PAPER – 5 : ADVANCED MANAGEMENT ACCOUNTING

QUESTIONS

Total Quality Management – Non Conformance Cost

1. 7 Star Sports Co. (7SSC) is engaged in the manufacture of cricket bats. Following table shows the budgeted figures for the coming year:

Particulars	₹ per unit
Selling Price	4,800
Less: Components (1 Set)	1,200
Assembling Costs	2,000
Delivery Cost	800
Contribution	800

Components like willow, rubber grip and handle bar in a set, are bought in and an assembling process carried out to transform them into a single bat. Market is intensely competitive where 7SSC currently holds 30% market share. Annual demand of these bats is 1,00,000 units.

On reviewing previous performance it is revealed that 3% of the bats supplied to customers were returned for free replacement because of faults. Defective components, which are initially bought in to assembling process, are held responsible for this. These returned bats cannot be repaired and have no scrap value. Supply of faulty bats to customers could be eliminated by implementing an inspection process immediately before the goods are delivered. This would improve customer perception thus resulting in an increase of 5% in current market share (making in all a total share of 35%).

(i) Calculate the quality non-conformance cost for the coming year, based on the budgeted figures and sales returns rate.

(ii) Calculate the impact on profitability due to implementation of inspection process for the bats.

Life Cycle Costing and Pricing Strategy

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

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

Cumulative Sales (units)	Selling Price ₹ per unit
0 to 2,200	750

2,201 to 7,700	600
7,701 to 15,950	525
15,951 to 59,950	450
59,951 and above	300

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

Weeks	**Sales Demand *per week (units)***
1-10	220
11-20	550
21-30	825
31-70	1,100
71-80	880
81-90	660
91-100	440
101-110	220
Thereafter	NIL

Unit variable costs are expected to be as follows:

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

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

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

Required:

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

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

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

Note: Ignore the time value of money.

Value Chain Analysis – Primary Activity

3. ABC Ltd. is engaged in business of manufacturing branded readymade garments. It has a single manufacturing facility at Ludhiana. Raw material is supplied by various suppliers.

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

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

State the primary activities as per Porter's Value Chain Analysis in the value chain of ABC Ltd with brief description.

Just in Time

4. KP Ltd. (KPL) manufactures and sells one product called "KEIA". Managing Director is not happy with its current purchasing and production system. There has been considerable discussion at the corporate level as to use of 'Just in Time' system for "KEIA". As per the opinion of managing director of KPL Ltd. - *"Just-in-time system is a pull system, which responds to demand, in contrast to a push system, in which stocks act as buffers between the different elements of the system such as purchasing, production and sales. By using Just in Time system, it is possible to reduce carrying cost as well as other overheads".*

KPL is dependent on contractual labour which has efficiency of 95%, for its production. The labour has to be paid for minimum of 4,000 hours per month to which they produce 3,800 standard hours.

For availing services of labour above 4,000 hours in a month, KPL has to pay overtime rate which is 45% premium to the normal hourly rate of ₹110 per hour. For avoiding this overtime payment, KPL in its current production and purchase plan utilizes full available normal working hours so that the higher inventory levels in the month of lower demand would be able to meet sales of month with higher demand level. KPL has determined that the cost of holding inventory is ₹70 per month for each standard hour of output that is held in inventory.

KPL has forecast the demand for its products for the first six months of year 2014 as follows:

Month	Demand (Standard Hrs)
Jan'14	3,150
Feb'14	3,760
Mar'14	4,060
Apr'14	3,350
May'14	3,650
Jun'14	4,830

Following other information is given:

(a) All other production costs are either fixed or are not driven by labour hours worked.

(b) Production and sales occur evenly during each month and at present there is no stock at the end of Dec'13.

(c) The labour are to be paid for their minimum contracted hours in each month irrespective of any purchase and production system.

As a chief accountant you are requested to comment on managing director's view.

Break-even Point – Production in Batches

5. Electro Life Ltd. is a leading Home Appliances manufacturer. The company uses just-in-time manufacturing process, thereby having no inventory. Manufacturing is done in batch size of 100 units which cannot be altered without significant cost implications. Although the products are manufactured in batches of 100 units, they are sold as single units at the market price. Due to fierce competition in the market, the company is forced to follow market price of each product. The following table provides the financial results of its four unique products:

	Alpha	Beta	Gamma	Theta	Total
Sales (units)	2,00,000	2,60,000	1,60,000	3,00,000	
	(₹)	(₹)	(₹)	(₹)	(₹)
Revenue	26,00,000	45,20,000	42,40,000	32,00,000	145,60,000
Less: Material Cost	6,00,000	18,20,000	18,80,000	10,00,000	53,00,000
Less: Labour Cost	8,00,000	20,80,000	12,80,000	12,00,000	53,60,000
Less: Overheads	8,00,000	7,80,000	3,20,000	12,00,000	31,00,000
Profit / (Loss)	4,00,000	(1,60,000)	7,60,000	(2,00,000)	8,00,000

Since, company is concerned about loss in manufacturing and selling of two products so, it has approached you to clear picture on its products and costs. You have conducted a detailed investigation whose findings are below:

The overhead absorption rate of ₹ 2 per machine hour has been used to allocate overheads into the above product costs. Further analysis of the overhead cost shows that some of it is caused by the number of machine hours used, some is caused by the number of batches produced and some are product specific fixed overheads that would be avoided if the product were discontinued. Other general fixed overhead costs would be avoided only by the closure of the factory. Numeric details are summarized below:

	₹	₹
Machine hour related		6,20,000
Batch related		4,60,000
Product specific fixed overhead:		
Alpha	10,00,000	
Beta	1,00,000	
Gamma	2,00,000	
Theta	1,00,000	14,00,000
General fixed overheads		6,20,000
		31,00,000

The other information is as follows:-

	Alpha	Beta	Gamma	Theta	Total
Machine Hours	4,00,000	3,90,000	1,60,000	6,00,000	15,50,000
Labour Hours	1,00,000	2,60,000	1,60,000	1,50,000	6,70,000

(i) You are required to prepare a profitability statement that is more useful for decision making than the profit statement prepared by Electro Life Ltd.

(ii) Calculate the break even volume in batches and also in approximate units for Product 'Alpha'.

Decision Making (Service Sector) - Quantitative Vs Qualitative Factors

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

HHCL provides treatment under package system where fees is charged irrespective of days a patient stays in the hospital. Consultant has estimated 2.50 patient days per patient. He wants to reduce it to 2 days. By doing this, consultant has targeted the

general variable cost of ₹ 500 per patient day. Annually 15,000 patients visit to the hospital for treatment.

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

Calculate the impact of Management Consultant's plan on profit of the company. Also comment on result and other factors that should be kept in mind before taking any decision.

Pareto Analysis

7. Generation 2050 Technologies Ltd. develops cutting-edge innovations that are powering the next revolution in mobility and has nine tablet smart phone models currently in the market whose previous year financial data is given below:

Model	Sales (₹'000)	Profit-Volume (PV) Ratio
Tab - A001	5,100	3.53%
Tab - B002	3,000	23.00%
Tab - C003	2,100	14.29%
Tab - D004	1,800	14.17%
Tab - E005	1,050	41.43%
Tab - F006	750	26.00%
Tab - G007	450	26.67%
Tab - H008	225	6.67%
Tab - I009	75	60.00%

Using the financial data, carry out a Pareto analysis (80/20 rule) of Sales and Contribution. Discuss your findings with appropriate recommendations.

Budget and Budgetary Control – Preparation and Monitoring Procedures

8. "Because a single budget system is normally used to serve several purposes, there is a danger that they may conflict with each other".

Do you agree? Discuss.

Standard Costing – Basic Concepts

9. KYC Ltd. uses a standard absorption costing system. The following details have been extracted from its budget for year 2013-14.

Fixed Overhead Cost	₹ 7,20,000
Production	36,000 units

In 2013-14 the Fixed Overhead Cost was over-absorbed by ₹3,200 and the Fixed Overhead Expenditure Variance was ₹20,000(F). What was the actual number of units produced in 2013-14?

Standard Costing – Reconciliation of Budgeted and Actual Profit

10. Osaka Manufacturing Co. (OMC) is a leading consumer goods company. The budgeted and actual data of OMC for the year 2013-14 are as follows:-

Particulars	Budget	Actual	Variance
Sales / Production (units)	2,00,000	1,65,000	(35,000)
Sales (₹)	21,00,000	16,92,900	(4,07,100)
Less: Variable Costs (₹)	12,66,000	10,74,150	1,91,850
Less: Fixed Costs (₹)	3,15,000	3,30,000	(15,000)
Profit	5,19,000	2,88,750	(2,30,250)

The budgeted data shown in the table is based on the assumption that total market size would be 4,00,000 units but it turned out to be 3,75,000 units. Prepare a statement showing reconciliation of budget profit to actual profit through marginal costing approach for the year 2013-14 in as much detail as possible.

Multinational Transfer Pricing

11. Celestial Electronics and Consumer Durables Corporation (CECDC), is a Taiwan (a state, Republic of China) based consumer electronics manufacturer. To expand its market share in South Asia it has formed CECDC India Pvt. Ltd. (CIPL) in India. For the purpose of performance evaluation, the Indian part is treated as responsibility centre. CIPL imports components from the CECDC and assembles these components into a LED TV to make it saleable in the Indian market. To manufacture an LED TV two units of component 'L_X' are required. The following cost is incurred by the CECDC to manufacture a unit of component 'L_X':

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

(*) *purchased from domestic market.*

CECDC incurs TWD 30 per unit as Wharfage Charges.

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

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

	Amount (₹)
Variable Costs *per unit*:	
Direct Material (excluding component 'L_X')	6,200
Direct Labour	115
Fixed Cost:	
Office and Administrative Overheads	1,18,00,000
Selling & Distribution Overheads	2,58,00,000

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

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

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

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

From the above information, Calculate:

(i) Minimum Price at which CECDC can transfer component 'L_X' to CIPL.

(ii) Maximum Price that can be paid by CIPL to CECDC for each component 'L_X'.

(iii) Profitability Statement for the group in TWD.

Note:

(i) For Duty and Tax calculation, consider *arm's length price* only.

(ii) Ignore the DTAA and other tax provisions.

(iii) Conversion Rate 1 INR = 0.50 TWD

Transportation Problem - Degeneracy

12. A project consists of four (4) major jobs, for which four (4) contractors have submitted tenders. The tender amounts, in thousands of rupees, are given in the each cell. The initial solution of the problem obtained by using Vogel's Approximation Method is given in the Table below:

Contractors	Job P	Job Q	Job R	Job S
A	112.50	100.00	127.50	167.50 [1]
B	142.50	105.00 [1]	157.50	137.50
C	122.50	130.00	120.00 [1]	160.00
D	102.50 [1]	112.50	150.00	137.50

Find the assignment, which minimizes the total cost of the project. Each contractor has to be awarded one job only.

Critical Path Analysis – Missing Figures and Network

13. The number of days of total float (TF), earliest start times (EST) and duration in days are given for some of the following activities.

Activity	TF	EST	Duration
1–2	0	0	???
1–3	2	???	???
1–4	5	???	???
2–4	0	4	???
2–5	1	???	5
3–6	2	12	???
4–6	0	12	???
5–7	1	???	???
6–7	???	23	???
6–8	2	???	???
7–8	0	23	???
8–9	???	30	6

(i) Find??? Figures.

(ii) Draw the network.

(iii) List the paths with their corresponding durations and state when the project can be completed.

PERT and CPM – Basic Concepts

14. State the validity of following statements along with the reasons:

(i) Two activities have common predecessor and successor activities. So, they can have common initial and final nodes.

(ii) In respect of any activity whether real or dummy, the terminal node should bear a number higher than the initial node number.

(iii) The difference between the latest event time and the earliest event time is termed as free float.

(iv) For every critical activity in a network, the earliest start and the earliest finish time as well as the latest finish time and the latest start time are the same.

(v) The optimal duration of a project is the minimum time in which it can be completed.

(vi) Resource leveling aims at smoothening of the resource usage rate without changing the project duration.

Simulation

15. An Investment Corporation wants to study the investment projects based on four factors: market demand in units, contribution per unit, advertising cost and the investment required. These factors are felt to be independent of each other. In analyzing a new consumer product, the corporation estimates the following probability distributions:

Demand (units)		Contribution per unit		Advertising Cost	
No.	Probability	₹	Probability	₹	Probability
10,000	0.20	25	0.25	50,000	0.22
20,000	0.25	35	0.30	60,000	0.33
30,000	0.30	45	0.35	70,000	0.44
40,000	0.25	55	0.10	80,000	0.01

The data for proposed investments are as follows:

Investment (₹)	50,00,000	55,00,000	60,00,000	65,00,000
Probability	0.10	0.30	0.45	0.15

Using simulation process, repeat the trials 5 times, compute the Return on Investment (ROI) for each trial and find the highest likely return.

Using the sequence (First 4 random numbers for the first trial, etc)

09 24 85 07 84 38 16 48 41 73 54 57 92 07 99

64 65 04 78 72

Application of Learning Curve in Standard Costing

16. City International Co. is a multiproduct firm and operates standard costing and budgetary control system. During the month of June firm launched a new product. An extract from performance report prepared by Sr. Accountant is as follows:

Particulars	Budget	Actual
Output	30 units	25 units
Direct Labour Hours	180.74 hrs.	118.08 hrs.
Direct Labour Cost	₹1,19,288	₹ 79,704

Sr. Accountant prepared performance report for new product on certain assumptions but later on he realized that this new product has similarities with other existing product of the company. Accordingly, the rate of learning should be 80% and that the learning would cease after 15 units. Other budget assumptions for the new product remain valid.

The original budget figures are based on the assumption that the labour has learning rate of 90% and learning will cease after 20 units, and thereafter the time per unit will be the same as the time of the final unit during the learning period, i.e. the 20th unit. The time taken for 1st unit is 10 hours.

Show the variances that reconcile the actual labour figures with revised budgeted figures in as much detail as possible.

Note:

The learning index values for a 90% and a 80% learning curve are −0.152 and −0.322 respectively.

[log 2 = 0.3010, log 3 = 0.47712, log 5 = 0.69897, log 7 = 0.8451, antilog of 0.6213 = 4.181, antilog of 0.63096 = 4.275]

Cost Classification

17. Identify the type of cost along with the reasons.

(i) An advertising program has been set and management has signed the non negotiable contract for a year with an agency. Under the terms of contract, agency will create 5 advertisements within the contract duration for the company and company will pay ₹12,00,000 for each advertisement.

(ii) A manager has to decide to run a fully automated operation that produces 100,000 widgets per year at a cost of ₹1,200,000, or of using direct labour to manually produce the same number of widgets for ₹1,400,000.

(iii) A Company had paid ₹5,00,000 a Marketing Research company to find expected demand of the newly developed product of the company.

(iv) A company has invested ₹25 lacs in a project. Company could have earned ₹2 lacs by investing the amount in Government securities.

(v) A Oil Refining Co. has paid a salary of ₹20,00,000 to the chairman for a particular year. The Company has sold 25 MT of Oil in that particular year.

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

Miscellaneous

18. Write a short note on-

(i) Predatory Pricing

(ii) Shadow Price

(iii) Inter-firm Comparison

(iv) Redundancy Error

SUGGESTED ANSWERS/ HINTS

1. (i) Calculation of Quality Non- Conformance Cost

Annual Sales	=	1,00,000 × 30%	
	=	30,000 units	
Number of returned bats which are replaced *free of cost*	=	$30{,}000 \text{units} \times \frac{3}{97}$	
	=	928 units	
Cost of 928 units that are replaced *free of charge*	=	928 × ₹4,000	
	=	₹37,12,000	(A)
Contribution Lost (Market Share) due to *faulty bats*	=	₹35,04,000	(B)
So, Total Quality Non-Conformance Cost [(A) + (B)]	=	₹72,16,000	

Statement Showing Contribution Lost (Market Share) due to *faulty bats*

Particulars	₹ '000
Sales (5,000 units × ₹4,800)	24,000
Less: Variable Cost [(₹1,200 units + ₹2,000 + ₹800) × 5,000 units)]	20,000
Less: Relevant Cost of *faulty bats* $\left[155 \text{units} \times (₹2{,}000 + ₹1{,}200)\right]$	496
Contribution	3,504

No. of Faulty Bats = $155 \left(5{,}000 \text{units} \times \frac{3\%}{97\%}\right)$

☞ **Quality Non-Conformance Costs** are costs that are incurred by a firm as an outcome of quality failures that have occurred.

(ii) Impact on Profitability due to *implementation of inspection process*

Implementing *inspection process* before delivery to the customer would eliminate risk of supplying faulty bat to the customer. This would lead to improvement in customer perception, thus increasing market share to 35%.

Additional Contribution due to *increase in market share*	=	₹35,04,000	(C)
Saving in the Delivery Cost on 928 faulty bats	=	928 units × ₹800	
	=	₹ 7,42,400	(D)
Total Increase in Profit [(C) + (D)]	=	₹ 42,46,400	

2. (i) Total Contribution Statement

Statement Showing 'Total Contribution' for remaining two phases

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

(ii) Pricing Strategy for Product α^3

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

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

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

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

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

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

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

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

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

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

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

Workings:

Statement of Cumulative Sales along with Sales Price and Variable Cost

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

3. Primary activities are the activities that are directly involved in transforming inputs into outputs and delivery and after-sales support to output. Following are the primary activities in the value chain of ABC Ltd.:-

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

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

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

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

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

4. Workings

Statement Showing 'Inventory Holding Cost' under Current System

Particulars	Jan	Feb	Mar	Apr	May	Jun
Opening Inventory* (A)	---	650	690	430	880	1,030
Add: Production*	3,800	3,800	3,800	3,800	3,800	3,800
Less: Demand*	3,150	3,760	4,060	3,350	3,650	4,830
Closing Inventory* (B)	650	690	430	880	1,030	-
Average Inventory $\left(\frac{A+B}{2}\right)$	325	670	560	655	955	515
Inventory Holding Cost @ ₹70	22,750	46,900	39,200	45,850	66,850	36,050

(*) *in terms of standard labour hours*

Inventory Holding Cost *for the six months* = ₹2,57,600

(₹22,750 + ₹46,900 + ₹39,200 + ₹45,850 + ₹66,850 + ₹36,050)

Calculation of Relevant Overtime Cost under JIT System

Particulars	Jan	Feb	Mar	Apr	May	Jun
Demand*	3,150	3,760	4,060	3,350	3,650	4,830
Production*	3,150	3,760	4,060	3,350	3,650	4,830
Normal Availablility*	3,800	3,800	3,800	3,800	3,800	3,800
Shortage (=Overtime*) (C)	---	---	260	----	----	1,030
Actual Overtime Hours $\left(\frac{C}{0.95}\right)$	---	---	273.68	----	----	1,084.21
Overtime Payment @ ₹159.50 [110+45%]	---	---	43,652	----	----	1,72,931

(*) *in terms of standard labour hours*

Total Overtime payment	=	₹2,16,583
		(₹43,652 + ₹1,72,931)
Therefore, saving in JIT system	=	₹2,57,600 – ₹2,16,583 = ₹41,017

Comments

Though KPL is saving ₹41,017 by changing its production system to Just-in-time but it has to consider other factors as well before taking any final call which are as follows:-

(i) KPL has to ensure that it receives materials from its suppliers on the exact date and at the exact time when they are needed. Credentials and reliability of supplier must be thoroughly checked.

(ii) To remove any quality issues, the engineering staff must visit supplier's sites and examine their processes, not only to see if they can reliably ship high-quality parts but also to provide them with engineering assistance to bring them up to a higher standard of product.

(iii) KPL should also aim to improve quality at its process and design levels with the purpose of achieving "Zero Defects" in the production process.

(iv) KPL should also keep in mind the efficiency of its work force. KPL must ensure that labour's learning curve has reached at steady rate so that they are capable of performing a variety of operations at effective and efficient manner. The workforce must be completely retrained and focused on a wide range of activities.

5. (i) Statement of Profitability of Electro Life Ltd

	Products (Amount in ₹)				
	Alpha	**Beta**	**Gamma**	**Theta**	**Total**
Sales	26,00,000	45,20,000	42,40,000	32,00,000	1,45,60,000
Direct Materials	6,00,000	18,20,000	18,80,000	10,00,000	53,00,000
Direct Wages	8,00,000	20,80,000	12,80,000	12,00,000	53,60,000
Overheads (W.N.2):					
Machine Related	1,60,000	1,56,000	64,000	2,40,000	6,20,000
Batch Related	1,00,000	1,30,000	80,000	1,50,000	4,60,000
Contribution	9,40,000	3,34,000	9,36,000	6,10,000	28,20,000
Product Specific Fixed Overheads	10,00,000	1,00,000	2,00,000	1,00,000	14,00,000
Gross Profit	(60,000)	2,34,000	7,36,000	5,10,000	14,20,000
General Fixed Overheads					6,20,000
Profit					8,00,000

(ii) Break-even Point

Total Sale Value of Product 'Alpha' = ₹ 26,00,000

Total Contribution of Product 'Alpha' = ₹ 9,40,000

Specific Fixed Overheads (Product Alpha) = ₹ 10,00,000

$$\text{Break-even Sales (₹)} = \frac{\text{Specific Fixed Cost}}{\text{Total Contribution}} \times \text{Total Sales Value}$$

$$= \frac{₹\,10,00,000}{₹\,9,40,000} \times ₹26,00,000$$

$$= ₹27,65,957.45$$

$$\text{Break-even Sales (units)} = \frac{₹\,27,65,957.45}{₹\,13.00} = 2,12,766 \text{ units}$$

However, production must be done in batches of 100 units. Therefore, **2,128 batches** are required for break even. Due to the production in batches, 34 units (2,128 batches × 100 units – 2,12,766 units) would be produced extra. These 34 units would add extra cost ₹282.20 (34 units × ₹8.3*). Accordingly, break-even units as calculated above will increase by 22 units $\left(\frac{₹\,282.20}{₹\,13.00}\right)$.

(*) $\left(\frac{₹\,6,00,000 + ₹\,8,00,000 + ₹\,1,60,000 + ₹\,1,00,000}{2,00,000 \text{ units}}\right)$

Break-even units of product 'Alpha' is 2,12,788 units (2,12,766 units + 22 units).

Workings:

W.N.-1

Calculation Showing Overhead Rates

Overhead's Related Factors	Overhead Cost (₹) [a]	Total No. of Units of Factors [b]	Overhead Rate (₹) [a] / [b]
Machining Hours	6,20,000	15,50,000 hrs.	0.40
Batch Production	4,60,000	9,200 batches	50.00

W.N.-2

Statement Showing - Overhead Costs Related to Product

Particulars	Alpha	Beta	Gamma	Theta
Machining hrs. related overheads	₹ 1,60,000 (4,00,000 hrs × ₹0.40)	₹ 1,56,000 (3,90,000 hrs × ₹ 0.40)	₹ 64,000 (1,60,000 hrs × ₹ 0.40)	₹ 2,40,000 (6,00,000 hrs × ₹ 0.40)

Batch related overheads	₹1,00,000 (2,000 batches × ₹ 50)	₹1,30,000 (2,600 batches × ₹ 50)	₹80,000 (1,600 batches × ₹ 50)	₹1,50,000 (3,000 batches × ₹ 50)

6. (i) Impact of Management Consultant's Plan on Profit of the HHCL

Human Health Care Ltd.

Statement Showing Cost Benefit Analysis

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

(ii) Comment

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

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

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

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

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

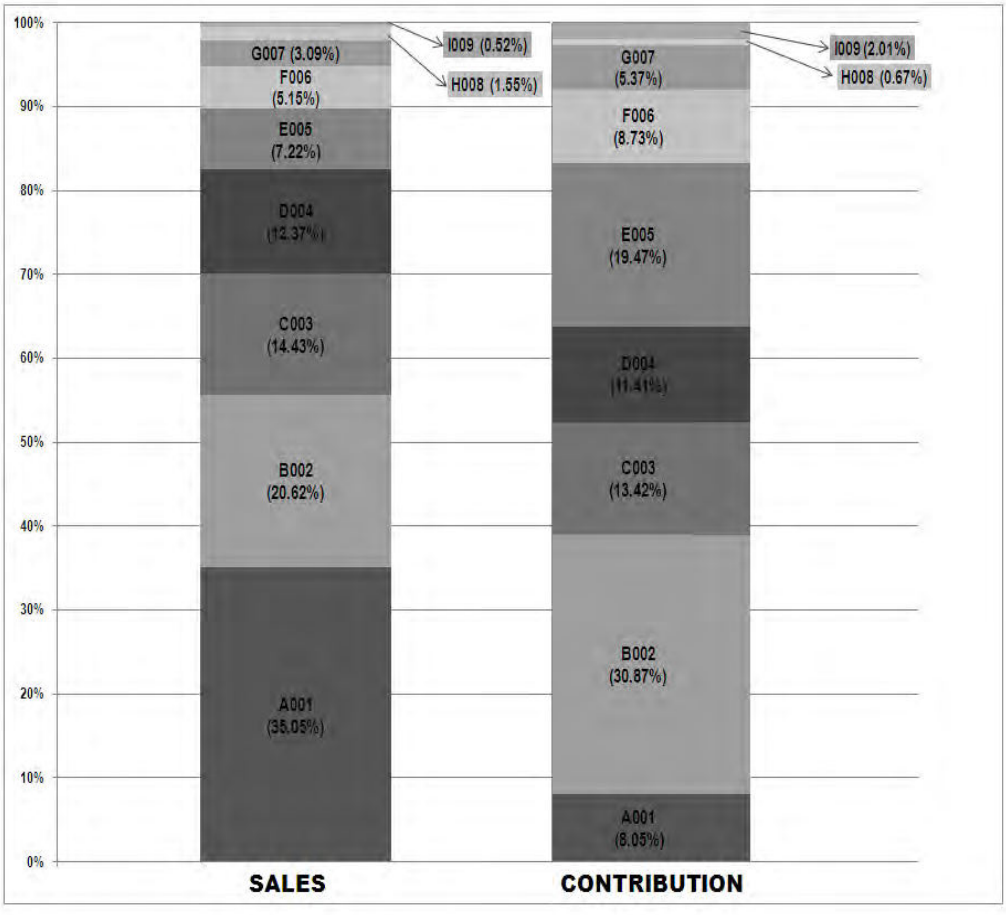
7. Statement Showing 'Pareto Analysis'

Model	Sales (₹'000)	% of Total Sales	Cumulative Total	Model	Cont. (₹'000)	% of Total Cont.	Cumulative Total %
Pareto Analysis Sales				Pareto Analysis Contribution			
A001	5,100	35.05%	35.05%	B002	690	30.87%	30.87%

B002	3,000	20.62%	55.67%	E005	435	19.47%*	50.34%
C003	2,100	14.43%	70.10%	C003	300	13.42%	63.76%
D004	1,800	12.37%	82.47%	D004	255	11.41%	75.17%
E005	1,050	7.22%	89.69%	F006	195	8.73%*	83.90%
F006	750	5.15%	94.84%	A001	180	8.05%	91.95%
G007	450	3.09%	97.93%	G007	120	5.37%	97.32%
H008	225	1.55%	99.48%	I009	45	2.01%	99.33%
I009	75	0.52%	100.00%	H008	15	0.67%	100.00%
	14,550	100.00%			2,235	100.00%	

(*) *Rounding - off difference adjusted.*

Diagram Showing 'Sales and Contribution'(NOT COMPULSORY)



☞ This Diagram is shown for **better understanding** of the concept.

Recommendations

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

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

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

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

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

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

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

8. A single budget system may be conflicting in planning and motivation, and planning and performance evaluation roles as below:

(i) Planning and motivation roles – Demanding budgets that may not be achieved may be appropriate to motivate maximum performance but they are unsuitable for planning purposes. For these, a budget should be a set based on easier targets that are expected to be met.

(ii) Planning and performance evaluation roles - For planning purposes budgets are set in advance of the budget period based on an anticipated set of circumstances or environment. Performance evaluation should be based on a comparison of active performance with an adjusted budget to reflect the circumstance under which managers actually operated.

9. Fixed Overhead Expenditure Variance = Budgeted Fixed Overheads – Actual Fixed Overheads

₹20,000 (F)	=	₹7,20,000 – Actual Fixed Production Overheads
Actual Fixed Overheads	=	₹7,00,000
Absorbed Fixed Overheads	=	Actual Fixed Overheads + Over Absorbed Fixed Overheads
	=	₹7,00,000 + ₹3,200
	=	₹7,03,200
Standard Absorption Rate *per unit*	=	₹7,20,000 / 36,000 units
	=	₹20
So, Actual Number of Units	=	₹7,03,200 / ₹20
	=	35,160 units

10. Statement of Reconciliation - Budgeted Vs Actual Profit

Particulars	**₹**
Budgeted Profit	5,19,000
Less: Sales Volume Contribution Planning Variance (Adverse)	52,125
Less: Sales Volume Contribution Operational Variance (Adverse)	93,825
Less: Sales Price Variance (Adverse)	39,600
Less: Variable Cost Variance (Adverse)	29,700
Less: Fixed Cost Variance (Adverse)	15,000
Actual Profit	2,88,750

Workings

Basic Workings

Budgeted Market Share (in %)	=	$\frac{2,00,000 \text{units}}{4,00,000 \text{units}}$ = 50%
Actual Market Share (in %)	=	$\frac{1,65,000 \text{units}}{3,75,000 \text{units}}$ = 44%
Budgeted Contribution	=	₹21,00,000 – ₹12,66,000
	=	₹8,34,000
Average Budgeted Contribution (*per unit)*	=	$\frac{₹8,34,000}{₹2,00,000}$ = ₹4.17
Budgeted Sales Price *per unit*	=	$\frac{₹21,00,000}{₹2,00,000}$ = ₹10.50

Actual Sales Price *per unit* = $\frac{₹16,92,900}{₹1,65,000}$ = ₹10.26

Standard Variable Cost *per unit* = $\frac{₹12,66,000}{₹2,00,000}$ = ₹6.33

Actual Variable Cost *per unit* = $\frac{₹10,74,150}{₹1,65,000}$ = ₹6.51

Calculation of Variances

Sales Variances:…….

Volume Contribution Planning* = Budgeted Market Share % × (Actual Industry Sales Quantity *in units* – Budgeted Industry Sales Quantity *in units*) × (Average Budgeted Contribution *per unit*)

= 50% × (3,75,000 units – 4,00,000 units) × ₹4.17

= 52,125 (A)

(*) *Market Size Variance*

Volume Contribution Operational** = (Actual Market Share % – Budgeted Market Share %) × (Actual Industry Sales Quantity *in units*) × (Average Budgeted Contribution *per unit*)

= (44% – 50 %) × 3,75,000 units × ₹4.17

= 93,825 (A)

(**) *Market Share Variance*

Price = Actual Sales – Standard Sales

= Actual Sales Quantity × (Actual Price – Budgeted Price)

= 1,65,000 units × (₹10.26 – ₹10.50) = 39,600 (A)

Variable Cost Variances:…….

Cost = Standard Cost for Production – Actual Cost

= Actual Production × (Standard Cost *per unit* – Actual Cost *per unit*)

= 1,65,000 units × (₹6.33 – ₹6.51) = ₹29,700(A)

Fixed Cost Variances:…….

Expenditure = Budgeted Fixed Cost – Actual Fixed Cost

= ₹3,15,000 – ₹3,30,000 = ₹15,000 (A)

☞ **Fixed Overhead Volume Variance** does not arise in a Marginal Costing system

11. (i) The minimum price at which CECDC can transfer component 'L_X' to CIPL is Variable Cost per unit *plus* Corporate Tax attributable to per unit of component 'L_X'

Minimum Transfer Price *per unit* of component 'L_X'

	Amount (TWD)
Direct Material	440.00
Direct Labour	120.00
Variable Overheads	40.00
Wharfage Charges	30.00
Corporate Tax attributable to per unit of component 'L_X' (W.N.1)	30.00
Total	660.00

Minimum Transfer Price *per unit* of component 'L_X' is 660 TWD or ₹1,320

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

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

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

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

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

Particulars	LED TV	Component 'Lx'	Total
Sales Revenue	9,62,500 (1,75,000 units × ₹11,000 × 0.50)	1,12,500 (1,50,000 units× 750TWD)	10,75,000
Total Revenue		**(A)**	**10,75,000**
Variable Manufacturing Cost (Component 'L_X')	2,10,000 (3,50,000 units × 600 TWD)	90,000 (1,50,000 units× 600TWD)	3,00,000
Wharfage Charges	10,500 (3,50,000 units × 30 TWD)	4,500 (1,50,000 units× 30TWD)	15,000
Other Variable Manufacturing	5,52,562.50	---	5,52,562.50

Cost (excluding 'Lx')	(1,75,000 units × ₹6,315 × 0.50)		
Import Duty	26,250 (10% × 3,50,000 units × 750TWD)	---	26,250
Shipment Cost	1,750 (3,50,000 units × ₹10 × 0.50)	---	1,750
Office and Admin. Overheads	5,900 (₹1,18,00,000 × 0.50)	---	5,900
Selling & Dist. Overheads	12,900 (₹2,58,00,000 × 0.50)	---	12,900
Corp. Taxes (W.N. 2 & 3)	30,191.25 (₹60,382.50 × 0.50)	15,000	45,191.25
Total Cost		**(B)**	**9,59,553.75**
Profit		(A) – (B)	1,15,446.25

Working Notes:

W.N.-1

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

	Amount
Profit *per unit* (750 TWD – 440 TWD – 120 TWD – 40 TWD – 30 TWD)	120
Corporate tax *per unit* (25% on 120 TWD)	30

W.N.-2

Calculation of Corporate Tax paid by CIPL (₹' 000)

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

W.N.-3

Calculation of Corporate Tax paid by CECDC (TWD)

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

12.

☞ Once the initial basic feasible solution is done, we have to do the optimality test. If it satisfy the condition that number of allocation is equal to m+n-1 where m= number of rows, n= number of columns. If allocation is less than m+n-1, then the problem shows degenerate situation. In that case we have to allocate an infinitely small quantity (e) in least cost and independent cell. Independent cells in Transportation Problems mean the cells which do not form a closed loop with occupied cells.

The table obtained after using VAM contains 4 occupied cells against the required number of 4 + 4 – 1 = 7, hence the solution is degenerate.

To remove degeneracy, a letter 'e' is placed in three independent cells. The problem for test of optimality is reproduced in table below:

Contractors	Job P	Job Q	Job R	Job S
A	112.50 e	100.00 e	127.50	167.50 1
B	142.50	105.00 1	157.50	137.50
C	122.50 e	130.00	120.00 1	160.00
D	102.50 1	112.50	150.00	137.50

☞ Alternatively **'e'** can also be allocated to cell C_{42} instead of C_{11}.

Now total number of allocations become equal to m + n -1 i.e. 7. This solution is tested for optimality.

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

					u_i
	112.50	100.00	110.00	167.50	0
	117.50	105.00	115.00	172.50	5.00
	122.50	110.00	120.00	177.50	10.00
	102.50	90.00	100.00	157.50	-10.00
v_j	112.50	100.00	110.00	167.50	

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

Δ_{ij} Matrix

		17.50	
25.00		42.50	-35.00
	20.00		-17.50
	22.50	50.00	-20.00

Since all values of Δ_{ij} are not positive, the solution given above is not optimal. Let us include the cell with highest negative Δ_{ij} which is C_{24} as a basic cell and try to improve the solution. The reallocated solution is given below which is tested for optimality-

e	e +1		1 -1
	1 -1		 +1
e		1	
1			

Revised allocations (improved initial solution) are as follows-

Contractors	Job P	Job Q	Job R	Job S
A	112.50 e	100.00 1	127.50	167.50
B	142.50	105.00 e	157.50	137.50 1
C	122.50 e	130.00	120.00 1	160.00
D	102.50 1	112.50	150.00	137.50

☞ Again there is a situation of degenracy to remove this situation a new **'e'** has been allocated to least cost independent cell C_{22}.

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

					u_i
	112.50	100.00	110.00	132.50	0
	117.50	105.00	115.00	137.50	5.00
	122.50	110.00	120.00	142.50	10.00
	102.50	90.00	100.00	122.50	-10.00
v_j	112.50	100.00	110.00	132.50	

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

Δ_{ij} Matrix

		17.50	35.00
25.00		42.50	
	20.00		17.50
	22.50	50.00	15.00

Since all the entries in the above Δ_{ij} Matrix table are non-negative, this solution is optimal. The optimal assignment is given below-

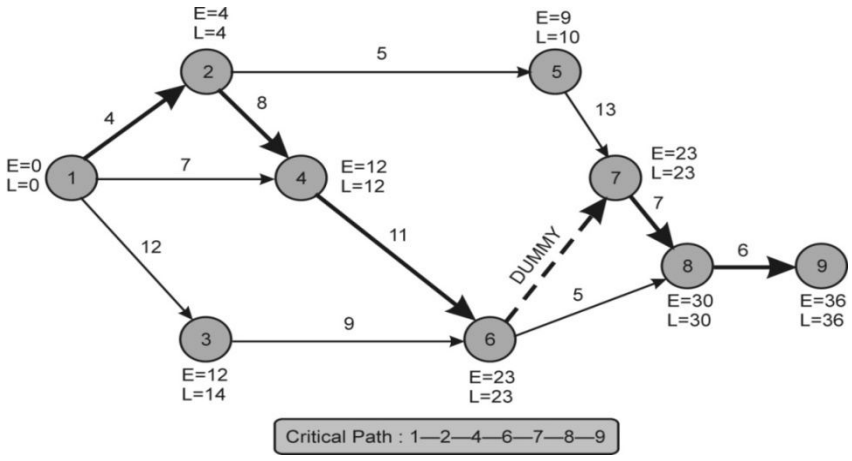
Contractor	Job	Cost of Project
A	Q	100.00
B	S	137.50
C	R	120.00
D	P	102.50
	Total	460.00

13. (i) Calculation of Missing Figures

Statement Showing Calculation of Missing Figures

Activity	Duration	EST	EFT	LST	LFT	Total Float
	D_{ij}	E_i	$E_i + D_{ij}$	$L_j - D_{ij}$	L_j	LST− EST
1–2	4	0	4	0	4	0
1–3	12	0	12	2	14	2
1–4	7	0	7	5	12	5
2–4	8	4	12	4	12	0
2–5	5	4	9	5	10	1
3–6	9	12	21	14	23	2
4–6	11	12	23	12	23	0
5–7	13	9	22	10	23	1
6–7	0	23	23	23	23	0
6–8	5	23	28	25	30	2
7–8	7	23	30	23	30	0
8–9	6	30	36	30	36	0

(ii) The Network for the given problem:



(iii) Paths with their corresponding durations

The Various Paths in the Network are:

1–2–4–6–7–8–9 with Duration 36 Days

1–2–5–7–8–9 with Duration 35 Days

1–3–6–7–8–9 with Duration 34 Days

1–2–4–6–8–9 with Duration 34 Days

1–3–6–8–9 with Duration 32 Days

1–4–6–7–8–9 with Duration 31 Days

1–4–6–8–9 with Duration 29 Days

The Critical Path is 1–2–4–6–7–8–9 with Duration 36 Days.

14. (i) Invalid

Reason: As per the rules of network construction, parallel activities between two events, without intervening events, are prohibited. Dummy activities are needed when two or more activities have same initial and terminal events. Dummy activities do not consume time or resources.

(ii) Valid

Reason: As per the conventions adopted in drawing networks, the head event or terminal node always has a number higher than that of initial node or tail event.

(iii) Invalid

Reason: The difference between the latest event time and the earliest event time is termed as slack of an event. Free float is determined by subtracting head event slack from the total float of an activity.

(iv) Invalid

Reason: For every critical activity in a network, the earliest start time and the latest start time is same and also the earliest finish time and the latest finish time is same.

(v) Invalid

Reason: The optimum duration is the time period in which the total cost of the project is minimum.

(vi) Valid

Reason: Resource leveling is a network technique used for reducing the requirement of a particular resource due to its paucity or insufficiency within a constraint on the project duration. The process of resource leveling utilize the large floats available on non-critical activities of the project and cuts down the demand of the resource.

15. Allocation of Random Numbers

Demand (units)

Units	Probability	Cumulative Probability	Random Nos.
10,000	0.20	0.20	00 – 19
20,000	0.25	0.45	20 – 44
30,000	0.30	0.75	45 – 74
40,000	0.25	1.00	75 – 99

Contribution per unit

₹	Probability	Cumulative Probability	Random Nos.
25	0.25	0.25	00 – 24
35	0.30	0.55	25 – 54
45	0.35	0.90	55 – 89
55	0.10	1.00	90 – 99

Advertising Cost

₹	Probability	Cumulative Probability	Random Nos.
50,000	0.22	0.22	00 – 21
60,000	0.33	0.55	22 – 54
70,000	0.44	0.99	55 – 98
80,000	0.01	1.00	99 – 99

Investment

₹	Probability	Cumulative Probability	Random Nos.
50,00,000	0.10	0.10	00 – 09
55,00,000	0.30	0.40	10 – 39
60,00,000	0.45	0.85	40 – 84
65,00,000	0.15	1.00	85 – 99

Simulation Table

Random Number	Demand Units	Contribution Per unit (₹)	Adv. Cost (₹)	Return (₹)	Investment (₹)	Return on Investment
09, 24, 85, 07	10,000	25	70,000	1,80,000	50,00,000	3.60%
84, 38, 16, 48	40,000	35	50,000	13,50,000	60,00,000	22.50%
41, 73, 54, 57	20,000	45	60,000	8,40,000	60,00,000	14.00%

92, 07, 99, 64	40,000	25	80,000	9,20,000	60,00,000	15.33%
65, 04, 78, 72	30,000	25	70,000	6,80,000	60,00,000	11.33%

Highest Likely Return is 22.50% relating to trial 2.

16. Working Note

The usual learning curve model is

$$y = ax^b$$

Where

y = Average time per unit for x units

a = Time required for first unit

x = Cumulative number of units produced

b = Learning coefficient

W.N.1

Time required for first 15 units based on revised learning curve of 80% (when the time required for the first unit is 10 hours)

$$y = 10 \times (15)^{-0.322}$$

$$\log y = \log 10 - 0.322 \times \log 15$$

$$\log y = \log 10 - 0.322 \times \log (5 \times 3)$$

$$\log y = \log 10 - 0.322 \times [\log 5 + \log 3]$$

$$\log y = 1 - 0.322 \times [0.69897 + 0.47712]$$

$$\log y = 0.6213$$

$$y = \text{antilog of } 0.6213$$

$$y = 4.181 \text{ hours}$$

$$\text{Total time for 15 units} = 15 \text{ units} \times 4.181 \text{ hours}$$

$$= 62.72 \text{ hours}$$

Time required for first 14 units based on revised learning curve of 80% (when the time required for the first unit is 10 hours)

$$y = 10 \times (14)^{-0.322}$$

$$\log y = \log 10 - 0.322 \times \log 14$$

$$\log y = \log 10 - 0.322 \times \log (2 \times 7)$$

$$\log y = \log 10 - 0.322 \times [\log 2 + \log 7]$$

$$\log y = 1 - 0.322 \times [0.3010 + 0.8451]$$

log y	=	0.63096
y	=	antilog of 0.63096
y	=	4.275 hrs
Total time for 14 units	=	14 units × 4.275 hrs
	=	59.85 hrs

Time required for 25 units based on revised learning curve of 80% (when the time required for the first unit is 10 hours)

Total time for first 15 units	=	62.72 hrs
Total time for next 10 units	=	28.70 hrs [(62.72 − 59.85) hours × 10 units]
Total time for 25 units	=	62.72 hrs + 28.70 hrs
	=	91.42 hrs

W.N.2

Computation of Standard and Actual Rate

Standard Rate	=	$\frac{₹1,19,288}{180.74\,\text{hrs.}}$
	=	₹ 660.00 per hr.
Actual Rate	=	$\frac{₹79,704}{118.08\,\text{hrs.}}$
	=	₹ 675.00 per hr.

W.N.3

Computation of Variances

Labour Rate Variance	=	Actual Hrs × (Std. Rate – Actual Rate)
	=	118.08 hrs × (₹660.00 – ₹675.00) = ₹1,771.20 (A)
Labour Efficiency Variance	=	Std. Rate × (Std. Hrs – Actual Hrs)
	=	₹660 × (91.42 hrs – 118.08 hrs)
	=	₹17,595.60 (A)

Statement of Reconciliation (Actual Figures Vs Budgeted Figures)

Particulars	₹
Actual Cost	79,704.00
Less: Labour Rate Variance (Adverse)	1,771.20
Less: Labour Efficiency Variance (Adverse)	17,595.60
Budgeted Labour Cost (Revised)*	60,337.20

Budgeted Labour Cost (Revised)*

= Std. Hrs. × Std. Rate

= 91.42 hrs. × ₹660

= ₹ 60,337.20

17. Cost Classification

(i) Committed Cost

Reason: Company cannot negotiate the price of advertisement in future and it has to make payment as soon as advertisement is prepared.

(ii) Differential Cost

Reason: In case of decision making among two alternatives, every manager has to compare the difference in cost involved.

(iii) Sunk Cost

Reason: Research expense has already been incurred and it will not affect any decision making in future.

(iv) Opportunity Cost

Reason: Income from government securities is the amount that company has forgone to earn income from its investment in the project.

(v) Period Cost

Reason: Salary of chairman is paid irrespective of productivity of the company.

(vi) Direct Cost

Reason: Amount paid for water can be directly attributed to the cost of finished product that is clothes.

18. (i) Predatory Pricing

Predatory Pricing occurs when a firm with significant market power sets prices at a sufficiently low level with the purpose of damaging or forcing a competitor to withdraw from the market. It may involve dumping, i.e. selling a product in a foreign market at below cost, or below the domestic market price (subject to, for example, adjustments for taxation differences, transportation costs, specification differences).

(ii) Shadow Price

Increase in value which would be created by having available one additional unit of a limiting resource at its original cost. This represents the opportunity cost of not having the use of the one extra unit.

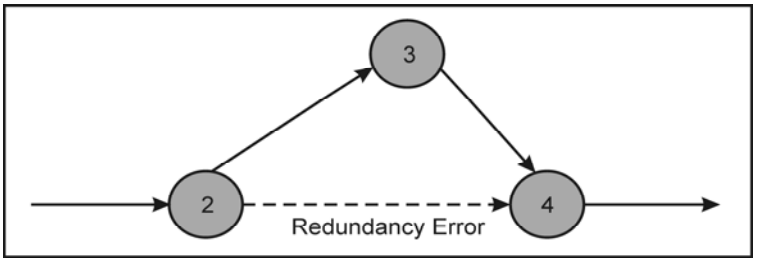
(iii) Inter-firm Comparison

It is technique of evaluating the performance, efficiency, costs and profits of firms in an industry. It consists of voluntary exchange of information/data concerning costs,

prices, profits, productivity and overall efficiency among firms engaged in similar type of operations for the purpose of bringing improvement in efficiency and indicating the weaknesses.

(iv) Redundancy

When dummy activities are inserted in a network diagram unnecessarily, this type of error is called error of redundancy. It is shown in the following figure:



PAPER – 6: INFORMATION SYSTEMS CONTROL AND AUDIT

QUESTIONS

Concepts of Governance and Management of Information Systems

1. (a) What is Governance of Enterprise IT (GEIT)? Explain its key benefits in brief.

   (b) Discuss key management practices for implementing risk management.

2. Discuss the areas, which should be reviewed by Internal Auditors as a part of the review of Governance, Risk and Compliance (GRC).

3. Discuss the key management practices for assessing and evaluating the system of Internal Controls in an enterprise in detail.

Information Systems Concepts

4. What do you understand by Transaction Processing System (TPS)? Briefly discuss the key activities involved in a TPS.

5. (a) Briefly discuss major misconceptions about Management Information System (MIS).

   (b) 'There are various constraints, which come in the way of operating an MIS'. Explain any four such constraints in brief.

6. What is Executive Information Systems (EIS)? Explain major characteristics of an EIS.

Protection of Information Systems

7. (a) What are the key components of a good Security Policy? Explain in brief.

   (b) Discuss five interrelated components of Internal Controls.

