holding at least 51% of the voting power are the same in the first and second year, the restriction imposed by section 79 is not applicable for the second year. Thus, the taxable income for the assessment year 2013-14 would be:

Particulars	Rs.
Business profit	18,00,000
Less: Current year's depreciation	9,00,000
	9,00,000
Less: Brought forward business loss [as per section 72(2)]	9,00,000
Taxable income	Nil

Unabsorbed depreciation relating to the earlier assessment years can be carried forward to the next assessment year i.e. 2014-15. There is no brought forward business loss and section 79 is not applicable in case of carry forward of unabsorbed depreciation. Section 32 governs the carry forward and set off of depreciation for which the shareholding pattern is not relevant at all. Consequently, the income for A.Y.2014-15 will be determined as under -

Particulars	Rs.	Rs.
Business income		45,00,000
Less: Current year's depreciation		7,50,000
		37,50,000
Less: Unabsorbed depreciation:-		
Assessment year 2010-11	15,00,000	
Assessment year 2011-12	12,00,000	

Assessment year 2012-13	9,00,000	36,00,000
Taxable Income for A.Y.2014-15		1,50,000

4. (a) (i) **Computation of total income of Govind Public Charitable Trust for A.Y. 2014-15**

	Particulars	Rs.(in Lacs)
(i)	Income from Engineering College – exempt under section 10(23C) (iiiad) as gross receipts do not exceed Rs. 1 crore.	Nil
(ii)	Income from properties held under trust	26.00
(iii)	Income from business undertaking held under trust (assumed that the business is incidental to the attainment of objectives of the trust and separate books are maintained satisfying section 11(4A))	2.00
		28.00
	85% of the income required to be spent (85% of Rs. 28 Lacs)	23.80
	<i>Less</i> : Amount spent on free scholarship, free meals and free medical centre	(-)9.00
	Repayment of loans for construction of health centre (this is utilized for the fulfillment of the objects of the trust) (See <i>CIT v.Janmbhoomi Press Trust (2000) 242 ITR 703</i>)	(-)3.00
		11.80
	<i>Less</i> : Option exercised under <i>Explanation 2</i> to section 11 of the Act	
	(i) Amount not received during the previous year	2.00
	(ii) income received on the last day to be spent in the next year	2.00
	Income of the trust liable to tax	7.80

(ii) In order to minimize and /or reduce the tax liability, the trustees may give a notice in writing to the Assessing Officer in the prescribed manner about their intention to accumulate the unspent amount of Rs. 7.80 Lacs specifying the period and the purpose for which, the accumulation is proposed to be made and invest the sum of Rs. 7.80 Lacs in specified assets as per section 11(5). This accumulation would be in compliance with section 11(2) and in such case no tax will be payable on the sum of Rs. 7.80 Lacs.

(b) Computation of taxable income of Mr. Kalra for A.Y.2014-15

Particulars	Rs.
Capital Gains	
(A) Long-term capital gain derived from transfer of land on Jaipur-Delhi highway acquired by NHAI in F.Y. 2008-09 for which award was paid in F.Y. 2013-14 is chargeable to tax in A.Y.2014-15 [See Note (i) below]	
Sale consideration i.e. compensation paid	15,00,000
Less: Indexed cost of acquisition [See Note (ii) below]	
$\frac{(10000 \times 582)}{100}$	<u>58,200</u>
Long Term Capital Gains (A)	<u>14,41,800</u>
(B) Sale of land at Chennai in February 2014 [See Note (iii) below]	
Full value of consideration as per section 50C [See Note (iv) below]	40,00,000
Less: Indexed cost of acquisition	
(Rs. 25,00,000 × 939/480)	48,90,625
Long Term Capital Loss (B)	<u>(8,90,625)</u>
Long Term Capital Gains (A - B)	5,51,175

Total income chargeable to tax arising as a result of these transactions in the A.Y.2014-15 is equal to Rs. 5,51,175 (i.e. Rs. 14,41,800 - Rs. 8,90,625). Long term capital loss can be set-off from the long term capital gain.

Notes:

- (i) The capital gains arising on compulsory acquisition shall be charged to tax in the year in which the compensation is first received as per section 45(5)(a).
- (ii) The option of fair market value as on 1.4.1981 is not exercised by the assessee since the fair market value is lower than the cost.
582 is the cost inflation index of F.Y.2008-09 i.e. the year in which the property was compulsorily acquired.
- (iii) The execution of sale deed is not compulsory for the purpose of charge of capital gain because the transfer of right enabling enjoyment of immovable property gives rise to charge of capital gains as held by the Kerala High Court in the case of *CIT v. C.F. Thomas (2006) 284 ITR 557*.
- (iv) As per section 50C, the value applied by the stamp valuation authority is deemed to be the full value of consideration received or accruing as a result of such transfer, since such value is higher than the sale consideration of Rs. 35

lacs. 939 is the cost inflation index of F.Y.2013-14 i.e. the year in which the property at Chennai was sold.

5. (a) Interest paid in respect of capital borrowed for the purposes of business or profession is admissible under section 36(1)(iii). However, the proviso to section 36(1)(iii) says that interest paid in respect of capital borrowed for acquiring an asset for extension of existing business or profession (whether capitalized in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use will not be allowed as deduction.

In this case, the asset (plant & machinery) was not put to use till the end of the previous year. Therefore, interest of Rs. 6,00,000 will not be allowed as a deduction. However, the cost of the asset shall be increased by the amount of interest and depreciation shall be admissible on the enhanced cost of Rs. 66,00,000, once the asset is put to use.

As regards the brokerage of Rs. 60,000 paid to a broker for arranging the loan there are two possible views –

The first view is that since the definition of the term "interest" under section 2(28A) includes service fee or other charges in respect of moneys borrowed, "brokerage" can be considered to fall under the scope of the term "other charges" and is therefore covered by the definition "interest". Hence, brokerage of Rs. 60,000 for arranging the loan will be treated in the same way as interest and capitalized with the cost of the asset.