8. What do you understand by Boundary Controls? Explain major boundary control techniques in brief.

9. (a) Briefly explain major Data Integrity Policies.

   (b) What do you understand by Asynchronous Attacks? Explain various forms of asynchronous attacks in brief.

Business Continuity Planning and Disaster Recovery Planning

10. (a) Discuss the objectives of Business Continuity Planning (BCP).

    (b) While developing a Business Continuity Plan, what are the key tasks that should be covered in the second phase 'Vulnerability Assessment and General definition of Requirement'?

11. (a) Discuss the maintenance tasks undertaken in the development of a BCP in brief.

    (b) A company has decided to outsource its recovery process to a third party site. What are the issues that should be considered by the security administrators while

drafting the contract?

Acquisition, Development and Implementation of Information Systems

12. (a) Describe major strengths of Prototyping Model.

    (b) What are the possible advantages of System Development Life Cycle (SDLC) from the perspective of IS Audit?

13. Explain two primary methods, which are used for the analysis of the scope of a project in System Development Life Cycle (SDLC).

14. Bring out the reasons as to why organizations fail to achieve their Systems Development Objectives?

Auditing of Information Systems

15. Discuss the issues relating to the performance of evidence collection and understanding the reliability of controls.

16. What do you understand by System Control Audit Review File (SCARF) technique? Explain various types of information collected by using SCARF technique in brief.

Information Technology Regulatory Issues

17. (a) Explain the objectives of the Information Technology Act, 2000.

    (b) Discuss the 'Use of Electronic Records in Government and its agencies' in the light of Section 6 of Information Technology Act 2000.

18. Mr. A has received some information about Mr. B on his mobile phone. He knows that this information has been stolen by the sender. He not only retained this information but also sent it to Mr. B and his friends. Because of this act, Mr. B is annoyed and his life is in danger. Read the above carefully and answer the following:

    (a) Under what sections of IT Act, 2000; Mr. B can file an FIR with police against Mr. A? Discuss the related provisions in detail.

    (b) Mr. A is reasonably suspected of having committed an offence under the IT Act, 2000. Specify the rank of police officers, who can search and arrest him and the concerned section of the said Act. Also explain the related provisions in detail.

Emerging Technologies

19. (a) Discuss the major goals of Cloud Computing in brief.

    (b) What do you understand by Public Cloud? Also discuss its major advantages in brief.

20. (a) 'The work habits of computer users and businesses can be modified to minimize adverse impact on the global environment'. Discuss some of such steps, which can be followed for Green IT.

(b) Discuss any four challenges to Cloud Computing in brief.

Questions based on Short Notes/Differential between various concepts

21. Write short notes on the following:
    (a) Trojan Horse
    (b) Snapshots
    (c) Test Plan under BCP & DRP
    (d) Audit Hooks
22. Differentiate between the following:
    (a) Black Box Testing and White Box Testing.
    (b) Differential Backup and Full Backup.
    (c) Structured English and Flowchart.

Questions based on the Case Studies

23. ABC Ltd. is a company dealing in electronic items through its various offices in India and abroad. Currently, the company is using various stand-alone systems, which are found to be on higher risk due to technology as well as supplier/s. By recognizing the importance of Information Technology, it intends to implement E-Governance system at all of its departments. Dependency on electronic information and IT systems is essential to support critical business processes. Accordingly, a system analyst is engaged to conduct requirements analysis and investigation of the present system. In addition, he also highlighted the importance of Risk Management and suggested that the management of IT related risks is now being understood as a key part of enterprise governance; hence, it must be managed properly. As a result of the same, efficient ways were explored to achieve the goals especially for risk management. Research Studies reveal that cost and efforts may be reduced up to a considerable level by reducing risk from the beginning in the SDLC.

    Read the above carefully and answer the following:

    (a) What do you mean by System Requirements Analysis? What are the activities to be performed during System Requirement Analysis phase?
    (b) Explain various Risk Management Strategies. In your opinion, which strategy you will recommend in this scenario and why?
    (c) Agile methodology is one of the popular approaches of system development. What are the major strengths of this methodology in your opinion?
24. PQR Institute is a distance learning Institute offering various professional courses, which are popular across the world. One of the prominent reasons of the popularity of the courses is rigorous examination system of the Institute, which is currently a manual

process. It is observed that its students are facing problems regarding their routine work and queries due to this manual process. In addition, they are required to visit the Institute physically even for very small tasks. In view of these aforementioned facts, the Controller of Examinations decided to launch a web based Portal to facilitate the students of different courses. It is proposed to upload the examination forms, admit cards, results etc. of various courses on this Portal. It is expected that the portal will be very useful for the students as it aims to provide the access of various examination related resources on anytime anywhere basis. For the implementation of this project, a technical consultant was appointed by the Institute. Accordingly, an initial feasibility study under various dimensions was done and a detailed report was submitted. As a next step, as per the recommendations of the consultant, an expression of interest was published by the Institute in various national/regional newspapers inviting organizations to showcase their capabilities and suggest a good solution as per the requirements of the examination department of the Institute.

Read the above carefully and answer the following:

(a) What are three major attributes of information security? Out of these attributes, which attribute will be having the highest priority while developing web based examination portal?

(b) In your opinion, what may be the possible dimensions under which the feasibility study of the proposed Portal was done?

(c) What may be the major validation methods for validating the vendors' proposal for developing the Portal?

25. XYZ Group is in the process of launching a new business unit to provide various technical consultancy services to the organizations worldwide to assist them in the computerization of their business modules. It involves a number of activities starting from capturing of requirements to maintenance. Business continuity and disaster recovery planning are two key activities, which must be taken care of right from the beginning. Business continuity focuses on maintaining the operations of an organization, especially the IT infrastructure in face of a threat that has materialized. Disaster recovery, on the other hand, arises mostly when business continuity plan fails to maintain operations and there is a service disruption. This plan focuses on restarting the operations using a prioritized resumption list. But both the plans must be assessed regarding their performance on a periodic basis.

Read the above carefully and answer the following:

(a) What are the issues, which are emphasized by the methodology for developing a Business Continuity Plan?

(b) Explain the objectives of performing Business Continuity Planning tests.

(c) Out of various backup options available, explain Incremental Backup in brief?

SUGGESTED ANSWERS / HINTS

1. (a) Governance of Enterprise IT (GEIT): Governance of Enterprise IT is a sub-set of corporate governance and facilitates implementation of a framework of IS controls within an enterprise as relevant and encompassing all key areas. The primary objectives of GEIT are to analyze and articulate the requirements for the governance of enterprise IT, and to put in place and maintain effective enabling structures, principles, processes and practices, with clarity of responsibilities and authority to achieve the enterprise's mission, goals and objectives.

Major benefits of GEIT are given as follows:

- It provides a consistent approach integrated and aligned with the enterprise governance approach.
- It ensures that IT-related decisions are made in line with the enterprise's strategies and objectives.
- It ensures that IT-related processes are overseen effectively and transparently.
- It confirms compliance with legal and regulatory requirements.
- It ensures that the governance requirements for board members are met.

(b) Key Management Practices for implementing Risk Management are given as follows:

- **Collect Data:** Identify and collect relevant data to enable effective IT related risk identification, analysis and reporting.
- **Analyze Risk:** Develop useful information to support risk decisions that take into account the business relevance of risk factors.
- **Maintain a Risk Profile:** Maintain an inventory of known risks and risk attributes, including expected frequency, potential impact, and responses, and of related resources, capabilities, and current control activities.
- **Articulate Risk:** Provide information on the current state of IT- related exposures and opportunities in a timely manner to all required stakeholders for appropriate response.
- **Define a Risk Management Action Portfolio:** Manage opportunities and reduce risk to an acceptable level as a portfolio.
- **Respond to Risk:** Respond in a timely manner with effective measures to limit the magnitude of loss from IT related events.

2. Major areas which should be reviewed by Internal Auditors as a part of the review of Governance, Risk and Compliance (GRC) are given as follows:

- **Scope:** The internal audit activity must evaluate and contribute to the improvement of governance, risk management, and control processes using a systematic and disciplined approach.
- **Governance:** The internal audit activity must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:
  - ♦ Promoting appropriate ethics and values within the organization;
  - ♦ Ensuring effective organizational performance management and accountability;
  - ♦ Communicating risk and control information to appropriate areas of the organization; and
  - ♦ Coordinating the activities of and communicating information among the board, external and internal auditors, and management.
- **Evaluate Enterprise Ethics:** The internal audit activity must evaluate the design, implementation, and effectiveness of the organization's ethics related objectives, programs, and activities. The internal audit activity must assess whether the information technology governance of the organization supports the organization's strategies and objectives.
- **Risk Management:** The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes.
- **Interpretation:** The internal audit activity must determine whether risk management processes are effective in a judgment resulting from the internal auditor's assessment that:
  - ♦ Organizational objectives support and align with the organization's mission;
  - ♦ Significant risks are identified and assessed;
  - ♦ Appropriate risk responses are selected that align risks with the organization's risk appetite; and
  - ♦ Relevant risk information is captured and communicated in a timely manner across the organization, enabling staff, management, and the board to carry out their responsibilities.
- **Risk Management Process:** The internal audit activity may gather the information to support this assessment during multiple engagements. The results of these engagements, when viewed together, provide an understanding of the organization's risk management processes and their effectiveness. Risk management processes are monitored through on-going management activities, separate evaluations, or both.

- **Evaluate Risk Exposures:** The internal audit activity must evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the:
  - ♦ Achievement of the organization's strategic objectives;
  - ♦ Reliability and integrity of financial and operational information;
  - ♦ Effectiveness and efficiency of operations and programs;
  - ♦ Safeguarding of assets; and
  - ♦ Compliance with laws, regulations, policies, procedures, and contracts.
- **Evaluate Fraud and Fraud Risk:** The internal audit activity must evaluate the potential for the occurrence of fraud and how the organization manages fraud risk.
- **Address Adequacy of Risk Management Process:** During consulting engagements, internal auditors must address risk consistent with the engagement's objectives and be alert to the existence of other significant risks. Internal auditors must incorporate knowledge of risks gained from consulting engagements into their evaluation of the organization's risk management processes. When assisting management in establishing or improving risk management processes, internal auditors must refrain from assuming any management responsibility by actually managing risks.

3. The key management practices for assessing and evaluating the system of internal controls in an enterprise are given as follows:

- **Monitor Internal Controls:** Continuously monitor, benchmark and improve the IT control environment and control framework to meet organizational objectives.
- **Review Business Process Controls Effectiveness:** Review the operation of controls, including a review of monitoring and test evidence to ensure that controls within business processes operate effectively. It also includes activities to maintain evidence of the effective operation of controls through mechanisms such as periodic testing of controls, continuous controls monitoring, independent assessments, command and control centres, and network operations centres. This provides the business with the assurance of control effectiveness to meet requirements related to business, regulatory and social responsibilities.
- **Perform Control Self-assessments:** Encourage management and process owners to take positive ownership of control improvement through a continuing program of self- assessment to evaluate the completeness and effectiveness of management's control over processes, policies and contracts.
- **Identify and Report Control Deficiencies:** Identify control deficiencies and analyze and identify their underlying root causes. Escalate control deficiencies and report to stakeholders.

- **Ensure that assurance providers are independent and qualified:** Ensure that the entities performing assurance are independent from the function, groups or organizations in scope. The entities performing assurance should demonstrate an appropriate attitude and appearance, competence in the skills and knowledge necessary to perform assurance, and adherence to codes of ethics and professional standards
- **Plan Assurance Initiatives:** Plan assurance initiatives based on enterprise objectives and conformance objectives, assurance objectives and strategic priorities, inherent risk resource constraints, and sufficient knowledge of the enterprise.
- **Scope assurance initiatives:** Define and agree with management on the scope of the assurance initiative, based on the assurance objectives.
- **Execute assurance initiatives:** Execute the planned assurance initiative. Report on identified findings. Provide positive assurance opinions, where appropriate, and recommendations for improvement relating to identified operational performance, external compliance and internal control system residual risks.

4. **Transaction Processing System (TPS):** At the lowest level of management, TPS is an information system that manipulates data from business transactions. Any business activity such as sales, purchase, production, delivery, payments or receipts involves transaction and these transactions are to be organized and manipulated to generate various information products for internal and external use. For example, selling of a product to a customer will give rise to the need of further information like customer billing, inventory status and increase in account receivable balance. TPS will thus record and manipulate transaction data into usable information.

Major activities involved in a TPS are given as follows:

- Capturing data and organizing in files or databases;
- Processing files/databases using application software;
- Generating information in the form of reports; and
- Processing queries from various quarters of the organization.

5. **(a)** Following are the major misconceptions about Management Information System (MIS):

- ♦ Any computer based information system is a MIS.
- ♦ Any reporting system is MIS.
- ♦ MIS is a management technique.
- ♦ MIS is a bunch of technologies.

- ♦ MIS is an implementation of organizational systems and procedures. It is a file structure.
- ♦ The study of MIS is about use of computers.
- ♦ More data in generated reports refers more information to managers.
- ♦ Accuracy plays vital role in reporting.

(b) Four major constraints, which come in the way of operating a Management Information System (MIS), are given as follows:

- Non-availability of experts, who can diagnose the objectives of the organization and provide a desired direction for installing a system, which operates properly. This problem may be overcome by grooming internal staff, which should be preceded by proper selection and training.
- Experts usually face the problem of selecting which sub-system of MIS should be installed and operated first. The criteria, which should guide the experts, depends its need and importance.
- Due to varied objectives of business concerns, the approach adopted by experts for designing and implementing MIS is no-standardized.
- Non-cooperation from staff is a crucial problem, which should be handled tactfully. This can be carried out by organizing lectures, showing films and also explaining to them the utility of the system. Besides this, some staff should also be involved in the development and implementation of the system to buy-in their participation.

6. Executive Information Systems (EIS): It is sometimes referred to as an Executive Support System (ESS) too. It serves at the strategic level i.e. top level managers of the organization. ESS creates a generalized computing and communications environment rather than providing any preset applications or specific competence.

Characteristics of EIS: Major characteristics of an EIS are given as follows:

- It is a Computer-based-information system that serves the information need of top executives.
- EIS enables users to extract summary data and model complex problems without the need to learn query languages statistical formulas or high computing skills.
- It provides rapid access to timely information and direct access to management reports.
- EIS is capable of accessing both internal and external data.
- EIS provides extensive online analysis tool like trend analysis, market conditions etc.
- EIS can easily be given as a DSS support for decision making.

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

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

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

- **Control Environment:** These are the elements that establish the control context in which specific accounting systems and control procedures must operate. The control environment is manifested in management's operating style, the ways authority and responsibility are assigned, the functional method of the audit committee, the methods used to plan and monitor performance and so on.
- **Risk Assessment:** These are the elements that identify and analyze the risks faced by an organisation and the way the risk can be managed. Both external and internal auditors are concerned with errors or irregularities that cause material losses to an organisation.
- **Control Activities:** These are the elements that operate to ensure transactions are authorized, duties are segregated, adequate documents and records are maintained, assets and records are safeguarded, and independent checks on performance and valuation of records. These are called accounting controls. Internal auditors are also concerned with administrative controls to achieve effectiveness and efficiency objectives.

- ♦ **Information and Communication:** These are the elements, in which information is identified, captured and exchanged in a timely and appropriate form to allow personnel to discharge their responsibilities.
- ♦ **Monitoring:** These are the elements that ensure internal controls operate reliably over time.

8. **Boundary Controls:** The major controls of the boundary system are the access control mechanisms that link authentic users to resource who are permitted to access. The access control mechanism has three steps - Identification, Authentication and Authorization with respect to the Access Control Policy.

Major Boundary Control techniques are given as follows:

- **Cryptography:** It deals with programs for transforming data into cipher text that are meaningless to anyone, who does not possess the authentication to access the respective system resource or file. A cryptographic technique encrypts data (clear text) into cryptograms (cipher text) and its strength depends on the time and cost to decipher the cipher text by a cryptanalyst. Three techniques of cryptography are transposition (permute the order of characters within a set of data), substitution (replace text with a key-text) and product cipher (combination of transposition and substitution).
- **Passwords:** User identification by an authentication mechanism normally with strong password may be a good boundary access control. A few best practices followed to avoid failures in this control system are; minimum password length, avoid usage of common dictionary words, periodic change of passwords, hashing of passwords and number of unsuccessful entry attempts.
- **Personal Identification Numbers (PIN):** PIN is similar to a password. It is assigned to a user by an institution using a random number stored in its database and sent independently to a user after identification. It can also be a customer selected number. Hence, a PIN may be exposed to vulnerabilities while issuance or delivery, validation, transmission and storage.
- **Identification Cards:** Identification cards are used to store information required in an authentication process. These cards are to be controlled through the application for a card, preparation of the card, issue, use and card return or card termination phases.
- **Biometric Devices:** Biometric identification e.g. thumb and/or finger impression, eye retina etc. are also used as boundary control techniques.

9. **(a)** Major Data Integrity Policies are given as under:

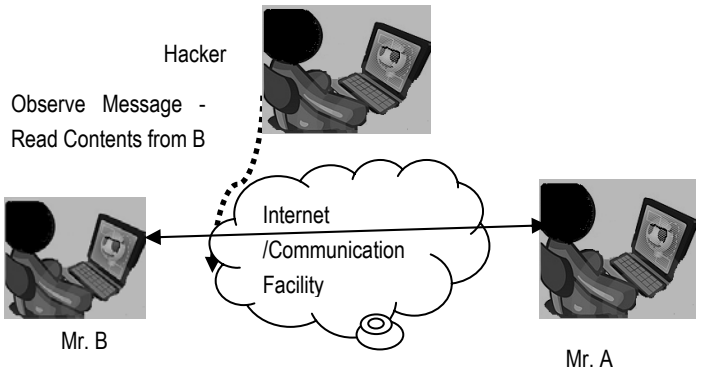
- ♦ **Virus-Signature Updating:** Virus signatures must be updated automatically when they are made available from the vendor through enabling of automatic updates.

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

(b) **Asynchronous Attacks:** Data that is waiting to be transmitted are liable to unauthorized access called Asynchronous Attack. They occur in many environments where data can be moved asynchronously across telecommunication lines. Numerous transmissions must wait for the clearance of the line before data being transmitted. These attacks are hard to detect because they are usually very small pin like insertions. There are many forms of asynchronous attacks; some of them are given as follows:

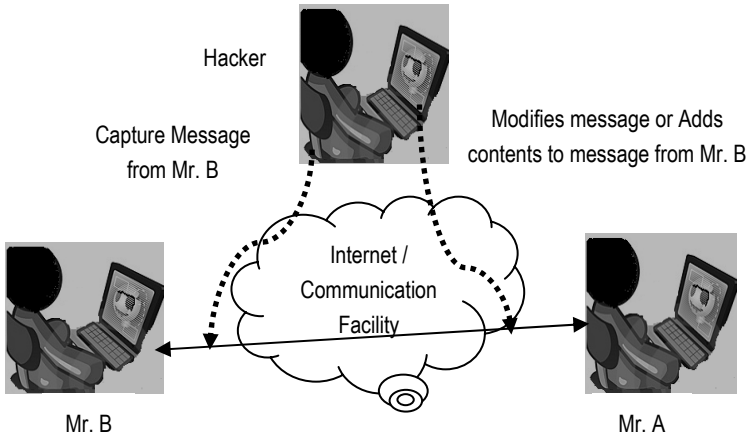
(i) **Data Leakage:** Data is a critical resource for an organization to function effectively. Data leakage involves leaking information out of the computer by means of dumping files to paper or stealing computer reports and tape.

(ii) **Wire-tapping:** This involves spying on information being transmitted over telecommunication network.



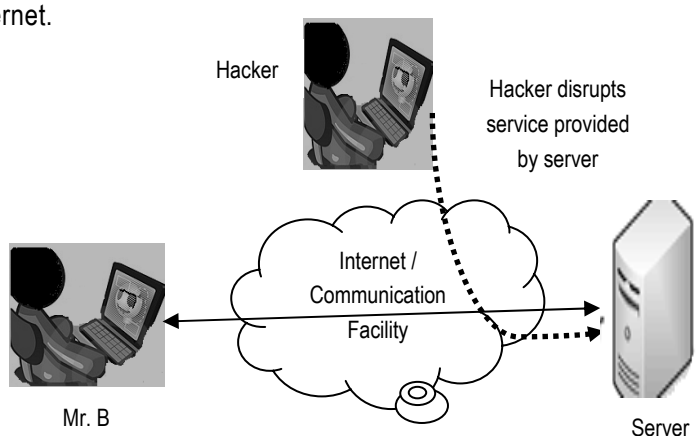
Wire Tapping

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



Piggybacking

(iv) Shutting Down of the Computer/Denial of Service: This is initiated through terminals or microcomputers that are directly or indirectly connected to the computer. Individuals, who know the high-level systems log on-ID initiate shutting down process. The security measure will function effectively if there are appropriate access controls on the logging on through a telecommunication network. When overloading happens some systems have been proved to be vulnerable to shutting themselves. Hackers use this technique to shut down computer systems over the Internet.



Denial of Service

10. (a) Objectives of Business Continuity Planning (BCP): The primary objective of a Business Continuity Planning is to enable an organization to survive a disaster and to re-establish 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 for the safety and well-being of people on the premises at the time of disaster;
- Continue critical business operations;
- Minimise the duration of a serious disruption to operations and resources (both information processing and other resources);
- Minimise immediate damage and losses;
- Establish management succession and emergency powers;
- Facilitate effective co-ordination of recovery tasks;
- Reduce the complexity of the recovery effort;

(b) While developing a Business Continuity Plan, the key tasks that should be covered in the second phase 'Vulnerability Assessment and General definition of Requirement' are given as follows:

- A thorough Security Assessment of the computing and communications environment including personnel practices; physical security; operating procedures; backup and contingency planning; systems development and maintenance; database security; data and voice communications security; systems and access control software security; insurance; security planning and administration; application controls; and personal computers.
- The Security Assessment will enable the project team to improve any existing emergency plans and disaster prevention measures and to implement required emergency plans and disaster prevention measures where none exist.
- Present findings and recommendations resulting from the activities of the Security Assessment to the Steering Committee so that corrective actions can be initiated in a timely manner.
- Define the scope of the planning effort.
- Analyze, recommend and purchase recovery planning and maintenance software required to support the development of the plans and to maintain the plans current following implementation.
- Develop a Plan Framework.

11. (a) Major maintenance tasks undertaken in development of a BCP are to:

- Determine the ownership and responsibility for maintaining the various BCP strategies within the enterprise;
- Identify the BCP maintenance triggers to ensure that any organizational, operational, and structural changes are communicated to the personnel who are accountable for ensuring that the plan remains up-to-date;

- Determine the maintenance regime to ensure the plan remains up-to-date;
- Determine the maintenance processes to update the plan; and
- Implement version control procedures to ensure that the plan is maintained up-to-date.

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

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

12. (a) Major strengths of Prototyping Model are given as follows:

- It improves both user participation in system development and communication among project stakeholders.
- It is especially useful for resolving unclear objectives; developing and validating user requirements; experimenting with or comparing various design solutions, or investigating both performance and the human computer interface.
- Potential exists for exploiting knowledge gained in an early iteration as later iterations are developed.
- It helps to easily identify, confusing or difficult functions and missing functionality.
- It enables to generate specifications for a production application.
- It encourages innovation and flexible designs.
- It provides for quick implementation of an incomplete, but functional application.
- It typically results in a better definition of users' needs and requirements than traditional systems development approach.

- A very short time period is normally required to develop and start experimenting with a prototype. This short time period allows system users to immediately evaluate proposed system changes.
- Since system users experiment with each version of the prototype through an interactive process, errors are hopefully detected and eliminated early in the developmental process. As a result, the information system ultimately implemented should be more reliable and less costly to develop than when traditional systems development approach is employed.

(b) From the perspective of the IS Audit, following are the possible advantages of System Development Life Cycle (SDLC):

- The IS auditor can have clear understanding of various phases of the SDLC on the basis of the detailed documentation created during each phase of the SDLC.
- The IS Auditor on the basis of his/her examination, can state in his/her report about the compliance by the IS management with the procedures, if any, set by management.
- If the IS Auditor has technical knowledge and ability to handle different areas of SDLC, s/he can be a guide during the various phases of SDLC.
- The IS auditor can provide an evaluation of the methods and techniques used through the various development phases of the SDLC.

13. Two primary methods which are used for the analysis of the scope of a project in SDLC are given as follows:

- **Reviewing Internal Documents:** The analysts conducting the investigation first try to learn about the organization involved in, or affected by, the project. For example, to review an inventory system proposal, an analyst may try to know how the inventory department operates and who are the managers and supervisors. Analysts can usually learn these details by examining organization charts and studying written operating procedures.
- **Conducting Interviews:** Written documents tell the analyst how the systems should operate, but they may not include enough details to allow a decision to be made about the merits of a systems proposal, nor do they present users' views about current operations. To learn these details, analysts use interviews. Interviews allow analysts to know more about the nature of the project request and the reasons for submitting it. Usually, preliminary investigation interviews involve only management and supervisory personnel.

14. Following are the major reasons due to which organizations fail to achieve their System Development objectives:

(i) **User Related Issues:** It refers to those issues where user/customer is reckoned as the primary agent. Some of the aspects with regard to this problem are mentioned as follows:

- **Shifting User Needs:** User requirements for IT are constantly changing. As these changes accelerate, there will be more requests for Information systems development and more development projects. When these changes occur during a development process, the development team faces the challenge of developing systems whose very purpose might change after the development process began.
- **Resistance to Change:** People have a natural tendency to resist change, and information systems development projects signal changes - often radical - in the workplace. When personnel perceive that the project will result in personnel cutbacks, threatened personnel will dig in their heels, and the development project is doomed to failure.
- **Lack of User Participation:** Often users do not participate in the development stage because they are preoccupied with their existing work, or do not understand the benefits of the new system. User apathy 'I have nothing to gain if I participate' is also a reason.
- **Inadequate Testing and User Training:** Often systems are not tested due to lack of time and rush to introduce the new system or because problems were not envisaged at the development stage. Inadequate user training may be a result of poor project planning, or lack of training techniques, or because user management does not release personnel for training due to operational pressure.

(ii) **Developer Related Issues:** It refers to the issues and challenges with regard to developers. Some of the critical bottlenecks are mentioned below:

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

(iii) **Management Related Issues:** It refers to the bottlenecks with regard to organizational set up, administrative and overall management to accomplish the system development goals. Some of such bottlenecks are mentioned as follows:

- ♦ **Lack of Senior Management Support and Involvement:** Developers and users of information systems watch senior management to determine 'which systems development projects are important' and act accordingly by shifting their efforts away from any project, which is not receiving management attention. In addition, management may not allocate adequate resources, as well as budgetary control over use of resources, assigned to the project.
- ♦ **Development of Strategic Systems:** Because strategic decision making is unstructured; the requirements, specifications, and objectives for such development projects are difficult to define.

(iv) **New Technologies:** When an organization tries to create a competitive advantage by applying advance technologies, it generally finds that attaining system development objectives is more difficult because personnel are not as familiar with the technology.

In order to overcome these aforementioned issues, organizations must execute a well-planned systems development process efficiently and effectively. Accordingly, a sound system development team is inevitable for project success.

15. The performance of evidence collection and understanding the reliability of controls involve the following major issues:

- **Data retention and storage:** A client's storage capabilities may restrict the amount of historical data that can be retained "on-line" and readily accessible to the auditor. If the client has insufficient data retention capacities the auditor may not be able to review a whole reporting period transactions on the computer system. For example, the client's computer system may save data on detachable storage device by summarizing transactions into monthly, weekly or period end balances.
- **Absence of input documents:** Transaction data may be entered into the computer directly without the presence of supporting documentation e.g. input of telephone orders into a telesales system. The increasing use of EDI will result in less paperwork being available for audit examination.
- **Non-availability of audit trail:** The audit trails in some computer systems may exist for only a short period of time. The absence of an audit trail will make the auditor's job very difficult and may call for an audit approach which involves auditing around the computer system by seeking other sources of evidence to provide assurance that the computer input has been correctly processed and output.
- **Lack of availability of output:** The results of transaction processing may not produce a hard copy form of output, i.e. a printed record. In the absence of physical output, it may be necessary for the auditor to directly access the electronic data retained on the client's computer. This is normally achieved by having the client provide a computer terminal and being granted "read-only" access to the required data files.

- **Audit evidence:** Certain transactions may be generated automatically by the computer system. For example, a fixed asset system may automatically calculate depreciation on assets at the end of each calendar month. The depreciation charge may be automatically transferred (journalized) from the fixed assets register to the depreciation account and hence to the client's income and expenditure account.
- **Legal issues:** The use of computers to carry out trading activities is also increasing. More organizations in both the public and private sector intend to make use of EDI and electronic trading over the Internet. This can create problems with contracts, e.g. when is the contract made, where is it made (legal jurisdiction), what are the terms of the contract and who are the parties to the contract.

16. **System Control Audit Review File (SCARF):** The SCARF technique involves embedding audit software modules within a host application system to provide continuous monitoring of the system's transactions. The information collected is written on a special audit file - the SCARF master files. Auditors then examine the information contained on this file to see if some aspect of the application system needs follow-up. In many ways, the SCARF technique is like the snapshot technique along with other data collection capabilities. Auditors might use SCARF technique to collect the following types of information:

    - **Application System Errors -** SCARF audit routines provide an independent check on the quality of system processing, whether there are any design and programming errors as well as errors that could creep into the system when it is modified and maintained.
    - **Policy and Procedural Variances -** Organizations have to adhere to the policies, procedures and standards of the organization and the industry to which they belong. SCARF audit routines can be used to check when variations from these policies, procedures and standards have occurred.
    - **System Exception -** SCARF can be used to monitor different types of application system exceptions. For example, salespersons might be given some leeway in the prices they charge to customers. SCARF can be used to see how frequently salespersons override the standard price.
    - **Statistical Sample -** Some embedded audit routines might be statistical sampling routines, SCARF provides a convenient way of collecting all the sample information together on one file and use analytical review tools thereon.
    - **Snapshots and Extended Records -** Snapshots and extended records can be written into the SCARF file and printed when required.
    - **Profiling Data -** Auditors can use embedded audit routines to collect data to build profiles of system users. Deviations from these profiles indicate that there may be some errors or irregularities.

- **Performance Measurement -** Auditors can use embedded routines to collect data that is useful for measuring or improving the performance of an application system.

17. (a) Major objectives of the Information Technology Act, 2000 are as follows:

- ♦ To grant legal recognition for transactions carried out by means of Electronic Data Interchange (EDI) and other means of electronic communication commonly referred to as "electronic commerce" in place of paper based methods of communication;
- ♦ To give legal recognition to Digital Signatures for authentication of any information or matter, which requires authentication under any law;
- ♦ To facilitate electronic filing of documents with Government departments;
- ♦ To facilitate electronic storage of data;
- ♦ To facilitate and give legal sanction to electronic fund transfers between banks and financial institutions;
- ♦ To give legal recognition for keeping of books of accounts by banker's in electronic form; and
- ♦ To amend the Indian Penal Code, the Indian Evidence Act, 1872, the Banker's Book Evidence Act, 1891, and the Reserve Bank of India Act, 1934.

(b) Section 6 provides for use of electronic records in government and its agencies even though the original law requiring these documents did not provide for electronic forms. It allows use of electronic form for:

- ♦ filing any form, application or other documents;
- ♦ creation, retention or preservation of records, issue or grant of any license or permit;
- ♦ receipt or payment in Government offices.

The appropriate Government has the power to prescribe the manner and format of the electronic records.

18. (a) Mr. B can file an FIR in police against Mr. A under the following Sections of Information Technology Act, 2000:

- ♦ **Section 66A:** Punishment for sending offensive messages through communication service, etc.;
- ♦ **Section 66B:** Punishment for dishonestly receiving stolen computer resource or communication device; and
- ♦ **Section 66E:** Punishment for violation of privacy.

All these applicable sections in this case are given as follows:

[Section 66A] Punishment for sending offensive messages through communication service, etc.

Any person who sends, by means of a computer resource or a communication device,-

(a) any information that is grossly offensive or has menacing character; or

(b) any information which he knows to be false, but for the purpose of causing annoyance, inconvenience, danger, obstruction, insult, injury, criminal intimidation, enmity, hatred, or ill will, persistently by making use of such computer resource or a communication device,

(c) any electronic mail or electronic mail message for the purpose of causing annoyance or inconvenience or to deceive or to mislead the addressee or recipient about the origin of such messages shall be punishable with imprisonment for a term which may extend to three years and with fine.

Explanation: For the purposes of this section, terms "Electronic mail" and "Electronic Mail Message" means a message or information created or transmitted or received on a computer, computer system, computer resource or communication device including attachments in text, image, audio, video and any other electronic record, which may be transmitted with the message.

[Section 66B] Punishment for dishonestly receiving stolen computer resource or communication device.

Whoever dishonestly receives or retains any stolen computer resource or communication device knowing or having reason to believe the same to be stolen computer resource or communication device, shall be punished with imprisonment of either description for a term which may extend to three years or with fine which may extend to rupees one lakh or with both.

[Section 66E] Punishment for violation of privacy

Whoever, intentionally or knowingly captures, publishes or transmits the image of a private area of any person without his or her consent, under circumstances violating the privacy of that person, shall be punished with imprisonment which may extend to three years or with fine not exceeding two lakh rupees, or with both.

(b) Not below the rank of an Inspector or any other officer of the Central Government or a State Government authorized by the Central Government in this behalf can search and arrest Mr. A, suspected of having committed an offence under the IT Act, 2000.

Related provisions have been covered in Section 80 of IT Act, 2000. The details are given as follows:

[Section 80] Power of Police Officer and Other Officers to Enter, Search, etc.

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any police officer, not below the rank of a Inspector or any other officer of the Central Government or a State Government authorized by the Central Government in this behalf may enter any public place and search and arrest

without warrant any person found therein who is reasonably suspected of having committed or of committing or of being about to commit any offence under this Act.

Explanation: For the purposes of this sub-section, the expression "Public Place" includes any public conveyance, any hotel, any shop or any other place intended for use by, or accessible to the public.

(2) Where any person is arrested under sub-section (1) by an officer other than a police officer, such officer shall, without unnecessary delay, take or send the person arrested before a magistrate having jurisdiction in the case or before the officer-in-charge of a police station.

(3) The provisions of the Code of Criminal Procedure, 1973 shall, subject to the provisions of this section, apply, so far as may be, in relation to any entry, search or arrest, made under this section.

19. (a) Major goals of Cloud Computing are given as follows:

- To create a highly efficient IT ecosystem, where resources are pooled together and costs are aligned with what resources are actually used;
- To access services and data from anywhere at any time;
- To scale the IT ecosystem quickly, easily and cost-effectively based on the evolving business needs;
- To consolidate IT infrastructure into a more integrated and manageable environment;
- To reduce costs related to IT energy/power consumption;
- To enable or improve "Anywhere Access" (AA) for ever increasing users; and
- To enable rapid provision of resources as needed.

(b) **Public Cloud:** This environment can be used by the general public. This includes individuals, corporations and other types of organizations. Typically, public clouds are administrated by third parties or vendors over the Internet, and the services are offered on pay-per-use basis. These are also called Provider Clouds. Business models like SaaS (Software-as-a-Service) and public clouds complement each other and enable companies to leverage shared IT resources and services.

The advantages of public cloud include the following:

- It is widely used in the development, deployment and management of enterprise applications, at affordable costs.
- It allows the organizations to deliver highly scalable and reliable applications rapidly and at more affordable costs.

Moreover, one of the limitations is security assurance and thereby building trust among the clients is far from desired but slowly liable to happen.

20. (a) Major steps, which can be followed for Green IT, are given as follows.

- Power-down the CPU and all peripherals during extended periods of inactivity.
- Try to do computer-related tasks during contiguous, intensive blocks of time, switching off hardware at other times.
- Power-up and power-down energy-intensive peripherals such as laser printers according to need.
- Use Liquid Crystal Display (LCD) monitors rather than Cathode Ray Tube (CRT) monitors.
- Use notebook computers rather than desktop computers whenever possible.
- Use the power-management features to turn off hard drives and displays after several minutes of inactivity.
- Minimize the use of paper and properly recycle waste paper.
- Dispose of e-waste according to central, state and local regulations.
- Employ alternative energy sources for computing workstations, servers, networks and data centers.

(b) Four challenges to Cloud Computing are given as follows:

- **Confidentiality:** Prevention of unauthorized disclosure of data is referred to as Confidentiality. Normally, Cloud works on public networks; therefore, there is a requirement to keep the data confidential the unauthorized entities. With the use of encryption and physical isolation, data can be kept secret. The basic approaches to attain confidentiality are the encrypting the data before placing it in a Cloud with the use of TC3 (Total Claim Capture & Control).
- **Integrity:** Integrity refers to the prevention of unauthorized modification of data and it ensures that data is of high quality, correct, consistent and accessible. After moving the data to the cloud, owner hopes that their data and applications are secure. It should be ensured that the data is not changed after being moved to the cloud. It is important to verify if one's data has been tampered with or deleted. Strong data integrity is the basis of all the service models such as Software as a Service (SaaS), Platform as a Service (PaaS) and Infrastructure as a Service (IaaS). Methods like Digital Signature, Redundant Array of Independent Disks (RAID) strategies etc. are some ways to preserve integrity in Cloud computing. The most direct way to enforce the integrity control is to employ cryptographic hash function. For example, a solution is developed as underlying data structure using hash tree for authenticated network storage.
- **Availability:** Availability refers to the prevention of unauthorized withholding of data andit ensures the data backup through Business Continuity Planning

(BCP) and Disaster Recovery Planning (DRP). In addition, Availability also ensures that they meet the organization's continuity and contingency planning requirements. Availability can be affected temporarily or permanently, and a loss can be partial or complete. Temporary breakdowns, sustained and Permanent Outages, Denial of Service (DoS) attacks, equipment failure, and natural calamities are all threats to availability. One of the major Cloud service provider, AWS had a breakdown for several hours, which led to data loss and access issues with multiple Web 2.0 services.

- **Architecture:** In the architecture of Cloud computing models, there should be control over the security and privacy of the system. The architecture of the Cloud is based on a specific service model. Its reliable and scalable infrastructure is dependent on the design and implementation to support the overall framework.

21. (a) **Trojan Horse:** These are malicious programs that are hidden under any authorized program. Typically, a Trojan horse is an illicit coding contained in a legitimate program, and causes an illegitimate action. The concept of Trojan is similar to bombs but a computer clock or particular circumstances do not necessarily activate it. A Trojan may:

- Change or steal the password or
- May modify records in protected files or
- May allow illicit users to use the systems.

Trojan Horse hides in a host and generally do not damage the host program. Trojans cannot copy themselves to other software in the same or other systems. The trojans may get activated only if the illicit program is called explicitly. It can be transferred to other system only if an unsuspecting user copies the Trojan program.

Christmas Card is a well-known example of Trojan. It was detected on internal E-mail of IBM system. On typing the word 'Christmas', it will draw the Christmas tree as expected, but in addition, it will send copies of similar output to all other users connected to the network. Because of this message on other terminals, other users cannot save their half finished work.

(b) **Snapshots:** Tracing a transaction in a computerized system can be performed with the help of snapshots or extended records. The snapshot software is built into the system at those points where material processing occurs which takes images of the flow of any transaction as it moves through the application. These images can be utilized to assess the authenticity, accuracy, and completeness of the processing carried out on the transaction. The main areas to dwell upon while involving such a system are to locate the snapshot points based on materiality of transactions when the snapshot will be captured and the reporting system design and implementation to present data in a meaningful way.

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

(d) **Audit Hooks:** There are audit routines that flag suspicious transactions. For example, internal auditors at Insurance Company determined that their policyholder system was vulnerable to fraud every time a policyholder changed his or her name or address and then subsequently withdrew funds from the policy. They devised a system of audit hooks to tag records with a name or address change. The internal audit department will investigate these tagged records for detecting fraud. When audit hooks are employed, auditors can be informed of questionable transactions as soon as they occur. This approach of real-time notification may display a message on the auditor's terminal.

22. (a) **Black Box Testing:** Black Box Testing takes an external perspective of the test object, to derive test cases. These tests can be functional or non-functional, though usually functional. The test engineer has no prior knowledge of the test object's internal structure. The test designer selects typical inputs including simple, extreme, valid and invalid input-cases and executes to obtain assurance or uncover errors.

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, the box is bigger and more complex, and 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 it is not supposed to, the black box test may not identify it.

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

(b) **Differential Backup:** A differential backup stores files that have changed since the last full backup. Therefore, if a file is changed after the previous full backup, a differential backup takes less time to complete than a full back up. Comparing with full backup, differential backup is obviously faster and more economical in using the backup space, as only the files that have changed since the last full backup are saved.

Restoring from a differential backup is a two-step operation: Restoring from the last full backup; and then restoring the appropriate differential backup. The downside to using differential backup is that each differential backup probably includes files that were already included in earlier differential backups.

Full Backup: A full backup captures all files on the disk or within the folder selected for backup. With a full backup system, every backup generation contains every file in the backup set. However, the amount of time and space such a backup takes prevents it from being a realistic proposition for backing up a large amount of data.

(c) **Structured English:** Structured English, also known as Program Design Language (PDL), is the use of the English language with the syntax of structured programming. Thus, Structured English aims at getting the benefits of both the programming logic and natural language. Program logic that helps to attain precision and natural language that helps in getting the convenience of spoken languages. A better structured, universal and precise tool is referred to as pseudo code.

Flowchart: Flowcharting is a pictorial representation technique that can be used by analysts to represent the inputs, outputs and processes of a business process. It is a common type of chart that represents an algorithm or process showing the steps as boxes of various kinds, and their order by connecting these with arrows. Flowcharts are used in analyzing, designing, documenting or managing a process or program in various fields.

23. (a) System Requirements Analysis is a phase, which includes a thorough and detailed understanding of the current system, identification of the areas that need modification/s to solve the problem, the determination of user/managerial requirements and to have fair ideas about various system development tools.

The following activities are performed in this phase:

- To identify and consult the stake owners to determine their expectations and resolve their conflicts;
- To analyze requirements to detect and correct conflicts and determine priorities;
- To verify requirements in terms of various parameters like completeness, consistency, unambiguous, verifiable, modifiable, testable and traceable;

- To gather data or find facts using tools like- interviewing, research/document collection, questionnaires, observation;
- To develop models to document Data Flow Diagrams, E-R diagrams; and
- To document activities such as interviews, questionnaires, reports etc. and development of a system dictionary to document the modelling activities.

The document/deliverable of this phase is a detailed system requirements report, which is generally termed as SRS.

(b) Following are the key risk management strategies:

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

In the given scenario, we would recommend to follow the strategy of 'Terminate/Eliminate the risk'. Because the company is currently using various stand-alone systems, which are found to be on higher risk due to technology as well as supplier/s. By using this strategy, the risk can be eliminated by replacing the technology with more robust products and by seeking more capable suppliers and vendors.

(c) Major strengths of Agile Methodology are given as follows:

- 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.

24. (a) Three major attributes of information security are given (CIA) that are as follows:

- **Confidentiality:** Prevention of the unauthorized disclosure of information;
- **Integrity:** Prevention of the unauthorized modification of information; and
- **Availability:** Prevention of the unauthorized withholding of information.

In the given scenario, Integrity will be having the highest priority while developing web based examination portal because in any examination system, the prime goal should be to make available the correct information only. It should not be altered or modified by any unauthorized person/s.

(b) The possible dimensions under which the feasibility study of the proposed Portal was done are given 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?
- **Behavioural:** Is the solution going to bring any adverse effect on quality of work life?
- **Legal:** Is the solution valid in legal terms?

(c) Major validation methods of validating the vendors' proposal for developing the Knowledge Portal are as follows:

(i) **Checklists:** It is the most simple and rather subjective method for validation and evaluation. The various criteria are put into check lists in the form of suitable questions against which the responses of the various vendors are validated. For example : Support Service Checklists may have parameters like – Performance, System development, Maintenance, Conversion, Training, Back-up, Proximity, Hardware, Software.

(ii) **Point-Scoring Analysis:** Point-scoring analysis provides an objective means of selecting the final system. There are no absolute rules in the selection

process, only guidelines for matching user needs with software capabilities. Evaluators must consider such issues as the University's needs to operate and maintain the portal, vendor reputations, software costs, user-friendliness for students (who are the customers in this case), and so forth.

(iii) **Public Evaluation Reports:** Several consultancy agencies compare and contrast the hardware and software performance for various manufacturers and publish their reports in this regard. This method has been frequently and usefully employed by several buyers in the past. For those criteria where published reports are not available, however, resort would have to be made to other methods of validation. This method is particularly useful where the buying staff has inadequate knowledge of facts. E.g. Public reports by agencies like Gartner's magic quadrant on systems used by other universities offering online courses may be considered.

(iv) **Benchmarking Problem for Vendor's Proposals:** Benchmarking problems for vendors' proposals are sample programs that represent at least a part of the buyer's primary computer work load and include software considerations and can be current applications programs or new programs that have been designed to represent planned processing needs. E.g. develop a set of sample requirements of a student and see whether the proposed system is able to effectively and efficiently deliver them. That is, benchmarking problems are oriented towards testing whether a computer system offered by the vendor meets the requirements of the buyer.

(v) **Test Problems:** Test problems disregard the actual job mix and are devised to test the true capabilities of the hardware, software or system. For example, test problems may be developed to evaluate the time required to download e-lectures (which are large sized files) by students, response time when large number of students login in at the same time, overhead requirements of the operating system in executing multiple user requests, length of time required to execute an instruction, etc. The results, achieved by the machine can be compared and price performance judgment can be made. It must be borne in mind, however that various capabilities to be tested would have to be assigned relative weightage as all requirements may not be equally important.

25. (a) The methodology for developing a Business Continuity Plan emphasizes the following:

(i) Providing management with a comprehensive understanding of the total efforts required to develop and maintain an effective recovery plan;

(ii) Obtaining commitment from appropriate management to support and participate in the effort;

(iii) Defining recovery requirements from the perspective of business functions;

(iv) Documenting the impact of an extended loss to operations and key business functions;

(v) Focusing appropriately on disaster prevention and impact minimization, as well as orderly recovery;

(vi) Selecting business continuity teams that ensure the proper balance required for plan development;

(vii) Developing a business continuity plan that is understandable, easy to use and maintain;

(viii) Planning the testing of plans in a systematic manner and measuring results of such tests; and

(ix) Defining how business continuity considerations must be integrated into ongoing business planning and system development processes in order that the plan remains viable over time.

(b) The objectives of performing BCP tests are to ensure that:

- the recovery procedures are complete and workable;
- the competence of personnel in their performance of recovery procedures can be evaluated;
- the resources such as business processes, IS systems, personnel, facilities and data are obtainable and operational to perform recovery processes;
- manual recovery procedures and IT backup system/s are current and can either be operational or restored; and
- the success or failure of business continuity training program is monitored.

(c) **Incremental Backup:** An Incremental Backup captures files that were created or changed since the last backup, regardless of backup type. This is the most economical method, as only the files that changed since the last backup are backed up. This saves a lot of backup time and space.

Normally, incremental backup are very difficult to restore. One will have to start with recovering the last full backup, and then recovering from every incremental backup taken since.

PAPER – 7 : DIRECT TAX LAWS

PART – III : QUESTIONS AND ANSWERS

QUESTIONS

Incomes which do not form part of total income

1. (a) Help All, a trust created on 1st January, 2014 for providing relief to the poor, applied for registration under section 12A on 1st March, 2014. On that date, its corpus fund comprised only of the initial contribution made by the trustees. The Commissioner denied registration solely on the ground that the trust had not commenced any charitable activity, due to which he could not satisfy himself about the genuineness of the trust. Is the ground for denial of registration by the Commissioner justified in this case? Discuss.

   (b) Educare, a trust created with the objective of promoting primary education in rural areas, filed an application for registration under section 12A on 1st April, 2013. Since the application was not disposed of by the Commissioner on or before 31st October, 2013 as required under section 12AA(2), the trust contended that it was deemed to be registered as per the provisions of section 12AA(1). Examine the correctness of contention of the trust.