The alternate view is based on the High Court decision in *C. Moolchand v. CIT (1956) 29 ITR 449 (Hyd.)*, where it was held that brokerage or commission paid to an agent for arranging a loan for the purpose of business is not allowable as deduction under section 36(1)(iii), but allowable under section 37(1). As per this view, Rs. 60,000 paid to broker for arranging the loan is allowable under section 37(1).

- (b) In order to assess income under the head "Income from house property" the assessee must be the owner of the house property. The need for registration of document in favour of a person to enable him to be treated as the owner of the house property for the purpose of section 22, was considered by the Supreme Court in the case of *CIT vs. Poddar Cement Pvt. Ltd. (1997) 226 ITR 625*.

It was held that so long as a person is entitled to receive income from the house property in his own right and not on behalf of someone else, it is not necessary that the sale deed must be registered in favour of the person to treat him as the owner of the property for the purpose of section 22. In such a case, the income derived from the property is chargeable to tax under the head "Income from house property". The

fact that registration is not yet complete does not affect the chargeability of such income under the head "Income from house property".

Therefore, the claim of Girdhar that rent should be assessed under the head "Income from other sources" and deduction of various expenses and depreciation should be allowed therefrom is not tenable.

- (c) In the instant case, the trust was created by Mr. Chawla himself out of his professional income. The client did not create the trust. The client did not impose any obligation in the nature of a trust binding on Mr. Chawla. Thus, there is no diversion of the money to the trust before it became professional income in the hands of Mr. Chawla. This case is one of application of professional income and not of diversion of income by overriding title. Therefore, the amount received by Mr. Chawla is chargeable to tax under the head "Profits and gains of business or profession".
- (d) This question is based on the principles laid down by Madras High Court in the case of *CIT v. Smt. R. Bharati (1999) 240 ITR 697* where the interpretation of the terms "professional qualifications" and "knowledge" came up for consideration as per proviso to section 64(1).

These words do not necessarily connote a qualification conferred by a recognized university after examining the candidate who has undergone a course of study in a technical subject or course of study preparing him for a profession of law, accountancy etc. Accordingly, the term "qualification" must be given a wide meaning as referring to the qualities which are required to be possessed by a person performing the work that he does, so long as that work is capable of being regarded as technical or professional.

The word "professional" is a term capable of very broad meaning and would encompass a variety of occupations. A large number of occupations are being practiced which form a source of livelihood and are capable of being regarded, as professions as long as they require certain degree of skill. A person having skill, experience and competence in a line of work can be regarded as professionally qualified for the purpose of section 64(1)(ii).

A model in the light of above is having skill, competence and experience in her line and is thus professionally qualified. Hence, the action of the Assessing Officer is not correct.

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

the only exception to this provision is when the business passes on to another person by inheritance.

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

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

6. (a) The selection of the form of organisation to carry on any business activity is essential in view of the differential tax rates prescribed under the Income-tax Act, 1961 and specific concessions and deductions available under the Act in respect of different entities. For the purpose of formulating advice as to the tax efficient structure of the business, it is necessary for the tax consultant to consider the following issues:
 - 1 In the case of sole proprietary concern, interest on capital and remuneration paid to the proprietor is not allowable as deduction under section 37(1) as the expenditure is of personal nature. On the other hand, in the case of partnership firm, both interest on capital and remuneration payable to partners are allowable under section 37(1) subject to the conditions and limits laid down in section 40(b). Remuneration and interest should however, be authorised by the instrument of partnership and paid in accordance with such instrument. Such interest and salary shall be taxable in the hands of partners to the extent the same is allowed to the firm under section 40(b). Interest to partners can be allowed up to 12% on simple interest basis, while the limit for allowability for partners' remuneration is based on book profit under section 40(b). As per section 40(b)(v) the partners' remuneration shall be allowed to the extent of aggregate of -
 - (a) On the first Rs. 3,00,000 of book profits or in case of loss – Rs. 1,50,000 or at the rate of 90% of book profits, whichever is more
 - (b) on the balance of book profits – at the rate of 60%
 2. Partner's share in the profits of firm is not taxed in the hands of the partners by virtue of section 10(2A).
 3. If a proprietary concern is formed, the salary of Mrs. Goswami shall be allowed as deduction under section 37(1).

4. The possibility of invoking section 40A(2) cannot be ruled out as salary is payable to a relative, who is an interested person within the meaning of section 40A(2). However, it can be argued successfully that salary of Rs. 5 Lacs is justified in view of her long experience as marketing manager of a multinational company and the fair market value of services to be rendered by her to the concern.
5. An issue arises as to whether remuneration of Mrs. Goswami would be includible in the total income of Mr. Goswami. Under section 64(1)(ii), remuneration of the spouse of an individual working in a concern in which the individual is having a substantial interest shall be included in the total income of the individual. **However, the clubbing provision does not apply if the spouse possesses technical or professional qualification and the income is solely attributable to the application of his or her technical or professional knowledge and experience.** Further, technical or professional qualification would not necessarily mean the qualifications obtained by degree or diploma of any recognized body [*Batta Kalyani vs. CIT (1985) 154 ITR 0059 (AP)*] The experience of Mrs. Goswami as a marketing manager in a multinational company for 15 years may reasonably be considered as a professional qualification for this purpose.
6. If Mrs. Goswami joins the proprietary concern or partnership concern of her husband as employee, remuneration of Rs. 5 lacs shall be taxed in her hands under the head "salary".
7. If she joins as partner in the business, remuneration shall be taxed in her hand as business income under section 28 to the extent such remuneration is allowed in the hands of the firm under section 40(b).
8. The tax rate applicable to an individual depends on the level of his/her income, whereas for partnership firms it is flat rate at 30%. For individuals, the rate of tax is at 10% on income exceeding Rs. 2,00,000 but not exceeding Rs. 5 lacs and @ 20% for income exceeding Rs. 5 lacs but not exceeding Rs. 10 lacs and @ 30% in respect of income exceeding Rs. 10 lacs for the assessment year 2014-15. Education cess @ 2% and Secondary and higher education cess@1% is attracted in both the cases.