Profits and gains of business or profession

2. Discuss, with the aid of decided case laws, whether the following expenditure are **revenue** or **capital** in nature –

   (a) Expenditure incurred on glow-sign boards displayed at dealer outlets;

   (b) Share issue expenses incurred by a company, where the public issue could not ultimately materialize on account of non-clearance by SEBI; and

   (c) Expenditure incurred for purchase of second-hand medical equipment for use as spare parts of existing equipment.

3. Ashiana Ltd., a company engaged in the business of manufacture of household equipments, furnishes the following particulars pertaining to P.Y. 2013-14. Compute the deduction allowable under section 32 and section 32AC for A.Y.2014-15, while computing its income under the head "Profits and gains of business or profession". Also, compute the written down value of plant and machinery as on 1.4.2014.

	Particulars	₹ in crores
1.	Written down value of plant and machinery (15% block) as on 1.4.2013	27.00
2.	Sold plant and machinery on 14.7.2013 (15% block)	3.00
3.	Purchase of second hand machinery (15% block) on 5.8.2013 for business purpose (the machinery was put to use immediately)	18.00
4.	Purchased new air-conditioners for office use on 27.8.2013	0.15

5.	Purchased new computers (60% block) on 1.12.2013 for office use	0.35
6.	Purchased computer accessories and peripherals (UPS, printers and scanners) on 1.12.2013 for office use	0.05
7.	Acquired and installed new plant and machinery (15% block) on 24.6.2013 (₹ 38 crore) and on 9.11.2013 (₹ 72 crore)	110.00

Profits and gains of business or profession, Capital Gains, Income from other sources & Provisions concerning deduction of tax at source

4. Mr. Harish, Vice President of ABC Bank, sold his house property in Chennai as well as his rural agricultural land for a consideration of ₹ 60 lakh and ₹ 15 lakh, respectively, to Mr. Suresh, a retail trader, on 10.10.2013. Mr. Harish had purchased the house property and the land in the year 2011 for ₹ 40 lakh and ₹ 10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 10.10.2013, is ₹ 85 lakh and ₹ 20 lakh for the house property and rural agricultural land, respectively.

   (a) Determine the tax implications in the hands of Mr. Harish and Mr. Suresh, if the date of agreement for sale of house property and rural agricultural land is 1.7.2013 and the stamp duty value on the said date was ₹ 75 lakh and ₹ 15 lakh, respectively. On the said date, Mr. Suresh made a cheque payment of ₹ 5 lakh to Mr. Harish for purchase of house property. Also, discuss the TDS implications, if any, in the hands of Mr. Suresh, assuming that both Mr. Harish and Mr. Suresh are resident Indians.

   (b) Would your answer be different if Mr. Harish is a property dealer and sold the house property in the course of his business?

Capital Gains

5. Mr. X was the owner of a residential house comprising of two floors. In April 2013, he entered into a collaboration agreement with Arihant Builders for developing the property. According to the terms of the agreement, Arihant Builders were to demolish the existing structure on the plot of land and develop, construct, and put up a building consisting of four independent floors - ground floor, first floor, second floor and third floor with terrace at its own cost. Mr. X handed over to Arihant Builders, the physical possession of the entire property, for the limited purpose of development. Arihant Builders was to get the third floor plus the undivided interest in the land to the extent of 25% for its exclusive enjoyment. The remaining floors (i.e., the ground, first and second) were to be handed over to Mr. X after construction.

   The cost of construction of each floor was ₹ 1 crore, which was borne by Arihant Builders. In addition to the cost of construction incurred by Arihant Builders on development of the property, a further amount of ₹ 5 crore was payable by Arihant Builders to Mr. X as consideration against the rights of Mr. X.

   You are required to discuss and resolve the following issues arising in the assessment of Mr. X as a result of the above transaction –

(i) For computation of capital gains, what should be the full value of consideration accruing as a result of transfer of the capital asset?

(ii) Is Mr. X eligible for exemption under section 54F?

(iii) If the answer to (ii) is yes, whether exemption is to be restricted to the cost of construction of one independent floor, on the reasoning that the floors given to Mr. X contained independent residential units having separate entrances and therefore, cannot qualify as a single residential unit?

Income from other sources

6. (a) Discuss the applicability of the provisions of section 56(2)(viib) in respect of the shares issued by the following closely held companies to resident Indians –

Company	Consideration received for issue of a share (₹)	Face value of a share (₹)	Fair Market Value (FMV) of a share (₹)	Number of shares issued
Win (P) Ltd.	370	300	350	1,00,000
Gain (P) Ltd.	330	300	350	2,00,000
Profit (P) Ltd.	290	300	280	3,00,000
Top (P) Ltd.	310	300	275	4,00,000

(b) Under section 2(22), dividend does not include, *inter alia*, any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a "substantial part of the business" of the company. What can be some of the tests to determine "substantial part of the business" of lending company for the purpose of application of exclusion provision under section 2(22)?

Set-off and carry forward of losses

7. Mr. Arjun was a partner in M/s. XYZ & Co., which dissolved on 31st August, 2013. As per the dissolution deed of the partnership firm, Mr. Arjun took over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partners were paid their dues. Mr. Arjun then ran the business as a sole proprietor with effect from 1st September, 2013. Relying upon the provisions section 78(2) and the decisions of the Supreme Court in *CIT v. Madhukant M. Mehta (2001) 247 ITR 805* and *Saroj Aggarwal v. CIT (1985) 156 ITR 497,* Mr. Arjun claimed the set-off of the losses suffered by the M/s. XYZ & Co. against his income earned as an individual proprietor for A.Y.2014-15 considering the case as inheritance of business. Discuss whether the claim of Mr. Arjun is tenable. In this regard, also examine whether there is any contradiction between the provisions of section 78(2) and section 170(1).

Deductions from Gross Total Income

8. From the following details, compute the total income of Mr. A, Mr. B and Mr. C for A.Y.2014-15 –

	Particulars	Mr. A ₹	Mr. B ₹	Mr. C ₹
(i)	Salary (computed)	9,25,000	10,45,000	11,15,000
(ii)	Interest income (on fixed deposits)	75,000	85,000	95,000

Mr. A, Mr. B and Mr. C are new retail investors who have made the following investments in equity shares/units of equity oriented fund of Rajiv Gandhi Equity Savings Scheme, 2013 for the P.Y.2013-14:

	Particulars	Mr. A ₹	Mr. B ₹	Mr. C ₹
(i)	Investment in listed equity shares	15,000	62,000	23,000
(ii)	Investment in units of equity-oriented fund	30,000	-	25,000

The particulars of their other investments/payments made during the P.Y.2013-14 are given hereunder -

	Particulars	₹
(1)	Deposit in Public Provident Fund (PPF) by Mr. A	80,000
(2)	Life insurance premium paid by Mr. C, the details of which are as follows -	

	Date of issue of policy	Person insured	Actual capital sum assured (₹)	Insurance premium paid during 2013-14 (₹)
(i)	14/5/2011	Self	1,00,000	25,000
(ii)	11/6/2012	Spouse	1,25,000	15,000
(iii)	31/7/2013	Handicapped Son (section 80U disability)	2,00,000	40,000

(3)	**Payment of medical insurance premium by the following persons to insure their health:**	

Payer	Amount in ₹	Mode of payment
Mr. A (aged 55 years)	20,000	Account payee cheque
Mr. B (aged 52 years)	15,000	Cash
Mr. C (aged 48 years)	10,000	Crossed cheque

(4)	Mr. B paid interest on loan taken for the purchase of house in which he currently resides. He is claiming benefit of self-occupation under section 23(2) in respect of this house. He does not own any other house.	1,90,000
	Repayment of principal amount of loan taken for purchase of the said house	1,50,000
	(The housing loan of ₹ 23 lakhs was sanctioned by HDFC on 3.4.2013 and disbursed in full on 10.4.2013, being the date of purchase of house property, the cost of which was ₹ 28 lakhs).	
(5)	Contribution by Mr.A by cheque to National Children's Fund during the year.	30,000
(6)	Mr. B makes the following donations during the P.Y.2013-14 -	
	Donation to BJP by crossed cheque	50,000
	Donation to Electoral trust by cash	50,000

What would be the tax consequence if Mr. A and Mr. C sold their entire investment in units of equity oriented fund in May 2014?

Assessment of companies

9. Alpha Ltd. earned a net profit of ₹ 15,75,000 after debit/credit of the following items to its profit and loss account for the year ended on 31.3.2014:

(a)	Items debited to Profit and Loss Account	₹
	Provision for income-tax	1,75,000
	Interest on income-tax	9,000
	Dividend distribution tax	32,000
	Provision for deferred tax	21,000
	Securities Transaction Tax	11,000
	Transfer to General Reserve	32,000
	Provision for gratuity based on actuarial valuation	27,000
	Provision for diminution in the value of investment	17,000

	Proposed dividend	30,000
	Preference dividend	18,000
	Expenditure to earn agricultural income	12,000
	Expenditure to earn LTCG exempt under section 10(38)	7,000
	Expenditure to earn dividend income	4,500
	Depreciation (including depreciation of ₹ 14,000 on revaluation)	36,000
(b)	**Items credited to Profit and Loss Account**	
	Amount credited to P& L A/c from Special Reserve	24,000
	Amount credited to P& L A/c from Revaluation Reserve	18,000
	Agricultural income	27,000
	LTCG exempt under section 10(38)	19,000
	Dividend income	21,000

The company provides the following additional information:

Brought forward Business Loss/Unabsorbed Depreciation:

Assessment Year	Amount as per books	
	Loss	Depreciation
2011-12	40,000	70,000
2012-13	50,000	40,000
2013-14	30,000	Nil

You are required to examine the applicability of section 115JB of the Income-tax Act, 1961 and compute book profit and the tax credit, if any, to be carried forward, assuming that the total income computed as per the provisions of the Income-tax Act, 1961 is ₹ 10,00,000.

10. ABC Ltd., an Indian company, receives the following dividend income during the P.Y. 2013-14 -

(1) from shares held in BCD Inc., a Danish company, in which it holds 25% of nominal value of equity share capital – ₹ 65,000;

(2) from shares held in EFG Inc., an English company, in which it holds 31% of nominal value of equity share capital – ₹ 1,50,000.

(3) from shares held in HIJ Inc., a Dutch company, in which it holds 62% of the nominal value of equity share capital - ₹ 1,07,000

(4) from shares held in Indian subsidiaries, on which dividend distribution tax has been paid by such subsidiaries – ₹ 47,000.

ABC Ltd. has paid remuneration of ₹ 16,000 for realising dividend, the break up of which

is as follows –

(1) ₹ 4,000 (BCD Inc.); (2) ₹ 7,000 (EFG Inc.); (3) ₹ 5,000 (Indian subsidiaries)

The business income of ABC Ltd. computed under the provisions of the Act is ₹ 48 lakh. Compute the total income and tax liability of ABC Ltd., ignoring MAT. Assuming that ABC Ltd. has distributed dividend of ₹ 4,20,000 in February, 2014, compute the additional income-tax payable by it under section 115-O. Ignore the provisions of double taxation avoidance agreement, if any, applicable in this regard.

Assessment of various entities

11. M/s. ABC & Co., a resident firm, has income of ₹ 95 lakh under the head "Profits and gains of business or profession". It undertook two projects in Tamil Nadu - a highway project in East Coast Road (ECR) which involves expansion of existing roads by constructing additional lanes and a roadway project in Old Mahabalipuram Road (OMR), which involves relaying of existing roads. The profit from the highway project in ECR is ₹ 50 lakh and roadway project in OMR is ₹ 30 lakh. The firm is also engaged in cement trading, the profit from which is ₹15 lakh. The trading unit transferred cement worth ₹ 5 lakh to the ECR project at ₹ 2 lakh. Compute the tax payable by M/s. ABC & Co. for A.Y.2014-15, assuming that it has no other income during the P.Y.2013-14.

12. A securitization trust distributes income of ₹ 6,50,000 on 17th August, 2013 to its investors comprising of -

	Category of investor	Income distributed (₹)
(i)	Mutual funds exempt under section 10(23D)	1,50,000
(ii)	Individuals and HUFs	1,00,000
(iii)	Companies	4,00,000

Compute the additional income-tax payable by the trust under section 115TA. Assuming that the additional income-tax payable as per section 115TA is paid to the credit of the Central Government on 7th November, 2013, compute the interest, if any payable, under section 115TB.

Assessment Procedure

13. (a) The assessment of Ashiana Pvt. Ltd. for the A.Y. 2012-13 was completed under section 143(3). On 25-3-2014, the Assessing Officer reopened the assessment on the ground that certain expenditure which ought to have been disallowed under section 40(a) was not done and hence, there has been escapement of income. During the course of hearing, he wants to take up some other matter also, which is not covered by the reason recorded. The company objects to the same, contending that the same is not permissible as per the provisions of the Income-tax Act, 1961. Examine the correctness of contention of Ashiana Pvt. Ltd.

(b) Can the Assessing Officer issue notice under section 148 to reopen the same

assessment order on the same grounds for which the Commissioner had issued notice under section 263? Examine critically in the context of provisions of the Income-tax Act, 1961.

14. Mr. Hari, aged 65 years, is a resident and ordinarily resident in India for the A.Y.2014-15. He owns a house property in Dubai, which he purchased on 30.4.2004, and he also has a bank account in the Bank of Dubai.

    (a) Mr. Hari contends that since his total income of ₹ 2,40,000 for the P.Y.2013-14, comprising of income from house property and bank interest, is less than the basic exemption limit, he need not file his return of income for A.Y.2014-15.

    (b) Mr. Hari also contends that the notice issued by the Assessing Officer under section 148 in June, 2014 for A.Y.2005-06 is not valid due to the following reasons –

        (i) There is no escaped income relating to that year; and

        (ii) The time period prescribed in section 149 for issuing notice under section 148 for A.Y.2005-06 has since lapsed.

    Discuss the correctness of the above contentions of Mr. Hari.

Appeals and Revision

15. Discuss the correctness or otherwise of the following statements with reference to the provisions of the Income-tax Act, 1961 –

    (i) An appeal before Appellate Tribunal cannot be decided in the event of difference of opinion between the Judicial member and the Accountant member on a particular ground;

    (ii) The Appellate Tribunal is empowered to grant indefinite stay for the demand disputed in the appeals before it.

Deduction, Collection and Recovery of tax

16. Discuss the applicability of provisions for deduction of tax at source under section 194H in the following cases –

    (i) Discount given to stamp vendors on purchase of stamp papers;

    (ii) Discount given on supply of SIM cards and recharge coupons by a telecom company to its distributors under a prepaid scheme.

Double Taxation Relief

17. Mr. Vallish, a resident Indian aged 36 years, earned a sum of ₹ 15 lakh during the P.Y.2013-14 from playing kabaddi matches in a country with which India does not have a double taxation avoidance agreement (DTAA). Tax of ₹ 3 lakh was levied on such income in the source country. In India, he earned a sum of ₹ 18 lakh during the P.Y.2013-14 from playing kabaddi matches. He has deposited ₹ 1 lakh in public

provident fund. He qualifies as a new retail investor under the Rajiv Gandhi Equity Savings Scheme, 2013 and has invested ₹ 50,000 in listed equity shares under the said scheme. He paid medical insurance premium of ₹ 18,000 to insure his health and ₹ 22,000 to insure the health of his father, aged 61 years, who is not dependent on him. Compute his income-tax liability for the A.Y.2014-15.

Transfer Pricing

18. Examine the following transactions and discuss whether the transfer price declared by the following assessees, who have exercised a valid option for application of safe harbour rules, can be accepted by the Income-tax Authorities –

	Assessee	International transaction	Aggregate value of transactions entered into in the P.Y.2013-14	Declared Operating Margin	Operat-ing Expense
(1)	A Ltd., an Indian company	Provision of system support services to X Inc., which is a "specified foreign company" in relation to A Ltd.	₹ 600 crore	₹ 90 crore	₹450 crore
(2)	B Ltd., an Indian company	Provision of data processing services with the use of information technology to Y Inc., its foreign subsidiary.	₹ 400 crore	₹ 62 crore	₹300 crore
(3)	C & Co., a partnership firm registered under the Partnership Act, 1932	Provision of contract R & D services relating to development of internet technology, to XYZ & Co., a foreign firm, which holds 12% interest in C & Co.	₹ 100 crore	₹ 20 crore	₹ 70 crore
(4)	D Ltd., an Indian company	Provision of contract R & D services relating to generic pharmaceutical drug, to ABC Inc., a foreign company which guarantees 15% of the total borrowings of D Ltd.	₹ 50 crore	₹ 9 crore	₹ 30 crore
(5)	Sole proprietary concern of Mr.E, solely engaged in the original manufacture and export of	100% export of automobile transmission and steering parts to LMN LLP, a foreign LLP, controlled by Mr.E jointly with his relatives.	₹ 12 crore	₹ 1 crore	₹ 10 crore

	automobile transmission and steering parts.				
(6)	F Ltd. an Indian company, solely engaged in the original manufacture and export of non-core auto components.	100% export of non-core auto components to GKG Inc., a foreign company. F Ltd. appoints two-thirds of the Board of Directors of GKG Inc.	₹ 12 crore	₹ 1 crore	₹ 10 crore

In all the above cases, it may be assumed that the Indian entity which provides the services assumes insignificant risk. It may also be assumed that the foreign entities referred to above are non-resident in India.

Would your answer change, if in any of the cases mentioned above, the foreign entity is located in a notified jurisdictional area?

Wealth-tax

19. Mr. Sridhar, an individual, furnishes the following particulars of his assets and liabilities as on 31.3.2014:

Assets:	**₹ in lakhs**
Residential house at Mumbai	40
Residential house at Chennai	25
Plot of land comprising an area of 325 square meters at New Delhi	90
House at Calcutta exclusively used for carrying on his business	22
Commercial complex at Chennai	30
Residential house at Bangalore let out for 310 days during the relevant previous year	15
Motor cars used in business of running them on hire	12
Shares in private limited companies	7
Cash in hand	2
Gold jewellery	8
Liabilities:	
Loan borrowed for purchase of land at New Delhi	30
Loan borrowed for purchase of shares in private limited companies	5
Loan borrowed for purchase of gold jewellery	4

The amounts stated against assets, except cash in hand, are the values determined as per section 7 of the Wealth-tax Act, 1957 read with Schedule III thereto.

Compute the net wealth of Mr. Sridhar as on valuation date 31.3.2014.

State the reasons for inclusion or exclusion of the various items.

20. Mrs. Gauri owns two residential houses, one in Chennai and another in Pune. Both the houses are meant to be used for residential purposes by Gauri and her family. The particulars of the houses are as follows:

    (i) The house at Chennai was purchased by her in March, 1980 for ₹ 12 lacs. The house was occupied by her maternal aunt, Mrs. Jyothi , without rent for four months from 1st April, 2013 to 31st July, 2013. The value of the house as per Schedule III to the Wealth-tax Act, 1957 on 31st March, 2014 is ₹ 28 lacs. Its value on the same basis as on 31st March, 1980 was ₹ 15 lacs.

    (ii) The house at Pune was purchased in February, 2006 for ₹ 11 lacs. The values of the house as per Schedule III to the Wealth-tax Act, 1957, on 31st March, 2006 and 31st March, 2014 are ₹ 7 lacs and ₹ 10 lacs, respectively.

    You are required to compute the value of each house for the purpose of computation of net wealth of Mrs. Gauri on the valuation date 31.03.2014.

SUGGESTED ANSWERS/HINTS

1. (a) The Karnataka High Court, in *DIT (Exemptions) v. Meenakshi Amma Endowment Trust (2013) 354 ITR 219,* opined that an application under section 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in a case where the registration is sought much later after formation of the trust.

The High Court further observed that the corpus fund included contribution made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities. The assessee-trust had not also collected any donation for the activities of the trust, by the time its application came up for consideration before them. When the application for registration was made, the trust, therefore, did not have sufficient funds for commencement of its activities.

The High Court observed that, with the money available with the trust, it cannot be expected to carry out activity of charity immediately. Consequently, in such a case, it cannot be concluded that the trust has not intended to do any activity of charity. In such a situation, where application is made shortly after formation of the trust, the objects of the trust as mentioned in the trust deed have to be taken into consideration by the authorities for satisfying themselves about the genuineness of the trust and not the activities carried on by it. Later on, if it is found from the subsequent returns filed by the trust, that it is not carrying on any charitable activity, it would be open to the concerned authorities to withdraw the registration granted or cancel the registration as per the provisions of section 12AA(3).

Applying the rationale of the above ruling, the Commissioner cannot deny registration solely on the ground that the trust had not commenced any charitable activity in this case, since the trust has applied for registration under section 12A within two months after its formation and the corpus fund comprised only of contribution made by the trustees. The Commissioner has to take into consideration the objects of the trust as mentioned in the trust deed to satisfy itself about the genuineness of the trust.

(b) As per the provisions of section 12AA(2), every order granting or refusing registration under section 12AA(1)(b), **shall** be passed by the registering authority before the expiry of six months from the end of the month in which the application was received under section 12A(1)(a) or section 12A(1)(aa).

The Madras High Court, in *CIT v. Karimangalam Onriya Pengal Semipu Amaipu Ltd. (2013) 354 ITR 483,* noted the decision of the Orissa High Court, in *Srikhetra, A.C. Bhakti-Vedanta Swami Charitable Trust v. ACIT (2006) (II) OLR 75,* wherein it was held that the period of six months as provided under section 12AA(2) is not mandatory. In that case, the Orissa High Court observed that in order to ascertain whether a provision is mandatory or not, the expression 'shall' is not always decisive. The nature of the statutory provision, whether mandatory or directory, has to be ascertained not only from the wording of the statute, but also from the nature and design of the statute and the purpose sought to be achieved. Further, since the consequence for non-adherence of the time limit of six months is not spelt out in the statute, it cannot be said that passing the order within such time limit is mandatory in nature. The Orissa High Court also opined that in the absence of any clear statutory intent to the contrary, when public duty is to be performed by the public authorities, the time-limit which is granted by the statute is normally directory and not mandatory. Hence, though the word 'shall' has been used in section 12AA(2), the period of six months provided thereunder is not mandatory but directory in nature.

Accordingly, the Madras High Court held that the time frame mentioned in section 12AA(2) is only directory in nature and non-consideration of the registration application within the said time frame of six months would not amount to "deemed registration".

Similar ruling was pronounced by the Madras High Court in the case of *CIT v. Sheela Christian Charitable Trust (2013) 354 ITR 478*, holding that there is no automatic or deemed registration if the application filed under section 12AA was not disposed of within the stipulated period of six months.

Applying the rationale of the Madras High Court ruling in the above cases, the contention that the trust is deemed to be registered, since its application for registration has not been disposed of within six months, is incorrect.

2. (a) Expenditure incurred on glow-sign boards displayed at dealer outlets

The Delhi High Court, in *CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR*

49, noted the following observations of the Punjab and Haryana High Court, in *CIT v. Liberty Group Marketing Division (2009) 315 ITR 125,* while holding that such expenditure was revenue in nature -

(i) The expenditure incurred by the assessee on glow sign boards does not bring into existence an asset or advantage for the enduring benefit of the business, which is attributable to the capital.

(ii) The glow sign board is not an asset of permanent nature. It has a short life.

(iii) The materials used in the glow sign boards decay with the effect of weather. Therefore, it requires frequent replacement. Consequently, the assessee has to incur expenditure on glow sign boards regularly almost every year.

(iv) The assessee incurred expenditure on the glow sign boards with the object of facilitating the business operation and not with the object of acquiring an asset of enduring nature.

The Delhi High Court concurred with the above observations of the Punjab & Haryana High Court and held that such expenditure on glow sign boards displayed at dealer outlets is revenue in nature.

(b) Share issue expenses incurred by a company, where the public issue could not ultimately materialize on account of non-clearance by SEBI

The issue relating to the nature of such expenditure came up before the Madras High Court in *Mascon Technical Services Ltd. v. CIT (2013) 358 ITR 545.* In that case, the Court observed that the assessee had taken steps to go in for a public issue and incurred share issue expenses for the same. However, it could not go in for the public issue by reason of the orders issued by the SEBI just before the proposed issue.

The High Court observed that though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts. The expenditure, therefore, constitutes a capital expenditure.

(c) Expenditure incurred for purchase of second-hand medical equipment for use as spare parts of existing equipment

The Karnataka High Court, in *Dr. Aswath N. Rao v. ACIT (2010) 326 ITR 188,* held that since the second hand machinery purchased by the assessee was for use as spare parts for the existing old machinery, the same had to be allowed as revenue expenditure.

3. Computation of depreciation allowance under section 32 for the A.Y. 2014-15

Particulars		Plant & Machinery	
		15%	60%
		(₹ in crores)	
WDV as on 01.04.2013		27.00	-
Add: Plant and Machinery acquired during the year			
- Second hand machinery	18.00		
- New plant and machinery	110.00		
- Air conditioner installed in office	0.15		
		128.15	
Computers (including accessories, peripherals etc. acquired during the year) ***[See Note 1 below]***		-	0.40
		155.15	0.40
Less: Asset sold during the year		3.00	Nil
WDV as on 31.3.2014 (before charging depreciation)		152.15	0.40
Less: Depreciation for the P.Y.2013-14 ***[See Working Note]***		32.22	0.12
WDV as on 1.4.2014		**119.93**	**0.28**
Working Note : Computation of depreciation for the P.Y.2013-14			
Normal depreciation [Under section 32(1)(ii)]			
Depreciation@30% on computers put to use for less than 180 days (50% of 60% × ₹ 0.40 crore)		-	0.12
Depreciation on plant and machinery (15% block)		17.42	
(₹ 72 crore × 7.5%) + [(₹ 152.15 crore - ₹ 72 crore) × 15%]			
Additional depreciation [Under section 32(1)(iia)]			
- New plant and machinery installed on 24.6.2013 (₹ 38 crore × 20%)	7.60		
- on 9.11.2013 (₹ 72 crore × 10%)	7.20	14.80	Nil
Total depreciation		**32.22**	**0.12**

Computation of deduction under section 32AC for the A.Y.2014-15

Particulars	(₹ in crore)
15% of ₹ 110 crore, being aggregate investment in new plant and machinery acquired and installed during the P.Y.2013-14 ***[See Note 2 below]***	16.50

Notes:

(1) The Delhi High Court, in CIT v. BSES Yamuna Powers Ltd. (2013) 358 ITR 47,

held that computer accessories and peripherals such as printers, scanners and server form an integral part of the computer system and they cannot be used without the computer. Consequently, they would be eligible for depreciation at 60%, being the rate applicable to computers including computer software. Also, in CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR 49, the Delhi High Court held that depreciation on UPS is allowable@60%, being the eligible rate of depreciation on computers including computer software and not at the general rate of 15% applicable to plant and machinery.

(2) *For the A.Y.2014-15, the company would be entitled for deduction under section 32AC since the investment in new plant and machinery acquired and installed during the P.Y.2013-14 is ₹ 110 crores (i.e., more than ₹ 100 crores). The deduction under section 32AC would be in addition to the depreciation allowable under section 32 for that year. However, the deduction under section 32AC would not be reduced to arrive at the written down value of plant and machinery.*

It may be noted that investment in second hand plant and machinery and air-conditioners and computers installed in office would neither be eligible for deduction under section 32AC nor for additional depreciation under section 32(1)(iia).

4. (a) Tax implications on sale of rural agricultural land and house property representing a capital asset in the hands of Mr. Harish, a salaried employee

(i)	**Tax implications in the hands of Mr.Harish, a salaried employee**
	Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. Harish. However, capital gains would arise on sale of house property, being a capital asset. As per section 50C, the stamp duty value of house property (i.e., ₹ 85 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, ₹ 45 lakh (i.e., ₹ 85 lakh – ₹ 40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2014-15. It may be noted that under section 50C, there is no option to adopt the stamp duty value on the date of agreement, even if the date of agreement is different from the date of registration and part of the consideration has been received on or before the date of agreement otherwise than by way of cash.
(ii)	**Tax implications in the hands of the buyer - Mr.Suresh, a retail trader**
	The house property purchased would be a capital asset in the hands of Mr. Suresh, who is a retail trader. The provisions of section 56(2)(vii) would be attracted in the hands of Mr. Suresh who has received immovable property, being a capital asset, for inadequate consideration. For the purpose of section 56(2)(vii), Mr. Suresh can take the stamp duty value on the date of agreement instead of the date of registration since he has paid a part of the

	consideration by a mode other than cash on the date of agreement. Therefore, ₹ **15 lakh,** being the difference between the stamp duty value of the property **on the date of agreement** (i.e., ₹ 75 lakh) and the actual consideration (i.e., ₹ 60 lakh) would be taxable as per section 56(2)(vii) under the head "**Income from other sources**" in the hands of Mr. Suresh. Since rural agricultural land is not a capital asset, the provisions of section 56(2)(vii) are not attracted in respect of receipt of agricultural land for inadequate consideration, since the definition of "property" under section 56(2)(vii) includes only **capital assets** specified thereunder.
(iii)	**TDS implications in the hands of the buyer, Mr.Suresh**
	Since the sale consideration of house property exceeds ₹ 50 lakh, Mr.Suresh is required to deduct tax at source under section 194-IA. The tax to be deducted under section 194-IA would be ₹ 60,000, being 1% of ₹ 60 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

(b) Tax implications on sale of house property representing stock-in-trade in the hands of Mr. Harish, a property dealer

(i)	**Tax implications in the hands of Mr. Harish for A.Y.2014-15** If Mr. Harish is a property dealer who has sold the house property in the course of his business, the provisions of section 43CA would be attracted, since the house property represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value. For the purpose of section 43CA, Mr. Harish can take the stamp duty value on the date of agreement instead of the date of registration, since he has received part of the consideration by a mode other than cash on the date of agreement. Therefore, **₹ 35 lakh**, being the difference between the stamp duty value on the date of agreement (i.e., ₹ 75 lakh) and the purchase price (i.e., ₹ 40 lakh), would be chargeable as **business income** in the hands of Mr. Harish.
(ii)	**TDS implications and taxability in the hands of Mr. Suresh for A.Y.2014-15** There would be no difference in the TDS implications or taxability in the hands of Mr. Suresh, whether Mr. Harish is a property dealer or a salaried employee. Therefore, the provisions of section 56(2)(vii) would be attracted in the hands of Mr. Suresh who has received house property, being a capital asset, for inadequate consideration. The TDS provisions under section 194-IA would also be attracted since the actual consideration for house property exceeds ₹50 lakh.

5. Applying the rationale of the Delhi High Court ruling in *CIT v. Gita Duggal (2013) 357 ITR 153*, wherein the facts are similar to the facts stated in the question -

(i) The full value of consideration would include the amount of ₹ 5 crore received by Mr. X as consideration as well as the cost of construction incurred by Arihant Builders in relation to the three floors handed over to Mr. X. Therefore, the full value of consideration in this case is ₹ 8 crore, being ₹ 5 crore plus ₹ 3 crore representing the cost of construction of three floors handed over to Mr.X, the owner.

(ii) Yes, Mr. X is eligible for exemption under section 54F. Since the cost of construction of the floors handed over to Mr.X has been included in the full value of consideration, the same would also represent investment by Mr.X in residential house. Hence, Mr. X is eligible for exemption under section 54F.

(iii) Section 54F uses the expression "residential house" and not "residential unit". Section 54F requires the assessee to acquire a "residential house" and so long as the assessee acquires a building, which may be constructed, for the sake of convenience, in such a manner as to consist of several units which can, if the need arises, be conveniently and independently used as an independent residence, the requirement of the section should be taken to have been satisfied. There is nothing in the section which requires the residential house to be constructed in a particular manner. The only requirement is that it should be for residential use and not for commercial use. The physical structuring of the new building, whether lateral or vertical, should not come in the way of considering the building as a residential house.

The fact that the residential house consists of several independent units cannot be permitted to act as an impediment to the allowance of the exemption under section 54F. It is neither expressly nor by necessary implication prohibited. Therefore, Mr.X is entitled to exemption of capital gains in respect of investment of ₹ 3 crores in the residential house, comprising of independent residential units handed over to him.

6. (a) Applicability of the provisions of section 56(2)(viib)

Co.	Face value of shares (₹)	FMV of shares (₹)	Consideration received (₹)	Applicability of section 56(2)(viib)
Win (P) Ltd.	300	350	370	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium (i.e., issue price exceeds the face value of shares). The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib).i.e., ₹ 20 lakh, being ₹ 20 (₹ 370 - ₹ 350) per share ×

				1,00,000 shares, shall be treated as income in the hands of Win (P) Ltd.
Gain (P) Ltd.	300	350	330	The provisions of section 56(2)(viib) are attracted since the shares are issued at a premium. However, no sum shall be chargeable to tax under the said section in the hands of Gain (P) Ltd. as the shares are issued at a price less than the FMV of shares.
Profit (P) Ltd.	300	280	290	Section 56(2)(viib) is not attracted since the shares are issued at a discount, though the issue price is greater than the FMV.
Top (P) Ltd.	300	275	310	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium. The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib). Therefore, ₹ 140 lakh, being ₹ 35 (₹ 310 - ₹ 275) per share × 4,00,000 shares, shall be treated as income in the hands of Top (P) Ltd.

(b) This question came up before the Bombay High Court in *CIT v. Parle Plastics Ltd. (2011) 332 ITR 63*. The Bombay High Court observed that under section 2(22), dividend does not include*, inter alia,* any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company.

In that case, 42% of the total assets of the lending company were deployed by it by way of loans and advances. Further, if the income earned by way of interest is excluded, the other business had resulted in a net loss. These factors were considered in concluding that lending of money was a substantial part of the business of the company. Since lending of money was a substantial part of the business of the lending company, the money given by it by way of advance or loan to the assessee could not be regarded as a dividend, as it had to be excluded from the definition of "dividend" by virtue of the specific exclusion in section 2(22).

The expression used in the exclusion provision of section 2(22) is "substantial part of the business". Sometimes, a portion which contributes a substantial part of the turnover, though it contributes a relatively small portion of the profit, would be termed as a substantial part of the business. Similarly, a portion which is relatively small as compared to the total turnover, but generates a large portion, say more than 50% of the total profit of the company, may also be a substantial part of its business.

Percentage of turnover in relation to the whole as also the percentage of the profit in relation to the whole and sometimes even percentage of manpower used for a particular part of the business in relation to the total manpower or work force of the company may be required to be taken into consideration for determining the substantial part of business.

The capital employed for a specific division of a company in comparison to total capital employed may also be relevant to determine whether the part of the business constitutes a substantial part.

7. The facts of the case are similar to the facts of *Pramod Mittal v. CIT (2013) 356 ITR 456*, wherein the Delhi High Court observed that upon dissolution, the partnership firm ceased to exist. The partnership firm and the proprietorship concern are two separate and distinct units for the purpose of assessment.

As per section 170(1), the partnership firm shall be assessed as such from 1st April of the previous year till the date of dissolution (i.e., 31st August, 2013, in this case). Thereafter, the income of the sole-proprietorship shall be taxable in the hands of the assessee as an individual. Thus, section 170(1) provides as to who will be assessable in respect of the income of the previous year from business, when there is a change in the person carrying on business by succession.

Section 78(2), however, deals with carry forward of losses in case of succession of business. It provides that only the person who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. An exception provided thereunder is in the case of succession by inheritance.

Therefore, section 170(1) providing the person in whose hands income is assessable in case of succession and section 78(2) providing for carry forward of losses in case of succession of business, deal with different situations and resultantly, there is no contradiction between these sections.

The income earned by the sole proprietor would include his share of loss as an individual but not the loss suffered by the erstwhile partnership firm in which he was a partner. The exception given in section 78(2), permitting carry forward of losses by the successor in case of inheritance, is not applicable in the present case since the partnership firm was dissolved and ceased to continue. Taking over of business by a partner cannot be considered as a case of inheritance due to death as per the law of succession. The Delhi High Court opined that the decision in *Madhukant M. Mehta's case* and *Saroj Aggarwal's case* cannot be applied since this is not a case of succession by inheritance. Therefore, the Court held that loss suffered by the erstwhile partnership firm before dissolution of the firm cannot be carried forward by the successor sole-proprietor, since it was not a case of succession by inheritance.

Applying the rationale of the Delhi High Court ruling to the case on hand, Mr. Arjun is not entitled to set-off the loss of the erstwhile partnership firm M/s. XYZ & Co. against the income earned by him as a sole-proprietor, since succession of a partnership firm by a sole-proprietor, being an erstwhile partner, is not a case of inheritance.

8. Computation of total income for A.Y.2014-15

	Particulars	Mr. A ₹	Mr. B ₹	Mr. C ₹
	Salary	9,25,000	10,45,000	11,15,000
	Income from house property ***[See Note 4]***		(1,50,000)	
	Income from other sources (Interest)	75,000	85,000	95,000
(A)	**Gross total income**	**10,00,000**	**9,80,000**	**12,10,000**
	Less: **Deductions under Chapter VIA**			
	Under section 80C			
	Deposit in PPF	80,000		
	LIC premium paid ***[See Note 1]***			62,500
	Principal repayment of housing loan (restricted to maximum ₹1,00,000) ***[See Note 4]***		1,00,000	
	Under section 80CCG			
	Investment in listed equity shares/ units of equity oriented fund of Rajiv Gandhi Equity Savings Scheme ***[See Note 2]***	22,500	25,000	Nil
	Under section 80D			
	Medical insurance premium ***[See Note 3]***	15,000	Nil	10,000
	Under section 80EE			
	Interest on housing loan ***[See Note 4]***		40,000	
	Under section 80G			
	Contribution to National Children's Fund ***[See Note 5]***	30,000		
	Under section 80GGC ***[See Note 6]***			
	Donation to BJP by crossed cheque		50,000	
	Cash donation to Electoral Trust		Nil	
(B)	**Total deduction under Chapter VIA**	**1,47,500**	**2,15,000**	**72,500**
(C)	**Total Income (A) – (B)**	**8,52,500**	**7,65,000**	**11,37,500**

Notes:

(1) Deduction u/s 80C in respect of life insurance premium paid by Mr. C

Date of issue of policy	Person insured	Actual capital sum assured	Insurance premium paid during 2013-14	Restricted to % of sum assured	Deduction u/s 80C
14/5/2011	Self	1,00,000	25,000	20%	20,000
11/6/2012	Spouse	1,25,000	15,000	10%	12,500
31/7/2013	Handicapped Son (section 80U disability)	2,00,000	40,000	15%	30,000
			Total		**62,500**

(2) Deduction under section 80CCG in respect of investment made as per the Rajiv Gandhi Equity Savings Scheme

Particulars		Mr. A	Mr. B
		₹	₹
(i)	Investment in listed equity shares	15,000	62,000
(ii)	Investment in units of equity-oriented fund	30,000	-
Total investment		**45,000**	**62,000**
50% of the above		22,500	31,000
Deduction under section 80CCG (restricted to a maximum of ₹25,000)		**22,500**	**25,000**

Mr. C is not eligible for deduction under section 80CCG since his gross total income exceeds ₹12 lakh.

(3) Medical Insurance Premium

(i) Medical insurance premium of ₹ 20,000 paid by account payee cheque by Mr. A is allowed as a deduction under section 80D, subject to a maximum of ₹ 15,000.

(ii) Medical insurance premium paid by cash is not allowable as deduction. Hence, Mr. B is not eligible for deduction under section 80D in respect of medical insurance premium of ₹ 15,000 paid in cash.

(iii) Mr. C is eligible for deduction of ₹ 10,000 under section 80D in respect of medical insurance premium paid by crossed cheque.

(4) Deduction in respect of interest and principal repayment of housing loan

Mr. B is eligible for a maximum deduction of ₹ 1,50,000 under section 24 in

	respect of interest on housing loan taken in respect of a self-occupied property, for which he is claiming benefit of "Nil" annual value. Therefore, ₹ 1,50,000 would represent his loss from house property. Mr. B is eligible for deduction of ₹ 40,000 under section 80EE, in respect of the balance interest on housing loan (₹ 1,90,000 – ₹ 1,50,000), since the following conditions are satisfied – (i) The loan is sanctioned by HDFC, a financial institution, during the period between 1.4.2013 and 31.3.2014; (ii) The loan amount sanctioned is less than ₹ 25 lakh; (iii) The value of the house property is less than ₹ 40 lakh; (iv) He does not own any other house property. Further, he is eligible for deduction in respect of principal repayment of housing loan subject to a maximum of ₹1 lakh under section 80C.
(5)	Contribution to National Children's Fund qualifies for 100% deduction under section 80G with effect from A.Y.2014-15. Therefore, Mr. A is entitled to 100% deduction of the sum of ₹ 30,000 contributed by him by way of cheque to National Children's Fund.
(6)	Mr. B is eligible for deduction under section 80GGC in respect of donation to a political party made otherwise than by way of cash. However, cash donation to electoral trust would not qualify for deduction under section 80GGC with effect from A.Y.2014-15.

Note *– In case Mr. A sells all the units of equity oriented fund in May 2014, the amount of ₹ 15,000 (i.e., 50% of ₹ 30,000), being deduction allowed to him under section 80CCG in A.Y.2014-15, would be subject to tax in the A.Y.2015-16, since the condition of the minimum fixed lock-in period of one year from the end of P.Y.2013-14 stipulated under the Rajiv Gandhi Equity Scheme, 2013, has been violated in this case. However, in the case of Mr. C, since deduction under section 80CCG was not allowed during the A.Y.2014-15 on account of his gross total income exceeding ₹ 12 lakh, no amount relating to that year can be subject to tax in the A.Y.2015-16, being the year of violation of condition.*

9. Computation of Book Profit of Alpha Ltd. under section 115JB

Particulars		₹	₹
Net Profit as per Profit & Loss Account			15,75,000
Add: **Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB**			
Income-tax paid or payable or provision therefor			
Provision for income-tax	1,75,000		
Interest on income-tax	9,000		
Dividend distribution tax	32,000	2,16,000	

Provision for deferred tax		21,000	
Transfer to General Reserve		32,000	
Provision for diminution in the value of investment		17,000	
Dividend paid or proposed			
Proposed dividend	30,000		
Preference dividend	18,000	48,000	
Expenditure to earn income exempt u/s 10 [except section 10(38)]			
Expenditure to earn agricultural income [exempt u/s 10(1)]	12,000		
Expenditure to earn dividend income [exempt u/s 10(34)]	4,500	16,500	
Depreciation		36,000	3,86,500
			19,61,500
Less: **Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB**			
Amount credited to profit and loss account from Special Reserve		24,000	
Depreciation (excluding depreciation on account of revaluation of fixed assets) (i.e. ₹ 36,000 – ₹ 14,000)		22,000	
Amount credited to profit and loss account from revaluation reserve (to the extent of depreciation on revaluation)		14,000	
Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less taken on cumulative basis		1,10,000	
Income exempt u/s 10 [except section 10(38)]			
Agricultural Income [since it is exempt under section 10(1)]		27,000	
Dividend income [since it is an income exempt under section 10(34)]		21,000	2,18,000
Book Profit			**17,43,500**
18.5% of book profit			3,22,548
Add: Education cess @ 2%		6,451	
Secondary and higher education cess @ 1%		3,225	9,676
Tax liability under section 115JB			**3,32,224**
Total income computed as per the provisions of the Income-tax Act, 1961		**10,00,000**	
Tax payable @ 30%			3,00,000

Add: Education cess @ 2%	6,000	
Secondary and higher education cess @ 1%	3,000	9,000
Tax Payable as per the Income-tax Act, 1961		**3,09,000**

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 18.5% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 18.5% thereof plus education cess @2% and secondary and higher education cess @ 1%. Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 18.5% of book profit, the book profit of ₹ 17,43,500 is deemed to be the total income and income-tax is payable @ 18.5% thereof plus education cess @2% and secondary and higher education cess @1%. The tax liability, therefore, works out to ₹ 3,32,224.

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, will be allowed as tax credit in the subsequent years. The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act. This tax credit is allowed to be carried forward for ten assessment years succeeding the assessment year in which the credit became allowable. Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Particulars	₹
Tax on book profit under section 115JB	3,32,224
Less: Tax on total income computed as per the other provisions of the Act	3,09,000
Tax credit to be carried forward	**23,224**

Notes:

1. Securities transaction tax does not form part of income-tax and hence, should not be added back to net profit for computing book profit.
2. Provision for gratuity based on actuarial valuation is a provision for meeting an ascertained liability. Therefore, it should not be added back for computing book profit.
3. Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which is credited to profit and loss account, would be deducted in arriving at the book profit. However, deduction of such long-term capital gains is

not allowed for computing book profit. Consequently, expenditure to earn such income should not be added back to arrive at the book profit. Section 10(38) also provides that such long term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under section 115JB.

10. Computation of total income of ABC Ltd. for A.Y. 2014-15

Particulars	₹
Profits and gains of business or profession	48,00,000
Income from other sources ***(See Note below)***	3,18,000
Total income	**51,18,000**

***Note* – Dividend income taxable under "Income from other sources"**

Particulars	₹
From BCD Inc., a Danish company, – net dividend (i.e., ₹ 65,000 – ₹ 4,000) is taxable at normal rates	61,000
From EFG Inc., an English company – gross dividend is taxable@15% under section 115BBD [no deduction is allowable in respect of any expenditure as per section 115BBD(2)]	1,50,000
From HIJ Inc., a Dutch company – gross dividend is taxable@15% under section 115BBD [no deduction is allowable in respect of any expenditure as per section 115BBD(2)]	1,07,000
From shares in Indian subsidiaries ₹ 47,000 – exempt under section 10(34) since dividend distribution tax has been paid under section 115-O [As per section 14A, no deduction is allowable in respect of expenditure incurred to earn exempt income]	Nil
	3,18,000

Computation of tax liability of ABC Ltd. for the A.Y.2014-15

Particulars	₹
Tax@15% under section 115BBD on ₹ 2,57,000 (gross dividend)	38,550
Tax@30% on balance income of ₹ 48,61,000	14,58,300
	14,96,850
Add: Education cess@2% and Secondary and higher education cess@1%	44,906
Tax liability	**15,41,756**

Computation of additional income-tax payable by ABC Ltd. under section 115-O		
Particulars		**₹**
Amount distributed by way of dividend		4,20,000
Less: Dividend received from Indian subsidiaries, on which DDT payable under section 115-O has been paid	47,000	
Dividend received from foreign subsidiary, HIJ Inc., on which tax is payable under section 115BBD	1,07,000	1,54,000
		2,66,000
Additional income-tax@15%		39,900
Add: Surcharge@10%		3,990
		43,890
Add: Education cess@2% and Secondary and higher education cess@1%		1,317
Additional income-tax payable under section 115-O		**45,207**

11. Computation of total income and tax liability of M/s. ABC & Co. for A.Y.2014-15

Particulars	₹
Profit from ECR project	50,00,000
Profit from OMR project	30,00,000
Profit from trading unit	15,00,000
Business income/Gross Total Income	95,00,000
Less: Deduction under section 80-IA **(See Notes 1 & 2 below)**	47,00,000
Total Income	**48,00,000**
Income-tax @30%	14,40,000
Add: Education cess@2% and SHEC@1%	43,200
Total tax liability under the regular provisions of the Act	**14,83,200**

The provisions of Chapter XII-BA on Alternate Minimum Tax shall apply to M/s. ABC & Co., since the firm has claimed deduction under section 80-IA.

Computation of Alternate Minimum Tax (AMT)

Particulars	₹
Total Income as per the Income-tax Act, 1961	48,00,000
Add: Deduction under section 80-IA	47,00,000
Adjusted Total Income	**95,00,000**
AMT = 18.5% × 95,00,000 =	**17,57,500**

Since the regular income-tax payable as per the provisions of the Act is less than the AMT, the adjusted total income of ₹ 95,00,000 would be deemed to be the total income of M/s. ABC & Co. and it would be liable to pay tax@18.5% thereof. The tax payable by M/s. ABC & Co. for the A.Y.2014-15 would, therefore, be ₹ 17,57,500 plus education cess@2% and secondary and higher education cess@1%, totaling ₹ 18,10,225.

M/s. ABC & Co. would be eligible for credit of ₹ 3,27,025, being the difference between the AMT of ₹ 18,10,225 and tax of ₹ 14,83,200 on total income computed under the regular provisions of the Act. Such credit can be set-off in the year in which tax on total income computed under the regular provisions of the Act exceeds the AMT. Such credit can be carried forward for succeeding ten assessment years.