Note : Considering the comparatives given above, Mr. Goswami is advised to commence a proprietary concern and pay salary to Mrs. Goswami. In the event of the business expanding and necessitating inclusion of Mrs. Goswami, it can always be resorted to with zero tax consequence by converting into a partnership firm or limited liability partnership, as the case may be, to avail all the advantages.

(b) Mr. Bajaj is entitled to relief under section 91, since: -

- (i) He is a resident in India during the relevant previous year.

- (ii) Income, by way of commission and dividend, accrues or arises to him outside India (in Hong Kong) during the previous year.
- (iii) Such income is not deemed to accrue or arise in India during the previous year.
- (iv) The income in question, namely, commission and dividend, has been subjected to income-tax in Hong Kong in the hands of Mr. Bajaj and he has paid tax on such income in Hong Kong.
- (v) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Hong Kong.

Therefore, he is entitled to the deduction under section 91, from the Indian income-tax payable by him, of a sum, calculated on such doubly taxed income at the Indian rate of tax or at the Hong Kong rate of tax, whichever is lower.

Computation of total income and tax liability of Mr. Bajaj for A.Y.2014-15

Particulars	Rs.
Income from business in India	2,50,000
Commission received from a company in Hong Kong	3,00,000
Dividend received from a company in Hong Kong	90,000
Interest on fixed deposits with banks in India	2,00,000
Total Income	8,40,000
Tax on the above:	
Upto Rs. 2,50,000	Nil
Over Rs. 2,50,000 & upto Rs. 5,00,000 @ 10%	25,000
Over Rs. 5,00,000 & upto Rs. 8,40,000 @ 20%	<u>68,000</u>
Education cess @ 2% and secondary and higher education cess @ 1%	2,790
Total tax liability	95,790
Average rate of income-tax in India: (Rs. 95,790/ Rs. 8,40,000 x 100)	11.40%
Average rate of income-tax in Hong Kong (Rs. 78,000/ Rs. 3,90,000 x 100)	20%
Double tax relief under section 91 shall be @11.40% or 20% of foreign income, whichever is less [i.e., Rs. 3,90,000 x 11.40%]	44,460
Net tax liability (Rs. 95,790 – Rs. 44,460)	51,330

- (c) Mr. Sujit, is required to maintain books of account as per section 44AA and get them audited under section 44AB, since his gross sales exceeded Rs. 1 crore. He is liable to pay penalty under section 271A for not maintaining his books of account as per section 44AA. Accordingly, the action of the Assessing Officer in levying penalty under section 271A is correct. However, where books of account have not been maintained, there cannot be a question of getting them audited. Audit of books of account presupposes maintenance of books of account. When admittedly Mr. Sujit has not maintained books, he cannot obviously get the audit done.

In *Surajmal Parsuram Todi v. CIT (1996) 222 ITR 691*, the Gauhati High Court has held that when a person commits an offence by not maintaining books of accounts as contemplated by section 44AA, the offence is complete and after that there can be no possibility of any offence as contemplated by section 44AB and, therefore, the imposition of penalty under section 271B is erroneous.

Therefore, in this case, the Assessing Officer is not justified in levying penalty under section 271B.

7. (a) Any income arising from an international transaction, where two or more “associated enterprises” enter into a mutual agreement or arrangement, shall be computed having regard to arm’s length price as per the provisions of Chapter X of the Act.

Section 92A defines an “associated enterprise” and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that “Surya Motors Ltd.” is associated with :-

- (i) Thin Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Surya Motors Ltd.;
- (ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Surya Motors Ltd. in its manufacturing process;
- (iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Surya Motors Ltd.

The transactions entered into by Surya Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2014-15.

	Particulars	Rs. (in crores)
	Income of Surya Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter – X	300.00
<i>Add:</i>	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of car @ \$ 200 each for 10,000 cars (\$ 200 x 10,000 x 63)	12.60

(ii)	Difference for excess payment of royalty of \$ 30,00,000 (\$ 30,00,000 x 63) [See Note below]	18.90
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (84*1000*1/100)	<u>840.00</u>
Total Income		<u>1,171.50</u>

The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Surya Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

Note: It is presumed that Surya Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.

- (b) (i) The definition of "work" under section 194C includes manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. In the instant case, Short Limited manufactures the product as per the specification given by Tall Limited by using the raw materials purchased from Tall Limited. Therefore, it falls within the definition of "work" under section 194C. Consequently, tax is to be deducted on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. If the material component is not mentioned separately in the invoice, tax is to be deducted on the whole of the invoice value.
- (ii) Provisions for deduction of tax at source under section 194J are attracted in respect of payment of fees for professional services, if the amount of such fees exceeds Rs. 30,000 in the relevant financial year. The service rendered by a commentator in relation to sports activities has been notified by the CBDT as professional service for the purpose of section 194J vide its *Notification No. 88 dated 21st August, 2008*. Therefore, tax is required to be deducted@10% from the fee of Rs. 5 lacs payable to the former cricketer.
- (iii) Section 195 requires deduction of tax at source by any person responsible for making payment to a non-resident, any interest or any other sum chargeable under the provisions of the Income-tax Act, 1961 (other than income chargeable under the head "Salaries").

Section 192(1) requires "any person" responsible for paying income under the head "Salaries" to deduct tax at source. Therefore, even if the payer is a foreign company, section 192 would be applicable.

TDS provisions under section 192 are attracted, if the salary payable to a non-resident is chargeable to tax in India. Under section 9(1)(ii), income which falls under the head "Salaries" shall be deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India shall be regarded

as income earned in India. Therefore, salary paid to Mr. David, a non-resident, attracts tax liability in India, as he has rendered services in India and the salary is attributable to such services.

Therefore, the foreign company, SN Limited, is liable to deduct tax at source under section 192 from the salary of Mr. David.