Notes:

(1) Section 80-IA(1) provides for 100% deduction of profits derived by an undertaking or an enterprise from an eligible business referred to in sub-section (4) for ten consecutive assessment years. Clause (i) of sub-section (4) provides that the deduction under section 80-IA would be applicable to any enterprise carrying on the business of developing or operating and maintaining or developing, operating and maintaining any infrastructure facility fulfilling the conditions mentioned therein. The *Explanation* to this clause defines "infrastructure facility" to include, *inter alia*, -

(a) a road, including a toll road, a bridge or a rail system and

(b) a highway project including housing or other activities being an integral part of the highway project.

The CBDT has, vide *Circular No.4/2010 dated 18.5.2010*, clarified that widening of an existing road by constructing additional lanes as a part of a highway project by an undertaking would be regarded as a new infrastructure facility for the purpose of section 80-IA(4)(i). However, simply relaying of an existing road would not be classifiable as a new infrastructure facility for this purpose.

Therefore, ABC & Co. would be eligible for deduction under section 80-IA in respect of the profits from ECR highway project, since it involves expansion of existing roads by constructing additional lanes as a part of the highway project. However, it would not be eligible for deduction under section 80-IA in respect of profits from the OMR project, which involves only relaying of existing roads.

(2) The ECR project is eligible for deduction@100% of the profits derived from its eligible business (i.e., the business of developing an infrastructure facility, being a highway project) under section 80-IA. However, the Trading Unit is not an "eligible business" and its profits are not eligible for deduction under section 80-IA . Since the trading unit has transferred cement worth ₹ 5 lakh to the ECR project at ₹ 2 lakh,i.e., a price lower than the fair market value, it is an inter-Unit transfer of goods between eligible business and other business, where the consideration for

transfer does not correspond with the market value of goods. As per section 80-IA(8), the profits of eligible business (i.e., ECR project) has to be computed as if the transfer has been made at market value i.e., at ₹ 5 lakh, for the purpose of deduction under section 80-IA. Therefore, the profits of the eligible business (i.e., ECR project), for the purpose of deduction under section 80-IA, would be ₹ 47 lakh (i.e., ₹ 50 lakh – ₹ 5 lakh + ₹ 2 lakh).

12. Computation of additional income-tax payable under section 115TA

	Category of investor	Income distributed (₹)	Rate of tax	Amount of tax (₹)
(i)	Mutual funds exempt under section 10(23D)	1,50,000	Nil	Nil
(ii)	Individuals and HUFs	1,00,000	28.325%	28,325
(iii)	Companies	4,00,000	33.99%	1,35,960
				1,64,285

The additional income-tax is payable on or before 31st August, 2013. However, the same was paid only on 7th November 2013.

Consequently, interest@1% per month or part of month is leviable under section 115TB, as follows –

Period	No. of months/ part of a month
1st September, 2013 – 30th September, 2013 (whole of first month)	1
1st October – 31st October, 2013 (whole of second month)	1
1st November – 7th November, 2013 (part of third month)	1
No. of months for which interest is leviable u/s 115TB	**3**

Interest under section 115TB is payable @1% per month for 3 months on the amount of additional tax payable i.e., ₹ 1,64,285. Therefore, interest payable under section 115TB is ₹ 4,929.

Notes:

(i) As per section 115TTA, the securitisation trust will be liable to pay additional income-tax on income distributed to its investors.

(ii) The rates of additional income-tax and the effective rate of tax (i.e., including surcharge@10% and cess@3%) in respect of each category are shown hereunder –

	Category of investors to whom income is distributed	Rate	Effective rate of tax
(1)	Persons, in whose case, income, irrespective of its nature and source, is exempt from tax under the Income-tax Act, 1961 [for example, mutual funds exempt under section 10(23D)]	Nil	Nil
(2)	Individuals and HUFs	25%	28.325%
(3)	Other Investors [i.e., investors other than mentioned in (1) and (2) above]	30%	33.99%

(iii) Such tax has to be paid within 14 days from the date of distribution or payment of such income, whichever is earlier.

(iv) The securitisation trust will be liable to pay simple interest on the amount of additional income-tax not paid within the specified time i.e., within 14 days from the date of distribution or payment of such income, whichever is earlier. Such interest is leviable at the rate of 1% for every month or part of the month on the amount of such tax not paid or short paid, as the case may be, for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid **[Section 115TB]**.

13. (a) The Assessing Officer may, in course of proceeding under section 147, assess or reassess any other income which has escaped assessment and which comes to his notice subsequently in the course of such proceeding.

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

Therefore, the contention of Ashiana Pvt. Ltd. is not correct.

(b) The Assessing Officer cannot issue notice under section 148 to reopen the same assessment order on the same grounds for which the Commissioner had issued notice under section 263 of the Income-tax Act, 1961, since the third proviso to section 147 specifically provides that the Assessing Officer may assess or reassess an income which is chargeable to tax and has escaped assessment, other than the income involving matters which are the subject matter of any appeal, reference or revision. Therefore, if the income relates to a matter which is the subject matter of revision under section 263, then the Assessing Officer cannot issue notice under section 148 to reopen the assessment order.

14. (a) The first contention of Mr. Hari is not correct.

Section 139(1) requires every resident and ordinarily resident having any asset (including financial interest in any entity) located outside India or signing authority in any account located outside India to file a return of income compulsorily whether or not he has income chargeable to tax. Mr. Hari has a house property in Dubai and a bank account in the Bank of Dubai. Therefore, Mr. Hari has to file his return of income mandatorily for the A.Y.2014-15, even though his total income of ₹ 2,40,000, comprising solely of income from house property and bank interest, is less than the basic exemption limit of ₹ 2,50,000 applicable to a senior citizen.

(b) Mr. Hari's second contention is also not correct.

Income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person is found to have any asset (including financial interest in any entity) located outside India. Accordingly, the Assessing Officer can serve a notice under section 148 on such assessee requiring him to furnish a return of income within the specified period, for the purpose of making an assessment, reassessment or re-computation under section 147.

Further, section 149 prescribes an extended time limit of sixteen years for issue of notice under section 148, in case income in relation to such assets located outside India has escaped assessment.

In this case, since Mr. Hari has a house property located outside India in the P.Y.2004-05, income is deemed to have escaped assessment for A.Y.2005-06. Notice under section 148 issued to Mr. Hari in June 2014 in respect of A.Y.2005-06 is valid, since the extended time limit of sixteen years from the end of the relevant assessment year has not expired.

15. (a) The statement is not correct

The statement given is not correct. As per the provisions of section 255, in the event of difference in opinion between the members of the Bench of the Income-tax Appellate Tribunal, the matter shall be decided on the basis of the opinion of the majority of the members. In case the members are equally divided, they shall state the point or points of difference and the case shall be referred by the President of the Tribunal for hearing on such points by one or more of the other members of the Tribunal. Such point or points shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who had first heard it.

(b) The statement is not correct

Section 254(2A) provides that the Appellate Tribunal, where it is possible, may hear and decide an appeal within a period of four years from the end of the financial year in which such appeal is filed.

The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose of the appeal within this period of stay.

Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. However, the aggregate period originally allowed and the period so extended should not exceed 365 days, even if the delay in disposing of the appeal is not attributable to the assessee. The Appellate Tribunal is required to dispose of the appeal within this extended period. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Therefore, the statement given in the question is not correct.

16. (i) The issue as to whether discount given to stamp vendors on purchase of stamp papers can be treated as "commission or brokerage" to attract the provisions for tax deduction at source came up before the Supreme Court in *CIT v. Ahmedabad Stamp Vendors Association (2012) 348 ITR 378*.

The principal issue in that case was whether stamp vendors were agents of the State Government who were being paid commission or brokerage or whether the sale of stamp papers by the Government to the licensed vendors was on "principal-to-principal" basis involving a "contract of sale".

On this issue, the Gujarat High Court had observed that the crucial question is whether the ownership in the stamp papers passes to the stamp vendor when the treasury officer delivers stamp papers on payment of price less discount. The Gujarat Stamp Supply and Sales Rules contemplate that the licensed vendor, while taking delivery of the stamp papers from the Government offices, is purchasing the stamp papers. The Rules also indicate that the discount which the licensed vendor has obtained from the Government is on purchase of the stamp papers.

If the licensed stamp vendors were mere agents of the State Government, no sales tax would have been leviable when the stamp vendors sell the stamp papers to the customers, because it would have been sale by the Government "**through**" stamp vendors. However, entry 84 in Schedule I to the Gujarat Sales Tax Act, 1969 specifically exempts sale of stamp papers by the licensed vendors from sales-tax. The very basis of the State Legislature enacting such exemption provision in respect of sale of stamp papers by the licensed vendors makes it clear that the sale of stamp papers by the licensed vendors to the customers would have, but for such exemption, been subject to sales tax levy. The question of levy of sales tax arises only because the licensed vendors themselves sell the stamp papers on their own and not as agents of the State Government. Had they been treated as agents of the State Government, there would be no question of levy of sales tax on sale of stamp papers by them, and consequently, there would have been no necessity for any

exemption provision in this regard.

Therefore, although the Government has imposed a number of restrictions on the licensed stamp vendors regarding the manner of carrying on the business, the stamp vendors are required to purchase the stamp papers on payment of price less discount on "principal to principal" basis and there is no "contract of agency" at any point of time. The definition of "commission or brokerage" under clause (i) of the *Explanation* to section 194H indicates that the payment should be received, directly or indirectly, by a person acting on behalf of another person*, inter alia,* for services in the course of buying or selling goods. Therefore, the element of agency is required in case of all services and transactions contemplated by the definition of "commission or brokerage" under *Explanation (i)* to section 194H. When the licensed stamp vendors take delivery of stamp papers on payment of full price less discount and they sell such stamp papers to the retail customers, neither of the two activities (namely, buying from the Government and selling to the customers) can be termed as service in the course of buying and selling of goods. The High Court, therefore, held that discount on purchase of stamp papers does not fall within the expression "commission or brokerage" to attract the provisions of tax deduction at source under section 194H.

The Supreme Court affirmed the above decision of the High Court holding that the said transaction is a sale and the discount given to stamp vendors for purchasing stamps in bulk quantity is in the nature of cash discount and consequently, section 194H has no application in this case.

(ii) The issue as to whether discount given on supply of SIM cards and recharge coupons by a telecom company to its distributors under a prepaid scheme would be treated as commission to attract the provisions of section 194H came up before the Kerala High Court in *Vodafone Essar Cellular Ltd. v. ACIT (TDS) (2011) 332 ITR 255*.

On this issue, the Kerala High Court observed that it was the SIM card which linked the mobile subscriber to the assessee`s network. Therefore, supply of SIM card by the assessee-telecom company was only for the purpose of rendering continued services to the subscriber of the mobile phone. The position was the same so far as recharge coupons were concerned, which were only air time charges collected from the subscribers in advance under a prepaid scheme.

There was no sale of any goods involved as claimed by the assessee and the entire charges collected by the assessee from the distributors at the time of delivery of SIM cards or recharge coupons were only for rendering services to ultimate subscribers. The assessee was accountable to the subscribers for failure to render prompt services pursuant to connections given by the distributor.

Therefore, the distributor only acted as a middleman on behalf of the assessee for procuring and retaining customers and therefore, the discount given to him was within the meaning of commission under section 194H on which tax was deductible.

17. Deduction under section 91 is allowable subject to satisfaction of the following conditions :-

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

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of Mr. Vallish and he has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, Mr. Vallish satisfies all the above conditions, and therefore, he is eligible for deduction under section 91.

Computation of tax liability of Mr. Vallish for the A.Y.2014-15

Particulars		₹	₹
Indian income			18,00,000
Foreign income			15,00,000
Gross Total Income			**33,00,000**
Less: **Deductions under Chapter VI-A**			
Deduction under section 80C			
PPF Contribution		1,00,000	
Deduction under section 80CCG			
Investment in listed equity shares under Rajiv Gandhi Equity Savings Scheme, 2013 (Since his gross total income exceeds ₹ 12 lakh, he is not eligible for deduction under section 80CCG even though he qualifies as a new retail investor)		Nil	
Deduction under section 80D			
Premium for insuring his health, restricted to	15,000		
Premium for insuring health of father, being a senior citizen, restricted to	20,000	35,000	1,35,000
Total Income			**31,65,000**
Tax on total income			7,79,500
Add: Education Cess @ 2%			15,590
Secondary and higher education cess @ 1%			7,795
			8,02,885

Less: Rebate under section 91 on doubly taxed income of ₹ 15,00,000 @ 20%, being the lower of average Indian tax rate and average rate of tax in the foreign country ***(See Note below)***		3,00,000
Net tax liability		**5,02,885**

Note – Calculation of Average Rate of Tax	
(i) Average rate of tax in India [i.e. ₹ 8,02,885/₹ 31,65,000 x 100]	25.37%
(ii) Average rate of tax in the foreign country [i.e. ₹ 3,00,000/ ₹ 15,00,000 x 100]	20%
Lower of the above, i.e., 20% has to be applied on the doubly taxed income of ₹ 15,00,000 to compute rebate under section 91	

18. Section 92CB(1) provides that the determination of arm's length price under section 92C or section 92CA shall be subject to safe harbour rules. Safe harbour means circumstances in which the income tax authorities shall accept the transfer price declared by the assessee. Section 92CB(2) empowers the CBDT to prescribe such safe harbour rules or circumstances under which the transfer price declared by the assessee shall be accepted by the Income-tax Authorities.

Accordingly, in exercise of the powers conferred by section 92CB read with section 295 of the Income-tax Act, 1961, the CBDT has, vide Notification No.73/2013 dated 18.9.2013, prescribed safe harbour rules. Rule 10TD provides that where an eligible assessee has entered into an eligible international transaction and the option exercised by the said assessee is not held to be invalid under Rule 10TE, the transfer price declared by the assessee in respect of such transaction shall be accepted by the income-tax authorities, if it is in accordance with the circumstances set out thereunder.

An eligible assessee is a person who has exercised a valid option for application of safe harbour rules and is engaged in, *inter alia*, providing the following services, with insignificant risk, to a non-resident associated enterprise –

(i) software development services; or

(ii) information technology enabled services; or

(iii) knowledge process outsourcing services; or

(iv) contract R & D services wholly or partly relating to software development; or

(v) contract R & D services wholly or partly relating to generic pharmaceutical drugs.

A person who is engaged in the manufacture and export of core or non-core auto components and where 90% or more of total turnover during the relevant previous year is

in the nature of original equipment manufacturer sales also falls within the definition of eligible assessee if he has exercised a valid option for application of safe harbour rules.

(1) X Inc. is a specified foreign company in relation to A Ltd. Therefore, the condition of A Ltd. holding shares carrying not less than 26% of the voting power in X Inc is satisfied. Hence, X Inc. and A Ltd. are deemed to be associated enterprises. Therefore, provision of systems support services by A Ltd., an Indian company, to X Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Systems support services falls within the definition of "software development services", and hence, is an eligible international transaction. Since A Ltd. is providing software development services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the aggregate value of transactions entered into in the P.Y.2013-14 exceed ₹ 500 crore, A Ltd. should have declared an operating profit margin of not less than 22% in relation to operating expense, to be covered within the safe harbour rules. However, since A Ltd. has declared an operating profit margin of only 20% (i.e., $\frac{90}{450}\times 100$), the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by A Ltd.

(2) Y Inc., a foreign company, is a subsidiary of B Ltd., an Indian company. Hence, Y Inc. and B Ltd. are associated enterprises. Therefore, provision of data processing services by B Ltd., an Indian company, to Y Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Data processing services with the use of information technology falls within the definition of "information technology enabled services", and is hence, an eligible international transaction. Since B Ltd. is providing data processing services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the aggregate value of transactions entered into in the P.Y.2013-14 does not exceed ₹ 500 crore, B Ltd. should have declared an operating profit margin of not less than 20% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since B Ltd. has declared an operating profit margin of 20.67% (i.e., $\frac{62}{300}\times 100$), the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by B Ltd in respect of such international transaction.

(3) XYZ & Co., a foreign firm holds 12% interest in C & Co., an Indian firm. Therefore, the condition of one enterprise, being a foreign firm, holding not less than 10% interest in another enterprise, being an Indian firm, is satisfied. Hence, XYZ & Co. and C & Co. are deemed to be associated enterprises. Therefore, provision of contract R & D services relating to software development by C & Co., an Indian firm, to XYZ & Co., a foreign firm, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Development of internet technology falls within the meaning of "contract R&D services wholly or partly relating to software development", and hence, is an eligible international transaction. Since C & Co., an Indian firm, is providing contract R & D services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Irrespective of the aggregate value of transactions entered into in the P.Y.2013-14, C & Co. should have declared an operating profit margin of not less than 30% in relation to operating expense, to be covered within the safe harbour rules. However, since C & Co. has declared an operating profit margin of only 28.57% (i.e., $\frac{20}{70}\times 100$), the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by C & Co.

(4) ABC Inc., a foreign company, guarantees 15% of the total borrowings of D Ltd., an Indian company. Since ABC Inc. guarantees not less than 10% of the total borrowings of D Ltd., ABC Inc. and D Ltd. are deemed to be associated enterprises. Therefore, provision of contract R & D services relating to generic pharmaceutical drug by D Ltd., an Indian company, to ABC Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Provision of contract R& D services in relation to generic pharmaceutical drug is an eligible international transaction. Since D Ltd. is providing such services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Irrespective of the aggregate value of transactions entered into in the P.Y.2013-14, D Ltd. should have declared an operating profit margin of not less than 29% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since D Ltd. has declared an operating profit margin of 30% (i.e., $\frac{9}{30}\times 100$), the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by D Ltd in respect of such international transaction.

(5) LMN LLP, a foreign LLP, is controlled by Mr.E jointly with his relatives. Mr. E also has control over his own sole proprietorship concern. Therefore, the sole proprietorship concern of Mr.E in India and LMN LLP are deemed to be associated enterprises.

Automobile transmission and steering parts fall within the meaning of "core auto components", and hence, 100% export of all such parts originally manufactured by the sole proprietorship concern of Mr.E is an eligible international transaction. Since the sole proprietorship concern of Mr.E is solely engaged in the original manufacture and 100% export of such parts and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Irrespective of the aggregate value of transactions entered into in the P.Y.2013-14, the sole-proprietorship concern of Mr.E should have declared an operating profit margin of not less than 12% in relation to operating expense, to be covered within the safe harbour rules. However, since A Ltd. has declared an operating profit margin of only 10% (i.e., $\frac{1}{10}\times 100$), the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by Mr.E.

(6) F Ltd. and GKG Inc. are deemed to be associated enterprises since F Ltd. appoints more than half of the Board of Directors of GKG Inc. Manufacture and export of non-core auto components is an eligible international transaction. Since F Ltd. is engaged in original manufacture of non-core auto components and 100% export of the same, it is an eligible assessee.

Irrespective of the aggregate value of transactions entered into in the P.Y.2013-14, F Ltd. should have declared an operating profit margin of not less than 8.5% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since F Ltd. has declared an operating profit margin of 10% (i.e., $\frac{1}{10}\times 100$), the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by F Ltd in respect of such international transaction.

The safe harbour rules shall not apply in respect of eligible international transactions entered into with an associated enterprise located in a notified jurisdictional area. Therefore, if in any of the cases mentioned above, the foreign entity is located in a NJA, the safe harbour rules shall not be applicable, irrespective of the operating profit margin declared by the assessee.

19. Computation of net wealth of Sridhar as on valuation date 31.03.2014

	Particulars	Amount in ₹
(a)	Residential house at Mumbai	40,00,000

(b)	Residential house at Chennai	25,00,000
(c)	Plot of land comprising an area of 325 square meters at New Delhi is an asset but exempt under section 5(vi)	Nil
(d)	House at Calcutta exclusively used for carrying on his business - not an asset under section 2(ea)	Nil
(e)	Commercial complex at Chennai - not an asset under section 2(ea)	Nil
(f)	Residential house at Bangalore let out for 310 days during the relevant previous year - not an asset under section 2(ea)	Nil
(g)	Motor cars used in the business of running them on hire - not an asset under section 2(ea)	Nil
(h)	Shares in private limited companies - not an asset under section 2(ea)	Nil
(i)	Cash in hand in excess of ₹ 50,000	1,50,000
(j)	Gold jewellery	8,00,000
		74,50,000
	Less: **Debts incurred in relation to assets**	
(k)	Loan borrowed for purchase of land at New Delhi (not deductible since exemption under section 5(vi) has been claimed in respect of the said land)	Nil
(l)	Loan borrowed for purchase of shares in private limited companies (not deductible since shares are not included in net wealth)	Nil
(m)	Loan borrowed for purchase of gold jewellery	4,00,000
Net Wealth		**70,50,000**

Reasons for inclusion or exclusion of the various items are furnished below:

(a) Residential house at Mumbai is included in net wealth, as residential house is an "asset" within the meaning of section 2(ea) of the Wealth-tax Act, 1957. Exemption under section 5(vi) is not claimed in respect of this house as it is more beneficial for the assessee to claim exemption in respect of plot of land at New Delhi whose value is higher.

(b) Residential house at Chennai is an asset under section 2(ea) and, therefore, included in the net wealth.

(c) Plot of land measuring 325 square metres at New Delhi is exempt under section 5(vi) and, therefore, does not form part of net wealth. One house or part thereof or a plot of land, not exceeding 500 square metres, belonging to an individual or a Hindu Undivided Family is exempt under section 5(vi) without any monetary ceiling.

(d) House at Calcutta, occupied for own business purposes, is not an asset by virtue of the specific exclusion under item (3) of section 2(ea)(i). Hence, the same does not form part of net wealth.

(e) Commercial complex at Chennai is not an asset by virtue of the specific exclusion under item (5) of section 2(ea)(i).

(f) Any residential property let out for a minimum period of 300 days in the previous year is not an asset due to the specific exclusion under item (4) of section 2(ea)(i). Residential house at Bangalore let out for more than 300 days is, therefore, not includible in net wealth.

(g) Motor cars used in business of running them on hire are not assets as per section 2(ea)(ii) and, therefore, excluded from net wealth.

(h) Shares in private limited companies are not included in the definition of "asset" under section 2(ea). Therefore, they do not from part of net wealth.

(i) In case of individuals, cash in hand in excess of ₹ 50,000 constitutes an asset. Therefore, ₹ 1,50,000, being cash in hand in excess of ₹ 50,000, is included in Mr. Sridhar's net wealth.

(j) Gold jewellery constitutes an asset as per section 2(ea)(iii) and is, hence, includible in net wealth.

(k) Debts incurred in relation to an exempted asset are not deductible in computing net wealth. Loan borrowed for purchase of land at New Delhi is not deductible as exemption under section 5(vi) has been claimed in respect of the said land.

(l) Loan borrowed for purchase of shares in private limited companies is not deductible while computing net wealth, as shares are not included in net wealth.

(m) Gold jewellery, being an asset, has been included in the net wealth. Therefore, loan borrowed for purchase thereof is deductible in computing net wealth.

20. In the given case, Mrs. Gauri is the owner of two residential houses for self-occupation, one at Chennai and another at Pune.

The value of any one house can be claimed as exempt under section 5(vi) of the Wealth-tax Act, 1957. Mrs. Gauri should first determine the value to be adopted for wealth-tax purpose and then should select the house with the higher value for availing such exemption.

As per section 7(2) of the Wealth-tax Act, 1957, the value of a house belonging to Mrs. Gauri and exclusively used by her for residential purposes throughout the period of 12 months immediately preceding the valuation date, may, at her option, be taken to be the value determined in the manner laid down in Schedule III as on the valuation date next following the date on which she became the owner of the house or the valuation date relevant to the assessment year commencing on 1st April, 1971, whichever valuation date is later.

This benefit of pegging down of value is available only if the house is self-occupied by Mrs. Gauri throughout the period of 12 months immediately preceding the valuation date.

Therefore, such benefit of pegging down of value cannot be availed for the house situated at Chennai since the house was occupied by the Gauri's relative for a part of the year. The Schedule III value of the flat at Chennai as on the valuation date 31st March, 2014, being ₹ 28 lacs, or the cost of acquisition of ₹ 12 lacs, whichever is higher, is to be adopted as the value for wealth-tax purpose. Therefore, ₹ 28 lacs is the value of the Chennai house for wealth-tax purpose.

The benefit of pegging down of value can be opted for the flat situated at Pune, as it was self-occupied by Mrs. Gauri throughout the 12 months immediately preceding the valuation date of 31st March, 2014 for her residential purposes. In case of the house at Pune, the Schedule III value as on 31st March, 2006, being the first valuation date after she became the owner, i.e. ₹ 7 lacs can be adopted, since its cost of acquisition does not exceed ₹ 50 lacs. Therefore, ₹ 7 lacs is the value of the Pune house for wealth-tax purposes.

It would be more beneficial for Mrs. Gauri to claim exemption under section 5(vi) in respect of the Chennai house since the value of the Chennai house (₹ 28 lacs) is higher than the value of the Pune house (₹ 7 lacs) as on the valuation date 31st March, 2014.

Applicability of Legislative Amendments/Circulars etc. for November, 2014 – Final Examination

Paper 7 : Direct Tax Laws & Paper 8 : Indirect Tax Laws

Applicability of the Finance Act, Assessment Year etc. for November, 2014 Examination

The provisions of direct and indirect tax laws, as amended by the Finance Act, 2013, including notifications and circulars issued upto 30th April, 2014. The applicable assessment year for Direct Tax Laws is A.Y. 2014-15.

ANNEXURE

Part I: Statutory Update - Direct Tax Laws

Significant Notifications and Circulars issued between 1.5.2013 and 30.4.2014

I NOTIFICATIONS

1. Notification No. 38/2013 dated 30.05.2013 (as amended by Notification No. 18/2014 dated 21.03.2014)

Approval of Agricultural Extension Project under section 35CCC: Conditions and Guidelines

In order to incentivize the business entities to provide better and effective agriculture extensive services, section 35CCC was inserted to provide weighted deduction of a sum equal to 150% of expenditure incurred by **an assessee** on agricultural extension project in accordance with the prescribed guidelines.

Accordingly, the CBDT in exercise of the powers conferred by section 295 read with section 35CCC(1) of the Income tax Act, 1961, vide Notification No. 38/2013 dated 30.05.2013, prescribed rule 6AAD and 6AAE that contains the guidelines and conditions, for approval of the agricultural extension project. Rule 6AAD has been substituted and Rule 6AAE has been amended by this notification.

(a) Conditions to be fulfilled for approval of agricultural extension project under section 35CCC [Rule 6AAD]:

The agricultural extension project shall be considered for notification if it fulfils **all** of the following conditions, namely :—

(i) the project shall be undertaken by an assessee for training, education and guidance of farmers;

(ii) the project shall have prior approval of the Ministry of Agriculture, Government of India; and

(iii) an expenditure (not being expenditure in the nature of cost of any land or building) exceeding the amount of twenty-five lakh rupees is expected to be incurred for the project.

An assessee shall make an application in Form 3C-O to the Member(IT), CBDT for notification of such project under section 35CCC.

(b) Conditions to be fulfilled for claiming weighted deduction [Rule 6AAE]:

(i) The assessee undertaking agricultural extension project shall maintain separate books of account of such agricultural extension project and get such books of account audited by an Accountant.

(ii) The audit report shall include the comments of the auditor on the true and fair view of the books of account maintained for agricultural extension project, the genuineness of the activities of the agricultural extension project and fulfillment of the conditions specified in the relevant provisions of the Act or the rules.

(iii) The assessee shall not accept an amount exceeding the amount as approved in the notification from the beneficiary under the eligible agricultural extension project for training, education, guidance or any material distributed for the purposes of such training, education or guidance.

(iv) The assessee shall not get any direct or indirect benefit from the notified agricultural extension project except the deduction of the eligible expenditure in accordance with the provisions of section 35CCC of the Act and prescribed rules.

(v) All expenses (not being expenditure in the nature of cost of any land or building), as reduced by the amount received from beneficiary, if any, incurred wholly and exclusively for undertaking an eligible agricultural extension project shall be eligible for deduction under section 35CCC.

However, expenditure incurred on the agricultural extension project which is reimbursed or reimbursable to the assessee by any person, whether directly or indirectly, shall not be eligible for deduction under section 35CCC.

(vi) The assessee shall, on or before the due date of furnishing the return of income under section 139(1), furnish the following to the Commissioner of Income-tax or the Director of Income-tax, as the case may be, namely:—

(a)	the audited statement of accounts of the agricultural extension projects for the previous year along with the audit report and amount of deduction claimed under section 35CCC(1).
(b)	a note on the agricultural extension project undertaken by it during the previous year and the programme of agricultural extension project to be undertaken during the current year and the financial allocation for such programme; and
(c)	a certificate from the Ministry of Agriculture, Government of India, regarding the genuineness of the agricultural extension project undertaken by the assessee during the previous year.

2. Notification No. 39/2013 dated 31.05.2013

Time and mode of payment of tax deducted at source under section 194-IA to the credit of Central Government, furnishing challan-cum-statement and TDS Certificate [Rules 30, 31A & 31]

New section 194-IA has been inserted by Finance Act, 2013, requiring every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to deduct tax, at the rate 1% of such sum, at the time of credit of such sum to the account of the resident transferor or at the time of payment of such sum to a resident transferor, whichever is earlier.

Accordingly, the time and mode of, payment of tax deducted at source under section 194-IA, furnishing Challan-cum-statement and TDS Certificate have been provided, by amending Rules 30, 31A & 31, respectively -

(i) Such sum deducted under section 194-IA shall be paid to the credit of the Central Government within a period of seven days from the end of the month in which the deduction is made and shall be accompanied by a challan-cum-statement in Form No.26QB *[Rule 30].*

(ii) The amount so deducted has to be deposited to the credit of the Central Government by electronic remittance within the above mentioned time limit, into RBI, SBI or any authorized bank *[Rule 30]*.

(iii) Every person responsible for deduction of tax under section 194-IA shall also furnish to the DGIT (Systems) or any person authorized by him, a challan-cum-statement in Form No.26QB electronically within seven days from the end of the month in which the deduction is made *[Rule 31A]*.

(iv) Every person responsible for deduction of tax under section 194-IA shall furnish the TDS certificate in Form No.16B to the payee within 15 days from the due date for furnishing the challan-cum-statement in Form No.26QB under Rule 31A, after generating and downloading the same from the web portal specified by the DGIT (Systems) or the person authorized by him *[Rule 31]*.

3. Notification No. 40/2013 dated 6.06.2013

Notification of Cost Inflation Index for F.Y.2013-14

Clause (v) of *Explanation* to section 48 defines "Cost Inflation Index", in relation to a previous year, to mean such Index as the Central Government may, by notification in the Official Gazette, specify in this behalf, having regard to 75% of average rise in the Consumer Price Index for urban non-manual employees.

Accordingly, the Central Government has, in exercise of the powers conferred by clause (v) of *Explanation* to section 48, specified the Cost Inflation Index for the financial year 2013-14 as 939.

S. No.	Financial Year	Cost Inflation Index	S. No.	Financial Year	Cost Inflation Index
1.	1981-82	100	18.	1998-99	351
2.	1982-83	109	19.	1999-2000	389
3.	1983-84	116	20.	2000-01	406
4.	1984-85	125	21.	2001-02	426
5.	1985-86	133	22.	2002-03	447
6.	1986-87	140	23.	2003-04	463
7.	1987-88	150	24.	2004-05	480
8.	1988-89	161	25.	2005-06	497
9.	1989-90	172	26.	2006-07	519
10.	1990-91	182	27.	2007-08	551

11.	1991-92	199	28.	2008-09	582
12.	1992-93	223	29.	2009-10	632
13.	1993-94	244	30.	2010-11	711
14.	1994-95	259	31.	2011-12	785
15.	1995-96	281	32.	2012-13	852
16.	1996-97	305	**33.**	**2013-14**	**939**
17.	1997-98	331			

4. Notification No. 41/2013 dated 10.06.2013

Transfer Pricing Rules made applicable to Specified Domestic Transactions as well

With effect from A.Y 2013-14, the transfer pricing provisions have been extended to Specified Domestic Transactions. Accordingly, the transfer pricing rules prescribed for international transactions have been suitably amended to make the same applicable for specified domestic transactions, as well.

Rule No.	Particulars	Amendment
10A	Meaning of expressions used in computation of Arm's length price	**Definition of "associated enterprise" and "enterprise" included** **"Associated Enterprise"** shall - (i) have the same meaning as assigned to it in section 92A; and (ii) in relation to a specified domestic transaction entered into by an assessee, include -- (A) the persons referred to in section 40A(2)(b) in respect of a transaction referred to in section 40A(2)(a); (B) other units or undertakings or businesses of such assessee in respect of a transaction referred to in section 80A or section 80-IA(8); (C) any other person referred to in section 80-IA(10) in respect of a transaction referred to therein; (D) other units, undertakings, enterprises or business of such assessee, or other person referred to in section 80-IA(10) or in respect of a transaction referred to in section 10AA or the transactions referred to in Chapter VI-A to which the provisions of section 80-IA(8) or section 80-IA(10) are applicable; **"Enterprise"** shall have the same meaning as assigned to it in clause (iii) of section 92F and shall, for the

		purposes of a specified domestic transaction, include a unit, or an enterprise, or an undertaking or a business of a person who undertakes such transaction.
10AB	Other methods of determination of ALP	This Rule provides that for the purpose of section 92C(1)(f), the other method for determination of the arm's length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts. This Rule has now been made applicable to specified domestic transactions as well.
10B	Determination of ALP under section 92C	The methods for determination of arm's length price specified in this Rule for the purpose of section 92C(2) in relation to an international transaction shall also be made applicable in respect of specified domestic transactions.
10C	Most appropriate method	Sub-rule (1) provides that, for the purposes of section 92C(1), the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to an international transaction. Sub-rule (2) specifies the factors to be taken into account in selecting the most appropriate method. This Rule is now made applicable in respect of a specified domestic transaction as well.
10D	Information and documents to be kept and maintained under section 92D	Sub-rule (1) requires every person who has entered into an international transaction to maintain the requisite information and documents as detailed thereunder. As per sub-rule (2), maintenance of information and documents shall not apply where the aggregate value of international transactions does not exceed 1 crore rupees. However, sub-rule (1) shall be applicable for every specified domestic transaction irrespective of its value.

10E	Report from an accountant to be furnished under section 92E	This rule provides for submission of audit report from a chartered accountant by every person who has entered into an international transaction. This provision would now apply to a person entered into a specified domestic transaction as well.

5. Notification No. 54/2013, dated 15.07.2013

Approval of skill development project under section 35CCD: Conditions and Guidelines

In order to encourage **companies** to invest on skill development projects, section 35CCD was inserted, to provide for weighted deduction of a sum equal to 150% of the expenditure (not being expenditure in the nature of cost of any land or building) incurred on skill development project notified by the CBDT, in accordance with the prescribed guidelines.

Accordingly, the CBDT has, in exercise of the powers conferred by section 295 read with section 35CCD(1) of the Income-tax Act, 1961, laid down the guidelines and conditions for approval of a skill development project under section 35CCD.

<table>
<tr><th>S. No.</th><th colspan="2">Particulars</th></tr>
<tr><td>(1)</td><td colspan="2"><u>Guidelines for approval of Skill Development Project under section 35CCD:</u>
A skill development project shall be considered for notification if it is undertaken by an eligible company and the project is undertaken in separate facilities in a training institute [Rule 6AAF(1)]</td></tr>
<tr><td></td><td>(i)</td><td>"Eligible company" means a company, which is -
• engaged in the business of manufacture or production of any article or thing specified in the Eleventh Schedule; not being beer, wine and other alcoholic spirits and tobacco & tobacco preparations such as cigars and cheroots, cigarettes, biris, smoking mixtures for pipes and cigarettes, chewing tobacco and snuff or
• engaged in providing the following services
<table>
<tr><th>S. No.</th><th>Particulars</th></tr>
<tr><td>1.</td><td>Accounting services</td></tr>
<tr><td>2.</td><td>Architect services</td></tr>
<tr><td>3.</td><td>Automobile repair or maintenance</td></tr>
<tr><td>4.</td><td>Banking, insurance and financial services including ATM installation, maintenance and operations or banking correspondents or insurance agents</td></tr>
<tr><td>5.</td><td>Beauty and cosmetology, including hair styling or manicurists or pedicurists</td></tr>
<tr><td>6.</td><td>Cable operators or Direct To Home (DTH) services</td></tr>
</table></td></tr>
</table>

		7.	Cargo Handling and stevedoring services
		8.	Construction including painting or woodwork or plumbing or flooring or electrical wiring or installation or maintenance of lifts
		9.	Courier services
		10.	Design services including fashion or gems and jewellery or apparel or industrial designing
		11.	Event management
		12.	Facilities management, housekeeping, cleaning services
		13.	Fire and safety services
		14.	Food processing or preservation services, including post harvesting and post farm gate skills
		15.	Health and Wellness services including spa or nutritionists or weight management or health instructors or yoga or gym trainers
		16.	Home decor services, landscaping
		17.	Hospital and Healthcare services, such as Lab technicians, nursing and other paramedical staff
		18.	Hospitality, including culinary skills or catering services
		19.	Logistics and Transportation by any mode, including by air, sea, road, rail or pipelines, and related services such as driving or operation of heavy machinery equipment, forwarding agents, packers and movers
		20.	Market research services
		21.	Media or film or advertising
		22.	Mining and extraction of mineral resources, including hydrocarbons
		23.	Packaging and Warehousing, including both ambient temperature storage and cold storage, operation of Internal Container Depots and Container Freight Stations
		24.	Port and maritime services such as dredging, piloting, tug boat operations, shipbuilding, ship scrapping, bunkering
		25.	Power Sector Services, including those required for erection or installation or maintenance of equipment or towers, etc. in generation, transmission or distribution sector projects
		26.	Private Security, including guards, supervisors, installation and maintenance of security equipment etc.
		27.	Refrigeration and air-conditioning
		28.	Repair and maintenance services, including Installation and servicing of household goods or white goods

		29. Retail marketing, including shop floor assistants or merchandisers 30. Telecom services, including erection and maintenance of towers 31. Travel and tourism, including guides or ticketing or sales or cab drives
	(ii)	**"Training Institute"** means a training institute set up by the Central or State Government or a local authority or a training institute affiliated to National Council for Vocational Training or State Council for Vocational Training. A skill development project in respect of existing employees of the company shall not be eligible for notification under section 35CCD(1), where the training of such employees commences after six months of their recruitment **[Rule 6AAG(3)].**
(2)	**Application for approval of project [Rule 6AAF(2)]:**	Such company, before undertaking any skill development project, shall : - make an application for notification of such project under section 35CCD(1), in duplicate, in Form No. 3CQ, to the National Skill Development Agency(NSDA); and - also send a copy of the application in Form No. 3CQ to the Commissioner of Income tax or the Director of the Income tax as the case may be, having jurisdiction over the case, accompanied by the acknowledgement receipt as evidence of having furnished the application form in duplicate to the NSDA.
(3)	**Conditions laid down under Rule 6AAG:**	**(i)** The Company which undertakes a skill development project shall maintain separate books of account of the skill development project and get such books of account audited by an Accountant. **(ii)** All expenses (not being expenditure in the nature of cost of any land or building), incurred wholly and exclusively for undertaking a notified skill development project shall be eligible for deduction under section 35CCD. However, the expenditure incurred on the skill development project which is reimbursed or reimbursable to the company by any person, whether directly or indirectly, shall not be eligible for deduction under section 35CCD. **(iii)** The company shall, on or before the due date of furnishing the return of income under section 139(1), furnish the audited statement of accounts of the skill development project for the previous year along with the audit report and amount of deduction claimed under section 35CCD(1) to the Commissioner of Income-tax or the Director of Income-tax, as the case may be.

6. Notification No.57 / 2013 dated 01.08.2013

Documents and information, to be furnished by the assessee for claiming treaty benefits, prescribed

For claiming treaty benefits, sections 90(4) and 90A(4) provide that a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of "prescribed particulars" therein.

Further, sections 90(5) and 90A(5) require **an assessee** to **provide such other documents and information, as may be prescribed**, for claiming the treaty benefits, in addition to such certificate issued by the foreign Government.

Accordingly, the assessee shall provide the following information in Form No. 10F**:**

(i) Status (individual, company, firm etc.) of the assessee;

(ii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);

(iii) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;

(iv) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and

(v) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (iv) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The assessee shall keep and maintain such documents as are necessary to substantiate the information provided. An income-tax authority may require the assessee to provide the said documents in relation to a claim by the said assessee of any relief under an agreement referred to in section 90(1) or section 90A(1), as the case may be.

7. Notification No. 64/2013, dated 19.08.2013

Notification of foreign company for claiming exemption under section 10(48)

Income received by a foreign company in India in Indian currency from sale of crude oil, any other goods or rendering of services, as may be notified by the Central Government in this behalf, to any person in India is exempt under section 10(48)**.** For this purpose,

the foreign company, as well as the arrangement or agreement, should be notified by the Central Government having regard to the national interest. The foreign company should not be engaged in any other activity in India, except receipt of income under such arrangement or agreement.

Accordingly, vide this notification, the Central Government, having regard to the national interest, has notified for the purposes of the said clause, the National Iranian Oil Company, as the foreign company and the Memorandum of Understanding entered between the Government of India in the Ministry of Petroleum and Natural Gas and the Central Bank of Iran on the 20th January, 2013, as the agreement subject to the condition that the said foreign company shall not engage in any activity in India , other than the receipt of income under the agreement aforesaid.

The Notification is deemed to be effective from 20th January, 2013.

8. Notification No. 67/2013 dated 02.09.2013

Furnishing of information by the person responsible for making any payment chargeable to tax to a non-corporate non-resident or to a foreign company

The CBDT has, vide this notification, inserted new Rule 37BB relating to furnishing of information by the person responsible for making any payment, including any interest or salary or any other sum chargeable to tax, to a non-corporate non-resident or to a foreign company.

Sub-rule (1) requires such person to furnish the following:

(i) the information in Part A of Form No.15CA, if the amount of payment does not exceed ₹ 50,000 and the aggregate of such payments made during the financial year does not exceed ₹ 2,50,000;

(ii) the information in Part B of Form No.15CA for payments other than the payments referred in clause (i), after obtaining-

  (a) a certificate in Form No.15CB from an "accountant" as defined in the *Explanation* below section 288(2); or

  (b) a certificate from the Assessing Officer under section 197; or

  (c) an order from the Assessing Officer under section 195(2) or section 195(3).

Sub-rule (2) requires the information in Form No. 15CA to be furnished by the person electronically to the website designated by the Income-tax Department and the submission of the signed printout of the said form to the authorised dealer under section 10(1) of the Foreign Exchange Management Act, 1999, prior to remitting the payment.

Sub-rule (3) provides that an income-tax authority may require the authorised dealer to furnish the signed printout for the purposes of any proceedings under the Act.

Further, in respect of the payments of the nature described in the "Specified list" given in the said Notification (like Indian investment abroad in equity, debt securities, subsidiaries and associates, branches and wholly-owned subsidiaries, real estate, remittance towards business travel, personal gifts and donations, donations to charitable and religious institutions abroad etc.) no information is required to be furnished under sub-rule (1).

9. Notification No. 73/2013, dated 18.09.2013

Notification of Safe Harbour Rules

Section 92CB(1) provides that the determination of arm's length price under section 92C or section 92CA shall be subject to safe harbour rules. Safe harbour means circumstances in which the income tax authorities shall accept the transfer price declared by the assessee.

Section 92CB(2) empowers the CBDT to prescribe such safe harbour rules or circumstances under which the transfer price declared by the assessee shall be accepted by the Income-tax Authorities.

Accordingly, in exercise of the powers conferred by section 92CB read with section 295 of the Income-tax Act, 1961, the CBDT has, vide this notification, prescribed safe harbour rules. These rules are explained hereunder:

1. Safe Harbour [Rule 10TD read with Rule 10TA, Rule 10TB and Rule 10TC]

Where an eligible assessee has entered into an eligible international transaction and the option exercised by the said assessee is not held to be invalid under Rule 10TE, the transfer price declared by the assessee in respect of such transaction shall be accepted by the income-tax authorities, if it is in accordance with the circumstances mentioned below:

<table>
<tr><th>S. No.</th><th>Eligible International Transaction[1]</th><th>Circumstances</th><th>Definition</th></tr>
<tr><td></td><td>[Rule 10TC]</td><td>[Rule 10TD]</td><td>[Rule 10TA]</td></tr>
<tr><td>(i)</td><td>Provision of software development services</td><td>The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is –<table><tr><td>Not less than the prescribed percentage</td><td>Where the aggregate value of such transactions entered into during the previous year</td></tr><tr><td>20%</td><td>does not exceed a sum of ₹ 500 crore;</td></tr><tr><td>22%</td><td>exceeds a sum of ₹ 500 crore.</td></tr></table></td><td>“Software development services” means,-<table><tr><td>(i)</td><td>business application software and information system development using known methods and existing software tools;</td></tr><tr><td>(ii)</td><td>support for existing systems;</td></tr><tr><td>(iii)</td><td>Converting or translating computer languages;</td></tr><tr><td>(iv)</td><td>adding user functionality to application programmes;</td></tr><tr><td>(v)</td><td>debugging of systems;</td></tr><tr><td>(vi)</td><td>adaptation of existing software; or</td></tr><tr><td>(vii)</td><td>preparation of user documentation.</td></tr></table>It, however, does not include any R&D services whether or not in the nature of contract R&D services.</td></tr>
<tr><td>(ii)</td><td>Provision of information technology enabled services</td><td>The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is –</td><td>“Information technology enabled services” means the following business process outsourcing services provided mainly with the assistance or use of information technology, namely:-</td></tr>
</table>

[1] Eligible international transaction means an international transaction between the eligible assesee and its associated enterprise, either or both of whom are non-residents, and which comprises of the transactions described in column (2) of the above table.

		Not less than the prescribed percentage	Where the aggregate value of such transactions entered into during the previous year		
		20%	does not exceed a sum of ₹ 500 crore;		
		22%	exceeds a sum of ₹ 500 crore.		
				(i)	back office operations
				(ii)	call centres or contact centre services
				(iii)	data processing and data mining
				(iv)	insurance claim processing
				(v)	legal databases
				(vi)	creation and maintenance of medical transcription excluding medical advice
				(vii)	translation services
				(viii)	payroll
				(ix)	remote maintenance
				(x)	revenue accounting
				(xi)	support centres
				(xii)	website services
				(xiii)	data search integration and analysis
				(xiv)	remote education excluding education content development
				(xv)	clinical database management services excluding clinical trials
				It, however, does not include any R&D services whether or not in the nature of contract R&D services.	
(iii)	Provision of knowledge process	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to		"Knowledge process outsourcing services" means the following business process outsourcing services provided mainly with the assistance or use of	

	outsourcing services	operating expense is not less than 25%, irrespective of the aggregate value of the transactions entered into during the previous year.
(iv)	Advancing of intra-group loans	Where the amount of loan does not exceed ₹ 50 crore. — The **Interest rate** declared in relation to the eligible international transaction ***is not less*** than the **base rate** of SBI as on 30th June of the relevant previous year **+ 1.5%**.
		Where the amount of loan exceeds ₹ 50 crore. — The **Interest rate** declared in relation to the eligible international transaction ***is not less*** than the **base rate** of SBI as on 30th June of the relevant previous year **+ 3%**.

information technology requiring application of knowledge and advanced analytical and technical skills, namely:-

(i)	geographic information system
(ii)	human resources services
(iii)	engineering and design services
(iv)	animation or content development and management
(v)	business analytics
(vi)	financial analytics
(vii)	market research

It, however, does not include any R&D services whether or not in the nature of contract R&D services.

"Intra-group loan" means loan advanced to wholly owned subsidiary being a non-resident, where the loan–

(i)	is sourced in Indian rupees
(ii)	is not advanced by an enterprise, being a financial company including a bank or a financial institution or an enterprise engaged in lending or borrowing in the normal course of business; and
(iii)	does not include credit line or any other loan facility which has no fixed term for repayment;

(v)	Providing corporate guarantee	Where the amount guaranteed -	The commission or fee declared in relation to the eligible international transaction is at the rate not less than -
		does not exceed ₹ 100 crore.	2% p.a. on the amount guaranteed.
		exceeds ₹ 100 crore and the credit rating of the associated enterprise done by an agency registered with the SEBI is of the adequate to the highest safety	1.75% p.a. on the amount guaranteed
		"Corporate guarantee" means explicit corporate guarantee extended by a company to its wholly owned subsidiary being a non-resident in respect of any short-term or long-term borrowing. Explicit corporate guarantee, however, does not include – (i) letter of comfort; (ii) implicit corporate guarantee; (iii) performance guarantee; or (iv) any other guarantee of similar nature.	
(vi)	Provision of contract R&D services wholly or partly relating to software development.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 30%, irrespective of the aggregate value of the transactions entered into during the previous year.	"Contract research and development (R&D) services wholly or partly relating to software development" means the following, namely:- (i) R & D producing new theorems and algorithms in the field of theoretical computer science; (ii) development of information technology at the level of operating systems, programming languages, data

				management, communications software and software development tools;
			(iii)	development of Internet technology;
			(iv)	research into methods of designing, developing, deploying or maintaining software;
			(v)	software development that produces advances in generic approaches for capturing, transmitting, storing, retrieving, manipulating or displaying information;
			(vi)	experimental development aimed at filling technology knowledge gaps as necessary to develop a software programme or system;
			(vii)	R & D on software tools or technologies in specialized areas of computing (image processing, geographic data presentation, character recognition, artificial intelligence and such other areas); or
			(viii)	upgradation of existing products where source code has been made available by the principal.
				"Generic pharmaceutical drug" means a drug that is comparable to a drug already approved by the regulatory authority in dosage form, strength, route of administration, quality and performance characteristics, and intended use.
(vii)	Provision of contract R&D services wholly or partly relating to generic pharma-ceutical drugs	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 29%, irrespective of the aggregate value of the transactions entered into during the previous year.		

<table>
<tr><td>(viii)</td><td>Manufacture and export of core auto components</td><td>The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 12%, irrespective of the aggregate value of the transactions entered into during the previous year.</td><td>“Core auto components” means ,<table><tr><td>(i)</td><td>engine and engine parts, including piston and piston rings, engine valves and parts cooling systems and parts and power train components;</td></tr><tr><td>(ii)</td><td>transmission and steering parts, including gears, wheels, steering systems, axles and clutches;</td></tr><tr><td>(iii)</td><td>suspension and braking parts, including brake and brake assemblies, brake linings, shock absorbers and leaf springs;</td></tr></table></td></tr>
<tr><td>(ix)</td><td>Manufacture and export of non-core auto components</td><td>The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 8.5%, irrespective of the aggregate value of the transactions entered into during the previous year.</td><td>“Non-core auto components” mean auto components other than core auto components.</td></tr>
<tr><td colspan="4">Notes:
(1) The above provisions shall apply for A.Y. 2013-14 to A.Y. 2017-18.
(2) The second proviso to section 92C(2) provides that if the variation between the arm’s length price determined and the price at which the transaction has been undertaken does not exceed such percentage, not exceeding 3%, as may be notified by the Central Government in the Official Gazette, the price at which the transaction has actually been undertaken shall be deemed to be the arm’s length price. However, no comparability adjustment and allowance under the second proviso to section 92C(2) shall be made to the transfer price declared by the eligible assessee and accepted under the Safe Harbour Rules given above.
(3) Section 92D requiring every person who has entered into an international transaction to keep and maintain the prescribed information and documents and section 92E requiring such person to obtain a report from an accountant and furnish such report on or before the specified date in prescribed form and manner, shall apply irrespective of the fact that the assessee exercises his option for safe harbor in respect of such transaction.</td></tr>
</table>

Meaning of certain terms used above

<table>
<tr><th></th><th>Term</th><th>Meaning</th></tr>
<tr><td>(i)</td><td>Operating expense [Rule 10TA]</td><td>The costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including depreciation and amortisation expenses relating to the assets used by the assessee, but not including the following, namely, -
<table>
<tr><td>(i)</td><td>interest expense;</td></tr>
<tr><td>(ii)</td><td>provision for unascertained liabilities;</td></tr>
<tr><td>(iii)</td><td>pre-operating expenses;</td></tr>
<tr><td>(iv)</td><td>loss arising on account of foreign currency fluctuations;</td></tr>
<tr><td>(v)</td><td>extraordinary expenses;</td></tr>
<tr><td>(vi)</td><td>loss on transfer of assets or investments;</td></tr>
<tr><td>(vii)</td><td>expense on account of income-tax; and</td></tr>
<tr><td>(viii)</td><td>other expenses not relating to normal operations of the assessee;</td></tr>
</table></td></tr>
<tr><td>(ii)</td><td>Operating revenue [Rule 10TA]</td><td>The revenue earned by the assessee in the previous year in relation to the international transaction during the course of its normal operations but not including the following, namely, -
<table>
<tr><td>(i)</td><td>interest income;</td></tr>
<tr><td>(ii)</td><td>income arising on account of foreign currency fluctuations;</td></tr>
<tr><td>(iii)</td><td>income on transfer of assets or investments;</td></tr>
<tr><td>(iv)</td><td>refunds relating to income-tax;</td></tr>
<tr><td>(v)</td><td>provisions written back;</td></tr>
<tr><td>(vi)</td><td>extraordinary incomes; and</td></tr>
<tr><td>(vii)</td><td>other incomes not relating to normal operations of the assessee;</td></tr>
</table></td></tr>
<tr><td>(iii)</td><td>Operating profit margin [Rule 10TA]</td><td>Operating profit margin, in relation to operating expense, means the ratio of operating profit, being the operating revenue in excess of operating expense, to the operating expense expressed in terms of percentage;</td></tr>
</table>

(iv)	Eligible Assessee *[Rule 10TB(1)]*	A person who has exercised a valid option for application of safe harbor rules and -

(i)	is engaged in providing the following services **with insignificant risk -**	
	software development services; or	to a non-resident associated enterprise (i.e., foreign principal);
	information technology enabled services; or	
	knowledge process outsourcing services	
(ii)	has made any intra-group loan;	
(iii)	has provided a corporate guarantee;	
(iv)	is engaged in providing contract R & D services wholly or partly relating to software development, **with insignificant risk**,	to a non-resident associated enterprise (i.e., foreign principal);
(v)	is engaged in providing contract research and development services wholly or partly relating to generic pharmaceutical drugs, **with insignificant risk**,	
(vi)	is engaged in the manufacture and export of core or non-core auto components and where 90% or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales	

Factors to be considered for identifying an eligible assessee with insignificant risk, referred to in clauses of (i), (iv) & (v) of Rule 10TB(1) defining an "Eligible assessee" [Rule 10TB (2) & (3)]

	Particulars	Foreign Principal [For Clause (i)]	Foreign Principal [For Clauses (iv) & (v)]	Eligible Assessee [For clauses (i), (iv) & (v)]	Remark
(1)	Economically significant functions	Performs most of the economically significant functions involved either through its own	Performs most of the economically significant functions involved **in research or product**	Carries out the work assigned to it by the foreign principal.	Economically significant functions would include critical functions such as conceptualization and design

		employees or through its associated enterprises	**development cycle** either through its own employees or through its associated enterprises		of the product and providing the strategic direction and framework.
(2)	Funds, Capital and other economically significant assets	Provides funds/ capital and other economically significant assets including intangibles required	Provides funds/ capital and other economically significant assets including intangibles required **for research or product development.**	Does not assume or has no economically significant realized risks. Receives remuneration from the Foreign Principal for carrying out the work.	If a contract shows that the foreign principal is obligated to control the risk but the conduct shows that the eligible assessee is doing so, then the contractual terms are not the final determinant.
(3)	Supervision and control	Has not only the capability to control or supervise but also actually controls or supervises **the activities carried out** through its strategic decisions to perform core functions as well as monitor activities on regular basis.	Has not only the capability to control or supervise but also actually controls or supervises **the research or product development** through its strategic decisions to perform core functions as well as monitor activities on regular basis.	Works under the direct supervision of the foreign principal or its associated enterprise	
(4)	Ownership rights	Has ownership right on **any intangible generated or on the outcome of intangible generated or arising during the course of rendering of services.**	Has ownership right on the **outcome of the research**	Has no ownership right (legal or economic).	This fact should be evident from the contract as well as from the conduct of the parties.

Procedure [Rule 10TE]

(1) Furnishing Form 3CEFA

(i) For exercising the option for safe harbor, the assessee has to furnish Form 3CEFA, complete in all respects, to the Assessing Officer on or before the due date specified in *Explanation 2* below section 139(1), for furnishing return of income for –

the relevant assessment year	In case the option is exercised only for that assessment year
the first of the assessment years	In case the option is exercised for more than one assessment year.

(ii) The return of income for the relevant assessment year or the first of the relevant assessment years, as the case may be, has to be furnished by the assessee on or before the date of furnishing Form 3CEFA.

(iii) In respect of the assessment year or years following the initial assessment year, the assessee has to furnish a statement to the Assessing Officer before furnishing return of income of that year, providing –

- details of eligible transactions,
- their quantum and
- the profit margins or the rate of interest or commission.

(2) Period for which the option for safe harbor shall remain in force

(i) The period specified in Form 3CEFA or a period of five years, whichever is less.

(ii) The option for safe harbor shall not remain in force in respect of any assessment year following the initial assessment year, if -

(1) the option is held to be invalid for the relevant assessment year by the Transfer Pricing Officer or by the Commissioner in respect of an objection filed by the assessee against the order of the Transfer Pricing Officer, as the case may be; or

(2) the eligible assessee opts out of the safe harbour, for the relevant assessment year, by furnishing a declaration to that effect, to the Assessing Officer.

(3) Circumstances requiring determination of ALP as per sections 92C and 92CA

In the following cases, the arm's length price in relation to an international transaction shall be determined in accordance with the provisions of sections 92C and 92CA without having regard to the profit margin or the rate of interest or commission as specified rule 10TD -

(i) Where no option for safe harbour has been exercised by an eligible assessee in respect of an eligible international transaction entered into by the assessee; or

(ii) Where the option exercised by the assessee is held to be invalid

Non-applicability of Safe Harbour Rules in certain cases [Rule 10TF]

The rules for safe harbor, contained in Rules 10TA , 10TB, 10TC, 10TD or 10TE, shall **not** apply in respect of eligible international transactions entered into with an associated enterprise located in –

(i) any country or territory notified under section 94A [a Notified Jurisdictional Area (NJA)]; or

(ii) a no tax or low tax country or territory.

"No tax or low tax country or territory" means a country or territory in which the maximum rate of income-tax is less than 15%.

No recourse to MAP[Rule 10TG]

Where transfer price in relation to an eligible international transaction declared by an eligible assessee is accepted by the income tax authorities under section 92CB, the assessee shall not be entitled to invoke Mutual Agreement Procedure (MAP) under an agreement for avoidance of double taxation entered into with a country or specified territory outside India as referred to in sections 90 or 90A.

10. Notification No.79/2013 dated 07.10.2013

Reverse Mortgage Scheme amended to include within its scope, disbursement to an annuity sourcing institution for periodic payments by way of annuity to the Reverse Mortgagor

The Central Government had notified the Reverse Mortgage Scheme, 2008 in exercise of the powers conferred by clause (xvi) of section 47 of the Income-tax Act, 1961. Reverse Mortgage means mortgage of a capital asset by an eligible person against a loan obtained by him from an approved lending institution. Such kind of a transaction is not regarded as transfer under section 47(xvi) and amounts received by the Reverse Mortgagor as loan, either in lump-sum or in installment, are exempt under section 10(43).

The Central Government has, vide this notification, amended the Reverse Mortgage Scheme, 2008, to include within its scope, disbursement of loan by an approved lending institution, in part or in full, to the annuity sourcing institution, for the purposes of periodic payments by way of annuity to the reverse mortgagor. This would be an additional mode of disbursement i.e., in addition to direct disbursements by the approved lending institution to the Reverse Mortgagor by way of periodic payments or lump sum payment in one or more tranches.

An annuity sourcing institution has been defined to mean Life Insurance Corporation of India or any other insurer registered with the Insurance Regulatory and Development Authority.

Maximum Period of Reverse Mortgage Loan

	Mode of disbursement	Maximum period of loan
(a)	Where the loan is disbursed directly to the Reverse Mortgagor	20 years from the date of signing the agreement by the reverse mortgagor and the approved lending institution.
(b)	Where the loan is disbursed, in part or in full, to the annuity sourcing institution for the purposes of periodic payments by way of annuity to the Reverse mortgagor	The residual life time of the borrower.

11. Notification No. 86/2013 dated 01.11.2013

Notification of Cyprus as a Notified Jurisdictional Area under section 94A

In order to discourage assessees from entering into transactions with persons located in countries or territories outside India which do not have effective information exchange mechanism with India, section 94A empowers the Central Government to notify such country or territory outside India as a notified jurisdictional area (NJA).

Accordingly, in exercise of the powers conferred by section 94A(1), the Central Government has specified 'Cyprus' as a NJA for the purposes of the said section. The tax consequences of notifying Cyprus as a NJA under section 94A are as follows –

(i) A transaction where one of the parties thereto is a person located in Cyprus would be deemed to be an international transaction and all parties to the transaction would be deemed as associated enterprises. Accordingly, all the provisions of transfer pricing would be attracted in respect of such transaction. However, the benefit of permissible variation between the arm's length price and the transfer price [provided in the second proviso to section 92C(2)] based on the rate notified by the Central Government would not be available in respect of such transaction.

(ii) Person located in Cyprus shall include a person who is a resident of Cyprus and a person, not being an individual, which is established in Cyprus. It would also include a permanent establishment of any other person in Cyprus.

(iii) Payments made to any financial institution located in Cyprus would not be allowed as deduction unless the assessee authorizes the CBDT or any other income-tax authority acting on its behalf to seek relevant information from the financial institution on behalf of the assessee.

(iv) No deduction in respect of any other expenditure or allowance, including depreciation, arising from the transaction with a person located in Cyprus would be allowed unless the assessee maintains the prescribed documents and furnishes the prescribed information.

(v) Any sum credited or received from a person located in Cyprus would be deemed to be the income of the recipient-assessee if he does not explain satisfactorily the source of such money in the hands of such person or in the hands of the beneficial owner, if such person is not the beneficial owner.

(vi) The rate of TDS in respect of any payment made to a person located in Cyprus, on which tax is deductible at source, will be the higher of the following rates –

(1) rates specified in the relevant provision of the Income-tax Act, 1961; or

(2) rate or rates in force; or

(3) 30%.

12. Notification No. 94/2013, dated 18.12.2013

Notification of "Rajiv Gandhi Equity Savings Scheme, 2013" for the purpose of deduction under section 80CCG

The Finance Act, 2012 had inserted section 80CCG in the Income-tax Act, 1961 to provide for a one-time deduction for A.Y.2013-14 to a resident individual who acquires listed equity shares in a previous year in accordance with a scheme notified by the Central Government, to encourage flow of savings in financial instruments and improve the depth of domestic capital market. However, only a resident individual, being a new retail investor, whose gross total income did not exceed Rs.10 lakh was eligible for the benefit of deduction. The deduction was 50% of amount invested in such equity shares or Rs.25,000, whichever is lower. The maximum deduction of Rs.25,000 was available on investment of Rs.50,000 in such listed equity shares.

The Finance Act, 2013 has amended the provisions of section 80CCG w.e.f. A.Y.2014-15 so that the benefit of deduction under this section is available to a new retail investor, being a resident individual with gross total income of up to **₹ 12 lakh**, for investment in listed equity shares **or listed units of equity oriented fund,** in accordance with a notified scheme. Further, the deduction shall be allowed **for three consecutive assessment years**, beginning with the assessment year relevant to the previous year in which the listed equity shares or listed units of equity oriented fund were first acquired. The quantum of deduction would continue to remain the same.

Accordingly, the Central Government has, in exercise of the powers conferred by section 80CCG(1), notified the Rajiv Gandhi Equity Savings Scheme, 2013. The said scheme provides for eligibility criteria, procedure for investment, period of holding and other conditions.

S. No.	Particulars	Content
1.	**Eligibility**	The deduction under this scheme shall be available to a **new retail investor** who complies with the conditions of the Scheme and whose gross total income for the financial year in which the investment is made under the Scheme is less than or equal to ₹12 lakh.
		New retail investor means a resident individual,: (i) **who has not opened a demat account** and has not made any transactions in the derivative segment before - - the date of opening of a demat account; or - the first day of the **initial year**, (whichever is later) However, an individual who is not the first account holder of an existing joint demat account shall be deemed to have not opened a demat account for the purposes of this Scheme; (ii) **who has opened a demat account** but has not made any transactions in the equity segment or the derivative segment before – - the date he designates his existing demat account for the purpose of availing the benefit under the Scheme; or - the first day of the **initial year**. (whichever is later)
		Initial year means - (a) the financial year in which the investor designates his demat account as Rajiv Gandhi Equity Savings Scheme account and makes investment in the eligible securities for availing deduction under the Scheme; or

		(b) the financial year in which the investor makes investment in eligible securities for availing deduction under the Scheme for the first time, if the investor does not make any investment in eligible securities in the financial year in which the account is so designated.
2.	**Procedure for investment under the Scheme**	A new retail investor shall make investments under the Scheme in the following manner, namely:- 1. the new retail investor may invest in one or more financial years in a block of three consecutive financial years beginning with the initial year; 2. the new retail investor may make investment in eligible securities in one or more than one transaction during any financial year during the three consecutive financial years beginning with the initial year in which the deduction has to be claimed; 3. the new retail investor may make any amount of investment in the demat account but the amount eligible for deduction under the Scheme shall not exceed fifty thousand rupees in a financial year; 4. the new retail investor shall be eligible for the tax benefit under the Scheme only for three consecutive financial years beginning with the initial year, in respect of the investment made in each financial year; 5. if the new retail investor does not invest in any financial year following the initial year, he may invest in the subsequent financial year, within the three consecutive financial years beginning with the initial year, in accordance with the Scheme; 6. the new retail investor who has claimed a deduction under sub-section (1) of section 80CCG of the Act in any assessment year shall not be allowed any deduction under the Scheme for the same investment for any other assessment year; 7. the new retail investor shall be permitted a grace period of seven trading days from the end of the financial year so that the eligible securities purchased on the last trading day of the financial year also get credited in the demat account and such securities shall be deemed to have been acquired in the financial year itself; 8. the new retail investor can make investments in securities other than the eligible securities covered under the Scheme and such investments shall not be subject to the conditions of the Scheme nor shall they be counted for availing the benefit under the Scheme;

<table>
<tr><td></td><td></td><td>9. the deduction claimed shall be withdrawn if the lock-in period requirements of the investment are not complied with or any other condition of the Scheme is contravened by the new retail investor.</td></tr>
<tr><td>3.</td><td>Period of holding</td><td>The period of holding of eligible securities invested in each financial year shall be under a lock-in period of three years to be counted in the following manner:
<table>
<tr><th>Type of lock-in</th><th>Meaning</th><th>Condition</th></tr>
<tr><td>Fixed lock-in period</td><td>The period commencing from the date of purchase of eligible securities in the relevant financial year and ending on 31st March of the year immediately following the relevant financial year.</td><td>The new retail investor shall hold eligible securities for fixed lock-in period. He shall not be permitted to sell, pledge or hypothecate any eligible security during the fixed lock-in period.</td></tr>
<tr><td>Flexible lock-in period</td><td>The period of two years beginning immediately after the end of the fixed lock-in period shall be called the flexible lock-in period.</td><td>The new retail investor shall be permitted to trade the eligible securities after the completion of the fixed lock-in period subject to the conditions prescribed under the scheme.
The demat account should be compliant for a cumulative period of a minimum of 270 days during each of the two years of the flexible lock-in period. The demat account shall be considered as compliant for the number of days for which the value of the investment portfolio of eligible securities (other than those which are in fixed lock-in) is equal to or higher than the corresponding investment claimed as eligible for the purpose of deduction under section 80CCG.</td></tr>
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4.	**Other Conditions**	(i) While making initial investments up to Rs.50,000, the total cost of acquisition of eligible securities shall not include brokerage charges, securities transaction tax, stamp duty, service tax and any other tax, which may appear in the contract note. (ii) Where the investment of the new retail investor undergoes a change as a result of involuntary corporate actions including demerger of companies, amalgamation and such other actions, as may be notified by SEBI, resulting in debit or credit of securities covered under the Scheme, the deduction claimed by such investor shall not be affected. (iii) In the case of voluntary corporate actions, including buy-back resulting only in debit of securities where new retail investor has the option to exercise his choice, the same shall be considered as a sale transaction for the purpose of the Scheme.
5.	**Consequence of failure to comply with the prescribed conditions**	If the new retail investor fails to fulfill any of the provisions of the Scheme, the deduction originally allowed to him under section 80CCG(1) for any previous year, shall be deemed to be the income of the assessee of the previous year in which he fails to comply with the provisions of the Scheme and shall be liable to tax for the assessment year relevant to such previous year.
6.	**Savings**	A new retail investor who has invested in accordance with the Rajiv Gandhi Equity Savings Scheme, 2012 shall continue to be governed by the provisions of that Scheme to the extent it is not in contravention of the provisions of this Scheme and such investor shall also be eligible for the benefit of investment made in accordance with this Scheme for the financial years 2013-14 and 2014-15.

13. Notification No.6/2014 dated 15.01.2014

Contributory Health Service Scheme of the Department of Space notified under section 80D

Section 80D(2)(a) provides for deduction in respect of medical insurance premium paid or for contribution made by an individual to the Central Government Health Scheme **or such other scheme as may be notified by the Central Government.** Accordingly, the Central Government has notified the Contributory Health Service Scheme of the Department of Space, contribution to which would be eligible for deduction under section 80D.

Therefore, any contribution made by an individual towards the Contributory Health Service Scheme of the Department of Space would be eligible for deduction under section 80D, subject to the overall limit of Rs.15,000 or Rs. 20,000, as the case may be.

14. Notification No. 9/2014 dated 22.01.2014

Foreign Institutional Investors notified as per section 115AD

Section 115AD contains the special provisions for taxation of income of foreign institutional investors (FIIs) from securities or capital gains arising from transfer of securities. As per clause (a) of *Explanation* to section 115AD, the expression "Foreign Institutional Investor" means such investor as the Central Government may, by notification in the Official Gazette, specify in this behalf.

Accordingly, the Central Government has specified Foreign Portfolio Investors (FPIs) registered under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, as FII for the purposes of section 115AD. Hence, the special provisions for taxation of income of FIIs from securities and capital gains arising from transfer of securities, as contained in section 115AD, would apply to such income of Foreign Portfolio Investors registered under SEBI (FPI) Regulations, 2014.

15. Notification No. 24/2014 dated 01.04.2014

Notification of Income-tax Return Forms for the AY 2014-15

Rule 12 of Income-tax Rules, 1962 prescribing income-tax return forms applicable in respect of different categories of persons has been amended to make the same applicable for assessment year 2014-15. Further, new income-tax return forms – SAHAJ (ITR-1), ITR-2, SUGAM (ITR-4S) and ITR-V for the Assessment year 2014-15 have been substituted in the place of the existing return forms. However, there are no changes in the applicability of return forms.

Applicability of income-tax return forms to various categories of persons [Rule 12(1)]

Form No.	Applicability
ITR-1 SAHAJ	A person, being an individual, whose has - (a) Income under the head "Salaries" or family pension; (b) Income from One House Property (excluding cases where loss is brought forward from previous years); or (c) Income from Other Sources (excluding Winnings from Lottery and Income from Race Horses). He should, however, not have any loss under this head. However, the following persons cannot file their return in Form ITR-1, even if they have only income falling under the above categories – (1) A resident, other than not-ordinarily resident in India, who has an asset (including financial interest in any entity) located outside India or signing authority in any account located outside India; or

	(2) A person who has claimed any relief under section 90 or 90A or deduction under section 91; or (3) A person who has income not chargeable to tax, exceeding Rs.5,000.
ITR-2	A person, being an individual (not being an individual eligible to file return in ITR-1) or HUF, not having income from business or profession.
ITR-3	A person, being an individual or a HUF, who is a partner in a firm and whose income chargeable under the head "Profits and gains of business or profession" includes **only** income by way of interest, salary, bonus, commission or remuneration due to or received by him from such firm.
ITR-4S SUGAM	A person, being an individual or a HUF, deriving business income and such income is computed in accordance with special provisions referred to in section 44AD and 44AE. However, the following persons cannot file their return in Form ITR-4S, even if they have only business income computed as per the provisions of section 44AD or section 44AE – (1) A resident, other than not-ordinarily resident in India, who has an asset (including financial interest in any entity) located outside India or signing authority in any account located outside India; or (2) A person who has claimed any relief under section 90 or 90A or deduction under section 91; or (3) A person who has income not chargeable to tax, exceeding Rs.5,000.
ITR-4	A person, being an individual or HUF, other than those to whom ITR-1, ITR-2, ITR-3 and ITR-4S are applicable, and having income from a proprietary business or profession.
ITR-5	A person, not being an individual or a HUF or a company or a person who is required to file return in Form ITR-7. In effect, ITR-5 is applicable in case of a firm, LLP, AOP, BOI, artificial juridical person referred to in section 2(31)(vii), co-operative society and local authority. However, persons required to file return in Form ITR-7 cannot use this form.
ITR-6	A company, other than a company claiming exemption under section 11. A company required to file its return in Form ITR-7, therefore, cannot use this form.
ITR-7	A person, including a company, whether or not registered under section 25 of the Companies Act, 1956, required to furnish return under section 139(4A) or section 139(4B) or section 139(4C) or section 139(4D)
ITR V	Verification of return filed electronically without digital signature or in paper form or in bar-coded form.

Filing of annexure-less return [Rule 12(2)]

The return forms (ITR-1, ITR-2, ITR-3, ITR-4, ITR-4S, ITR-5 & ITR-6) shall not be accompanied by any annexure such as statement showing the computation of tax, TDS certificates, challan etc.. However, where an assessee is required to furnish a report of audit under section 44AB, 92E, or 115JB, the same shall be furnished electronically. ***Likewise, the notice in writing given to the Assessing Officer under section 11(2)(a) mentioning the purpose for which the income is being accumulated or set apart by a charitable trust/institution and the period thereof, is also required to be furnished electronically.***

Manner of filing return of income [Rule 12(3)]

The return of income may be furnished in any of the following manners:

(i) in paper form; or

(ii) electronically under digital signature; or

(iii) electronically without digital signature [followed by submission of the verification of the return in Form ITR-V]; or

(iv) bar coded return in paper form

The following persons are required to furnish the return of income electronically, but have the option to furnish the same with or without digital signature, for A.Y.2014-15:

(i) A person, other than a company and persons required to furnish the return in Form ITR-7, whose total income exceeds Rs.5 lakh.

(ii) An individual or HUF, being a resident other than not-ordinarily resident in India, having assets (including financial interest in any entity) located outside India or signing authority in any account located outside India and required to furnish the return in Form ITR-2, ITR-3 or ITR-4.

(iii) A person claiming relief of tax under section 90 or 90A or deduction of tax under section 91.

(iv) A person required to furnish return in ITR-5, other than a firm to which provisions of section 44AB are applicable.

(v) A person, other than political party referred to in section 139(4B), required to furnish the return in Form ITR -7. Such person also has the option to furnish return in paper form.

The following persons are required to furnish the return of income electronically under digital signature:

(i) a company required to furnish its return in ITR-6;

(ii) a firm required to furnish return in ITR-5 or an individual or HUF required to furnish return in ITR 4 and to whom the provisions of section 44AB are applicable;

(iii) a political party referred to in section 139(4B), required to furnish return in ITR 7.

Note – *The portion marked in* ***bold italics*** *above represent the changes/additions made by Notification No.24/2014 dated 1.4.2014.*

II. CIRCULARS

1. Circular No.06/2013 dated 29.6.2013

Clarifications on Functional Profile of Development Centres engaged in contract R&D Services with insignificant risk – Conditions relevant to identify such Development Centres

There exists divergent views amongst the field officers and taxpayers regarding the functional profile of development centres engaged in contract R & D services for the purposes of determining arm's length price/transfer pricing. In some cases, while taxpayers insist that they are contract R & D service providers with insignificant risk, the TPOs treat them as full or significant risk-bearing entities and make transfer pricing adjustments accordingly.

The CBDT has, vide this Circular, addressed this issue by classifying the Research and Development Centres set up by foreign companies into three broad categories based on functions, assets and risk assumed by the centre established in India. While the three categories are not water-tight compartments, it is possible to distinguish them based on functions, assets and risk, as shown hereunder -

	Categories of R&D Centres	Nature of functions performed and level of risks assumed by the corresponding category of the Development Centre
(1)	Centres which are entrepreneurial in nature	Performs significantly important functions and assumes substantial risks
(2)	Centres which are based on cost-sharing arrangements	Performs functions which are of relatively lesser significance and assumes moderate risks.
(3)	Centres which undertake contract research and development	Performs functions which are of low significance and assumes minimal risks

The assessees, largely, tend to claim that the Development Centre in India is a contract R&D service provider with insignificant risk, and consequently, adopt the Transactional Net Margin Method (TNMM) as the most appropriate method.

The CBDT, after due consideration, has laid down the following guidelines for identifying the Development Centre as a contract R & D service provider with insignificant risk –

	Foreign Principal	Indian Development Centre	Remark
(1)	Performs most of the economically significant functions involved in research or product development cycle either through its own employees or through its associated enterprises.	Carries out the work assigned to it by the foreign principal.	Economically significant functions would include critical functions such as conceptualization and design of the product and providing the strategic direction and framework.
(2)	Provides funds/ capital and other economically significant assets including intangibles for research or product development. Provides remuneration to the Indian Development Centre for the work carried out by the latter.	Does not assume or has no economically significant realized risks	If a contract shows that the foreign principal is obligated to control the risk but the conduct shows that the Indian Development Centre is doing so, then the contractual terms are not the final determinant of actual activities.
(3)	Has not only the capability to control or supervise but also actually controls or supervises research or product development through its strategic decisions to perform core functions as well as monitor activities on regular basis.	Works under the direct supervision of the foreign principal or its associated enterprise	
(4)	Has ownership right on the outcome of the research	Has no ownership right (legal or economic) on the outcome of the research	This fact should be evident from the contract as well as from the conduct of the parties.

In the case of a foreign principal being located in a country/territory widely perceived as a low or no tax jurisdiction, it will be presumed that the foreign principal is not controlling the risk. However, the Indian Development Centre may rebut this presumption to the satisfaction of the revenue authorities. Low tax jurisdiction shall mean any country or

territory notified in this behalf under section 94A of the Act or any other country or territory that may be notified for the purpose of Chapter X of the Act;

The Assessing Officer or the Transfer Pricing Officer, as the case may be, shall have regard to the guidelines above and shall take a decision based on the totality of the facts and circumstances of the case. In doing so, the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall be guided by the conduct of the parties and not merely by the terms of the contract.

The Assessing Officer or the Transfer Pricing Officer, as the case may be, shall bear in mind the provisions of section 92C of the Income-tax Act, 1961 and Rule 10A to Rule 10C of the Income-tax Rules, 1962. He has to apply the guidelines laid down in the Circular and select the 'most appropriate method'.

2. Circular No.05/2013 dated 29.06.2013

Withdrawal of Circular No.2/2013, dated 26-3-2013 on application of Profit Split Method for computation of Arm's Length Price

The Circular No. 2/2013 listed the factors to be taken into account for selection and application of the profit split method as the most appropriate method for computation of arm's length price.

Since the Circular appeared to give the impression that there was a hierarchy among the six methods listed in section 92C and that Profit Split Method (PSM) was the preferred method in the case involving unique intangible or in multiple interrelated international transactions, the CBDT has, consequently, withdrawn the said Circular (i.e., Circular No. 2/2013 dated 26th March 2013), with immediate effect.

3. Circular No.10/2013, dated 16.12.2013

Disallowance of interest etc. paid to a resident at any time during the previous year without deduction of tax under section 40(a)(ia)

Section 40(a)(ia) provides for disallowance of any interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in section 139(1).

There have been conflicting interpretations by judicial authorities regarding the applicability of provisions of section 40(a)(ia), with regard to the amount not deductible in computing the income chargeable under the head 'Profits and gains of business or profession'. Some court rulings have held that the provisions of disallowance under section 40(a)(ia) apply only to the amount which remained payable at the end of the relevant financial year and would not be invoked to disallow the amount which had actually been paid during the previous year without deduction of tax at source.

***Departmental View*:** The CBDT's view is that the provisions of section 40(a)(ia) would cover not only the amounts which are payable as on 31st March of a previous year but also amounts which are payable at any time during the year. The statutory provisions are amply clear and in the context of section 40(a)(ia), the term "payable" would include "amounts which are paid during the previous year".

The Circular has further clarified that where any High Court decides an issue contrary to the above "Departmental View", the "Departmental View" shall not be operative in the area falling in the jurisdiction of the relevant High Court.

4. Circular No. 1/2014, dated 13.1.2014

Non-deduction of tax at source on the service tax component comprised in payments made to residents, if the service-tax component is indicated separately

The CBDT had issued Circular No.4/2008 dated 28.4.2008 clarifying that tax is to be deducted at source under section 194-I, on the amount of rent paid/payable without including the service tax component. However, this Circular was silent regarding deduction of tax at source on the service tax component of other payments on which TDS provisions are applicable.

Accordingly, in exercise of the powers conferred under section 119, the Board has, vide this Circular, clarified that wherever in terms of the agreement/contract between the payer and the payee, the service tax component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source under Chapter XVII-B on the amount paid/payable without including such service tax component.

5. Circular No. 2/2014 dated 20.01.2014

Taxability of Awards received by a Sportsman

The CBDT had issued Circular No.447 on 22nd January, 1986 clarifying that awards received by a sportsman, who is not a professional, will not be liable to tax in his hands as the award will be in the nature of a gift and/or personal testimonial. This Circular was applicable when the gift was not taxable in the hands of the recipient. Thereafter, in the year 2005, there was a fundamental change in the manner of treatment of gift through insertion of sub-clauses (xiii), (xiv) and (xv) of section 2(24). Corresponding amendments were also made in section 56(2) by insertion of clauses (v), (vi) and (vii), thereby making an amount of money or immovable property received without consideration taxable subject to provisions of these clauses. Consequently, the CBDT has, through this Circular, clarified that *Circular No.447* had become inapplicable w.e.f. 1-4-2005, since the statutory provisions have overridden the same.

It may however be noted that, in terms of provisions of section 10(17A), Central Government approves awards instituted by Central Government, State Government or other bodies as also the purposes for rewards instituted by Central Government or State

Government from time to time. Tax exemption can be sought by eligible persons in respect of awards or rewards covered by such approvals.

6. Circular No. 5/2014, dated 11.2.2014

Clarification regarding disallowance of expenses under section 14A in cases where corresponding exempt income has not been earned during the financial year

The Finance Act, 2001 had introduced section 14A, with retrospective effect from 1st April, 1962, to provide that no deduction shall be allowed in respect of expenditure incurred relating to income which does not form part of total income. A controversy has arisen as to whether disallowance can be made by invoking section 14A even in those cases where no income has been earned by an assessee, which has been claimed as exempt during the financial year.

The CBDT has, through this Circular, clarified that the legislative intent is to allow only that expenditure which is relatable to earning of income. Therefore, it follows that the expenses which are relatable to earning of exempt income have to be considered for disallowance, irrespective of the fact whether such income has been earned during the financial year or not.

The above position is clarified by the usage of the term "includible" in the heading to section 14A [Expenditure incurred in relation to income not includible in total income] and Rule 8D [Method for determining amount of expenditure in relation to income not includible in total income], which indicates that it is not necessary that exempt income should necessarily be included in a particular year's income, for triggering disallowance. Also, the terminology used in section 14A is "income under the Act" and not "income of the year", which again indicates that it is not material that the assessee should have earned such income during the financial year under consideration.

In effect, section 14A read along with Rule 8D provides for disallowance of expenditure even where the taxpayer has not earned any exempt income in a particular year.

7. Circular No. 6/2014, dated 11.2.2014

Clarification regarding scope of additional income-tax on distributed income under section 115R

Section 115R provides for levy of additional tax on distributed income to unit holders. Some Assessing Officers have taken a view that mutual funds/specified companies are required to pay additional income- tax under section 115R not only on income distributed by way of dividend but also on payments made at the time of redemption/repurchase of units as well as at the time of allotment of bonus units to existing investors.

On these issues, the CBDT has clarified the following –

(i) Section 115R(2) requires payment of additional income-tax at the rates prescribed thereunder in respect of any amount distributed by a specified company or a mutual fund to its unit holders. The income so distributed by such entities constitutes dividend paid to the unit holders and is liable to tax thereunder. However, **redemption of units or repurchase of units would not attract levy of tax under**

section 115R(2) as such income is not in the nature of income "distributed" to the unit holders and hence, lies outside the purview of this section.

(ii) Further, the income so distributed by the mutual fund or the specified company is specifically exempt from tax under section 10(35) in the hands of the recipient unit holders. As per the proviso to section 10(35), exemption of income thereunder is not applicable to those cases where transfer of units take place. The recipient of income is, therefore, liable to pay capital gains tax, if applicable, as per the relevant provisions of the Act, on transfer of such units.

(iii) Also, since issue of bonus units is not akin to distribution of income by way of dividend, the same would not be subject to additional income tax under section 115R. This inference can be drawn from the provisions of section 55, prescribing "cost of acquisition" of bonus shares as Nil for the purposes of computation of capital gains tax.

Thus, in view of the above position, the CBDT has, in exercise of its powers under section 119, clarified that additional income-tax under section 115R(2) is to be levied on income distributed by way of dividend to unit-holders of mutual fund or specified companies. Further, it is specifically clarified that receipts from redemption/repurchase of units or allotment of additional units by way of bonus units would **not** be subject to levy of additional income-tax thereunder.

8. Circular No. 8/2014 dated 31.03.2014

Taxability of partner's share, where the income of the firm is exempt under Chapter III / deductible under Chapter VI-A

Section 10(2A) provides that a partner's share in the total income of a firm which is separately assessed as such shall not be included in computing the total income of the partner. In effect, a partner's share of profits in such firm is exempt from tax in his hands.

Sub-section (2A) was inserted in section 10 by the Finance Act, 1992 with effect from 1.4.1993 consequent to change in the scheme of taxation of partnership firms. Since A.Y.1993-94, a firm is assessed as such and is liable to pay tax on its total income. A partner is, therefore, not liable to tax once again on his share in the said total income.

An issue has arisen as to the amount which would be exempt in the hands of the partners of a partnership firm, in cases where the firm has claimed exemption/deduction under Chapter III or Chapter VI-A.

The CBDT has clarified that the income of a firm is to be taxed in the hands of the firm only and the same can under no circumstances be taxed in the hands of its partners. Therefore, the entire profit credited to the partners' accounts in the firm would be exempt from tax in the hands of such partners, even if the income chargeable to tax becomes Nil

in the hands of the firm on account of any exemption or deduction available under the provisions of the Act.

9. Circular No. 09/2014, dated 23.04.2014

Clarification regarding treatment of expenditure incurred for development of roads/highways in Build-Operate-Transfer (BOT) agreements under the Income-tax Act, 1961

The CBDT has, vide this Circular, clarified the tax treatment of expenditure incurred on development and construction of infrastructural facilities like roads/highways on Build-Operate-Transfer (BOT) basis with right to collect toll - whether the same is entitled to depreciation under section 32(1)(ii) or can be amortized by treating it as an allowable business expenditure under the relevant provisions of the Income- tax Act, 1961.

Generally, the BOT basis projects are entered into between the developer and the government or the notified authority, on the following terms:

(i) In such projects, the developer, in terms of concessionaire agreement with Government or its agencies, is required to construct, develop and maintain the infrastructural facility of roads/highways which, *inter alia*, includes laying of road, bridges, highways, approach roads, culverts, public amenities etc. at its own cost and its utilization thereof for a specified period.

(ii) The possession of land is handed over to the assessee (i.e., the developer) by the Government/ notified authority for the purpose of construction of the project without any actual transfer of ownership. The assessee, therefore, has only a right to develop and maintain such asset. It also enjoys the benefits arising from the use of asset through collection of toll for a specified period, without having actual ownership over such asset. Therefore, the rights in the land remain vested with the Government/notified agencies.

(iii) Since the assessee does not hold any rights in the project except recovery of toll fee to recoup the expenditure incurred, it cannot be treated as an owner of the property, either wholly or partly, for purposes of allowability of depreciation under section 32(1)(ii). Thus, claim of depreciation on tollways is not allowable due to non-fulfillment of ownership criteria in such cases.

(iv) Where the assessee incurs expenditure on a project for development of roads/highways, it is entitled to recover cost incurred towards development of such facility (comprising of construction cost and other pre-operative expenses) during construction period. Further, expenditure incurred by the assessee on such BOT projects brings to it an enduring benefit in the form of right to collect the toll during the period of agreement.

The Supreme Court, in *Madras Industrial Investment Corporation Ltd. vs. CIT 225 ITR 802,* allowed the spreading over of liability over a number of years on the ground that there was continuing benefit to the company over a period. Therefore, analogously, expenditure incurred on an infrastructure project for development of roads/highways under BOT agreement may be treated as having been made/incurred for the purposes of

business or profession of the assessee and same shall be allowed to be spread during the tenure of concessionaire agreement.

In view of the above, the CBDT, in exercise of the powers conferred under section 119, clarifies that the cost of construction on development of infrastructure facility, being roads/highways under BOT projects, may be amortized and claimed as allowable business expenditure under the Act in the following manner:

(i) The amortization allowable may be computed at the rate which ensures that the whole of the cost incurred in creation of infrastructural facility of road/highway is amortised evenly over the period of concessionaire agreement after excluding the time taken for creation of such facility.

(ii) Where an assessee has claimed any deduction out of initial cost of development of infrastructure facility of roads/highways under BOT projects in earlier years, the total deduction so claimed for the assessment years prior to assessment year under consideration may be deducted from the initial cost of infrastructure facility of roads/highways and the cost so reduced shall be amortised equally over the remaining period of toll concessionaire agreement.

The clarification given in this Circular is applicable only to those infrastructure projects for development of road/highways on BOT basis where ownership is not vested with the assessee under the concessionaire agreement.

Part II : Judicial Update – Direct Tax Laws

Significant Legal Decisions

Basic Concepts

1. Can waiver of loan or advance taken for the purpose of relocation of office premises be treated as a revenue receipt liable to tax?

CIT v. Softworks Computers P. Ltd. (2013) 354 ITR 16 (Bom.)

Facts of the case:

In the present case, the assessee-company worked as a dedicated software development centre for Speedwing British Airways (Speedwing BA). It provided transaction processing facilities and airline control system services to Speedwing BA. The assessee-company was located in the same premises as that of Speedwing BA. As a matter of arrangement, it was decided that the assessee-company should relocate itself to an independent location, for which purpose, Speedwing BA provided an advance of one lakh pounds to the assessee-company. Later, Amadeus Global Travel stepped into the shoes of Speedwing BA and assumed its rights and liabilities. Consequently, a new agreement was signed between the assessee-company and Amadeus Global Travel which, *inter alia,* relieved the assessee-company of its liability to repay the advance of one lakh pounds.

Assessee's view vs. Assessing Officer's view:

The assessee-company claimed that such waiver, being capital in nature, was not taxable and hence, did not include the same while computing its taxable income. The Assessing Officer, however, opined that such waiver of loan was a revenue receipt, and so he added the same to the income of the assessee-company.

High Court's decision:

On appeal, the Bombay High Court held that since the advance taken by the assessee-company was utilized by it for the purpose of relocating its office premises i.e., for acquisition of a capital asset, namely, a new office, the waiver of the same cannot be said to be waiver or remission of trading liability to attract taxability under the Act. Waiver of such advance, being capital in nature, is not taxable under the Act.

2. What is the nature of grant received by a subsidiary company from its holding company to recoup the losses incurred year after year and to enable it to meet its liabilities - Capital or Revenue?

CIT v. Handicrafts and Handlooms Export Corporation of India Ltd. (2014) 360 ITR 0130 (Delhi)

Facts of the case:

The assessee, a Government company, operates a channelising agency for sale of handicrafts and handlooms abroad. In the relevant previous year, it received a grant of ₹

25 lakh from its holding company, the State Trading Corporation of India (STC). The Assessing Officer opined that the said amount was a revenue receipt chargeable to tax.

Tribunal's view:

The Appellate Tribunal held that the grant received was not taxable as revenue receipt since the said grant was given to recoup the losses incurred by the assessee and was hence, in the nature of capital contribution.

High Court's Observations:

The High Court examined the judgment of the Supreme Court in *Sahney Steel and Press Works Ltd. v. CIT (1997) 228 ITR 253,* which laid down the test for determining whether subsidy received by an assessee is taxable as capital or revenue receipt. As per the said test, if any subsidy is given, the character of the subsidy in the hands of the recipient - whether revenue or capital - will have to be determined by having regard to the purpose for which the subsidy is given. The point of time, the source and the form of subsidy are immaterial. The object for which the subsidy is given, would, thus determine the nature of subsidy. If it is given by way of assistance to the assessee in carrying on of his trade or business, it has to be treated as trading receipt.

The High Court observed that, in this case, ₹ 25 lakhs was not paid by a third party or by a public authority but by the holding company. It was not on account of any trade or commercial transaction between the subsidiary and holding company. The intention and purpose behind the said payment was to secure and protect the capital investment made by STC Ltd. The payment of grant by STC Ltd. and receipt thereof by the assessee was not during the course of trade or performance of trade, and thus, could not partake the character of a trading receipt. The same was in the nature of a capital grant.

The High Court observed the difference between Government Grant and payment made by STC, as pointed out by the Division Bench in *Handicrafts and Handlooms Corporation Ltd. v. CIT (1983) 140 ITR 532*. The grants given were specific amounts paid by STC to the assessee, in order to enable the assessee, which was its subsidiary and was incurring losses year after year, to recoup these losses and to enable it to meet its liabilities. These amounts, therefore, cannot form part of the trading receipts of the assessee since these were not in the nature of grants received from an outsider or the Government on general grounds such as for carrying on of trade.

High Court's Decision:

The High Court, in this case, observed that in all the years, it was the case of a 100% holding company coming to the rescue of its subsidiary. Applying the rationale of Apex Court decision in the case of *Sahney Steel [1997] 228 ITR 253 (SC)*, which requires the nature of subsidy to be decided on the basis for which the subsidy was given, the High Court held that grant given by the holding company in this case is in the nature of capital receipt since its purpose is to secure and protect the capital investment made in the subsidiary company.

Incomes which do not form part of total income

3. In a case where the application for registration of a charitable trust is not disposed of within the period of 6 months as required under section 12AA(2), can the trust be deemed to have been registered as per provisions of section 12AA?

CIT v. Karimangalam Onriya Pengal Semipu Amaipu Ltd. (2013) 354 ITR 483 (Mad)

High Court's Observations:

On this issue, the Madras High Court observed that as per the provisions of section 12AA(2), every order granting or refusing registration under section 12AA(1)(b), **shall** be passed by the registering authority before the expiry of six months from the end of the month in which the application was received under section 12A(1)(a) or section 12A(1)(aa).

The Madras High Court observed the decision of the Orissa High Court, in *Srikhetra, A.C. Bhakti-Vedanta Swami Charitable Trust v. ACIT (2006) (II) OLR 75,* wherein it was held that the period of six months as provided under section 12AA(2) is not mandatory. In that case, the Orissa High Court observed that in order to ascertain whether a provision is mandatory or not, the expression 'shall' is not always decisive. The nature of the statutory provision, whether mandatory or directory, has to be ascertained not only from the wording of the statute, but also from the nature and design of the statute and the purpose sought to be achieved. Further, since the consequence for non-adherence of the time limit of six months is not spelt out in the statute, it cannot be said that passing the order within such time limit is mandatory in nature. The Orissa High Court also opined that in the absence of any clear statutory intent to the contrary, when public duty is to be performed by the public authorities, the time-limit which is granted by the statute is normally directory and not mandatory. Hence, though the word 'shall' has been used in section 12AA(2), the period of six months provided thereunder is not mandatory but directory in nature.