- (iv) Section 192 requires deduction of tax from salary at the time of payment. Thus, the employer is not required to deduct tax at source when salary has not been paid but is merely credited to the account of the employee in its books of account. TPO Ltd. therefore, is not required to deduct tax at source in respect of the salary merely credited to the account of employee Dinesh which is not paid.

MOCK TEST PAPER – 2
FINAL COURSE: GROUP – II
PAPER – 8: INDIRECT TAX LAWS

Question No. 1 is compulsory.

Attempt any five questions from the remaining six Questions.

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

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) Determine the amount of CENVAT credit available with Hindan Manufacturing Ltd. in respect of the following items procured by them in the month of October, 2014:-

Items	Excise duty paid (including EC and SHEC) (Rs.)
Raw materials	52,000
Capital goods used for generation of electricity for captive use within the factory	1,00,000
Motor spirit	40,000
Inputs used for construction of a building	1,00,000
Dairy and bakery products consumed by the employees	5,000

(Note: The aggregate value of clearances of Hindan Manufacturing Ltd. for the financial year 2013-14 is Rs. 450 lakh) (5 Marks)

- (b) Hanuman Ltd. has a real estate business. It furnishes the following information pertaining to services provided:

Particulars	Amount (Rs.)
Construction services provided to International Labour Organisation	10,00,000
Construction of private clinic of a doctor	50,00,000
Construction of private clinic of a doctor	25,00,000
Repair service provided to State Government relating to plant for sewerage treatment	20,00,000
Construction of roads in a factory	80,00,000
Construction of residential complex meant for use of Member of Parliament	80,00,000

Renting of residential dwelling for use as residence	2,00,000
Repair and maintenance of a Railway Station	15,00,000

Compute the value of taxable service and the service tax liability of Hanuman Ltd. assuming that it is not eligible for small service providers' exemption under Notification No. 33/2012 – ST dated 20.06.2012. (10 Marks)

(c) A material was imported by air at CIF price of 5,000 US\$. Freight paid was 1,500 US\$ and insurance cost was 500 US\$. The banker realized the payment from importer at the exchange rate of Rs. 61 per dollar. Central Board of Excise and Customs notified the exchange rate as Rs. 60 per US\$. Find the value of the material for the purpose of levying duty. (5 Marks)

2. (a) What are the circumstances under which the certificate of registration can be revoked or suspended under Central Excise? (4 Marks)

(b) Shiv Ltd. enters into a contract with XYZ Ltd. for construction of a new building to be used primarily for commercial purposes for a total consideration of Rs.150 lakh on 02.07.2013. The relevant details are given as under:

Stage	Date	Date of issuance of invoice	Date of payment	Amount paid (Rs.)
Initial booking	02.07.2013	02.07.2013	02.07.2013	15 lakh
50% completion of building	15.03.2014	22.03.2014	29.03.2014	60 lakh
75% completion of building	20.06.2014	24.07.2014	25.07.2014	35 lakh
100% completion of building	30.09.2014	21.10.2014	20.10.2014	40 lakh

Note: A certificate from a Chartered Engineer registered with the Institution of Engineers (India) has been obtained with respect to each stage of completion of building. (8 Marks)

(c) After visiting USA, Mrs. & Mr. Aman brought to India a lap-top computer valued at Rs. 80,000, personal effects valued at Rs. 90,000 and a personal computer for Rs. 52,000. What is the customs duty payable? (4 Marks)

3. (a) The assessee M/s Z & Co. Ltd. were engaged in the manufacture of 'tarpaulin made ups'. This was nothing but tarpaulin cloth prepared by making a solution of wax, aluminum stearate and pigments that were mixed. The solution was heated in a vessel and was transferred to a tank. Grey cotton canvas fabric was then dipped into the solution and passed through two rollers, whereafter the canvas was dried by exposure to sun. The tarpaulin made ups were prepared by cutting the cloth into

various sizes and stitched and eyelets were fitted.

The central excise department has issued a show cause notice to M/s Z & Co. Ltd. that the process of preparing tarpaulin made up by means of cutting, stitching and fixing eyelets amounts to manufacture under the Central Excise Act, 1944. Write a brief note with reference to decided case law, if any, whether the department's view in the matter is legally sustainable. (4 Marks)

- (b) Pawan Ltd. is engaged in providing the taxable services and has been filing its service tax returns regularly. However, its jurisdictional Commissioner has the reasons to believe that Pawan Ltd. has understated the value of its taxable services for the previous year. Can the jurisdictional Commissioner of Central Excise direct such person to get his accounts audited by a Chartered Accountant to the extent and for the period as may be specified by him? Discuss briefly.

Will your answer be different if Pawan Ltd. contends that its accounts for the previous year have been audited under the Income-tax Act, 1961? (8 Marks)

- (c) LMN Company Ltd. had imported brine shrimp eggs. This was classified as 'prawn feed' for customs duty purposes under chapter heading No. 2309 of the Customs Tariff schedule which includes use as animal feed. The department's view was that this should be classified under chapter heading No. 051199 as non-edible animal products unfit for human consumption. M/s. LMN Company Ltd. provided literature to support their contention that the imported material contained little organisms/embryos which later became larva that were fed to the prawns. Therefore, according to the importers, the nature and character of the product was not changed or altered by nurturing or incubation. Hence, the classification should be as prawn feed under chapter heading No. 2309.