High Court's decision:

Accordingly, in the present case, the Madras High Court held that the time frame mentioned in section 12AA(2) is only directory in nature and non-consideration of the registration application within the said time frame of six months would not amount to "deemed registration".

Note - *Similar ruling was pronounced by the Madras High Court in the case of CIT v. Sheela Christian Charitable Trust (2013) 354 ITR 478, holding that there is no automatic or deemed registration if the application filed under section 12AA was not disposed of within the stipulated period of six months.*

4. Where a charitable trust applied for issuance of registration under section 12A within a short time span (nine months, in this case) after its formation, can registration be denied by the concerned authority on the ground that no charitable activity has been commenced by the trust?

DIT (Exemptions) v. Meenakshi Amma Endowment Trust (2013) 354 ITR 219 (Kar.)

Facts of the case:

In the present case, the assessee, being a trust, made an application under section 12A for issuance of registration within nine months of its formation. The registration authority issued a show cause notice to the assessee-trust to furnish its audited accounts as also material indicating the actual activities undertaken by the trust. In response to the said notice, the assessee-trust furnished the details, wherein it indicated that it has not yet commenced any charitable activity. The concerned registration authority, not being satisfied with the reply, refused to grant registration to the trust on the ground that it has not commenced any charitable activity.

Issue:

The issue under consideration is whether registration under section 12AA can be denied on the ground of non-commencement of charitable activity, where an application for registration has been made within a short-time span after the formation of the trust.

High Court's observations:

On this issue, the Karnataka High Court opined that an application under section 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in case the registration is sought much later after formation of the trust.

The High Court further observed that, in this case, the corpus fund included contribution made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities. Also, it was not the Revenue's contention that the assessee-trust had collected lots of donations for the activities of the trust, by the time its application came up for consideration before them. When the application for registration was made, the trust, therefore, did not have sufficient funds for commencement of its activities.

High Court's decision:

The High Court observed that, with the money available with the trust, it cannot be expected to carry out activity of charity immediately. Consequently, in such a case, it cannot be concluded that the trust has not intended to do any activity of charity. In such a situation, the objects of the trust as mentioned in the trust deed have to be taken into consideration by the authorities for satisfying themselves about the genuineness of the trust and not the activities carried on by it. Later on, if it is found from the subsequent returns filed by the trust, that it is not carrying on any charitable activity, it would be open to the concerned authorities to withdraw the registration granted or cancel the registration as per the provisions of section 12AA(3).

Income from house property

5. **Whether the rental income derived from the unsold flats which are shown as stock-in-trade in the books of the assessee would be taxable under the head 'Profits and gains from business and profession' or under the head 'Income from house**

property', where the actual rent receipts formed the basis of computation of income?

New Delhi Hotels Ltd. v. ACIT (2014) 360 ITR 0187 (Delhi]

On this issue, in *CIT v. Ansal Housing Finance and Leasing Co. Ltd. (2013) 354 ITR 180*, where the deemed rent (i.e., annual letting value) formed the basis of computation of income from unsold flats held as stock-in-trade, the Delhi High Court held that such rent was taxable under the head "Income from house property". Further, in *CIT v. Discovery Estates Pvt. Ltd.* and *CIT v. Discovery Holding Pvt. Ltd. (2013) 356 ITR 159*, the same issue emerged when the actual rent formed the basis of computation of income from unsold flats held as stock-in-trade. In that case also, the Delhi High Court held that the income was taxable under the head "Income from house property".

High Court's Decision:

In this case, the Delhi High Court followed its own decision in the case of *CIT vs. Discovery Estates Pvt. Ltd / CIT vs. Discovery Holding Pvt. Ltd.,* wherein it was held that rental income derived from unsold flats which were shown as stock-in-trade in the books of the assessee should be assessed under the head "Income from house property" and not under the head "Profits and gains from business and profession".

***Note** – In effect, irrespective of whether it is the deemed rent or actual rent which forms the basis of computing income from unsold flats held as stock-in-trade, the head under which the income is taxable would be "Income from house property".*

Profits and Gains of Business or Profession

6. Is *Circular No. 5/2012 dated 01.08.2012* disallowing the expenditure incurred on freebies provided by pharmaceutical companies to medical practitioners, in line with *Explanation* to section 37(1), which disallows expenditure which is prohibited by law?

Confederation of Indian Pharmaceutical Industry (SSI) v. CBDT (2013) 353 ITR 388 (H.P.)

High Court's observations:

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

The CBDT, considering the fact that the claim of any expense incurred in providing freebies to medical practitioners is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, has, *vide Circular*

No.5/2012 dated 1.8.2012, clarified that the expenditure so incurred shall be inadmissible under section 37(1). The disallowance shall be made in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebies and claimed it as a deductible expense in its accounts against income.

High Court's decision:

The High Court opined that the contention of the assessee that the above mentioned Circular goes beyond section 37(1) was not acceptable. As per *Explanation* to section 37(1), it is clear that any expenditure incurred by an assessee for any purpose which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession. The sum and substance of the circular is also the same. Therefore, the circular is totally in line with the *Explanation* to section 37(1).

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

7. Can the amount of employees' contribution towards provident fund, deducted and credited to the employee's PF account by the employer-assessee after the "due date" under the EPF & Miscellaneous Provisions Act, 1952, but before the due date of filing return of income under the Income-tax Act, 1961, be allowed as deduction while computing business income of the employer-assessee?

CIT v. Kichha Sugar Co. Ltd. (2013) 356 ITR 351 (Uttarakhand)

High Court's observations:

On this issue, the Uttarakhand High Court observed that the "due date" referred to in section 36(1)(va) must be read in conjunction with the "due date" referred to in the first proviso to section 43B. A combined reading of both the sections would make it clear that the due date referred to in section 36(1)(va) is the due date as mentioned in section 43B i.e., the due date of filing of return of income. Therefore, any amount of employees' contribution paid by the employer-assessee to the provident fund authorities after the due date under the Employees Provident Fund & Miscellaneous Provisions Act, 1952 (EPF & MP Act) but before the due date of filing the return for the previous year, shall be allowable as deduction in the hands of the employer-assessee.

The High Court opined that the Assessing Officer had committed an error in disallowing the said payment on account of delay in depositing the same to the credit of the account of the employee maintained with the provident fund authorities, taking a view that the due date mentioned in section 36(1)(va) is the due date fixed by the provident fund authorities under the EPF & MP Act, without considering the provisions of section 43B. The High Court concurred with the opinion of the previous appellate authority/ies that the amount paid was no longer in the hands of the employer and thus, cannot be taken as income in the hands of the employer-assessee.

High Court's decision:

Therefore, the employees' contribution to provident fund, deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer-assessee with the provident fund authority on or before the due date of filing the return for the previous year.

Note - *As per provisions of section 2(24)(x), any sum received by the assessee from his employees as a contribution towards, inter alia, any provident fund, shall be included in the income of the assessee.*

Section 36(1)(va) provides for deduction, while computing income under the head 'Profit and gains of business or profession', of any sum received by the assessee from any of its employees to which provisions of section 2(24)(x) apply, provided the same is credited by the assessee to the employee's account in the relevant fund on or before the due date. Explanation to section 36(1)(va) clarifies that the "due date" referred to therein is the date by which the assessee is required as an employer to credit an employee's contribution to the employee's account in the relevant fund (i.e., Provident Fund, in this case) under any Act (i.e., EPF & MP Act, in this case).

Section 43B provides for certain deductions only on actual payment. The first proviso to section 43B permits such payments to be made on or before the due date of filing of return under section 139(1), for the purpose of admissibility of deduction. The payments covered under section 43B include, inter alia, any sum payable by the assessee as an employer by way of contribution to any provident fund.

Thus, whereas section 43B permits payment of employer's contribution to PF on or before the due date of filing of return to qualify for deduction, section 36(1)(va) provides a time limit upto the due date specified under the EPF & MP Act for credit of employee's contribution to the employee's PF account, for claiming deduction under that section.

In this case, the High Court has concluded that the extended time limit upto the due date of filing of return under section 43B is also available for credit of employee's contribution to his PF Account, even though Explanation to section 36(1)(va) requires such payment to be made on or before the due date under the EPF & MP Act to qualify for deduction.[1]

8. What is the nature of expenditure incurred on glow-sign boards displayed at dealer outlets - capital or revenue?

CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR 49 (Delhi)

[1] *Recently, the Gujarat High Court, in CIT v. Gujarat State Road Transport Corporation (2014) 223 Taxmann 398, held that employees contribution to provident fund, deposited by an employer after the due date under the EPF & MP Act but before the due date of filing of return for the relevant assessment year, is not allowable as deduction under section 36(1)(va).*

High Court's observations:

On this issue, the Delhi High Court noted the following observations of the Punjab and Haryana High Court in *CIT v. Liberty Group Marketing Division [2009] 315 ITR 125,* while holding that such expenditure was revenue in nature -

(i) The expenditure incurred by the assessee on glow sign boards does not bring into existence an asset or advantage for the enduring benefit of the business, which is attributable to the capital.

(ii) The glow sign board is not an asset of permanent nature. It has a short life.

(iii) The materials used in the glow sign boards decay with the effect of weather. Therefore, it requires frequent replacement. Consequently, the assessee has to incur expenditure on glow sign boards regularly in almost each year.

(iv) The assessee incurred expenditure on the glow sign boards with the object of facilitating the business operation and not with the object of acquiring asset of enduring nature.

High Court's decision:

The Delhi High Court concurred with the above observations of the P & H High Court and held that such expenditure on glow sign boards displayed at dealer outlets was revenue in nature.

9. What is the eligible rate of depreciation in respect of computer accessories and peripherals under the Income-tax Act, 1961?

CIT v. BSES Yamuna Powers Ltd (2013) 358 ITR 47 (Delhi)

Assessee's contention vs. Department's contention:

The assessee claimed depreciation on computer accessories and peripherals at the rate of 60%, being the eligible rate of depreciation on computers including computer software. However, the Revenue contended that computer accessories and peripherals cannot be treated at par with computers and computer software, and hence were eligible for depreciation at the general rate applicable to plant and machinery, i.e., 15%.

High Court's decision:

The High Court observed that computer accessories and peripherals such as printers, scanners and server etc. form an integral part of the computer system and they cannot be used without the computer. Consequently, the High Court held that since they are part of the computer system, they would be eligible for depreciation at the higher rate of 60% applicable to computers including computer software.

Note *- The Delhi High Court, in CIT v. Orient Ceramics and Industries Ltd. [2013] 358 ITR 0049, following its own judgment in the above case, held that depreciation on UPS is allowable @ 60%, being the eligible rate of depreciation on computers including computer software, and not at the general rate of 15% applicable to plant and machinery.*

10. Can share issue expenses incurred by a company be treated as capital in nature, if the public issue could not ultimately materialize on account of non-clearance by SEBI?

Mascon Technical Services Ltd. v. CIT (2013) 358 ITR 545 (Mad.)

Facts of the case:

The assessee-company incurred share issue expenses of ₹ 35.39 lakh for its proposed public issue, which could not ultimately materialize due to non-clearance by the SEBI. It claimed such expenses as revenue in nature, on the ground that the same was incurred for augmenting its working capital. The claim of the assessee was, however, rejected by the Assessing Officer.

Assessee's contention vis-à-vis Tribunal's contention:

On appeal to the Tribunal, the assessee contended that the expenditure incurred was only for the purpose of bettering the cash availability and the working capital of the company, and hence, the same should be allowed as a revenue expenditure. The assessee further contended that since incurring of share issue expenses did not result in increase in the share capital of the company on account of the reasons beyond its control, such expenditure should be allowed as revenue expenditure.

The Tribunal rejected the said contention of the assessee and took the view that the share issue expenditure was incurred *prima facie* for expansion of the capital base of the company and was, hence, in the nature of capital expenditure. The fact that the efforts had got frustrated later on would not alter the nature of the expenditure.

High Court's Decision:

The High Court noted that the assessee-company had taken steps to go in for a public issue and incurred share issue expenses for the same. However, it could not go in for the public issue by reason of the orders issued by the SEBI just before the proposed issue. Though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts. The expenditure, therefore, constitutes a capital expenditure.

11. Can depreciation under section 32 be allowed on the plant and machinery which is ready for use but could not be put to use at any time during the previous year due to some extraneous reason, for example, paucity of raw material?

CIT v. Chennai Petroleum Corporation Ltd. (2013) 358 ITR 314 (Mad.)

Facts of the case:

The assessee claimed depreciation on the gas sweetening plant, which was built during the relevant previous year, but was not put to use in that year on account of non-availability of raw material i.e., sour gas. In the earlier previous year, the plant was commissioned by running a test run for the first time and depreciation was allowed for

that year by the Department, considering the trial run as equivalent to putting the said plant to use. However, the assessment for the relevant previous year was reopened on the ground that the assessee had not disclosed the material fact that the plant was not in use for the whole of the said previous year

Assessee's contention vis-à-vis Assessing Officer's contention:

The assessee's contention was that the plant was ready for use for the year under consideration and the non-availability of raw material was an impediment to put the plant to use. The expression "used" in section 32(1) should be understood to include passive as well as active use. In this case, the asset was in good condition and ready for use. It could have been put to actual use in any minute, at any time during the relevant previous year, and hence the claim for depreciation cannot be denied.

The Assessing Officer, however, completed the assessment rejecting the assessee's claim on the ground that the asset had never been put to use during the whole of the relevant previous year i.e., the second year of installation of the plant.

Majority view of the Tribunal:

The Accountant Member of the Tribunal supported the assessee's view that once the plant was ready for use, it was entitled to depreciation. The Judicial Member, however, was of the view that unless the assets have been actually put to use, the claim of the assessee could not be granted. The Third Member i.e., the Vice President of the Appellate Tribunal agreed with the view taken by the Accountant Member in favour of the assessee.

High Court's observations:

The High Court referred to the Supreme Court ruling in *Liquidators of Pursa Ltd. v. CIT (1954) 25 ITR 265* in context of the expression "used for the purpose of business" for claim of depreciation. The Court held that so long as the business was a going one and the machinery got ready for use but could not be put to use due to certain extraneous circumstances, depreciation under section 32 would be allowable.

High Court's decision:

The High Court confirmed the majority decision of the Tribunal holding that, in this case, the machinery was entitled to depreciation since the business was a going concern and the machinery, being ready for use, could not be actually put to use due to an extraneous reason, namely, raw material paucity.

Capital Gains

12. Where the stamp duty value under section 50C has been adopted as the full value of consideration, can the reinvestment made in acquiring a residential property, which is in excess of the actual net sale consideration, be considered for the purpose of computation of exemption under section 54F, irrespective of the source of funds for such reinvestment?

Gouli Mahadevappa v. ITO (2013) 356 ITR 90 (Kar.)

Facts of the case:

In the present case, the assessee sold a plot of land for ₹ 20 lakhs and reinvested the sale consideration of ₹ 20 lakhs together with agricultural income of ₹ 4 lakhs, in construction of a residential house. The assessee claimed capital gains exemption under section 54F, taking into consideration the entire investment of ₹ 24 lakhs. The Assessing Officer, applying the provisions of section 50C, deemed the stamp duty value of ₹ 36 lakhs as the full value of consideration since the consideration received or accruing as a result of transfer of capital asset (i.e. ₹ 20 lakhs) was less than the value adopted by the stamp valuation authority (i.e., ₹ 36 lakhs). The same was not disputed by the assessee before the Assessing Officer.

Assessing Officer's contention vis-a-vis assessee's contention:

The Assessing Officer allowed exemption under section 54F, taking into consideration investment in construction of residential house, to the extent of actual net consideration of ₹ 20 lakhs. He did not consider the balance amount of ₹ 4 lakhs, invested in the construction of residential house, out of agricultural income, for computation of exemption under section 54F, even though the sale consideration adopted for the purpose of computation of capital gains i.e., stamp duty value of ₹ 36 lakhs, was more than the amount of ₹ 24 lakhs invested in the new house.

The assessee contended that the entire investment of ₹ 24 lakhs made in construction of the residential house should be considered for computation of exemption under section 54F, irrespective of the source of funds for such reinvestment. Further, the assessee also contended before the High Court that the registration value adopted under section 50C was excessive and disproportionate to the market value of the property.

High Court's observations:

On the issue of applicability of section 50C, the Karnataka High Court observed that section 50C(2) allows an opportunity to the assessee to contend, before the Assessing Officer, the correctness of the registration value fixed by the State Government. Had he done so, the assessing authority would have invoked the power of appointing a Valuation Officer for assessing the fair market value of the property. The High Court held that when the assessee had not disputed the registration value at that point of time, it is not permissible for the assessee to now contend, at this stage, that the registration value does not correspond to the market value. Hence, the value of ₹ 36 lakhs adopted under section 50C has to be deemed as the full value of consideration.

High Court's decision:

On the issue of exemption under section 54F, the High Court held that when capital gain is assessed on notional basis as per the provisions of section 50C, and the higher value i.e., the stamp duty value of ₹ 36 lakhs under section 50C has been adopted as the full value of consideration, the entire amount of ₹ 24 lakhs reinvested in the residential house within the prescribed period should be considered for the purpose of exemption under section 54F, irrespective of the source of funds for such reinvestment.

13. Where transfer of shares in a company has been effected, fulfilling all the requirements for claim of exemption under section 10(38), can such exemption be denied on the ground that the transaction is a colorable device, since the underlying asset transferred is, in effect, land, which is a short-term capital asset, on sale of which capital gains tax liability would have been attracted?

Bhoruka Engineering Inds. Ltd. v. DCIT (2013) 356 ITR 25 (Kar.)

Facts of the case:

Bhoruka Steel Ltd. (BSL), a group company of the assessee, was incorporated in the year 1969. It had a mini steel plant at Bangalore. It commenced commercial production in 1972 and set up a refractory plant at Bangalore. BSL was declared as a sick industrial company in 1996 and IDBI was appointed as the Operating Agency. The rehabilitation scheme formulated envisaged sale of the surplus assets of BSL, which included 30 acres of land. A decision was taken in the meeting held on 29th July, 2002, to offer the land first to the promoters/sister companies jointly or severally with the reserve price of ₹ 25 lakhs per acre on the condition that the dues of the secured creditors and the others as per the rehabilitation scheme were cleared by 31st December, 2002. Bhoruka Financial Services Ltd. (BFSL), a public limited company and a group company engaged in financial services, offered to purchase the 30 acres of land at a price of ₹ 25 lakhs per acre. The Committee approved the sale of 15 acres of land to BFSL at ₹ 3.75 crores. Accordingly, the land measuring 15 acres was sold to BFSL in June 2004 through registered sale deeds for ₹ 3.75 crores, the then prevailing market price which was accepted for the purpose of section 50C also.

The assessee-company is a limited company whose shares are quoted in the stock exchange. The assessee is holding shares in BFSL since October, 1984. The assessee, together with other promoter shareholders, held 98.73% shares in BFSL, the remaining being held by the public shareholders. In the financial year 2005-06, the assessee-company sold its shares to DLF Commercial Developers Ltd. (DLFCDL) for a net consideration of ₹ 20.29 crores. The other promoters also sold their shares to DLFCDL and the total net consideration, including that of the assessee, was ₹ 89.28 crores. The assessee claimed the capital gain arising on sale of such shares as exempt under section 10(38), since the shares, being a long-term capital asset, were sold in a recognized stock exchange and securities transaction tax has been paid on such sale.

Revenue's contention:

The Revenue contended that the substance of the above transaction was the transfer of land, which would attract short-term capital gains tax in the hands of BFSL. BSL had sold its immovable property to its associate concern, BFSL, for a nominal value of ₹ 3.75 crores. BFSL, never before doing any business other than financial services, purchases the land for ₹ 3.75 crores and immediately thereafter, the assessee-company and its entire group, holding 98.73% of shares in BFSL, sell their entire shareholding of BFSL to DLFCDL for a consideration of ₹ 89.28 crores, without attracting corresponding tax liability. This is made possible by getting away from Bangalore Stock Exchange and going to Magadh Stock Exchange to carry out the sale transaction and by paying securities transaction tax for claiming exemption from long-term capital gains arising on

sale of shares under section 10(38). The shares of BFSL were listed in Bangalore Stock Exchange, but hardly got traded. The last quoted value of the share was ₹ 5 in the year 1985. The promoters of BFSL sought permission from SEBI to exempt them from making public announcement in respect of sale of equity shares to DLFCDL.

Further, the promoters of BFSL had disposed of all the other assets held by BFSL except land, before the shares were sold to DLFCDL. BFSL was, in effect, reduced to a shell company, which was used to transfer a real asset and the promoters took the fruits of the transaction. The intention of the promoters was to transfer the underlying asset, being land to DLFCDL. The Revenue contended that DLFCDL could not have bought the shares of BFSL at a substantial rate of ₹ 4,490 per share. Since the area where the land was situated had high commercial value, DLFCDL had purchased the shares of BFSL keeping in mind the value of the underlying asset, being the land. The land had, in effect, been transferred to DLFCDL by way of the above circuitous transaction.

Appellate authorities' views:

The Commissioner (Appeals) concurred with the view of the assessing authority and held that the corporate veil had to be pierced and the substance of the transaction (i.e. sale of a short-term capital asset, being land, giving rise to taxable short-term capital gains), has to be considered. The Tribunal was of the view that the transaction in question was a colorable device to avoid payment of short-term capital gains tax. This view was further substantiated by applying the rationale of case of *Vodafone International Holdings B. V. v. Union of India reported in (2012) 341 ITR 1 (SC)*.

High Court's observations:

The Karnataka High Court observed that in *Vodafone* case, it was also mentioned that 'Tax planning may be legitimate provided it is within the framework of law' and 'colorable devices cannot be a part of tax planning and it is wrong to encourage or entrain the belief that it is honorable to avoid the payment of tax by resorting to dubious methods'. Therefore, in that case, it was inferred that tax planning within the framework of law is legal. However, tax evasion through the use of colorable devices and by resorting to dubious methods and subterfuges is not allowed.

The High Court further observed that the assessee is entitled to manage its affairs within the four corners of law so as to attract minimum tax liability or no tax liability. However, the same should be real and genuine and not a sham or make-believe. He may legitimately claim the advantage of any express terms or of any omissions that he can find in his favour in taxing statutes in absence of any specific tax avoidance provision. Further, the intention of the legislature in a taxation statute is to be gathered from the language of the provisions particularly where the language is plain and unambiguous. In a taxing Act, it is not possible to assume any intention or governing purpose of the statute more than what is stated in the plain language.

If the transaction in question is sham or colorable and entered into with the sole intention of evading payment of tax, then such a transaction would not have any legitimacy. For determining whether a transaction is a valid transaction or a sham, each case should be seen on a standalone basis.

High Court's decision:

The Karnataka High Court observed that, in this case, the assessee-company was holding shares in BFSL from 1st October, 1984. Therefore, the shares represent a long-term capital asset. The transaction had taken place subsequent to 28th September, 2004. Hence, the second condition for claim of exemption is fulfilled. The transaction had taken place through the Magadh Stock Exchange and securities transaction tax has been paid on such sale. Where all the three conditions have been fulfilled, the assessee is entitled to exemption under section 10(38) in respect of long-term capital gains arising from such transfer. Merely because capital gains tax liability would have been attracted had a registered sale deed been executed by BFSL for selling land to DLFCDL, it cannot be concluded that the shareholders of BFSL transferring their shares after complying with the legal requirements would not be entitled to the benefit of exemption.

The High Court further noted that the companies involved in the transaction were existing companies. Thus, neither of the companies came into existence as a part of the scheme for purchase of immovable property or transfer of shares for the purpose of evading payment of tax. The event of transfer of shares happened in ordinary course of business and is legal. The transaction is, therefore, real, valuable consideration is paid, all legal formalities are complied with, and what is transferred is shares and not immovable property. Hence, it is a valid legal transaction and cannot be termed as a colorable device or sham transaction or an unreal transaction.

14. Where a building, comprising of several floors, has been developed and re-constructed, would exemption under section 54/54F be available in respect of the cost of construction of -

(i) the new residential house (i.e., all independent floors handed over to the assessee); or

(ii) a single residential unit (i.e., only one independent floor)?

CIT v. Gita Duggal (2013) 357 ITR 153 (Delhi)

Facts of the case:

In the present case, the assessee was the owner of property comprising the basement, ground floor, first floor and second floor. In the year 2006, she entered into a collaboration agreement with a builder for developing the property. According to the terms of the agreement, the builder was to demolish the existing structure on the plot of land and develop, construct, and/or put up a building consisting of basement, ground floor, first floor, second floor and third floor with terrace at its own costs and expenses. The assessee handed over to the builder, the physical possession of the entire property, along with 22.5% undivided interest over the land. The handing over of the entire property was, however, only for the limited purpose of development. The builder was to get the third floor plus the undivided interest in the land to the extent of 22.5% for his exclusive enjoyment. In addition to the cost of construction incurred by the builder on development of the property, a further amount of ₹ 4 crores was payable by the builder to the assessee as consideration against the rights of the assessee.

Assessee's contention vis-à-vis Assessing Officer's contention:

The assessee, in her return of income, showed only ₹ 4 crore as sales consideration. The Assessing Officer, however, took the view that the sale consideration for the transfer should include not only the amount of ₹ 4 crores received by the assessee in cash, but also the cost of construction amounting to ₹ 3.44 crore incurred by the developer in respect of the other floors, which were handed over to the assessee.

The assessee contended that if the cost of construction incurred by the builder is to be added to the sale price, then, the same should also correspondingly be considered as re-investment in the residential house for exemption under section 54.

However, the Assessing Officer rejected the claim for exemption under section 54 on the ground that the floors obtained by the assessee contained separate residential units having separate entrances and cannot qualify as a single residential unit. He contended that deduction under section 54F was allowable, and that too only in respect of cost of construction incurred in respect of one unit i.e., one floor.

Appellate authorities' views:

The Commissioner (Appeals), on the basis of the judgment in *CIT v. D. Ananda Basappa [2009] 309 ITR 0329* (Kar.), took a contrary view. The Tribunal concurred with the view of the Commissioner (Appeals), observing that the words "a residential house" appearing in section 54/54F of the Act cannot be construed to mean a single residential house since under section 13(2) of the General Clauses Act, "singular" includes "plural".

High Court's observations:

The High Court observed that sections 54 and 54F use the expression "residential house" and not "residential unit" and it is the Assessing Officer who has introduced a new concept of "residential unit" into these sections. Sections 54 and 54F require the assessee to acquire a "residential house" and so long as the assessee acquires a building, which may be constructed, for the sake of convenience, in such a manner as to consist of several units which can, if the need arises, be conveniently and independently used as an independent residence, the requirement of the section should be taken to have been satisfied. There is nothing in these sections which requires the residential house to be constructed in a particular manner. The only requirement is that it should be for residential use and not for commercial use. The physical structuring of the new building, whether lateral or vertical, should not come in the way of considering the building as a residential house.

High Court's decision:

The High Court held that the fact that the residential house consists of several independent units cannot be permitted to act as an impediment to the allowance of the deduction under section 54 or section 54F. It is neither expressly nor by necessary implication prohibited. Therefore, the assessee is entitled to exemption of capital gains in respect of investment in the residential house, comprising of independent residential units handed over to the assessee.

15. In the case of an assessee, being a dealer in shares and securities, whose portfolio comprises of shares held as stock-in-trade as well as shares held as investment, is it permissible under law to convert a portion of his stock-in-trade into investment and if so, what would be the tax treatment on subsequent sale of such investment?

CIT v. Yatish Trading Co. Pvt. Ltd. (2013) 359 ITR 320 (Bom.)

Facts of the case:

The assessee, being a dealer in shares and securities, has a trading as well as an investment portfolio of shares and securities. On 1st April 2002 and 1st October 2004, the assessee converted certain shares and securities held as stock-in-trade into investments and thereafter, in the A.Y.2006-07, it transferred such converted shares and securities and declared income arising on such transfer under the head "Profits and gains of business or profession" and "Capital gains". The profits and gains up to the date of conversion was offered as business income (i.e., fair market value on the date of conversion minus the cost of acquisition). The profits and gains arising after conversion up to the date of sale was offered as capital gains (i.e., sale price minus the fair market value on the date of conversion). The Assessing Officer, however, assessed the entire income arising on transfer of such converted shares and securities as business income.

Appellate Authorities' findings & views:

The CIT (Appeals) opined that the view of the assessee was logical and reasonable. The Tribunal noted that the Department had accepted the conversion of stock-in-trade into investment while assessing the income of A.Y.2003-04 and A.Y.2005-06. Further, the books of account of the assessee showed such shares (on which the assessee offered income as capital gains) as investment. Also, the mere fact that the assessee-company was trading in the shares and securities cannot estop it from holding certain shares as investment and offering the gains on sale of such shares to tax under the head "Capital gains". It is open for a trader in shares to have a trading as well as an investment portfolio of shares and securities.

High Court's decision:

The High Court concurred with the Tribunal's ruling that the gains arising on sale of those shares held as investments by the dealer-assessee (i.e., the difference between the sale price and the fair market value on the date of conversion) were to be assessed under the head "Capital gains" and not under the head "Profits and gains of business or profession".

16. Where a leasehold property is purchased and subsequently converted into freehold property and then sold, should the period of holding be reckoned from the date of purchase or from the date of conversion for determining whether the resultant capital gains is short-term or long-term?

CIT v. Smt. Rama Rani Kalia (2013) 358 ITR 0499 (All.)

Facts of the case:

The assessee purchased a leasehold property on July 7, 1984. Such leasehold rights in the property were converted into freehold rights on March 29, 2004. She sold the property on March 31, 2004 and declared long-term capital gains on the transfer. The Assessing Officer opined that since the property was acquired by converting the leasehold right into freehold right on March 29, 2004, and was sold within three days on March 31, 2004, the resultant capital gains would be short-term.

Appellate Authorities' views:

The Commissioner (Appeals) opined that the conversion of leasehold property into freehold property was nothing but improvement of the title over the property, as the assessee was the owner prior to conversion. The Tribunal affirmed this view of the Commissioner (Appeals) and held that the gains were long-term capital gains, as the assessee was the owner of the property even prior to conversion.

High Court's observations:

The High Court observed that the difference between "short-term capital asset" and "long-term capital asset" is the period over which the property has been held by the assessee and not the nature of title over the property. The lessee of the property has rights as the owner of the property subject to the covenants of the lease deed. Accordingly, the lessee may, subject to covenants of the lease deed, transfer the leasehold rights of the property with the consent of the lessor.

High Court's decision:

The High Court, therefore, concurred with the views of the Tribunal that conversion of the rights of the lessee from leasehold to freehold is only by way of improvement of her rights over the property, which she enjoyed. It would not have any effect on the taxability of gain from such property, which is related to the period over which the property is held. Since, in this case, the period of holding is more than 36 months, the resultant capital gains would be long-term.

Set-off and carry forward of losses / Assessment of firms

17. Can the loss suffered by an erstwhile partnership firm, which was dissolved, be carried forward for set-off by the individual partner who took over the business of the firm as a sole proprietor, considering the succession as a succession by inheritance?

Pramod Mittal v. CIT (2013) 356 ITR 456 (Delhi)

Facts of the case:

In the present case, the assessee was previously a partner in a firm. As per the dissolution deed of the partnership firm, with effect from 18th September, 2004, he took

over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partner was paid his dues. He then ran the business as a sole proprietor with effect from that date. The assessee, relying upon section 78(2) and the decisions of the Supreme Court in *CIT v. Madhukant M. Mehta (2001) 247 ITR 805 (SC)* and *Saroj Aggarwal v. CIT (1985) 156 ITR 497 (SC),* claimed the set-off of the losses suffered by the erstwhile partnership firm against his income earned as an individual proprietor, considering the case as inheritance of business.

However, considering that only the person who has suffered the loss is entitled to carry forward and set-off the same, the claim of the assessee was disallowed by the Assessing Officer. The Tribunal concurred with the Assessing Officer's view.

High Court's observations:

The High Court observed that upon dissolution, the partnership firm ceased to exist. Also, the partnership firm and the proprietorship concern are two separate and distinct units for the purpose of assessment. As per section 170(1), the partnership firm shall be assessed as such from 1st April of the previous year till the date of dissolution (i.e., 18th September, 2004). Thereafter, the income of the sole- proprietorship shall be taxable in the hands of the assessee as an individual. Thus, section 170(1) provides as to who will be assessable in respect of the income of the previous year from business, when there is a change in the person carrying on business by succession.

Section 78(2), however, deals with carry forward of losses in case of succession of business. It provides that only the person who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. An exception provided thereunder is in the case of succession by inheritance.

Therefore, section 170(1) providing the person in whose hands income is assessable in case of succession and section 78(2) providing for carry forward of losses in case of succession of business, deal with different situations and resultantly, there is no contradiction between these sections.

The income earned by the sole proprietor would include his share of loss as an individual but not the loss suffered by the erstwhile partnership firm in which he was a partner. The exception given in section 78(2), permitting carry forward of losses by the successor in case of inheritance, is not applicable in the present case since the partnership firm was dissolved and ceased to continue. Taking over of business by a partner cannot be considered as a case of inheritance due to death as per the law of succession. The High Court opined that the decision in *Madhukant M. Mehta's case* and *Saroj Aggarwal's case* cannot be applied since this is not a case of succession by inheritance.

High Court's decision:

Therefore, the loss suffered by the erstwhile partnership firm before dissolution of the firm cannot be carried forward by the successor sole-proprietor, since it is not a case of succession by inheritance. The assessee sole-proprietor is, therefore, not entitled to set-off the loss of the erstwhile partnership firm against his income.

Note - *In Madhukant M. Mehta's case, the sole proprietor had expired and after his death the heirs succeeded the business as a partnership concern. Therefore, the losses suffered by the deceased proprietor was allowed to be set-off by the partnership firm since the case falls within the exception mentioned under section 78(2), i.e., a case of succession by inheritance.*

Also, in Saroj Aggarwal's case, upon death of a partner, his legal heirs were inducted as partners in the partnership firm. The partnership firm was not dissolved on the death of the partner. The partnership firm which suffered the losses continued with induction of the legal heirs of the deceased partner. This, being a case of succession by inheritance, the benefit of carry forward of losses was given to the re-constituted partnership firm.

In the present case, however, the partnership firm was dissolved and the take over of the running business of the firm by the erstwhile partner as a sole proprietor was not a case of succession by inheritance. Hence, the carry forward of losses of the firm by the sole proprietor was not allowed in this case.

Deductions from Gross Total Income

18. Can Duty Drawback be treated as profit derived from the business of the industrial undertaking to be eligible for deduction under section 80-IB?

CIT v. Orchev Pharma P. Ltd. (2013) 354 ITR 227 (SC)

Supreme Court's Decision

On this issue, the Supreme Court, following the decision in case of *Liberty India v. CIT (2009) 317 ITR 218 (SC)* held that Duty Drawback receipts cannot be said to be profits derived from the business of industrial undertaking for the purpose of computation of deduction under section 80-IB.

Note - *In the case of Liberty India v. CIT (2009) 317 ITR 218 (SC), the Supreme Court observed that DEPB / Duty drawback are incentives which flow from the schemes framed by the Central Government or from section 75 of the Customs Act, 1962. Section 80-IB provides for the allowing of deduction in respect of profits and gains derived from eligible business.* ***However, incentive profits are not profits derived from eligible business under section 80-IB. They belong to the category of ancillary profits of such undertaking.*** *Profits derived by way of incentives such as DEPB/Duty drawback cannot be credited against the cost of manufacture of goods debited in the profit and loss account and they do not fall within the expression "profits derived from industrial undertaking" under section 80-IB. Hence, Duty drawback receipts and DEPB benefits do not form part of the profits derived from the eligible business for the purpose of the deduction under section 80-IB.*

19. Whether the process of bottling of gas into gas cylinders amounts to production of gas cylinders for the purpose of deduction under section 80-IB?

Puttur Petro Products P. Ltd. v. ACIT [2014] 361 ITR 290 (Kar.)

High Court's Decision:

Applying the rationale of the Apex Court decision in the case of *CIT v. Vinbros and Co. [2012] 349 ITR 697*, the High Court held that the process of bottling of gas into gas cylinders, which requires a very specialised process and independent plant and machinery, amounts to production of "gas cylinders" containing gas for the purpose of claiming deduction under section 80-IB.

Assessment of Various Entities

20. Would the ancestral property received by the assessee after the death of his father and was distributed among his family members be considered as HUF property or Individual property?

Commissioner of Income-tax v. D. L. Nandagopala Reddy (Individual) (2014) 360 ITR 0377 (Kar)

Facts of the case:

In the present case, Laxmaiah Reddy had no sons and therefore, he adopted the assessee vide a registered adoption deed dated June 25, 1956. The property, which is the subject matter of the suit, originally belonged to Venkateshwaraiah (assessee's grandfather). The assessee's father (Laxmaiah Reddy), took his share in the joint family property and executed a release deed in favour of the remaining members of the joint family *vide* a registered release deed dated November 23, 1927 and bequeathed all his properties in favour of the assessee. The assessee, in turn, distributed the property in favour of his wife and children. This was done by oral partition which was evidenced by a memorandum of partition dated August 6, 1998.

Thereafter, a transaction was entered into by the assessee with the builder for development of the property. The Assessing Officer treated the consideration received from the builder by the assessee and his wife as their individual income and assessed the same to tax in their individual hands.

Assessing Officer's contention:

The revenue contended that when assessee's father got the property under a release deed, it ceased to be the joint family property. Since that property was bequeathed in favour of the assessee, he became its owner after the death of his father. Therefore, it was a separate property and, consequently, the income derived therefrom is assessed to tax in the hands of the assessee as separate property.

High Court's observation:

The High Court observed that the property originally belonged to Hindu Undivided Family (HUF). One of the members of the family (i.e., the assessee's father) went out of the joint

family under a release deed and the remaining members continued to be the members of joint family. After the death of assessee's father and mother, the assessee, being the adopted son, became the sole surviving co-parcener. When such property came to the hands of the assessee it was not his individual property; it was the property of his Hindu Undivided Family.

High Court's Decision:

The High Court held that that when the property came to the hands of the assessee, it was not his self-acquired property; it was property belonging to his HUF. The assessee had given a portion of the property to his wife without a registered document, which is possible only if the property is a HUF property. If such property is treated as a self-acquired property, then assessee would have been able to give the portion of the property to his wife only by registered document.

Income-tax Authorities

21. Can the Assessing Officer call for information under section 133(6), which is useful or relevant to any enquiry, where no proceeding is pending against a person, with the permission of Director or Commissioner?

Kathiroor Service Co-operative Bank Ltd. v. CIT (CIB) (2014) 360 ITR 0243 (SC)

Facts of the case:

The Assessing Officer, with the prior approval of the Commissioner, issued notice under section 133(6) to the assessee, a co-operative society engaged in banking business, calling for general information regarding details of all persons (whether resident or non-resident) who had made (a) cash transactions of ₹ 1 lakh and above in any account, and/or (b) time deposits of ₹ 1 lakh or above, for the period of three years between April 1, 2005, and March 31, 2008, expressly stating therein that failure to furnish the information would attract penal consequences.

The assessee objected to the said notice, *inter alia*, on the ground that such notice seeking for information which is unrelated to any existing or pending proceeding against the assessee could not be issued under the provisions of the Act.

Supreme Court's Observations:

The Supreme Court observed that the Assessing Officer has been empowered to requisition information which will be useful for or relevant to **any enquiry** or proceeding under the Income-tax Act, 1961 in the case of any person. However, an income-tax authority below the rank of the Director or Commissioner can exercise this power in respect of an **enquiry** in a case where no proceeding is pending, only with the prior approval of the Director or the Commissioner.

Apex Court's Decision:

The Supreme Court held that information of general nature could be called for from banks. In this case, since notices have been issued after obtaining approval of the Commissioner, the assessing authority had not erred in issuing the notices to assessees requiring them to furnish information regarding account holders with cash transactions or deposits of more than ₹ 1 lakh. The Supreme Court, therefore, held that for such enquiry under section 133(6), the notices could be validly issued by the assessing authority.

Assessment Procedure / Appeals and Revision

22. Can an assessee, objecting to the reassessment notice issued under section 148, directly approach the High Court in the normal course contending that such reassessment proceedings are apparently unjustified and illegal?

Samsung India Electronics P. Ltd. v. DCIT (2014) 362 ITR 460 (Del.)

Facts of the case

In the present case, Samsung Electronics Co. Ltd., the Korean Company was subjected to regular assessment for the assessment year 2006-07. The assessment order was passed, pursuant to the directions under section 144C(5) made by the Disputes Resolution Panel. For the same assessment year, i.e., A.Y.2006-07, assessee was issued a reassessment notice dated March 30, 2013 under section 148. Against this reassessment notice, assessee filed a writ petition before the High Court.

High Court Observations

The High Court observed the Apex court ruling in the case of *GKN Driveshafts (India) Ltd. v. ITO [2003] 259 ITR 19 (SC)*, wherein, it was laid down that **when a notice under section 148 is issued, the proper course of action for the noticee is to file a return and if he so desires, to seek reasons for issuing notices. The Assessing Officer is bound to furnish reasons within a reasonable time. On receipt of the reasons, the noticee is entitled to file objections to issuance of notice and the Assessing Officer is bound to dispose of the objections by passing a speaking order.**

The High Court noted that the assessee has not filed objections before the Assessing Officer and has directly approached the court by way of the writ petition. On this issue, the assessee contended that they were justified in approaching the High Court directly as the reassessment proceedings *ex facie* were unjustified and illegal. The assessee relied upon the decision of the Delhi High Court in *Techspan India P. Ltd. v. ITO [2006] 283 ITR 212 (Delhi)* in which reference was made to the decision of the Gujarat High Court in *Garden Finance Ltd. v. Asst. CIT [2004] 268 ITR 48 (Guj),* wherein it was observed that the exercise of the powers under section 148 may be so arbitrary or *mala fide* that the court may entertain the petition without requiring the assessee to approach the Assessing Officer, but such a case was an exception and not a rule. In *Techspan India P. Ltd.'s* case, the High Court had given concurrent reasons and made observations when a writ court should interfere. However, there is no need to go into the said question and controversy in the present case, since it does not occasion or require a different

treatment from the procedure followed in other cases in which re-assessment proceedings were/are initiated.

High Court's Decision:

The High Court, thus, held that it will not be appropriate and proper in the facts of the present case to permit and allow the petitioner to bypass and forgo the procedure laid down by the Supreme Court in *GKN Driveshafts (India) Ltd. (supra),* since the said procedure has been almost universally followed and has helped cut down litigation and crystallise the issues, if and when the question comes up before the Court.

Penalties

23. Can an assessee who has surrendered his income in response to the specific information sought by the Assessing Officer in the course of survey, be absolved from the penal provisions under section 271(1)(c) for concealment of income?

MAK Data P. Ltd. v. CIT (2013) 358 ITR 593 (SC)

Facts of the case:

The assessee-company filed its return of income for the A.Y. 2004-05 declaring an income of ₹ 16.17 lakh along with tax audit report. The assessee's case was selected for scrutiny and notices were issued under section 143(2) and section 142(1). During the course of assessment proceedings, it was noticed by the Assessing Officer that certain documents, namely, share application forms, bank statements, memorandum of association of companies, affidavits, copies of income-tax returns and assessment orders and blank share transfer deeds duly signed, had been found in the course of survey proceedings under section 133A conducted on December 16, 2003, in the case of a sister concern of the assessee, and the same were impounded.

The Assessing Officer issued a show cause notice dated October 26, 2006 to the assessee seeking specific information regarding the documents pertaining to share applications found in the course of survey, particularly, blank transfer deeds signed by persons who had applied for the shares.

In its reply to the show cause notice, the assessee made an offer to surrender a sum of ₹ 40.74 lakhs by way of voluntary disclosure without admitting any concealment or any intention to conceal and subject to non-initiation of penalty proceedings and prosecution. The Assessing Officer, however, completed the assessment bringing the sum of ₹ 40.74 lakhs to tax and levied penalty under section 271(1)(c) for concealment of income and not furnishing true particulars.

Assessee's contention:

The assessee contended that the penalty proceedings were not maintainable since the Assessing Officer had not recorded his satisfaction to the effect that there has been concealment of income/furnishing of inaccurate particulars of income. Further, it also

contended that the surrender of income was a conditional surrender before any investigation in the matter.

Appellate Authorities' view:

The Commissioner (Appeals) did not accept the assessee's contention. The Tribunal, however, was of the view that the amount of ₹ 40.74 lakhs was surrendered by the assessee to settle the dispute with the Department. It opined that since the assessee, for one reason or the other, agreed or surrendered certain amounts for assessment, the imposition of penalty solely on the basis of the assessee's surrender could not be sustained. The Tribunal, therefore, allowed the appeal and set aside the penalty order.

The High Court, however, accepted the plea of the Revenue that there was absolutely no explanation by the assessee for the concealed income of ₹ 40.74 lakhs. The High Court took the view that in the absence of any explanation in respect of surrendered income, the first part of *Clause (A) of Explanation 1 to section 271(1)(c)* would be attracted.

Apex Court's Observations:

The Apex Court observed that the assessee had stated that the surrender of the additional sum was with a view to avoid litigation, to buy peace and to channelize the energy and resources towards productive work and to make amicable settlement with the Income-tax Department. The Court observed that these types of defenses are, however, not recognized under the statute. It further observed that the survey was conducted and documents were impounded ten months before the assessee filed its return of income. The Court opined that had it been the intention of the assessee to make full and true disclosure of its income, it would have filed the return declaring an income inclusive of the amount which was surrendered later during the course of the assessment proceedings. It is the statutory duty of the assessee to record all its transactions in the books of account, to explain the source of payments made by it and to declare its true income in the return of income filed by it from year to year.

Apex Court's Decision

The Apex Court was, therefore, of the view that surrender of income in this case is not voluntary, in the sense, that the offer of surrender was made in view of detection made by the Assessing Officer in the survey conducted in the sister concern of the assessee. The Apex Court, therefore, concurred with the view of the High Court that levy of penalty is correct in law.

Note: *According to Explanation 1 to section 271(1)(c), where in respect of any facts material to the computation of the total income of any person under this Act,-*

(A) such person fails to offer an explanation or offers an explanation which is found by the Assessing Officer or the Commissioner (Appeals) or the Commissioner to be false, or

(B) such person offers an explanation which he is not able to substantiate and fails to prove that such explanation is bona fide and that all the facts relating to the same and material to the computation of his total income have been disclosed by him,

then the amount added or disallowed in computing the total income of such person as a result thereof shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed.

In this case, since the assessee has failed to offer an explanation regarding surrendered income, the amount of income surrendered is deemed to represent the income in respect of which particulars have been concealed, thereby attracting penal provisions under section 271(1)(c).

Miscellaneous Provisions

24. Can loan, exceeding the specified limit, advanced by a partnership firm to the sole-proprietorship concern of its partner be viewed as a violation of section 269SS to attract levy of penalty?

CIT v. V. Sivakumar (2013) 354 ITR 9 (Mad.)

Facts of the case:

In the present case, the assessee was a partner in four firms and also had a sole-proprietary business. In the relevant previous year, the partnership firms had advanced loan to the assessee in cash exceeding the specified amount mentioned in section 269SS. The Assessing Officer initiated penalty proceedings under section 271D in view of violation of section 269SS. The Assessing Officer recorded a factual finding that the said money had been advanced by the partnership firm as a loan and were debited to the accounts of the proprietary concern; therefore, it was evident that the assessee had taken loan from the firms in cash in the capacity of the proprietor and not as a partner. Consequently, the provisions of section 269SS had been violated.

Assessee's contention:

The assessee contended that the amount is taken in the capacity of the partner and it cannot be taken as an independent transaction and therefore, there is no violation of section 269SS. Also, the assessee contended that the partnership firm has no separate legal entity and there is no separate identification between the firm and the partner.

Tribunal's view:

The Tribunal, relying upon the various court decisions, confirmed the finding of the Commissioner (Appeals) that partnership firm is not a juristic person and there is no separate identity for the firm and the partners; Being a partner, the assessee had withdrawn amounts from the firms and there were no reasons to doubt the genuineness of the transactions. Consequently, the transactions between the firm and the partner cannot be brought within the meaning of section 269SS.

High Court's decision:

The High Court, relying upon the various court decisions, upheld the decision of the Tribunal holding that there is no separate identity for the partnership firm and that the partner is entitled to use the funds of the firm. In the present case, the assessee has acted *bona fide* and that there was a reasonable cause within the meaning of section 273B. Therefore, the transaction cannot be said to be in violation of section 269SS and no penalty is attracted in this case.

Provisions for deduction and collection of tax

25. Can the transmission, wheeling and SLDC charges paid by a company engaged in distribution and supply of electricity, under a service contract, to the transmission company be treated as fees for technical services so as to attract TDS provisions under section 194J or in the alternative, under 194C?

Ajmer Vidyut Vitran Nigam Ltd., In re (2013) 353 ITR 640 (AAR)

Facts of the case:

In the present case, the applicant is a government company engaged in the business of distribution and supply of electricity to customers in various districts of Rajasthan. The activity of distribution is preceded by the production of electricity and its transmission from the point of production to the point of distribution. The production is by the generating company, which is another entity and transmission to the applicant is through the transmission system network of the transmission company. The transmission company carries the electrical energy to the applicant at the distribution system network of the applicant. The applicant then distributes the energy to the end customers.

The transmission of electricity from the point of generation to the point of distribution of the applicant is termed as "wheeling". The applicant pays transmission and wheeling charges for this wheeling, which it contends are statutory charges. The transmission company also functions as a State Load Dispatch Centre (SLDC), which is responsible for the general co-ordination of production and transmission of electricity to ensure uniform distribution in the State. The applicant pays to the transmission company, SLDC charges, which it claims as statutory in nature, since the levy is in terms of the Electricity Act, 2003.

Applicant's contention:

The applicant contended that the above charges were not in the nature of fees for technical services to attract TDS provisions under section 194J, on the following grounds –

(i) The transmission does not involve rendering of any technical services nor were technically qualified staff of the transmission company involved in the transmission of electrical energy;

(ii) The SLDC charges were also mere statutory charges and does not involve rendering of technical services;

(iii) The payment of transmission, wheeling and SLDC charges were in the nature of reimbursement of actual cost and hence, do not generate any income in the hands of the transmission company.

Revenue's contention:

The Revenue, on the other hand, was of the view that the transmission of electrical energy from the point of generation to the point of distribution of the applicant involves rendering of technical services and consequently, the applicant was bound to withhold tax. The Revenue supported its view on the basis of the following contentions –

(i) Transmission of electrical energy is a technical service and requires constant involvement of a technical system consisting of sophisticated instruments, constant

monitoring and supervision by persons with a technical ability and knowledge to operate and manage the system so as to ensure regular and consistent supply of electricity at the grid voltage at the distribution point of the applicant.

(ii) As regards SLDC charges, the services rendered require the technical support and services of technically qualified staff and therefore they were technical services within the meaning of section 194J.

(iii) The fact that the contract between both the parties is backed by a statutory obligation cannot alter the nature of services rendered.

AAR's observations:

The AAR did not agree with the applicant's contention regarding transmission and wheeling charges not constituting fees for technical services on the ground that no rendering of technical services was involved for maintaining proper and regular transmission of electrical energy. It was also not in agreement with the applicant's argument that the services of technical personnel were not needed for ensuring due and proper transmission of electrical energy from the generation point to the distribution point. The AAR concurred with the Revenue's view that the personnel of the transmission company had to ensure regular and consistent transmission of electrical energy at the grid voltage at the distribution point of the applicant.

AAR's decision:

The AAR, considering the definition of fees for technical services under section 9(1)(vii) and the process involved in proper transmission of electrical energy, held that transmission and wheeling charges paid by the applicant to the transmission company are in the nature of fees for technical services, in respect of which the applicant has to withhold tax thereon under section 194J.

As regards SLDC charges, the AAR opined that the main duty of the SLDC is to ensure integrated operation of the power system in the State for optimum scheduling and dispatch of electricity within the State. The SLDC charges paid appeared to be more of a supervisory charge with a duty to ensure just and proper generation and distribution in the State as a whole. Therefore, such services were not in the nature of technical service to the applicant; Resultantly, it does not attract TDS provisions under section 194J or under section 194C.

26. Can discount given on supply of SIM cards and pre-paid cards by a telecom company to its franchisee be treated as commission to attract the TDS provisions under section 194H?

Bharti Cellular Ltd. v. ACIT (2013) 354 ITR 507 (Cal.)

High Court's observations:

On this issue, the Calcutta High Court observed the Supreme Court ruling in *Bhopal Sugar Mills' case (1977) 40 STC 42*, wherein it was held that the true relationship

between the parties has to be gathered from the nature of the contract, its terms and conditions. The terminology used by the parties is not decisive of the said relationship.

The High Court, on perusal of the agreement between the assessee-telecom company and the franchisees, observed that –

(1) the property in the start-up pack and pre-paid coupons, even after transfer and delivery to the franchisee, remained with the assessee-telecom company;
(2) the franchisee really acted as a facilitator and/or instrument of providing services by the assessee-telecom company to the ultimate subscriber;
(3) the franchisee had no free choice to sell the pre-paid coupons and sim cards and everything including the selling price was regulated by the assessee-telecom company;
(4) the rate at which the franchisee sells to the retailers is also regulated and fixed by the assessee-telecom company.

In the real sense, the franchisee acted on behalf of the assessee-telecom company for selling start-up pack, prepaid recharge coupons to the customer. Therefore, the relationship between the assessee and the franchisee is essentially that of principal and agent, though the nomenclature used is "franchisee". The franchisees were, thus, agents of the assessee, getting a fixed percentage of commission, in the form of discount.

High Court's decision:

Considering the above, the High Court held that there is an indirect payment of commission, in the form of discount, by the assessee-telecom company to the franchisee. Therefore, the assessee is liable to deduct tax at source on such commission as per the provisions of section 194H.

Note - *Similar ruling was pronounced by the Kerala High Court in Vodafone Essar Cellular Ltd. v. ACIT (TDS) (2011) 332 ITR 255, wherein it was held that there was no sale of goods involved as claimed by the assessee-telecom company and the entire charges collected by the assessee from the distributors at the time of delivery of SIM cards or recharge coupons were only for rendering services to ultimate subscribers. The assessee was accountable to the subscribers for failure to render prompt services pursuant to connections given by the distributor. Therefore, the distributor only acted as a middleman on behalf of the assessee for procuring and retaining customers and consequently, the discount given to him was within the meaning of commission on which tax was deductible under section 194H.*

27. Would commission payment remitted outside India to a non-resident (who is not liable to pay tax in India) for procuring export orders outside India attract disallowance under section 40(a)(i) for non-deduction of tax at source under section 195?

CIT v. Model Exims (2013) 358 ITR 72 (Allahabad)

Facts of the case:

The assessee is a partnership firm engaged in manufacture and export of finished leather, shoe-uppers and leather products. For the assessment year 2007-08, the assessee made a payment to overseas entities, in respect of the services of procurement of export orders outside India, without deduction of tax at source under section 195, on the understanding that these payments were covered by Circular Nos. 23/1969, 163/1975 and 786/2000[2] and were hence, not taxable under the scheme of the Act.

The Assessing Officer, however, disallowed the commission payment under section 40(a)(i) for non-deduction of tax at source, on the basis of the provisions contained under section 195 and section 9.

Revenue's contention:

The Revenue contended that the liability to deduct tax arises out of section 195; therefore, the liability has to be determined in accordance with the provisions of law and not of the circulars. Even if earlier circulars did not make it obligatory on the part of assessee to deduct TDS, the assessee would be liable to deduct tax at source as –

(i) the Circulars did not create any vested right and were only clarificatory in nature;

(ii) the Circulars were withdrawn by virtue of Circular No.7/2009 dated 22.10.2009, and the withdrawal would be retrospective in nature; and

(iii) the assessment is to be made after withdrawal of the circulars, in accordance with law.

High Court's observations:

The High Court observed that the earlier Circulars did not oblige the assessee to deduct tax at source. The assessment in question for the assessment year 2007-08 would be governed by the said circulars, which were operative at the relevant time. The assessee was not entitled to deduct tax at source as per the said circulars. Circular No. 7/2009 dated 22.10.2009, withdrawing the earlier circulars became operative only from that date and not earlier. The circulars in force in the relevant year were binding upon the Department; the Assessing Officer did not have any right to ignore the circulars and to disallow the expenditure under section 40(a)(i) for non-deduction of tax at source under section 195.

High Court's decision:

The High Court further observed that there was no obligation to deduct tax at source under section 195 on commission paid to a non-resident, who was not liable to pay tax in India. The payment of commission to foreign agents also did not entitle such foreign agents to pay tax in India. Thus, there was no obligation to deduct tax at source under section 195 on the commission paid to a non-resident recipient, who was not liable to pay tax in India.

[2] These circulars were later withdrawn by *Circular No. 7 dated 22.10.2009*

Further, there was also nothing on record to demonstrate that the non-resident agents had been appointed as selling agents, designers or technical advisers[3].

Note *– Even after withdrawal of Circular Nos. 23/1969, 163/1975 and 786/2000 by Circular No.7/2009 dated 22.10.2009, commission payment to a foreign agent, not having a permanent establishment in India, for booking orders outside India is not subject to tax deduction at source. A foreign agent of an Indian exporter operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.*

Since commission income for booking orders by non-resident who remains outside India is not subject to tax in India, consequently, disallowance under section 40(a)(i) is not attracted in respect of payment of commission to such non-resident outside India even though tax has not been deducted at source.

28. Where the assessee fails to deduct tax at source under section 194B in respect of the winnings, which are wholly in kind, can he be deemed as an assessee-in-default under section 201?

CIT v. Hindustan Lever Ltd. (2014) 361 ITR 0001 (Kar.)

Facts of the case:

In the present case, the assessee is a company engaged in the business of manufacture and sale of various consumer goods/products. During the previous years relevant to A.Y.2001-02 and A.Y.2002-03, it had conducted certain sales promotion schemes. The assessee advertised the schemes wherein coupons were inserted in packs/containers of their products. Some of those coupons indicated that on purchase of the packs/ containers, they would get prizes, as indicated in coupons. The prizes that were offered were Santro car, Maruti car, gold chains, gold coins, gold tablas, silver coins, emblems, etc. The total amount of prizes distributed valued ₹ 6,51,238 for the A.Y.2001-02 and ₹ 54,73,643 for the A.Y.2002-03.

The Assessing Officer, having received the information about the schemes, sought clarification and also conducted survey of the assessee's business premises under section 133A. The Assessing Officer, thereafter, passed an order dated 3.1.2002, under sections 201(1) and 201(1A) for the A.Y.2001-02 and treated the assessee as an assessee-in-default of its obligation in terms of section 194B. Similar order was passed for the A.Y.2002-03. According to the Assessing Officer, the assessee was obliged to ensure that the tax in respect of the winnings, wholly in kind, was remitted before the winnings were released. Having failed to do so, the proceedings under section 201(1)

[3] In case the payments were in the nature of fees for technical services, the same would have necessitated deduction of tax at source on account of "deemed accrual" of such income as per *Explanation* below section 9(2), if such services were utilized in India.

were initiated. The Assessing Officer held that although the customers did not pay anything extra to receive the prize, nevertheless, they had participated in the scheme by purchasing the products advertised to take a chance at winning the prize. It was further held that what has been paid as prize-in-kind in various schemes conducted by the assessee is a lottery on which the tax was deductible under section 194B. As the assessee neither deducted the tax nor ensured payment thereof before the winnings were released, he treated the assessee as an assessee-in-default. He passed similar order dated 28.3.2002 for the A.Y.2002-03.

Appellate Tribunal's view:

The Tribunal held that the schemes conducted by the assessee were not a lottery, as the said expression was understood up to the A.Y.2001-02. The Tribunal observed that the customers did not pay any excess amount for getting coupons indicating winnings in the packs/containers of products they purchased, and, therefore, nothing was paid by them for participating in the scheme. Accordingly, the Tribunal concluded that although there was an element of chance but as no consideration or payment was made by the customers for the purpose of participation in the lottery with the object of winning the prizes, the schemes conducted by the assessee would not fall within the ambit of section 194B.

The Tribunal further held that having regard to the insertion of *Explanation* below section 2(24)(ix), the scheme conducted by the assessee would be a lottery for the A.Y.2002-03 but nevertheless they accepted the alternate contention that having regard to *Circular No. 390, dated August 8, 1984 [See (1984) 149 ITR (St.) 5]*, there was no obligation on the respondent to deduct tax at source in respect of prizes paid in kind and in the absence of any such obligation, no proceedings under section 201 could be taken against the respondent.

High Court's view:

From a bare perusal of section 194B, it is clear that the person responsible for paying to any person any income by way of winnings from any lottery in an amount exceeding ten thousand rupees shall, at the time of payment thereof, deduct income-tax thereon at the rates in force. A combined reading of sections 194B and 201 shows that if any such person fails to "deduct" the whole or any part of the tax or after deducting, fails to pay the tax as required by or under the Act, then such person shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax. **The provisions contained in these sections do not cast any duty to deduct tax at source where the winnings are wholly in kind. If the winnings are wholly in kind, as a matter of fact, there cannot be any deduction of tax at source. The word "deduction" employed in this provision postulates a reduction or subtraction of an amount from a gross sum to be paid and payment of the net amount thereafter.** Where the winnings are wholly in kind the question of deduction of any sum therefrom does not arise and in that eventuality, the only responsibility, as cast under section 194B, is to ensure that tax is paid by the winner of the prize before the prize or winnings is or are released in his favour.

High Court's decision:

The High Court observed that if the assessee fails to ensure that tax is paid before the winnings are released in favour of the winner, then, section 271C empowers the Joint Commissioner to levy penalty equivalent to the amount of tax not paid, and under section 276B, such non-payment of tax is an offence attracting rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine. However, the High Court held that proceedings under section 201 cannot be initiated against the assessee.

29. Are TDS provisions under section 194H attracted in a case where an assessee, a dairy, makes an outright sale of milk to its concessionaires at a certain price (which is lower than the MRP fixed by the assessee-dairy) and the concessionaires make full payment for the purchases on delivery and bear all the risks of loss, damage, pilferage and wastage?

C IT v. Mother Dairy India Ltd. (2013) 358 ITR 218 (Delhi)

Facts of the case:

The assessee-dairy undertook activities in connection with procurement, processing, storage and marketing including retail sale of milk and other products. The Dairy was called upon to explain why orders should not be passed under section 201(1)/(1A) treating it as an assessee in default, for failure on its part to deduct tax at source on the difference between the payments made by concessionaires to the assessee-dairy and the MRP at which the concessionaires had to sell the milk to the ultimate consumer, by the treating such difference as "commission" within the meaning of *Explanation (i)* to section 194H.

Assessee's contention:

In reply to the show cause notice, the assessee-dairy explained that it had sold the products to the concessionaires on a principal to principal basis, and the same can be evidenced from the following facts:

- the concessionaires bought the products at a given price after making full payment for the purchases on delivery;
- the milk and other products once sold to the concessionaires became their property and could not be taken back; and
- any loss on account of damage, pilferage and wastage was to the account of the concessionaires.

Owing to these facts, the assessee contended that the difference between payment made by the concessionaires and the MRP could not be treated as "commission" for services rendered and consequently, there was no liability on the part of the assessee to deduct tax at source.

Assessing Officer's view:

The Assessing Officer, however, contended that the relationship existing between the assesse-dairy and the concessionaires was not that of principal to principal but it was a relationship of a principal and an agent, due to the following reasons –

(i) The booths from which the concessionaires sold milk and other products of the assessee, were owned by the Dairy; and

(ii) Even after sale to the concessionaires, the assessee-dairy had a right to inspect the booths and check the milk and other products stored in the booth at any time.

Accordingly, he treated the difference between the bill value and the MRP fixed by the assessee-dairy as commission paid to the concessionaires on which the assessee-dairy ought to have deducted tax at source under section 194H.

Appellate Authorities' view:

The Commissioner (Appeals) concurred with the opinion of the Assessing Officer and passed an order affirming the Assessing Officer's view.

The Tribunal, however, on a perusal of the agreement entered into between the assessee-dairy and the concessionaires as well as the other relevant facts of the case, observed that there was an actual sale of milk by the assessee to the concessionaires on delivery and that the assessee was not under any obligation to take back any portion of the unsold milk in any condition whatsoever. The Tribunal was of the view that the other conditions imposed on the concessionaires by the assessee such as the right to inspect the booths at any time, right to check the registers and ensure the proper usage of the equipment, furniture, machinery by the concessionaires did not affect the relationship of principal to principal between the assessee and the concessionaires. The Tribunal opined that such terms were included in the agreement only for the purpose of safeguarding the booths, the equipment, furniture etc. which were owned by the assessee. The Tribunal concluded that since the real test was whether the property in the milk and the products passed to the concessionaires at the time of delivery, and this test was satisfied, the difference between the price at which the assessee sold the milk and the other products to the concessionaires and the MRP at which the concessionaires were to sell them to the consumers was not liable to be treated as commission within the meaning of section 194H.

High Court's Observations:

The High Court concurred with the Tribunal's ruling holding that the terms of the agreement clearly indicated that the relationship between the assessee and the concessionaire was on a principal to principal basis. The Dairy having given space, machinery and equipment to the concessionaire would naturally like to incorporate clauses in the agreement to ensure that its property is properly maintained by the concessionaire, especially because milk and other products are consumed in large quantities by the general public and any unattended defect in the storage facilities can cause serious health hazards. These terms are included in the agreement only to

ensure the smooth operation of the system. Therefore, merely due to the existence of these clauses, it cannot be inferred that the relationship between the assessee and the concessionaire is that of principal and an agent.

High Court's decision:

The High Court opined that the issue had to be decided on the basis of the fact as to when and what point of time the property in the goods passed to the concessionaire. In this case, the concessionaire became the owner of the milk and products on taking delivery of the same from the assessee-dairy. Therefore the relationship between the assessee and the concessionaire is a Principal to Principal relationship. The High Court, therefore, held that the difference between the purchase price (price paid to the Dairy) and the MRP is the concessionaire's income from business and cannot be categorized as commission to attract the provisions of section 194H.

30. Are the provisions of section 234D levying interest on excess refund attracted in a case where the refund granted to the assessee in pursuance of the order of Commissioner (Appeals) was reversed on account of setting aside of such order by the Tribunal?

DIT (International Taxation) v. Delta Air Lines Inc. (2013) 358 ITR 0367 (Bom.)

Facts of the case:

In the present case, the Assessing Officer disallowed the benefit of article 8 of the Double Taxation Avoidance Agreement between India and the U.S.A. (DTAA) to the assessee. The Commissioner (Appeals), on the other hand, held that the assessee was entitled to the benefit of article 8 of the DTAA. The Tribunal, however, set aside the order of the Commissioner (Appeals) and restored the order passed by the Assessing Officer. While giving effect to the order of the Tribunal, the Assessing Officer apart from levying interest under sections 234A and 234B, also levied interest under section 234D on the refund granted to the assessee pursuant to the order of Commissioner (Appeals).

Appellate Authorities' contention:

The assessee challenged the order of the Assessing Officer levying interest under section 234D by filing an appeal before the Commissioner (Appeals). The Commissioner (Appeals) opined that since the refund was not granted under section 143(1), section 234D was not attracted. The Tribunal concurred with the view of the Commissioner (Appeals).

High Court's decision:

The High Court observed that interest under section 234D is chargeable only where the refund has been granted to the assessee while processing the return of income under section 143(1) and thereafter, such refund is found to be excessive under the regular assessment.

In the present case, the refund was not granted under section 143(1). The refund was not granted even by way of an assessment order passed under section 143(3) read with section 147. The same was granted pursuant to the order passed by the Commissioner (Appeals). Consequently, the High Court concurred with the Tribunal's view that the provisions of section 234D were not attracted in this case.

***Note**: Section 234D(1) provides that where any refund is granted to the assessee under section 143(1) and -*

(a) no refund is due on regular assessment; or

(b) the amount refunded under section 143(1) exceeds the amount refundable on regular assessment,

the assessee shall be liable to pay simple interest @1½% on the whole or the excess amount refunded, for every month or part of a month comprised in the period from the date of grant of refund to the date of such regular assessment.

Explanation 1 to section 234D provides that where, in relation to an assessment year, the assessment is made for the first time under section 147 or section 153A, the assessment so made shall be regarded as regular assessment for the purpose of this section.

Therefore, the above provisions of section 234D(1) read with Explanation 1 thereto makes it clear that interest thereunder is attracted only in a case where refund is granted to the assessee under section 143(1), which becomes refundable on account of the order passed under section 143(3) or section 147 or section 153A.

31. Can refund of tax due to the assessee for a particular assessment year be adjusted, against sums due from the assessee in respect of another assessment year, under section 245, without giving prior intimation to the assessee of the proposed adjustment?

Jeans Knit P. Ltd. v. DCIT (2013) 358 ITR 0505 (Kar.)

Facts of the case:

In the present case, the company is an export oriented unit. A certain deduction was disallowed for A.Y.2007-08 by the Assessing Officer, but subsequently, on appeal by the assessee, the same was allowed by the Commissioner (Appeals). Consequent to the order of Commissioner (Appeals), the assessee became entitled to a refund of ₹ 14.25 crores. While giving effect to the order of Commissioner (Appeals), the Assessing Officer adjusted the refund towards the tax demand for the A.Y. 2008-09.

High Court's Observations:

On the issue of whether refund can be adjusted against demand for the subsequent year without prior intimation, the Karnataka High Court referred to the following High Court rulings–

(i) The Karnataka High Court's ruling in *Fosroc Chemicals (India) Ltd. v. CIT (2001) 248 ITR 607*, wherein it was observed that for the purpose of any adjustment of the

amount due to the assessee by way of refund against an outstanding demand due from the assessee to the Revenue, an intimation in writing is required to be given to the concerned person of the action proposed. Proposed action would mean a notice before making the adjustments and not an intimation of making the adjustment. An order passed purporting to adjust the refund due to the assessee without prior intimation would be against the express provisions of law and is hence, bad in law. The provisions of section 245 are mandatory in nature.

(ii) The Delhi High Court's ruling *in Vijay Kumar Bhati v. CIT (1994) 205 ITR 110*, wherein it was held that any order of set-off of refund purporting to be made without prior intimation is neither fair, nor just, nor reasonable and has to be ignored.

(iii) The Calcutta High Court's ruling in *J.K. Industries Ltd. v. CIT (1999) 238 ITR 820*, wherein it was held that the Revenue has no jurisdiction to make an adjustment of a refund without following the provisions section 245 and without giving prior intimation to the assessee as required by that section.

High Court's Decision:

In view of the above rulings, the Karnataka High Court, in this case, held that the communication informing the adjustment of refund, without prior intimation to the assessee, is illegal and contrary to law. Therefore, the High Court set aside the order in so far as it relates to adjustment of refund against tax due.

PAPER – 8 : INDIRECT TAX LAWS

PART – III : QUESTIONS AND ANSWERS

QUESTIONS

Basic concepts of central excise

1. With reference to the provisions of Central Excise Act, 1944, explain whether the following items can be considered as excisable goods:

   (i) Huge metal tanks erected at site for storing petroleum products in oil refineries. Such tanks are not embedded in earth, but once erected they cannot be physically moved and will have to be necessarily dismantled in case of sale/disposal.

   (ii) Turn key projects

Classification of excisable goods

2. Mr. X manufactures a cream called as 'Moisture-BN' which has certain pharmaceutical contents. The cream is prescribed by dermatologists for curing dry skin conditions and at the same time is also available without prescription of a medical practitioner. Mr. X classifies the cream as a medicament since it has pharmaceutical contents and is being prescribed by dermatologists for treating dry skin conditions.

   However, the Central Excise Officer is of the view that the cream should be classified as a cosmetic/toilet preparation as (i) the same is mainly used for 'care' of the skin and (ii) can also be purchased without prescription of a medical practitioner. The Central Excise Officer contends that even if a cosmetic product contains certain subsidiary pharmaceutical contents or even if it has certain subsidiary curative value, it would still be treated as cosmetics only.

   What do you think should be the correct classification of the cream; a medicament or a cosmetic/toilet preparation? Support your answer with the help of a decided case law, if any.

Valuation of excisable goods

3. Alpha Ltd., a manufacturer of excisable goods, has two production units-Unit A and Unit B. Unit A of Alpha Ltd. manufactures product 'X'. 80% of such production is consumed captively by Unit B to further manufacture product 'Y' and the remaining 20% is sold to unrelated buyers at ₹ 75 per unit. In March, 2014, Unit A has manufactured 1000 units of product 'X'. Assuming that there is no opening and closing inventory of product X, compute its assessable value for the purpose of central excise duty from the following information provided by Alpha Ltd. in relation to Unit A for the month of March, 2014-

Particulars	₹
Cost of direct materials (inclusive of central excise duty @ 12.36%)*	22,472
Cost of direct salaries (includes house rent allowance of ₹ 12,000)	30,000
Consumable stores and repairs	8,400

Depreciation of machinery	500
Quality control cost	4,300
Research & development cost	2,700
Administrative cost:	
Production related	2,000
Project management related	1,800
Interest and financial charges	2,400
Cost incurred due to break down of machinery	1,300
Amortised cost of moulds and tools received free of cost from the production unit 'B' for being used only in the manufacture of goods to be consumed by unit 'B'	600
Selling and distribution cost	4,600
Scrap value realized	1,500

***Note:** CENVAT credit of the excise duty so paid is available.*

CENVAT credit

4. LMN Ltd. manufactures machinery for sugar and cement plants. It entered into a contract for setting up a sugar manufacturing plant in Mexico. For this purpose, it manufactured certain machines in its own factory and also purchased certain other machinery from other dealers/manufacturers. Both the machineries (manufactured and bought-out) were then put in a container and transported to Mexico for setting up the sugar plant.

   LMN Ltd. has availed CENVAT credit on bought-out machinery describing them as eligible capital goods. The Central Excise Officer, however, has disallowed such credit.

   Examine whether the action taken by the Central Excise Officer is correct in law, with the help of a decided case law, if any.

SSI exemption

5. PQR & Co. is eligible for exemption in terms of *Notification No. 8/2003 CE dated 01.03.2003* for the year 2013-14. It provides the following particulars with regard to the clearances of goods effected during the said year:

Particulars	₹ (in lakh)
Value of domestic clearance of goods with own brand name	210
Value of clearance of goods with the brand name of others (including ₹ 40 lakh in respect of goods manufactured in a rural area)	100
Value of clearances for exports	120
Value of clearances for captive consumption (Final products are eligible for SSI exemption)	160

Value of clearances of goods exempted under notification other than *Notification No. 8/2003* (Assume rate of excise duty at 12%)	40

Exports made by PQR & Co. are exempt from duty. Determine the total duty payable and duty payable in cash, if any, by PQR & Co. in respect of the year 2013-14.

Additional Information:

Excise duty paid on inputs consumed in exempt and dutiable clearances in the year 2013-14 is ₹ 2,25,000 and ₹ 4,50,000 respectively. Excise duty paid on capital goods purchased in the year 2013-14 is ₹ 6,35,000.

Show your workings with explanations where required.

Basic concepts of service tax

6. Chunni Lal is engaged in the activity of preparation of place for organizing event or function by way of erection/laying of pandal and shamiana. He is of the view that service tax is not leviable on his activity as it is a transaction involving "transfer of right to use goods" and hence, is a deemed sale.

   Examine whether the contention of Chunni Lal is valid in law.

Basic concepts of service tax

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

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

   Examine the service tax liability of Mr. A with respect to the residential building owned by him.

Place of provision of service

8. With reference to Place of Provision of Services Rules, 2012, answer the following question:

   (i) A movie-on-demand is provided as on-board entertainment during the Bangalore-Delhi leg of a Singapore-Bangalore-Delhi flight against a charge of ₹ 500 per passenger in addition to the fare of ₹ 25,000 per passenger. What will be the place of provision of service in this case? Will your answer change, if the above service is provided on a Delhi-Bangalore-Singapore-Malaysia flight during the Singapore-Malaysia leg?

(ii) Mr. Sumit has a permanent residence at Ahmedabad. He has a savings bank account with Ahmedabad Branch of Safe and Sound Bank. On April 1, 2012, Mr. Sumit opened a safe deposit locker with the Ahmedabad Branch of Safe and Sound Bank. Mr. Sumit went to USA for official work in December, 2012 and has been residing there since then. Mr. Sumit contends that since he is a non-resident during the year 2013-14 in terms of the Income-tax Act, service tax cannot be levied on the locker fee charged by Safe and Sound Bank for the year 2013-14.

Examine the correctness of the contention of Mr. Sumit.

Point of taxation

9. Determine whether the following services amount to continuous supply of service in the following independent cases:-

(i) XYZ & Co., a firm of interior decorators, enters in to a contract with Mr. Mehta on 01.08.2013 for doing up the interiors of his newly constructed home for a total consideration of ₹ 60 lakh. As per the terms of the contract, XYZ & Co. will complete the work by 31.01.2014 and consideration will be paid in six equal instalments on the first day of each month covered during the period of contract.

(ii) Mr. Kapoor has taken a mobile connection from Cell Two, a telecom service provider, on 10.01.2014. However, on account of poor service, he discontinued the services of Cell Two on 15.03.2014.

Valuation of taxable service

10. Shambhu Pvt. Ltd. was awarded a contract in November, 2013 for providing flooring and wall tiling services in respect of a building located in Delhi by Nath Ltd. As per the terms of contract, Shambhu Pvt. Ltd. was to provide all the required material for execution of the contract. However, a portion of the material was also provided by Nath Ltd.

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

Particulars	₹
Gross amount (excluding all taxes) charged by the Shambhu Pvt. Ltd. for the contract	6,00,000
Fair market value of the material supplied by Nath Ltd.	1,00,000
Amount charged by Nath Ltd. for the material (inclusive of VAT)	60,000
Excise duty paid on inputs	12,750
Service tax paid on input services	6,000
Excise duty paid on capital goods, purchased during the year, used in the contract	4,000

Special audit

11. Raman, a service provider, has his operations spread out in multiple locations. His registered premises are situated in Mumbai. The jurisdictional Commissioner is of the view that it is not possible to obtain a true and complete picture of the accounts of Raman from his registered premises. Thus, he has directed Raman to get his accounts audited by Mr. P, a Chartered Accountant, nominated by him for the relevant financial year. However, Raman contests that his accounts have already been audited under Income-tax Act, 1961 by Mr. Y, another Chartered Accountant, and thus, do not require any other audit.

    With reference to the provisions of Finance Act, 1994, examine the correctness of the contention of Raman.

Penalties

12. Steft (P) Ltd., a service provider, has availed and utilized credit of excise duty without actual receipt of excisable goods. A personal penalty of ₹ 1,90,000 has been imposed on Mr. Mudit, Manager of Steft (P) Ltd. and ₹ 72,000 on Miss Sneha, an officer of Steft (P) Ltd. who were in charge of, and were responsible to, Steft (P) Ltd. for the conduct of its business at the time of such availment and utilization of the credit.

    Discuss whether such penalty can be imposed on Mr. Mudit and Miss Sneha under section 78A of Finance Act, 1994. Can penalty be imposed on manager or officer of a company in any other case? Explain.

Large tax payer

13. BPT Ltd., a service provider, has been granted the acceptance of being a large tax payer unit by the Chief Commissioner of Central Excise, Large Tax payer Unit on 12.12.2013. BPT Ltd. wants to know the procedure to be followed by it as a large tax payer and the facilities available to it under service tax law. You are required to advice BPT Ltd. in this regard.

Best judgment assessment under service tax

14. The best judgment assessment under section 72 of the Finance Act, 1994 is an ex-parte assessment procedure. Examine the validity of the statement.

Special provision for payment of service tax

15. Arihant Life Insurance Company Ltd. (ALICL) has started its operations in the year 2013-14. During the year 2013-14, Arihant Life Insurance Company Ltd. (ALICL) has charged gross premium of ₹ 180 lakh from policy holders with respect to life insurance policies; out of which ₹ 100 lakh have been allocated for investment on behalf of the policy holders.

    Compute the service tax liability of ALICL for the year 2013-14 under rule 6(7A) of the Service Tax Rules, 1994

(i) if the amount allocated for investment has been intimated by ALICL to policy holders at the time of providing service.

(ii) if the amount allocated for investment has not been intimated by ALICL to policy holders at the time of providing of service.

(iii) if the gross premium charged by ALICL from policy holders is only towards risk cover.

Note: ALICL has not opted for small service provider's exemption available under Notification No. 33/2012 ST dated 20.06.2012.

Types of duty

16. With reference to the Customs Tariff Act, 1975, discuss the validity of the imposition of customs duties in the following cases:-

(a) Both countervailing duty and anti-dumping duty have been imposed on an article to compensate for the same situation of dumping.

(b) Countervailing duty has been levied on an article for the reason that the same is exempt from duty borne by a like article when meant for consumption in the country of origin.

(c) Definitive anti-dumping duty has been levied on articles imported from a member country of World Trade Organization as a determination has been made in the prescribed manner that import of such article into India threatens material injury to the indigenous industry.

Valuation of imported goods

17. Compute the assessable value and total customs duty payable under the Customs Act, 1962 for an imported machine, based on the following information:

		US $
(i)	Cost of the machine at the factory of the exporter	20,000
(ii)	Transport charges from the factory of exporter to the port for shipment	800
(iii)	Handling charges paid for loading the machine in the ship	50
(iv)	Buying commission paid by the importer	100
(v)	Lighterage charges paid by the importer	200
(vi)	Freight incurred from port of entry to Inland Container depot	1,000
(vii)	Ship demurrage charges	400
(viii)	Freight charges from exporting country to India	5,000

Date of bill of entry	20.01.2014 (Rate BCD 20%; Exchange rate as notified by CBEC ₹ 60 per US $)
Date of entry inward	25.03.2014 (Rate of BCD 10%; Exchange rate as notified by CBEC ₹ 65 per US $)
Additional duty payable under section 3(1) of the Customs Tariff Act, 1975	12%
Additional duty payable under section 3(5) of the Customs Tariff Act, 1975	4%

Warehousing of imported goods

18. With reference to section 61 of the Customs Act, 1962, comment on the validity of the following statements:

    (a) Goods, other than capital goods, intended for use in any hundred per cent export-oriented undertaking, can be warehoused till the expiry of five years.

    (b) Interest free period of ninety (90) days under section 61(2)(ii) in respect of warehoused goods (not intended for being used in 100% EOU) commences from the date on which an into-bond bill of entry in respect of such goods is presented.

Provisions relating to illegal import, penalty etc.

19. Cargo Logistics Pvt. Ltd. (Cargo Logistics) is a duly appointed steamer agent of the vessel Queen Mary Utah. 110 containers of MS Scrap were imported in the said vessel by an Indian importer. Cargo Logistics had affixed the seal on the said containers after stuffing and took charge of the sealed containers. On the entry of the Vessel in India, Cargo Logistics filed the Import General Manifest and also dealt with the Customs Department for appropriate orders that had to be passed in terms of section 42 of the Customs Act, 1962. Section 42 prescribes that no conveyance can leave without a written order.

    Customs Department, on finding that 40 of the said containers were empty, levied a penalty on Cargo Logistics under section 116 of the Customs Act, 1962 for short landing of the goods. Cargo Logistics is of the view that penalty for short landing of the goods can only be imposed on the person-in-charge of the vessel and not on a steamer agent.

    Discuss with the help of a decided case law, if any, whether penalty for short landing of goods can be imposed on the steamer agent of a vessel.

Foreign Trade Policy

20. Answer the following questions with reference to the provisions of Foreign Trade Policy:

    (i) Bestron Ltd. manufactures goods by using imported inputs and supplies the same under Aid Programme of the United Nations. The payment for such supply is

received in free foreign exchange. Can Bestron Manufacturers seek Advance Authorization in relation to the supplies made by it?

(ii) LMN Ltd. has imported inputs without payment of duty under Advance Authorization. The CIF value of such inputs is ₹20,00,000. The inputs are processed and the final product is exported. The exports made by LMN Ltd. are subject to general rate of value addition prescribed under Advance Authorization Scheme. No other input is being used by LMN Ltd. in the processing. What should be the minimum FOB value of the exports made by the LMN Ltd. as per the provisions of Advance Authorization?

SUGGESTED ANSWERS

1. As per section 2(d) of Central Excise Act, 1944, excisable goods means goods which are specified in the First Schedule and the Second Schedule to the Central Excise Tariff Act, 1985 as being subject to a duty of excise and includes salt. Further, for being called goods, items ought to be movable and marketable.

Section 37B *Order No. 58/1/2002 CX dated 15.01.2002* issued by CBEC has specifically dealt with the excisability of, *inter alia,* the two given items. Therefore, in the light of the above provisions and the said order, the excisability of the two items are discussed below:

(i) The afore-mentioned order, *inter alia,* provides that if items assembled or erected at site and attached by foundation to earth cannot be dismantled without substantial damage to its components and thus cannot be reassembled, then the items would not be considered as moveable and will, therefore, not be excisable goods.

The said order clarifies that though such huge metal tanks are not embedded in the earth, they are erected at site, stage by stage, and after completion they cannot be physically moved. Further, on sale/disposal they have to be necessarily dismantled and sold as metal sheets/scrap and it is not possible to assemble the tank all over again. Therefore, such tanks are not moveable and cannot be considered as excisable goods.

(ii) As per the said order, turn key projects like steel plants, cement plants, power plants etc. involving supply of large number of components, machinery, equipments, pipes and tubes etc. for their assembly/installation/erection/integration/inter-connectivity on foundation/civil structure etc. at site, will not be considered as excisable goods for imposition of central excise duty. However, their components would be dutiable in the normal course.

2. The facts of the given case are similar to the case of *CCEx. v. Ciens Laboratories 2013 (295) ELT 3 (SC)*. In the instant case, the Supreme Court made the following significant observations:

(i) When a product contains pharmaceutical ingredients that have therapeutic or prophylactic or curative properties, the proportion of such ingredients is not

invariably the decisive factor in classification. The relevant factor is the curative attributes of such ingredients that render the product a medicament and not a cosmetic.

(ii) Though a product is sold without the prescription of a medical practitioner, it does not lead to the immediate conclusion that all products that are sold over / across the counter are cosmetics. There are several products that are sold over-the-counter and are yet, medicaments.

(iii) Prior to adjudicating upon whether a product is a medicament or not, it ought to be seen as to how do the people who actually use the product, understand it to be. If a product's primary function is "care" and not "cure", it is not a medicament. Medicinal products are used to treat or cure some medical condition whereas cosmetic products are used in enhancing or improving a person's appearance or beauty.

(iv) A product that is used mainly in curing or treating ailments or diseases and contains curative ingredients, even in small quantities, is to be treated as a medicament.

Based upon the above observations, the Supreme Court held that presence of pharmaceutical ingredients in the cream showed that it was used for prophylactic and therapeutic purposes namely, for curing dry skin conditions of the human skin and was not primarily intended to protect the skin; therefore, the same was classifiable as a medicament.

Applying the ratio of the above-mentioned decision to the given situation, it can be concluded that owing to the pharmaceutical constituents present in the cream 'Moisture-BN' and its use for the cure of certain skin diseases, the same would be classifiable as a medicament and not as a cosmetic/toilet preparation.

3. Rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, has been amended vide *Notification No. 14/2013 CE (NT) dated 22.11.2013* to provide that where whole or part of the excisable goods are not sold by the assessee but are used for captive consumption, the value of goods meant for captive consumption shall be 110% of the cost of production or manufacture of such goods.

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

Since in the present case, only a part of the excisable goods are used for captive consumption (80% of 1,000 units i.e., 800 units), assessable value of such 800 captively consumed units will be determined in accordance with rule 8 of Valuation Rules. The assessable value of remaining 200 units sold to unrelated buyers will be determined under section 4 of Central Excise Act, 1944 i.e., transaction value.

Computation of cost of production as per CAS-4 and value of product 'X'

S. No.	Particulars	₹
1.	Material consumed:	
	Cost of direct materials ₹ 22,472	
	Less: Central excise duty $\left(\frac{₹\ 22,472}{112.36}\times 12.36\right)$ ₹ 2,472 (Note 1)	20,000
2.	Direct wages and salaries:	
	Cost of direct salaries (including house rent allowance of ₹ 12,000)	30,000
3.	Works overheads:	
	Consumable stores and repairs	8,400
	Depreciation of machinery	500
4.	Quality control cost	4,300
5.	Research & development cost	2,700
6.	Administrative overheads (relating to production activity):	2,000
	Total	67,900
	Less: Scrap value realized	1,500
	Cost of production of 1,000 units of product 'X'	66,400
	Cost of production for 800 units of product 'X' $\left(\frac{₹\ 66,400}{1,000}\times 800\right)$	53,120
	Add: Amortised cost of moulds and tools received free of cost from unit 'B' for being used only in the manufacture of goods to be consumed by unit 'B'	600
	Cost of production of 'X' produced for captive consumption	53,720
	Value of 800 units of product 'X' consumed captively [₹ 53,720 × 110%]	**59,092**

Notes:

1. Since CENVAT credit is available on central excise duty paid on direct materials, it has been deducted from the cost of direct materials in accordance with the Cost Accounting Standard-4 [CAS-4].
2. Administrative overheads in relation to activities other than manufacturing activities like project management activities have not been included in cost of production [CAS-4].
3. Interest and financial charge being a financial charge has not been considered to be a part of cost of production [CAS-4].

4. Abnormal cost like break down of machinery does not form part of cost of production [CAS-4].
5. Selling and distribution cost have not been considered while computing the cost of production as they are not in relation to production activity [CAS-4].

Value of 800 units of product 'X' consumed captively for the purpose of excise duty is ₹ 59,092.

Value of 200 units of product 'X' sold to unrelated buyers for the purpose of excise duty is ₹ 15,000 (200 units x ₹ 75) [Section 4 of Central Excise Act, 1944].

4. Yes, the action taken by the Central Excise Officer is correct in law.

One of the basic conditions for availing CENVAT credit on inputs or capital goods is that excise duty must have been levied on final product. Excise duty is levied when manufacture in India results in emergence of excisable goods. Since in the given case, the sugar plant was set up in Mexico, it could not be said to be manufactured in India and thus, no duty would have been levied on the same. Therefore, there could not be any question of availing CENVAT credit of the duty paid on the inputs or capital goods.

Supreme Court in the case of *KCP Ltd. v. CCEx. 2013 (295) ELT 353 (SC)* has also taken a similar view and held that CENVAT credit could not be allowed to the assessee as no excise duty was paid under the Central Excise Act, 1944, on sugar plant set up in a foreign country.

5. Computation of turnover of PQR & Co. eligible for exemption during the year 2013-14

Particulars	**₹ in lakh**
Value of domestic clearances with own brand name	210
Value of clearances of goods with brand name of others manufactured in rural area [Note 1.(b)]	40
Total	**250**

Computation of excise duty payable

Particulars	**₹**
On 1st clearance of ₹ 150 lakh duty payable is	Nil
On balance clearance of ₹ 100 lakh i.e. (250-150) @ 12%	12,00,000
On clearances of ₹ 60 lakh with brand name of others (excluding rural area clearances) @ 12% [Note 2]	7,20,000
Total	19,20,000
Add: Education cess and secondary and higher education cess @ 3%	57,600
Total excise duty payable	**19,77,600**
Less: CENVAT credit available on inputs consumed in dutiable clearances	4,50,000
CENVAT credit available on capital goods [Note 1.(d) and 3]	6,35,000
Excise duty payable in cash	**8,92,600**

Notes:

1. As per *Notification No. 8/2003 CE dated 01.03.2003,*

   (a) captive consumption (used in the manufacture of final products which are eligible for SSI exemption) and exempt and export clearances are not included in determining the limit of ₹ 150 lakh for SSI exemption.

   (b) clearances with brand name of others which are ineligible for SSI exemption has to be excluded while determining the limit of ₹ 150 lakh. However, clearances with the brand name of others manufactured in rural area are eligible for SSI exemption and hence, such clearances are included while determining the limit of ₹ 150 lakh.

   (c) in respect of units availing SSI exemption, no CENVAT credit is available on inputs consumed in exempt clearances of ₹ 150 lakhs.

   (d) in respect of units availing SSI exemption, CENVAT credit on capital goods can be availed but utilized only after clearances of ₹ 150 lakh.

2. Duty is not payable on export clearance and exempt clearances. Further, intermediate goods used captively in the manufacture of final products which are eligible for SSI exemption are also exempt from excise duty. Thus, duty will be payable only in respect of the goods manufactured with brand name of others.

3. Further, entire credit on capital goods can be taken in the same financial year by such units (Rule 4 of the CENVAT Credit Rules, 2004).

6. The issue that whether the activity of erection/laying of pandal and shamina is a service or deemed sale involving transfer of right to use goods has been addressed in Board's *Circular No. 168/3/2013-ST dated 15.04.2013.* The Circular clarified as under:

(i) The activity of providing pandal and shamiana along with erection thereof is generally coupled with other incidental activities like supply of crockery, furniture, sound system, lighting arrangements, etc. It is a reasonably specialized job and is carried out by the supplier with the help of his own labour.

(ii) For a transaction to be regarded as "transfer of right to use goods", the transfer has to be coupled with effective control and possession. In the case of *Rashtriya Ispat Nigam Ltd. v. CTO 1990 77 STC 182,* the High Court held that since the effective control and possession was with the supplier, there is no transfer of right to use (upheld subsequently by Supreme Court in *2002 126 STC 0114*).

(iii) Further, in *Harbans Lal v. State of Haryana 1993 088 STC 0357*, the High Court held that if pandal, is given to the customers for use only after having been erected, then it is not transfer of right to use goods.

(iv) In the case of *BSNL v. UOI 2006 (2) S.T.R. 161 (S.C.),* the Supreme Court held that to constitute the transaction for the transfer of the right to use the goods, the transaction must have the following attributes:-

   (a) There must be goods available for delivery;

(b) There must be a consensus ad idem as to the identity of the goods;

(c) The transferee should have a legal right to use the goods and, consequently, all legal consequences of such use including any permissions or licenses required therefor should be available to the transferee;

(d) For the period during which the transferee has such legal right, it has to be the exclusion of the transferor: this is the necessary concomitant or the plain language of the statute, viz., a "transfer of the right to use" and not merely a license to use the goods :

(e) Having transferred the right to use the goods during the period for which it is to be transferred, the owner cannot again transfer the same right to others.

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

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

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

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

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

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

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

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

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

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

8. (i) As per rule 12 of Place of Provision of Service Rules, 2012, the place of provision of services provided on board a conveyance during the course of a passenger transport operation, including services intended to be wholly or substantially consumed while on board, shall be the first scheduled point of departure of that conveyance for the journey**.** Hence, in this case the place of provision of this service will be Singapore, which is outside the taxable territory and hence, would not be liable to service tax.

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

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

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

As per rule 9 of Place of Provision of Service Rules, 2012 [POPS Rules], the place of provision of services provided by a banking company, or a financial institution, or a non-banking financial company, to account holders is the location of the service provider.

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

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

9. **(i)** As per rule 2(c) of Point of Taxation Rules, 2011, continuous supply of service, *inter alia,* means any service which is provided, or agreed to be provided continuously or on recurrent basis, under a contract, for a period exceeding three months with the obligation for payment periodically or from time to time. Since in the given case, service is provided for a period of six months with the obligation of periodic payment, the same will amount to continuous supply of service.

(ii) As per rule 2(c) of Point of Taxation Rules, 2011, continuous supply of service, *inter alia,* includes any service where the Central Government, by a notification in the Official Gazette, prescribes provision of a particular service to be a continuous supply of service, whether or not subject to any condition.

In this regard, Central Government has notified that provision of, *inter alia,* telecommunication services shall be treated as continuous supply of service.

Since in the given case, service provided is telecommunication service, the provision thereof would amount to continuous supply of service irrespective of the period for which the service has been rendered.

10. The contract entered into by Shambhu Pvt. Ltd. requires the provision of both services and material and is for the purpose of carrying out completion of an immovable property. Therefore, it falls within the scope of term 'works contract' as defined under section 65B(54) of the Finance Act, 1994. As per section 66E(h) of Finance Act, 1994, service portion in the execution of a works contract is a declared service and thus, service provided by Shambhu Pvt. Ltd. would be liable to service tax.