Decide with the help of case law, if any, whether the contention of the assessee, M/s. LMN Co. is correct in law. (4 Marks)

4. (a) Write a note on duty payment 'under protest' with reference to the Central Excise Act, 1944 and the rules made thereunder. (4 Marks)
- (b) Compute service tax liability from the following particulars for the financial year 2013-14:

Gross amount (excluding all taxes) charged by the service provider for providing works contract service	Rs. 1,00,000
Actual value of material transferred in the above works contract (VAT under the relevant State VAT Law has been paid on this value)	Rs. 70,000
Excise duty paid on inputs	Rs. 8,750
Service tax paid on input services	Rs. 1,000
Excise duty paid on the capital goods, purchased during the year, used in the provision of works contract service	Rs. 1,000
Rate of service tax	12.36%

(8 Marks)

- (c) Briefly write a note on whether an exporter who has been held guilty of exporting 'prohibited goods' is entitled to an option to pay fine in lieu of confiscation under section 125 of the Customs Act, 1962. *(4 Marks)*
5. (a) Under what circumstances it may be beneficial to pay duty and claim rebate under Rule 18 of Central Excise Rules, 2002. *(4 Marks)*
- (b) Determine the place of provision of services as well as their taxability in each of the following cases:
- (i) Mr. X, the owner of an immovable property located in New Delhi gives the said property to Mr. Y of London on rent, for commercial purposes.
 - (ii) Mr. Ram, a Delhi based interior decorator, provides his professional services in respect of property which is intended to be located in San Diego, U.S.A.
 - (iii) A U.S.A. based company possessing specialization in mineral exploration has been awarded a contract for mineral exploration in respect of specific sites in Canada by Mumbai based Mr. Krishna Kapoor.
 - (iv) PQR Ltd. agrees to provide services connected with oil exploration [by virtue of single agreement for consolidated consideration] to MNO Ltd. in respect of specific sites located in Assam, Gujarat and Maharashtra. The proportion of services provided by PQR Ltd. in relation of above States worked out to be 25%, 60% and 15%. PQR Ltd. does not have a centralized registration. *(8 Marks)*
- (c) Briefly state the rights of the owner of warehoused goods under the Customs Act, 1962. *(4 Marks)*

Or

Briefly explain the term 'export' for the purpose of duty drawback under section 75 of the Customs Act, 1962. Is duty drawback available if the goods do not reach the destination? *(4 Marks)*

6. (a) If a manufacturer manufactures various products, can he avail CENVAT credit on some products and exemption under Notification No. 8/2003-CE dated 01.03.03 on some other products? *(4 Marks)*
- (b) XYZ Constructions Ltd. is engaged in providing the services by way of construction of roads. The said services are exempt from service tax vide mega exemption notification- Notification No. 25/2012 ST dated 20.06.2012. Examine whether the sub-contractors who provide architects services and consulting engineer's services, which are used by XYZ Constructions Ltd. in relation to such construction service, are also exempt from service tax. *(8 Marks)*
- (c) AB Corporation, a manufacturer-exporter, has approached CD Corporation, a merchant exporter, to export one of its consignments as owing to some technical

difficulties, AB Corporation could not export the consignment itself. The shipping bills relating to the consignment bear the name of CD Corporation. Bank Realization Certificate, GR declaration, export order and invoice are also in the name of CD Corporation. Comment whether AB Corporation would be deemed as the exporter under FTP. *(4 Marks)*

7. (a) An assessee sold certain goods to MNO Ltd. for Rs. 20,000 (excluding excise duty and other taxes) on 09.09.2014. The buyer, MNO Ltd., is a related person as defined under section 4(3)(b) of the Central Excise Act, 1944. It did not sell the goods, but used it as intermediary product. The cost of production of the said goods determined as per CAS-4 was Rs. 16,000. Determine the assessable value in the given case.

What will be the assessable value, if in the aforesaid case, MNO Ltd. is not related to the assessee? *(4 Marks)*

- (b) Discuss the prosecution, arrest and bail implications, if any, in respect of the following cases:
- (i) Mr. Govind provides consulting engineer's services of Rs. 60 lakh during the month of July, 2014 and knowingly evades the payment of service tax.
 - (ii) Mr. Vijay avails and utilizes credit of service tax of Rs. 45 lakh during the quarter ending September, 2014 without actual receipt of taxable service.
 - (iii) Mr. Vivek fails to supply any information [with service tax implications of Rs. 52 lakh] which he was required to supply under the Service Tax Rules, 1994.
 - (iv) Miss Radha collected service tax of Rs. 70 lakh in the month of June, 2014 but did not deposit the said amount until 31st March, 2015. She has committed such offence for the second time. *(8 Marks)*
- (c) Mention the reward scheme provided under FTP which aims to compensate high transport costs and offset other disadvantages in the export of specified agricultural and village industry products. What is the general rate of entitlement under the Scheme? How can the duty scrips issued under the Scheme be utilized? *(4 Marks)*

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

1. (a) Computation of the amount of CENVAT credit available with Hindan Manufacturing Ltd.:-

Items	Excise duty paid (including EC and SHEC) (Rs.)
Raw materials	52,000
Capital goods used for generation of electricity for captive use (50% of Rs. 1,00,000) (Note-1 & 2)	50,000
Motor spirit (Note-3)	Nil
Inputs used for construction of a building (Note-3)	Nil
Dairy and bakery products consumed by the employees (Note-3)	<u>Nil</u>
Total CENVAT credit available	<u>1,02,000</u>

Notes:-

1. Capital goods used for generation of electricity for captive use within the factory are eligible capital goods under rule 2(a) of the CENVAT Credit Rules, 2004.
2. Since, aggregate value of clearances of Hindan Manufacturing Ltd. for the financial year 2013-14 is Rs. 450 lakh i.e. more than Rs. 400 lakh, it is not eligible for SSI exemption. Therefore, CENVAT credit of only upto 50% of the duty paid is available in respect of the eligible capital goods in the year of purchase [Rule 4(2)(a)].
3. As per the definition of inputs under rule 2(k), there is specific exclusion with regard to the following:-
 - (i) motor spirit
 - (ii) goods used for construction of a building or a civil structure or a part thereof

(iii) any goods, such as food items used primarily for personal use or consumption of any employee

(b) Computation of value of taxable service and service tax liability of Hanuman Ltd:-

Particulars	Amount (Rs.)
Construction services provided to International Labour Organisation (Note-1)	Nil
Construction of private clinic of a doctor (Note-1)	50,00,000
Repair service provided to State Government relating to plant for sewerage treatment (Note-1)	Nil
Construction of roads in a factory (Note-1)	20,00,000
Construction of residential complex meant for use of a Member of Parliament (Note-1)	Nil
Renting of residential dwelling for use as residence (Note-2)	Nil
Repair and maintenance of a Railway Station (Note-1)	<u>15,00,000</u>
Value of taxable service	<u>85,00,000</u>
Service tax @ 12% [Rs. 85,00,000×12%]	10,20,000
Education cess @ 2% [Rs. 10,20,000×2%]	20,400
Secondary and higher education cess @ 1% [Rs. 10,20,000×1%]	<u>10,200</u>
Service tax liability	<u>10,50,600</u>

Notes:

1. Following service are exempt from service tax vide mega exemption notification - *Notification No. 25/2012-ST dated 20.06.2012:-*

- Any services provided to the specified international organisations.
- Construction of hospitals for the Government, a local authority or a Governmental authority. However, such services provided to any other person are taxable.
- Repair service provided to State Government relating to plant for sewerage treatment.
- Services provided by way of construction of roads for use by general public. However, construction of roads which is not for use by general public is taxable.
- Construction of residential complex meant for use of a Member of Parliament.

(f) Services by way of construction, erection, or installation of original works pertaining to railway. Therefore, repair and maintenance of railways is liable to service tax.

2. Services by way of renting of residential dwelling for use as residence are included in the negative list and hence, are not taxable.

(c) **Computation of assessable value**

Particulars	Amount
CIF value	5000 US \$
Less: Freight	1500 US \$
Less: Insurance	<u>500 US \$</u>
Therefore, FOB value	<u>3000 US \$</u>
Assessable value for Customs purpose	
FOB value	3000 US \$
Add: Freight (20% of FOB value) [Note 1]	600 US \$
Add: Insurance (actual)	<u>500 US \$</u>
CIF for customs purpose	4100 US \$
Add: 1% for landing charges [Note 2]	<u>41 US \$</u>
Value for customs purpose	4141 US \$
Exchange rate as per CBEC [Note 3]	Rs. 60 per US \$
Assessable value	Rs. 60 x 4141 US \$
	Rs. 2,48,460

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].

2. (a) The certificate of registration under the Central Excise Act, 1944, can be suspended or revoked by the Deputy Commissioner or the Assistant Commissioner of Central Excise under the following circumstances.

(i) when the assessee or any person under his employment has committed any

breach of any condition of the Central Excise Act or any rules made there under.

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

(b) Since in the present case, the construction services are provided by Shiv Ltd. to XYZ Ltd. under a contract for a period exceeding three months with the obligation for payment periodically, such services would fall within the ambit of term "continuous supply of service" as per rule 2(c) of the Point of Taxation Rules. The point of taxation in case of continuous supply of services is determined in accordance with provisions of rule 3 of Point of Taxation Rules.

Further, it is important to note that in case of continuous supply of service where the provision of the whole or part of the service is determined periodically on the completion of an event in terms of a contract, which requires service receiver to make any payment to service provider, the date of completion of each such event as specified in the contract shall be deemed to be the date of completion of provision of service.

Accordingly, the point of taxation with respect to each of the stages of completion is as follows:

Stage of Completion	Point of taxation
Initial booking	02.07.2013 as the date of completion of service, date of issuance of invoice and date of payment are the same.
50%	Since invoice has been issued within 30 days of completion of service, point of taxation is date of invoice (22.03.2014) or date of payment (29.03.2014) whichever is earlier, i.e. 22.03.2014.
75%	Since invoice has not been issued within 30 days of completion of service, point of taxation is date of completion of service (20.06.2014) or date of payment (25.07.2014) whichever is earlier, i.e. 20.06.2014.
100%	Since invoice has been issued within 30 days of completion of service, point of taxation is date of invoice (21.10.2014) or date of payment (20.10.2014) whichever is earlier, i.e. 20.10.2014.

(c) (1) As per Baggage Rules, 1998 in respect of a passenger of and above 10 years of age returning from a Country other than Nepal, Bhutan, Myanmar or China after a stay of more than three days.

(i) Personal effects are allowed duty free clearance without any value limit.

- (ii) Besides (i) above, articles upto a value of Rs. 35,000 carried as accompanied baggage are allowed duty free clearance [General free allowance].

Hence, duty shall be payable on Rs. 52,000 – Rs. 35,000 = Rs. 17,000.

- (2) One Laptop computer brought as baggage by a passenger of or above 18 years of age (other than member of crew) is fully exempt from customs duty [Notification No. 11/2004 Cus dated 08.01.2004]
- (3) Effective rate of duty for baggage = 36.05% [35% + 2% primary education cess & 1% secondary & higher education cess]

Therefore, duty payable = Rs. 5,950 + Rs. 179

Total customs duty = Rs. 6,129

3. (a) The facts of the given case are similar to the one decided by the Apex Court in the case of *CCE v. Tarpaulin International 2010 (256) E.L.T. 481 (S.C.)* In this case, the Apex Court has observed that stitching of tarpaulin sheets and making eyelets does not change the basic characteristic of the raw material as the process does not bring into existence a new and distinct product different from the original commodity. The original material used i.e., the tarpaulin, is still called tarpaulin made-ups even after undergoing the said process. Hence, the Supreme Court has held that process of making tarpaulin made ups by cutting, stitching the tarpaulin fabric and fixing eyelets therein cannot be said to be a manufacturing process liable to excise duty.

Therefore, in view of the above-mentioned judgement, the Department's view in the matter is not legally sustainable.

- (b) Section 72A(1) of Finance Act, 1994, *inter alia*, provides that if the Commissioner of Central Excise has reasons to believe that any person liable to pay service tax has failed to declare or determine the value of a taxable service correctly, he may direct such person to get his accounts audited by a Chartered Accountant nominated by him, to the extent and for the period as may be specified by the Commissioner.

Therefore, in the present case, jurisdictional Commissioner of Central Excise can direct Pawan Ltd. to get its accounts audited by a Chartered Accountant nominated by him, to the extent and for the period as may be specified by him.

Further, section 72A(3) provides that the Commissioner of Central Excise is empowered to direct a special audit even if the accounts of such person have been audited under any other law for the time being in force.

Therefore, the contention of Pawan Ltd. that its accounts for the previous year have been audited under the Income-tax Act, 1961 cannot be accepted and it will have to comply with the order, if any, of the jurisdictional Commissioner to get its accounts audited.

- (c) Yes, the contention of the assessee is justified in law. The facts of the given case are similar to the case of ***Atherton Engineering Co. Pvt. Ltd. v. UOI 2010 (256) ELT 358 (Cal.)***. In the instant case, the Court noted that it was the use of the product that had to be considered in the instant case. If a product undergoes some change after importation till the time it is actually used, it is immaterial, provided it remains the same product and it is used for the purpose specified in the classification. Therefore, in the instant case, it examined whether the nature and character of the product remained the same.

The Court opined that if the embryo within the egg was incubated in controlled temperature and under hydration, a larva was born. The larva did not assume the character of any different product. Its nature and characteristics were same as the product or organism which was within the egg.

Hence, the Court held that the said product should be classified as feeding materials for prawns under the heading 2309. These embryos might not be proper prawn feed at the time of importation but could become so, after incubation.

4. (a) Duty payment "under protest":-Section 11B of the Central Excise Act, 1944 provides that the time limit of one year for claiming refund of central excise duty shall not apply where the duty has been paid under protest.

As per the **Supplementary Instructions** issued by Central Board of Excise and Customs, any assessee who desires to pay duty under protest, may do so by following the procedure mentioned below:

- (i) The assessee shall inform the Superintendent or Inspector of Central Excise in writing giving reasons for paying duty under protest and a dated acknowledgement shall be given to him.
- (ii) The assessee shall mark invoices or monthly/quarterly returns indicating the goods on which duty is paid "under protest" If it is a lump-sum duty payment in respect of past demand, he may record the fact of duty payment under protest in the Personal Ledger Account, CENVAT Account and the Daily Stock Account.
- (iii) If a case is appealed against by the assessee or where the appeal period for further appeal is available, he may continue to pay duty under protest. However, if decision is not in his favour and he exhausts the appellate remedy or does not appeal within stipulated period, he shall not have any right to pay duty under protest.

- (b) **Computation of service tax liability as per rule 2A(i) of the Service Tax (Determination of Value) Rules, 2006:**

Particulars	Amount (Rs.)
Gross amount charged	1,00,000

Less: Actual value of goods transferred (Note-1)	<u>70,000</u>
Value of service portion in the execution of works contract	<u>30,000</u>
Service tax on Rs. 30,000 @12.36%	3,708
Less: CENVAT credit on inputs (Note-2)	-
CENVAT credit on input services	1,000
CENVAT credit on capital goods (50%) (Note-3)	<u>500</u>
Service tax payable	<u>2,208</u>

Notes:

1. Since VAT has been paid on the actual value of property in goods transferred in the execution of the works contract, such value adopted for the purposes of payment of VAT has been taken as the value of property in goods transferred in the execution of the said works contract [Clause (c) of Explanation to rule 2A(i) of the Valuation Rules].
 2. CENVAT credit of duties or cess paid on any inputs, used in or in relation to the said works contract, is not available [Explanation 2 to rule 2A of the Valuation Rules].
 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) As per section 125 of the Customs Act, 1962, whenever confiscation is ordered, the adjudicating officer *may* provide an option to the owner of the goods to pay redemption fine in lieu of confiscation if the importation or exportation of goods is prohibited. However, if importation or exportation of goods is not prohibited, the option to pay redemption fine *shall* be given to the owner of goods.

Therefore, an exporter guilty of exporting prohibited goods is not *entitled as such* to an option to pay fine in lieu of confiscation under section 125 of the Customs Act, 1962. It is at the discretion of the adjudicating officer to give or not to give such an option to the exporter guilty of exporting prohibited goods. However, the owner of the goods importing or exporting non-prohibited goods shall be entitled to such an option.

5. (a) It is usually preferable not to pay duty rather than to pay it and wait for refund from the government. However, in the following situations, it is beneficial to pay duty and claim rebate under Rule 18 of Central Excise Rules, 2002:
 - (A) If assessee has balance of duty in Capital Goods CENVAT Credit Account, it is advisable to pay duty and claim refund, as balance in Capital Goods CENVAT Credit Account is never refundable. The said situation may take place if duty paid on capital goods is heavy and assessee may not be able to utilize the credit.

- (B) An SSI Unit may pay excise duty and claim rebate, as getting refund of CENVAT Credit of inputs is not an easy proposition. Further, he is not entitled to get refund of duty paid on capital goods.
 - (C) When duty paid goods are proposed to be exported.
 - (D) Claiming rebate is comparatively easy procedure than claiming refund of duty paid on inputs under CENVAT Credit Rules, 2004.
- (b) (i) As per rule 5 of the Place of Provision of Service Rules, in case of a service that is 'directly in relation to immovable property', the place of provision is where the immovable property is located, irrespective of where the provider or receiver is located.

Since in the given case, the immovable property in question is located in New Delhi, the place of provision of service is New Delhi and resultantly, the service would be taxable in India.

- (ii) Since in the given case, the immovable property in question is located in San Diego, the place of provision of service is San Diego, U.S.A. and resultantly, the service would not be taxable in India [Rule 5 of the Place of Provision of Service Rules].
- (iii) In this case, since specific sites in respect of which mineral exploration is to be carried out are located in Canada, the place of provision of services as per rule 5 of the Place of Provision of Service Rules will be Canada which does not fall within the ambit of 'taxable territory' and resultantly, these services will not be taxable in India. The fact that service providing company is located in USA and service recipient is located in Mumbai (India) is not significant.
- (iv) Although all the locations given in this case fall within the taxable territory, Place of Provision of Service Rules are still applicable as these rules are also useful for those service providers who operate from multiple locations within India without having centralised registration for the purpose of determining the precise taxable jurisdiction applicable to their operations.

Where any immovable property related service referred to in rule 5 is provided at more than one location, including a location in the taxable territory, its place of provision shall be the location in the taxable territory where the greatest proportion of the service is provided [Rule 7 of the Place of Provision of Service Rules].

Therefore, in the present case, PQR Ltd. is liable to pay service tax and the place of provision of services would be Gujarat because greatest proportion of taxable service [i.e. 60%] is provided there.

- (c) Section 64 of Customs Act 1962, provides that with the sanction of the proper officer, and on payment of the prescribed fees, the owner of any goods either before or after warehousing the same -
- (i) inspect the goods;
 - (ii) separate damaged or deteriorated goods from the rest;
 - (iii) sort the goods or change the containers for the preservation, sale, export or disposal of the goods;
 - (iv) deal with the goods & their containers in such manner as may be necessary to prevent loss, deterioration or damage to the goods;
 - (v) show the goods for sale;
 - (vi) take samples of the goods without entry for home consumption, if the proper officer so permits, without payment of duty on such samples.

Or

As per rule 2(c) of the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995, 'export' with its grammatical variations and cognate expressions, means-

- (i) taking out of India to a place outside India, or
- (ii) taking out from a place in Domestic Tariff Area (DTA) to a special economic zone (SEZ), and
- (iii) loading of provisions or store or equipment for use on board a vessel or aircraft proceeding to a foreign port.

Export is defined as taking out of India to a place out of India and India includes Indian Territorial Waters. Hence, export is complete when goods leave territorial waters of India. Drawback is available once 'export' is complete i.e., the goods cross the territorial waters even if they do not reach the destination or they are destroyed. However, if goods are destroyed in territorial waters of India, drawback will not be available as the export is not complete [*UOI v. Rajindra Dyeing and Printing Mills (2005) 180 ELT 433(SC)*].

6. (a) Simultaneous availment of CENVAT and SSI exemption is permissible when a SSI unit manufactures branded (with other's brand name) and unbranded/self branded goods. In other words, where a SSI unit manufactures branded (with other's brand name) and unbranded/self branded goods, it can-
- avail CENVAT on inputs used in the manufacture of branded goods (with other's brand name) and pay duty on the final product; and

- avail SSI exemption on unbranded/self branded goods (in this case, CENVAT on inputs used in the manufacture of such exempted goods will not be allowed).

However, it may be noted that such simultaneous availment of CENVAT and SSI exemption is permissible only in case of simultaneous manufacture of branded (with other's brand name) and unbranded/self branded goods. In other cases, this is not permissible.

- (b) No, the sub-contractors who provide architect service and consulting engineer service, which are used by XYZ Constructions Ltd. in relation to such construction service, are not exempt from service tax. According to section 66F(1), reference to a service by nature or description in the Act shall not include reference to a service which is used for providing main service. Therefore, if any person is providing services by way of construction of roads such as architect's service and consulting engineer's service, which are used by the contractor in relation to such construction, the benefit of the mega-exemption would not be available to such persons unless the activities carried out by the sub-contractor independently and by itself falls in the ambit of the exemption.

Further, exemption is available to 'services by way of construction of roads' and not to 'services in relation to construction of roads'. It is thus apparent that just because the main contractor is providing the service by way of construction of roads, it would not automatically lead to the conclusion that services provided by the sub-contractor to the main contractor shall also be an exempt service.

- (c) The above scenario is a case of third-party exports.

Third-party exports means exports made by an exporter or manufacturer on behalf of another exporter(s). The conditions for being allowed as third-party exports under FTP are:

- (i) Export documents such as shipping bills shall indicate name of both manufacturing exporter/manufacturer and third party exporter(s).
- (ii) Bank Realization Certificate, GR declaration, export order and invoice should be in the name of third party exporter.

In the above case, though Bank Realization Certificate, GR declaration, export order and invoice are in the name of CD Corporation (third party exporter), the shipping bill does not have the name of AB Corporation (manufacturing exporter). Therefore, AB Corporation will not be treated as the exporter in this case.

7. (a) The proviso to rule 9 of the Central Excise Valuation (Determination of Excisable Goods) Rules, 2000 lays down that in a case where the related person does not sell the goods but uses or consumes such goods in the production or manufacture of articles, the value thereof shall be determined in the manner specified in rule 8 of the Valuation Rules which provides that the value will be 110% of the cost of

production or manufacture of such goods.

Therefore, when the goods are sold to MNO Ltd., the assessable value shall be 110% of Rs. 16,000 (Rs. 16,000 × 110%) i.e., Rs. 17,600.

However, in the instant case, if MNO Ltd. is an unrelated buyer, the assessable value will be the transaction value of the goods i.e. Rs. 20,000.

(b)

Person	Offence	Prosecution	Arrest	Bail
Mr Govind	Non-cognizable offence	6 months to 3 years	Arrest can be ordered by Commissioner of Central Excise	Bailable Offence
Mr. Vijay	Non-cognizable offence	Upto 1 year	No arrest	Bailable Offence
Mr. Vivek	Non-cognizable offence	6 months to 3 years	Arrest can be ordered by Commissioner of Central Excise	Bailable Offence
Miss Radha	Cognizable offence	Upto 7 years	Arrest can be ordered by Commissioner of Central Excise without arrest warrant	Non-Bailable/Bailable Offence

(c) Vishesh Krishi and Gram Udyog Yojana (VKGUY) has been provided under FTP to compensate high transport costs and offset other disadvantages in the exports of specified agricultural products. Eligible exporters are entitled for duty credit scrip equivalent to 5% of FOB value of exports realized in free foreign exchange. The scrip can be utilized for payment of customs duties of all freely importable items as well as for procurement of domestic items without payment of central excise duty as well as service tax. Further, it can also be utilized for payment of application fee to DGFT for obtaining any Authorisation.