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

As per rule 2A(ii)(C), in case of works contracts involving completion and finishing services such as floor and wall tiling of an immovable property, service tax shall be payable on 60% of the total amount charged for the works contract.

Computation of service tax liability as per rule 2A(ii)(C) of the Service Tax (Determination of Value) Rules, 2006

Particulars	**(₹)**
Gross amount (excluding all taxes) charged by Shambhu Pvt. Ltd. for the contract	6,00,000
Add: Fair market value of the material supplied by Nath Ltd.	1,00,000
Less: Amount charged by Nathu Ltd. for the material (including VAT)	60,000
Total amount charged	6,40,000
Value of service portion in the execution of works contract (60% of 6,40,000)	3,84,000
Service tax on ₹ 3,84,000 @12.36%	47,462.40

Less: CENVAT credit on inputs (Note-1)	-
CENVAT credit on input services	6,000
CENVAT credit on capital goods (50%) (Note-2)	2 ,000
Service tax payable	39,462.40
Service tax payable (rounded off)	**39,462**

Notes:

1. CENVAT credit of duties or cess paid on any inputs, used in or in relation to a works contract, is not available [Explanation 2 to rule 2A of the Valuation Rules].
2. 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].

11. Section 72A(1) of the 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 operations spread out in multiple locations and it is not possible or practicable to obtain a true and complete picture of his accounts from the registered premises falling under the jurisdiction of the said Commissioner, he may direct such person to get his accounts audited by a Chartered Accountant or Cost Accountant nominated by him, to the extent and for the period as may be specified by him.

Further, sub-section (3) of section 72A provides that Commissioner may order such special audit even if the accounts of such person have been audited under any other law for the time being in force.

Therefore, the fact that Raman's accounts have been audited under Income-tax Act, 1961 will not have any bearing on special audit ordered under section 72A of Finance Act, 1994. Thus, the contention of Raman is not correct in law.

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

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

Though in the given case, Mr. Mudit and Miss. Sneha were in charge of, and were responsible to, Steft (P) Ltd. for the conduct of its business at the time of such irregular availment and utilization of the credit, personal penalty could be imposed on both of them only if they are knowingly concerned with such contravention. Further, if it is established

that Mr. Mudit and Miss. Sneha are knowingly concerned with the contravention, the amount of penalty in case of Mr. Mudit will have to be restricted to ₹ 1,00,000.

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

(a) evasion of service tax; or

(b) issuance of invoice, bill or, as the case may be, a challan without provision of taxable service in violation of the rules made under the provisions of Chapter V; or

(c) failure to pay any amount collected as service tax to the credit of the Central Government beyond a period of six months from the date on which such payment becomes due.

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

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

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

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

(4) Any notice issued but not adjudged by any of the Central Excise Officer administering the Act or rules made thereunder immediately before the date of grant of acceptance by the Chief Commissioner of Central Excise, Large Taxpayer Unit (12.12.2013 in this case), shall be deemed to have been issued by Central Excise Officers of the said unit.

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

14. The issue as to whether the best judgment assessment under section 72 of the Finance Act, 1994 is an ex-parte assessment procedure is decided by the High Court in case of *N.B.C. Corporation Ltd. v. Commissioner of Service Tax 2014 (33) S.T.R. 113 (Del.)* wherein the High Court held that section 72 could *per se* not be considered as an ex parte assessment procedure as ordinarily understood under the Income-tax Act, 1961. Section 72 mandates that the assessee must appear and must furnish books of account, documents and material to the Central Excise Officer before he passes the best judgment assessment order. Thus, said order is not akin to an ex parte order.

Such an order will be akin to an ex parte order, when the assessee fails to produce records and the Central Excise Officer has to proceed on other information or data which may be available.

15. Rule 6(7A) of the Service Tax Rules, 1994 provides an option to an insurer carrying on life insurance business to pay service tax:

(i) on the gross premium charged from a policy holder reduced by the amount allocated for investment, or savings on behalf of policy holder, if such amount is intimated to the policy holder at the time of providing of service;

(ii) in all other cases, @ 3% of the premium charged from the policy holder in the first year and @ 1.5% of the premium charged from the policy holder in subsequent years towards the discharge of his service tax liability instead of paying service tax at the rate of 12%.

However, such option is not available in cases where the entire premium paid by the policy holder is only towards risk cover in life insurance.

In the light of the aforesaid provisions, service tax liability of ALICL for financial year 2013-14 would be computed as follows:

(i) If the amount allocated for investment has been intimated by ALICL to policy holders at the time of providing service, ALICL has the option to pay service tax on the gross premium charged from a policy holder reduced by the amount allocated for investment. Thus, service tax liability of ALICL for the year 2013-14 will be computed as under:

= ₹ (180-100) lakh × 12.36%= ₹ 9,88,800

(ii) If the amount allocated for investment has not been intimated by ALICL to policyholders at the time of providing of service, ALICL will have to pay service tax @ 3% of the premium charged from policy holders in the first year and @ 1.5% of the premium charged from policy holders in the subsequent years. Thus, service tax liability of ALICL for the year 2013-14, being first year of its operations, will be computed as under:

= ₹ 180 lakh × 3.09% (inclusive of 3% education cesses) = ₹ 5,56,200

(iii) If gross premium received from policy holders is only towards risk cover, ALICL cannot discharge its service tax liability using aforesaid option. In such a case, it will have to pay service tax @ 12.36% on the entire premium charged from the policy holders. Thus, service tax liability of ALICL for the year 2013-14 will be computed as under:

= ₹ 180 lakh × 12.36%= ₹ 22,24,800

16. (a) Not valid. As per section 9B of the Customs Tariff Act, 1975, no article shall be subjected to both countervailing and anti-dumping duties to compensate for the same situation of dumping or export subsidization.

(b) Not valid. As per section 9B of the Customs Tariff Act, 1975, countervailing or anti-dumping duties shall not be levied by reasons of exemption of such articles from duties or taxes borne by the like articles when meant for consumption in the country of origin or exportation or by reasons of refund of such duties or taxes.

(c) Valid. As per section 9B of the Customs Tariff Act, 1975, no definitive countervailing duty or anti-dumping duty shall be levied on the import into India of any article from a member country of the World Trade Organisation or from a country with whom Government of India has a most favoured nation agreement, unless a determination has been made in the prescribed manner that import of such article into India causes or threatens material injury to any established industry in India or materially retards the establishment of any industry in India.

17. Computation of assessable value and customs duty payable of the imported goods

Particulars	**US $**
Cost of the machine at the factory	20,000
Transport charges up to port	800
Handling charges at the port	50
F.O.B.	*20,850*
Freight charges up to India	5,000
Insurance charges @ 1.125% of F.O.B. [Note 1]	234.56
Lighterage charges paid by the importer [Note 4]	200
Ship demurrage charges on chartered vessels [Note 4]	400
C.I.F.	26,684.56
	(₹)
C.I.F. in Indian rupees @ ₹ 60/- per $ [Note 5]	16,01,073.60
Add: Landing charges @ 1% of CIF [Note 1]	16,010.736
Assessable value	**16,17,084.34**
Add: Basic customs duty @ 10% [Note 6] **[a]**	1,61,708.43
Total	17,78,792.77
Add: CVD @ 12% **[b]** [EC and SHEC on CVD are exempt]	2,13,455.13
Total	19,92,247.90
Add: Education cesses @ 3% of **[(a) + (b)]** [2% education cess + 1% secondary and higher education cess] **[c]**	11,254.91
Total **[d]**	20,03,502.81
Additional duty u/s 3(5) @ 4% of (d) above **[e]**	80140.11
Total custom duty payable [(a) +(b) + (c) + (e)]	4,66,558.58
Total custom duty payable (rounded off to nearest rupee)	**4,66,559**

Notes:

(1) Insurance charges and landing charges are included @ 1.125% of FOB value of goods and 1% of CIF value of goods respectively [Clauses (iii) and (ii) of first

proviso to rule 10(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

(2) Buying commission is not included in the assessable value [Rule 10(1)(a)(i) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

(3) Freight incurred from port of entry to Inland Container depot is not includible in assessable value [Fourth proviso to rule 10(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

(4) Ship demurrage charges and lighterage charges are included in the assessable value [Explanation to Rule 10(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

(5) Rate of exchange notified by CBEC on the date of presentation of bill of entry is considered [Explanation to section 14 of the Customs Act, 1962].

(6) Rate of duty is the rate prevalent on the date of presentation of bill of entry or the rate prevalent on the date of entry inwards, whichever is later [Section 15 of the Customs Act, 1962].

18. (a) Invalid. As per section 61 of the Customs Act, 1962, warehousing period for goods other than capital goods intended to be used in 100% EOU is three (3) years and not five (5) years.

(b) Invalid. As per section 61(2)(ii) of the Customs Act, 1962, where any warehoused goods (not intended for being used in 100 % EOU) remain in a warehouse beyond a period of ninety days, interest is payable for the period from the expiry of said ninety days till the date of payment of duty on the warehoused goods. Section 2(44) of the Customs Act, 1962 defines 'warehoused goods' as goods deposited in a warehouse.

Circular No. 39/2013 Cus dated 01.10.2013 has clarified that a harmonious reading of section 61 and section 2(44) of the Customs Act, 1962 indicates that when the goods deposited in a warehouse remain warehoused beyond a period of 90 days, then the interest starts accruing. In other words, the relevant date when the period of 90 days would commence would be the date of depositing the goods in the warehouse and not the date on which into-bond bill of entry in respect of such goods is presented.

19. Section 116 of the Customs Act, 1962 imposes a penalty on the person-in-charge of the conveyance *inter alia* for short-landing of the goods at the place of destination and if the deficiency is not accounted for to the satisfaction of the Customs Authorities. Section 2(31) of the Act defines "person-in-charge" to *inter alia* mean in relation to a vessel, the master of the vessel. Section 148 of the Act provides that the agent appointed by the person-in-charge of the conveyance and any person who represents himself to any officer of customs as an agent of any such person-in-charge is held to be liable for fulfillment in respect of the matter in question of all obligations imposed on such person-

in-charge by or under this Act and to penalties and confiscation which may be incurred in respect of that matter.

The High Court in the case of *Caravel Logistics Pvt. Ltd. v. Joint Secretary (RA) 2013 (293) ELT 342 (Mad.)* has held that conjoint reading of sections 2(31), 116 and 148 of Customs Act, 1962 makes it clear that in case of short-landing of goods, if penalty is to be imposed on person-in-charge of conveyance/vessel, it can also be imposed on the agent appointed by him. The High Court observed that if the assessee affixed seal on containers after stuffing and took their charge, he stepped into shoes of/acted on behalf of master of vessel (the person-in-charge).

Therefore, in the given case also penalty for short landing of goods can be imposed on Cargo Logistics Pvt. Ltd., the steamer agent of the vessel, Queen Mary Utah.

20. (i) Advance Authorization can be issued for supplies made to United Nations Organisations or under Aid Programme of the United Nations or other multilateral agencies and such supplies need to be paid for in free foreign exchange. Therefore, Bestron Ltd. can seek an Advance Authorization for the supplies made by it.

(ii) Advance Authorization necessitates exports with a minimum of 15% value addition (VA).

VA = [(A – B)/B x 100]

A = FOB value of export realized, B = CIF value of inputs covered by authorization.

Therefore, the minimum FOB value of the exports made by LMN Ltd. should be ₹ 23,00,000.

Applicability of Legislative Amendments/Circulars etc. for November, 2014 – Final Examination

Paper 7 : Direct Tax Laws & Paper 8 : Indirect Tax Laws

Applicability of the Finance Act, Assessment Year etc. for November, 2014 Examination

The provisions of direct and indirect tax laws, as amended by the Finance Act, 2013, including notifications and circulars issued upto 30th April, 2014. The applicable assessment year for Direct Tax Laws is A.Y. 2014-15.

ANNEXURE

Part I : Statutory Update – Indirect Tax Laws

Significant Notifications and Circulars issued between 01.05.2013 and 30.04.2014

Study Material for Indirect Tax Laws [August, 2013 edition] contains all the relevant amendments made by the Finance Act, 2013 and circulars/notifications issued up to 30.04.2013. However, for students appearing in November, 2014 examination, amendments made by notifications, circulars and other legislations made between 01.05.2013 and 30.04.2014 are also relevant. Such amendments are given hereunder:-

A. CENTRAL EXCISE

I. Amendments in the CENVAT Credit Rules, 2004

1. Procedure, safeguards, conditions and limitations prescribed for refund of CENVAT credit to service providers covered under partial reverse charge

Rule 5B stipulates that a service provider providing services taxed under reverse charge mechanism and unable to utilize the CENVAT credit availed on inputs and input services for payment of service tax on such output services, shall be allowed refund of such unutilized CENVAT credit.

The procedure, safeguards, conditions and limitations to which such refund shall be subject to have been prescribed by CBEC vide *Notification No. 12/2014 CE (NT) dated 03.03.2014* as under:

A. SAFEGUARDS, CONDITIONS AND LIMITATIONS

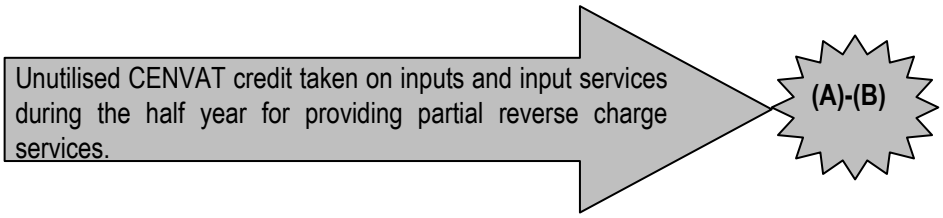
(a) Refund is admissible, of unutilised CENVAT credit taken on inputs and input services during the half year for which refund is claimed, for providing following output services:

(i) renting of a motor vehicle designed to carry passengers on non-abated value, to any person who is not engaged in a similar business;

(ii) supply of manpower for any purpose or security services; or

(iii) service portion in the execution of a works contract;

(hereinafter above mentioned services will be termed as **partial reverse charge services**). The amount of refund would be computed as follows:



where

$$A = \text{CENVAT credit taken on inputs and input services during the half year} \times \frac{\text{Turnover of output service under partial reverse charge duirng the half year}}{\text{Total turnover of goods and services during the half year}}$$

B = Service tax paid by the service provider for such partial reverse charge services during the half year.

(b) Refund shall not exceed the amount of service tax liability paid/payable by the service receiver with respect to the partial reverse charge services provided during the period of half year for which refund is claimed.

(c) Amount claimed as refund shall be debited by the claimant from his CENVAT credit account at the time of making the claim. However, if the amount of refund sanctioned is less than the amount of refund claimed, then the claimant may take back the credit of the difference between the amount claimed and the amount sanctioned.

(d) The claimant shall submit not more than one claim of refund under this notification for every half year.

(e) Refund claim shall be filed after filing of service tax return for the period for which refund is claimed.

(f) No refund shall be admissible for the CENVAT credit taken on input or input services received prior to 01.07.2012.

Half year means a period of six consecutive months with the first half year beginning from the 1st day of April every year and second half year from the 1st day of October of every year.

B. PROCEDURE FOR FILING THE REFUND CLAIM

(a) The output service provider shall submit an application in Form A, along with specified documents and enclosures, to jurisdictional Assistant Commissioner/Deputy Commissioner, before the expiry of 1 year* from the due date of filing of return for the half year. Copies of return(s) filed for the said half year shall also be filed along with the application.

**In case of more than one return required to be filed for the half year, 1 year shall be calculated from due date of filing of the return for the later period.*

However, last date of filing of application in Form A, for the half year ending on 30.09.2012, shall be 30.04.2014.

(b) The Assistant Commissioner/Deputy Commissioner, may call for any document in case he has reason to believe that information provided in the refund claim is incorrect or insufficient and further enquiry needs to be caused before the sanction of refund claim, and shall sanction the claim after satisfying himself that the refund claim is correct and complete in every respect.

2. Provisions relating to distribution of credit in case of input service distributor amended [Rule 7]

With effect from 01.04.2014, rule 7 has been amended to simplify the mechanism of distribution of CENVAT credit in case of input service distributor as under:

S. No.	Position as per erstwhile rule 7	Position as per the amended rule 7	
1.	In case of a unit exclusively engaged in manufacture of exempted goods/ providing exempted services, service tax paid on input services **used IN such a unit** was not allowed to be distributed as CENVAT credit.	In case of a unit exclusively engaged in manufacture of exempted goods/ providing exempted services, service tax paid on input services **used BY one or more such units** will not be allowed to be distributed as CENVAT credit	With the substitution of word 'IN' with 'BY', credit of services, which have been used by such units though not actually consumed within such units, would also not be distributed.
2.	Credit of service tax attributable to service **used wholly IN a unit** was to be distributed only to that unit.	Credit of service tax attributable to service **used wholly BY a unit** shall be distributed only to that unit.	Substitution of word 'IN' with 'BY' would increase the scope of services pertaining to which credit could be distributed to a unit. Resultantly, credit for services like good transport agency services, rent-a-cab service, testing and analysis of the product etc. would now be available to the unit availing them.
3.	Credit of service tax attributable to service **used IN more than one unit** was to be distributed pro rata on the basis of the turnover during the relevant period of the concerned unit to the **sum total of**	Credit of service tax attributable to service **used BY more than one unit** shall be distributed pro rata on the basis of the turnover of such units during the relevant period to the **total turnover of all its units, which are operational in**	In case of common input services, amount of CENVAT credit attributed to a unit may be reduced as now turnover of all operational units has to be taken in denominator instead of only the units to which the service

	the turnover of all the units to which the service related during the same period.	**the current year**, during the said relevant period.	relates.
4.	Relevant period was the month/quarter previous to the month/quarter during which the CENVAT credit was distributed. In case of an assessee who did not have any total turnover in the said period, the input service distributor was to distribute any credit only after the end of such relevant period wherein the total turnover of its units was available.	Relevant period shall be the 'financial year' preceding to the year during which credit is to be distributed for month/ quarter provided assessee has turnover in such preceding financial year. If the assessee does not have turnover for some/ all the units in the preceding financial year, relevant period shall be the last quarter for which details of turnover of all the units are available, previous to the month/ quarter for which credit is to be distributed.	Distribution of credit is now based on previous financial year's turnover instead of previous month's/quarter's turnover.

[Notification No. 5/2014-CE (NT) dated 24.02.2014]

3. Amendments in rule 3

(i) Duty leviable on transaction value to be paid on removal of capital goods as waste and scrap [Rule 3(5A)]

Rule 3(5A) of the CENVAT Credit Rules, 2004 provides for reversal of CENVAT credit in the event of removal of capital goods after being used, whether as capital goods or as waste/ scrap. Earlier, the quantum of credit that needs to be reversed was higher of the following two amounts:

(I) CENVAT credit taken on the said capital goods reduced by the specified percentage points calculated by straight line method for each quarter of a year or part thereof from the date of taking the CEVAT credit

or

(II) Duty leviable on transaction value.

However, with effect from 27.09.2013, if the capital goods are cleared as waste and scrap, the manufacturer shall pay an amount equal to the duty leviable on transaction value.

Thus, a manufacturer removing capital goods as waste and scrap will no longer be required to compare the amount equivalent to the duty leviable on transaction value with the amount equivalent to CENVAT credit taken on the said capital goods reduced by the specified percentage points. However, when capital goods will be removed, after being used, otherwise than as waste and scrap, the higher of the above-mentioned two amounts will be required to be paid.

[Notification No. 12/2013 CE (NT) dated 27.09.2013]

(ii) CENVAT credit taken on input services to be reversed if duty paid on final product remitted [Rule 3(5C)]

Earlier, where on any goods manufactured or produced by an assessee, the payment of duty was ordered to be remitted under rule 21 of the Central Excise Rules, 2002, the CENVAT credit taken on the inputs used in the manufacture or production of said goods was required to be reversed. Thus, earlier, reversal was only required in respect of inputs and not for input services.

Rule 3(5C) has been amended to provide that CENVAT credit taken on input services used in or in relation to the manufacture or production of said goods is also required to be reversed.

[Notification No. 1/2014 CE (NT) dated 08.01.2014]

(iii) Amount payable under sub-rules (5), (5A), (5B) and (5C) of rule 3 to be paid on or before the 5th day of the following month by utilizing CENVAT credit or otherwise

As per explanation 1 inserted after rule 3(5C), the amount payable under following sub-rules of rule 3 shall be paid by the manufacturer of goods or the provider of output service

(i)	**Rule 3(5)**	Reversal of credit in case of removal of inputs or capital goods as such from the factory/premises of the output service provider
(ii)	**Rule 3(5A)**	Reversal of credit in case of removal of capital goods after being used, whether as capital goods or as scrap or waste
(iii)	**Rule 3(5B)**	Reversal of credit in case of full or partial writing off of the value of input or capital goods before being put to use
(iv)	**Rule 3(5C)**	Reversal of credit in case of remission of duty on final product

- by debiting the CENVAT credit or otherwise
- on or before the 5th day of the following month except for the month of March, where such payment shall be made on or before the 31st day of the month of March.

[Notification No. 1/2014 CE (NT) dated 08.01.2014]

(iv) Failure to reverse the credit taken on inputs and input services used in goods on which duty is ordered to be remitted also to attract recovery provisions under rule 14 [Explanation 2 to rule 3(5C)]

Hitherto, as per explanation occurring after proviso to rule 3(5B), recovery provisions under rule 14 of the CENVAT Credit Rules, 2004 were applicable if the manufacturer of goods or the provider of output service fails to pay the amount payable under sub-rules (5), (5A) and (5B) of rule 3.

The said explanation has been omitted and a new explanation 2 has been inserted after rule 3(5C). As per the new explanation 2, in addition to sub-rules (5), (5A) and (5B) of rule 3, recovery provisions under rule 14 will also apply to sub-rule (5C) of rule 3.

In other words, even in a case where the manufacturer of goods or the provider of output service fails to reverse the CENVAT credit taken on inputs and input services used in goods on which duty has been ordered to be remitted, it would be recovered, in the manner provided under rule 14, for recovery of CENVAT credit wrongly taken.

[Notification No. 1/2014 CE (NT) dated 08.01.2014]

II. Amendment in the Central Excise Rules, 2002 – Threshold limit for e-payment of central excise duty reduced from ₹ 10 lakh to ₹ 1 lakh

Third proviso to rule 8(1) of the Central Excise Rules, 2002 has been amended to reduce the threshold limit for e-payment of central excise duty from ₹ 10 lakh to ₹ 1 lakh. Henceforth, with effect from 01.01.2014, where an assessee has paid an excise duty of ₹ 1 lakh or more including the amount paid by utilization of CENVAT credit, in the preceding financial year, he shall deposit the excise duty liable to be paid by him electronically through internet banking.

[Notification No. 15/2013 CE(NT) dated 22.11.2013]

III. Inter-related amendments in the CENVAT Credit Rules, 2004 and Central Excise Rules, 2002

1. Rule 12CCC of Central Excise Rules 2002 & Rule 12AAA of CENVAT Credit Rules, 2004 substituted with new rules-restriction to be imposed, facilities to be withdrawn and procedure for the same amended.

Rule 12CCC of the Central Excise Rules 2002 (hereinafter referred to a CER, 2002) and 12AAA of the CENVAT Credit Rules, 2004 (hereinafter referred to as CCR, 2004) empower the Central Government to provide for certain measures including restrictions on a manufacturer, first stage dealer, second stage dealer and an exporter and specify, by a notification in the Official Gazette, the nature of restrictions to be imposed, types of facilities to be withdrawn and procedure for issuance of such order.

Rule 12CCC of the CER, 2002 is invoked to prevent evasion of or default in payment of excise duty while rule 12AAA of the CCR, 2004 is invoked to prevent the misuse of the provisions of CENVAT credit.

With effect from 21.03.2014, said rules [Rule 12CCC of the CER, 2002 and rule 12AAA of the CCR, 2004] have been substituted with new rules respectively. As per the new rules, only Chief Commissioner of Central Excise can pass an order for imposing the restrictions on manufacturer, first stage dealer, second stage dealer and exporter, and for withdrawing the facilities provided to them. Earlier, any officer authorised by the Board was empowered to pass such an order.

The aforesaid rules empower the Central Government to specify, by a notification in the Official Gazette, the nature of restrictions, types of facilities to be withdrawn and procedure for issue of such order. Earlier, in pursuance of this power, *Notification No. 5/2012-CE(NT) dated 12.03.2012* had been issued. Now, the said notification has been superseded by *Notification No. 16/2014-C.E. (N.T.) dated 21.03.2014*.

A comparison between the erstwhile notification and the new notification is outlined as below:

<table>
<tr><th></th><th>Particulars</th><th>Notification No. 5/2012</th><th colspan="2">Notification No. 16/2014</th></tr>
<tr><td>1.</td><td>Specified offences</td><td colspan="3">Same under both the notifications</td></tr>
<tr><td>2.</td><td>Who is authorized to order the withdrawal of facilities & imposition of restrictions?</td><td>An officer authorized by CBEC</td><td colspan="2">Chief Commissioner of Central Excise</td></tr>
<tr><td rowspan="3">3.</td><td rowspan="3">Time period for which restrictions could be imposed on the commission of specified offences</td><td rowspan="3">Earlier, no time – limit was prescribed for which restrictions might be imposed/ facilities might be withdrawn for the offences committed- whether for the first time or subsequently.</td><td>Restrictions could be imposed for a period upto</td><td>for the offence committed</td></tr>
<tr><td>(i) 6 months</td><td>for the first time</td></tr>
<tr><td>(ii) 1 year</td><td>subsequently</td></tr>
</table>

4.	Restrictions that could be imposed on the commission of specified offences for ***second time or subsequently***	Earlier, in such case out of all the specified restrictions, following two restrictions may not be imposed: (i) the assessee may be required to maintain records of receipt, disposal, consumption and inventory of the principal inputs on which CENVAT credit has not been taken. (ii) the assessee may be required to intimate the Superintendent of Central Excise regarding receipt of principal inputs in the factory on which CENVAT credit has or has not been taken, within a period specified in the order and the said inputs shall be made available for verification upto the period specified in the order.	Any of the specified restrictions may be imposed.
5.	Monetary limit	Same under both the notifications	
6.	Procedure	Earlier, proposal to withdraw the facilities and impose restrictions was forwarded by Commissioner of Central Excise (CCE)/Additional Director General of Central Excise Intelligence (ADGCEI) to **Chief CCE/ DGCEI** who, after giving the defaulter an opportunity of being heard, might forward it to CBEC along with its	Now, proposal to withdraw the facilities and impose restrictions is to be forwarded by CCE/ ADGCEI to **Chief CCE** who, after giving the defaulter an opportunity of being heard, would pass the order withdrawing facilities and imposing restrictions for the period specified in the order.

		recommendations. Thereafter, an officer authorized by CBEC might pass the order withdrawing facilities and imposing restrictions for the period specified in the order.	

[Notification No.s 14 to 16/2014-Central Excise (N.T.) all dated 21.03.2014]

2. Importer issuing CENVATable invoices now required to obtain registration and submit quarterly returns

(i) Importer required to obtain registration [Rule 9(1) of the CER, 2002 amended]

Hitherto, every person, who produces, manufactures, carries on trade, holds private store-room or warehouse or otherwise uses excisable goods, was required to get registration under central excise.

With effect from 01.04.2014, an importer who issues an invoice on which CENVAT credit can be taken is also required to obtain such registration. Thus, such importer will have to obtain registration as a 'registered importer' with the central excise authorities to pass on the credit on the imported goods.

Consequently, Form A [Application for Central Excise Registration] has also been accordingly amended.

(ii) Importer required to file quarterly return [Rule 9(8) of the CCR, 2004 amended]

Earlier, rule 9(8) of the CCR, 2004 required a first stage dealer and a second stage dealer to submit a return (electronically) within 15 days from the close of each quarter of a year to the Superintendent of Central Excise.

With effect from 01.04.2014, said rule has been amended. Thus, now a registered importer is also required to submit such quarterly return.

Consequently, the return form prescribed for the same has also been accordingly amended.

[Notification Nos. 8 to 11/2014-Central Excise (N.T.) dated 28.02.2014]

IV. Amendment in rules 8, 9 and 10 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000

Hitherto, literal interpretation of rules 8, 9 and 10 lead to a conclusion that valuation methods prescribed therein will be applicable only in a case where ALL the goods were either captively consumed or sold to a unrelated buyer or to/through an inter-connected undertaking respectively. In other words, these rules did not cover the cases where some goods were captively consumed while others were sold, or a case where goods were partly sold to related buyers and partly to unrelated buyers.

With effect from 01.12.2013, rules 8, 9 and 10 dealing with determination of assessable value in case of captive consumption, sale to related person and sale to/through an inter-connected undertaking respectively have been amended to clearly state that these rules apply irrespective of whether the whole or a part of the clearances of manufactured goods are covered by the circumstances given in these rules. Each clearance is required to be assessed according to section 4(1)(a) or the relevant rule dealing with the circumstances of clearance of the goods, as the case may be.

Thus, now valuation mechanism provided in rules 8, 9 and 10 is applicable in following the cases:

(i) **Rule 8:** Where whole or part of the excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles.

(ii) **Rule 9:** Where whole or part of the excisable goods are sold by the assessee to or through a person who is related in the manner specified in any of the sub-clauses (ii), (iii) or (iv) of clause (b) of sub-section (3) of section 4 of the Central Excise Act, 1944.

(iii) **Rule 10:** Where whole or part of the excisable goods are sold by the assessee to or through an inter-connected undertaking.

For example, if an assessee clears his goods in such a way that first removal of goods is to an independent buyer, second removal is to such a related person who is covered under rule 9 and third removal is to a person who is covered under rule 10, while some goods are captively consumed, then the first removal should assessed under section 4(1)(a), second removal should be assessed under rule 9 and third removal should be assessed under rule 10, while captively consumed goods should be assessed under rule 8 of these rules. It may be noted that Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 are not required to be followed sequentially.

Consequently, clarifications with regard to following issues as contained in Serial no. 5, 12 and 14 of the *Circular no. 643/34/2002-CX dated 1-7-2002* containing reference to rules 8, 9 and 10 have also been deleted:

(i) How will valuation be done in cases of captive consumption (i.e. consumed within the same factory) including transfer to a sister unit or another factory of the same company/firm for further use in the manufacture of goods?

(ii) How will valuation be done when goods are sold partly to related persons and partly to independent buyers?

(iii) How will valuation be done when inputs or capital goods, on which CENVAT credit has been taken, are removed as such from the factory?

[Notification No. 14/2013 CE (NT) dated 22.11.2013 and Circular No. 975/09/2013-CX dated 25.11.2013]

V. OTHERS

1. Unregistered premises used solely for affixing lower ceiling prices on pharmaceutical products to comply with DPCO, 2013 exempted from obtaining central excise registration

Unregistered premises used solely for affixing a sticker/re-printing/re-labeling/re-packing of pharmaceutical products falling under Chapter 30 of the Central Excise Tariff Act, 1985 with lower ceiling price to comply with the notifications issued under Drugs (Prices Control) Order, 2013 have been exempted from obtaining registration under central excise. However, the exemption from registration will be available subject to the conditions specified in *Notification No. 22/2013 CE dated 29.07.2013* exempting the pharmaceutical products from payment of central excise duty.

[Notification No. 11/2013 CE (NT) dated 02.08.2013]

Note: Ministry of Chemicals and Fertilizers (Department of Pharmaceuticals) issued the new Drug Price Control Order (DPCO) on May 15, 2013 which required existing manufacturers/traders, selling medicines at a price higher than the ceiling price fixed by the Government to execute downward revision of prices. The Government mandated that the prices of scheduled drugs be changed within 45 days from the date the price notification came into force. For this purpose, the drugmakers had to re-print/re-label/re-pack the medicines which had already been sent out of their factories at sites other than the facilities registered under the Central Excise Act.

As pharmaceutical products falling under Heading 3004 of the Central Excise Tariff (scheduled formulations) are included in the Third Schedule to the Central Excise Act, 1944, labeling or re-labeling of containers including the declaration or alteration of retail sale price on it amounts to manufacture in terms of section 2(f)(iii) of the Central Excise Act, 1944. So, as not to impose any duty liability that may arise on account of re-printing/ re-labeling/ re-packing mandated by the DPCO, the Central Government has exempted scheduled formulations as defined under DPCO, 2013 which are subjected to re-labelling, reprinting, repacking or stickering, in unregistered premises from payment of excise duty.

2. Facility of removal without payment of duty extended to excisable goods stored and sold from Duty Free Shops at International Airports

The facility of removal without payment of duty provided under rule 20(1) of the Central Excise Rules, 2002 has been extended to all excisable goods intended for storage in godown/retail outlet of a Duty Free Shop in the Departure Hall/Arrival Hall of International Airport, appointed/licensed as 'warehouse' under sections 57 or 58 of the Customs Act, 1962 and for sale therefrom, against foreign exchange to passengers going out of India or to the passengers or members of crew arriving from abroad. The facility will be subject to specified limitations, conditions and safeguards *[Notification No. 07/2013 CE (NT) dated 23.05.2013].*

Consequently, godown or retail outlets of the above-mentioned Duty Free Shops will be deemed to be registered as a warehouse under rule 9 of the Central Excise Rules, 2002 *[Notification No. 09/2013 CE (NT) dated 23.05.2013].*

CBEC, vide *Circular No. 970/04/2013-CX dated 23.05.2013* has specified conditions, limitations, safeguards and procedures for removal of such excisable goods to godowns/retail outlets of Duty Free Shops to which warehousing provisions have been extended vide *Notification No. 07/2013 CE (NT) dated 23.05.2013*.

Note: Hitherto only foreign goods were sold in Duty Free Shops (DFS) located in the International Airports. A passenger going abroad or coming from a foreign country could buy foreign goods without customs duty and the incoming passenger could clear those goods without duty within his available limits as per the baggage rules.

The Central Government has now allowed excise duty-free sale of goods manufactured in India to international passengers or crew arriving from abroad at the DFS located in the arrival halls of international airports. Such exemption from excise duty is subject to limitations, conditions and safeguards as may be specified by the CBEC. Therefore, now a passenger arriving from abroad shall have the choice to buy either duty-free imported goods or duty-free indigenous goods within his overall permissible baggage allowance.

VI. CLARIFICATIONS

1. Good cleared against specified duty credit scrips not to be treated as exempted goods

Notifications Nos. 29/2012-CE, 30/2012-CE, 31/2012-CE, 32/2012-CE and 33/2012-CE all dated 09.07.2012 provide exemption to certain manufactured goods when cleared against the specified duty credit scrips issued to an exporter. The specified duty credit scrips are:

- Focus Product Scheme (FPS) duty credit scrip,
- Focus Market Scheme (FMS) duty credit scrip
- VKGUY (Special Agriculture and Village Industry Scheme) duty credit scrip
- Agri Infrastructure Incentive Scrip duty credit scrip
- Status Holder Incentive Scheme duty credit scrip

One of the conditions for availing of these exemptions is that duties leviable, but for these exemptions, are debited in or on the reverse of said scrip and the scrip holder is permitted to avail of CENVAT credit of the duties debited in the scrip.

In view of these provisions it has been clarified that such debit of duty in these scrips shall be treated as payment of duty for the purpose of determining the applicability of rule 6 of the CENVAT Credit Rules, 2004. The clearance of excisable goods against such specified duty credit scrips cannot be considered as clearances of exempted goods and

therefore, the provisions regarding payment of amount under rule 6(3) of the CENVAT Credit Rules, 2004 will not apply in such a case.

[Circular No. 973/07/2013-CX dated 04.09.2013]

2. Guidelines for arrest and bail under the Central Excise Act, 1944

In view of the amendments made in sections 9A, 20 and 21 of the Central Excise Act, 1944 vide the Finance Act, 2013, certain offences have been made cognizable and non-bailable. The following significant guidelines have been issued by CBEC vide *Circular No. 974/08/2013 CX dated 17.09.2013* with regard to implementation of arrest and bail provisions under the amended central excise law:

(i) A person can be arrested for both bailable and non-bailable offences. Since arrest takes away the liberty of an individual, the power must be exercised with utmost care and caution and only when the exigencies of the situation demand arrest.

(ii) Decision to arrest needs to be taken on case-to-case basis considering various factors, such as, nature & gravity of offence, quantum of duty evaded or credit wrongfully availed, nature & quality of evidence, possibility of evidences being tampered with or witnesses being influenced, cooperation with the investigation, etc. Thus, power to arrest has to be exercised after careful consideration of the facts of the case and the above factors.

(iii) A person can be arrested for non-bailable offence only when the offence committed by him is covered under clause (b) or clause (bbbb) of sub-section 9(1) and the duty involvement exceeds Rs. 50 lakh. Any person arrested for offences under these clauses should be informed of the grounds of arrest and produced before a magistrate without unnecessary delay and within 24 hours of arrest.

(iv) In respect of the following non-bailable offences, decision to arrest may be taken by the Commissioner:

  (a) clandestine removal of manufactured goods;

  (b) removal of goods without declaring the correct assessable value and receiving a portion of sale price in cash which is in excess of invoice price and not accounted for in the books of account;

  (c) taking CENVAT credit without receiving the goods specified in the invoice;

  (d) taking CENVAT credit on fake invoices;

  (e) issuing Cenvatable invoices without delivering the goods specified in the said invoice.

(v) In all other cases of cognizable and non-bailable offences, not referred above, the decision to arrest shall be taken by the Commissioner only with the approval of the jurisdictional Chief Commissioner. Examples of such cases are:

(a) removal of inputs as such, without reflecting such removal in records, on which CENVAT credit has been taken, without payment of amount equal to the credit availed on such inputs

(b) irregular and wrongful availment of benefit of central excise duty exemption by reason of fraud, collusion, willful misstatement, suppression of facts, or contravention of the provisions of the Act or the rules with intent to evade payment of duty, etc.

(vi) Chief Commissioners/ Commissioners of Central Excise are required to ensure that approval for arrest for non-bailable offence is granted only where the intent to evade duty is evident and element of mens rea/guilty mind is palpable.

(vii) Any person arrested for non-cognizable and bailable offence shall have to be released on bail, if he offers bail, and in case of default of bail, he is to be forwarded to the custody of magistrate. In terms of Notification no 9/99-C.E.(N.T.) dated 10-2-99, an officer not below the rank of Superintendent of Central Excise can exercise powers under section 21 including powers to grant bail.

(viii) Bail should be subject to the condition(s), as deemed fit, depending upon the facts and circumstances of each individual case. It has to be ensured that the amount of bail bond/ surety should not be excessive and should be commensurate with the financial status of the arrested person. Further the bail conditions should be informed by the arresting officer in writing to the person arrested and also informed on telephone to the nominated person of the person(s) arrested. Arrested person should be allowed to talk to the nominated person.

(ix) If the conditions of the bail are fulfilled by the arrested person, he shall be released by the officer concerned on bail.

(x) The arresting officer may, and shall if such a person is indigent and unable to furnish surety, instead of taking bail, discharge him on executing a bond without sureties to his appearance as provided under section 436 of Cr PC. However, in cases where the conditions for granting bail are not fulfilled, the arrested person shall be produced before the appropriate magistrate within 24 hours of arrest.

(xi) Only in the event of circumstances preventing the production of the person arrested before a Magistrate without unnecessary delay, the arrested person may be handed over to nearest Police Station for his safe custody during night, under proper Challan and produced before the magistrate the next day. These provisions shall apply for non-bailable offence also. The nominated person of the arrested person may also be informed accordingly.

3. Clarification on implementation of decision of Supreme Court in case of goods sold at a price below the cost

In case of *M/s Fiat India Ltd. 2012 (283) E.L.T 161 (S.C.)* [reported in Select Cases in Direct and Indirect Tax Laws-An essential reading for Final Course (Relevant for May, 2014 and

November, 2014 examination)], SC had held that in case the goods were sold at a price substantially lower than the cost of the manufacture to achieve market penetration, the transaction value declared under section 4 may be rejected.

CBEC, vide *Circular No. 979/03/20014-CX dated 15.01.2014,* has clarified that the transaction value cannot be rejected in every case where the declared value is lower than the manufacturing cost and profit. Due care will be taken at the level of the Commissioner to see whether the case at hand is similar to the facts and circumstances of the *FIAT* case.

Further, **extended period of limitation** shall apply only if there is a sale in the circumstances similar to the case of *M/s Fiat* and yet transaction value of goods is declared as the correct transaction value after the date of the judgment, ie. 29.08.2012.

4. Extension of warehousing and acceptance of Letter of undertaking in place of Bank Guarantee for export warehousing

Circular No. 976/10/2013-CX dated 12.12.2013 has made following amendments in *Circular No. 579/16/2001-CX. dated 26-6-2001* and *Circular No. 581/18/2001-CX. dated 29-6-2001* which prescribe conditions, procedures and safeguards applicable for storage in a warehouse registered at such places as may be specified by the Board and export therefrom regarding all excisable goods specified in the First Schedule to the Central Excise Tariff Act, 1985:

S.No.	Basis	*Circular No. 579/16/2001*	*Circular No. 976/10/2013*
1.	Period of warehousing	Any goods warehoused may be left in the warehouse in which they are deposited, or in any warehouse to which such goods have been removed, till the expiry of 3 years from the date on which such goods were first warehoused.	• Warehousing of goods shall initially be allowed for a period upto 6 months, which may be further extended by Assistant/ Deputy Commissioner, each extension being for a period not exceeding 6 months, subject to verification that the goods have not deteriorated in quality. • The maximum period, for which goods may be left in the warehouse in which they are deposited, or in any warehouse to which such goods have been removed, shall be three years from the date on which such goods were first warehoused. • Excisable goods shall be deemed to be cleared for home consumption on expiry of

			warehousing period including extensions granted, if any. • Duty and interest @ 24% per annum shall be charged on such deemed removal.
2.	Revocation/ suspension of warehouse registration	The excisable goods lodged therein shall either be cleared for home consumption on payment of duty or be removed to another warehouse without payment of duty.	The excisable goods lodged therein shall either be cleared for home consumption on payment of duty and interest @ 24% per annum or shall be removed to another warehouse without payment of duty.
S.No.	**Basis**	***Circular No. 581/18/2001***	***Circular No. 976/10/2013***
3.	Requirement to furnish security equal to 25% of the Bond amount	An exporter is required to furnish security equal to 25% of the Bond amount for availing the facility of export warehousing.	Now, where exporter is a manufacturer and a Status Holder with a clean track record, requirement to furnish security equal to 25% of bond amount shall be replaced by the requirement of furnishing an LUT initially for a period upto 6 months which may be extended by a further period not exceeding 6 months. Further, extensions in the warehousing period as provided in point 1. above shall be allowed to such exporter only on furnishing security of 25% of the bond amount.

5. Clarification regarding levy of the Education Cess and the Secondary and Higher Education Cess on other cesses

Education Cess and the Secondary and Higher Education Cess are not to be calculated on cesses which are levied under Acts administered by Department/Ministries other than Ministry of Finance (Department of Revenue*) [for instance, Sugar cess levied under the Sugar Cess Act, 1982, Tea Cess levied under Tea Act, 1953]* but are only collected by the Department of Revenue in terms of those Acts.

[Circular No. 978/02/2014-CX dated 07.01.2014]

B. SERVICE TAX

I. EXEMPTIONS:

1. Mega exemption notification amended

Mega exemption *Notification No. 25/2012-ST dated 30.06.2012* has been amended as follows:-

(a) Services in relation to serving of food/ beverages by an air conditioned canteen maintained in a factory exempted

Services provided, in relation to serving of food or beverages, by a canteen have been exempted from service tax provided such canteen:-

(i) is maintained in a factory covered under the Factories Act, 1948, and

(ii) has the facility of air-conditioning or central air-heating at any time during the year.

[Notification No. 14/2013-ST dated 22.10.2013]

(b) Services provided by NSDC or by an approved SSC/assessment agency/training partner exempted

Services provided by:-

(i) the National Skill Development Corporation (NSDC) set up by the Government of India;

(ii) a Sector Skill Council (SSC) approved by the NSDC;

(iii) an assessment agency approved by the SSC or the NSDC;

(iv) a training partner approved by the NSDC or the SSC

in relation to:-

(a) the National Skill Development Programme implemented by the NSDC; or

(b) a vocational skill development course under the National Skill Certification and Monetary Reward Scheme; or

(c) any other Scheme implemented by the NSDC

have been exempted from service tax.

[Notification No. 13/2013-ST dated 10.09.2013]

Note: *Prior to 10.05.2013, courses run by an institute affiliated to NSDC were not liable to service tax as same were included in the definition of approved vocational courses and thus were exempt vide entry (l) of the negative list. With effect from 10.05.2013, the Finance Act, 2013 made the courses run by an institute affiliated to NSDC liable to service tax by amending the definition of approved vocational courses.*

With effect from 10.09.2013, said services have been exempted from service tax by incorporating them in the mega exemption notification. Hence, such services were taxable only during the period between 10.05.2013 and 09.09.2013.

(c) Services provided by cord blood banks by way of preservation of stem cells exempted

Services provided by cord blood banks by way of preservation of stem cells or any other service in relation to such preservation have been exempted from service tax.

[Notification No. 04/2014-ST dated 17.02.2014]

(d) Loading/unloading/packing/storage/warehousing of rice exempted

Services by way of loading, unloading, packing, storage or warehousing of rice have been exempted from service tax.

[Notification No. 04/2014-ST dated 17.02.2014]

(e) Scope of definition of 'Governmental authority' widened

The definition of "Governmental authority" has been substituted with the following new definition:-

"Governmental authority" means an authority or a board or any other body;

(i) set up by an Act of Parliament or a State Legislature; or

(ii) established by Government,

with 90% or more participation by way of equity or control, to carry out any function entrusted to a municipality under article 243W of the Constitution.

Thus, the scope of the definition has been enhanced. Henceforth, an authority or a board or any other body established by Government with 90% or more participation by way of equity or control need not be set up under an Act of Parliament or a State Legislature to qualify as Governmental authority.

[Notification No. 02/2014-ST dated 30.01.2014]

(f) Expansion in the scope of exemption of services provided by way of sponsorship of sports events

Hitherto, services provided by way of sponsorship of sporting events organized by a national sports federation, or its affiliated federations were exempt from service tax where the participating teams or individuals represent any district, State or zone. The said exemption has been extended even in a case where the participating teams or individuals represent any **COUNTRY**.

[Notification No. 01/2014-ST dated 10.01.2014]

2. Exemption to restaurant and accommodation services provided between 17.09.2013 and 31.03.2013 in Uttarakhand

Following taxable services provided, during the period between 17th September, 2013 and 31st March, 2014, to any person in the State of Uttarakhand are exempt from whole of the service tax leviable thereon:-

(i) Services by way of renting of a room in a hotel, inn, guest house, club, campsite or other commercial place meant for residential or lodging purposes.

(ii) Services provided in relation to serving of food or beverages by a restaurant, eating joint or mess.

[Exemption Order 1/2013-ST dated 17.09.2013]

3. Revised scheme of service tax exemption in case of services provided to SEZ unit/Developer

Notification No. 40/2012-ST dated 20.06.2012 prescribing the scheme for claiming exemption in respect of the services received by a developer/units of an SEZ has been superseded by *Notification No. 12/2013-ST dated 01.07.2013.* The new notification has expanded the scope of *ab-initio* exemption and refund available to SEZ unit/developer.

The significant relevant changes in the new notification vis-à-vis erstwhile notification have been outlined as follows:-

Basis	***NN 40/2012***	***NN 12/2013***
Services eligible for *ab initio* exemption	Only specified services wholly consumed within SEZ were eligible for the *ab initio* exemption. Further, the definition of wholly consumed services, linked with the Place of Provision of Services Rules, 2012, emphasized that the specified services must be provided only within SEZ.	Specified services received by the SEZ Unit or the Developer used exclusively for the authorized operations are eligible for the *ab initio* exemption. Consequently, any services used exclusively for the authorized operations whether provided within SEZ or outside, will be eligible for upfront exemption.
Refund of service tax paid on the common services shared between authorized operations in SEZ and its DTA operations	Maximum refund was restricted as under:- **Maximum refund** = $\frac{ST \times ET}{TT}$ where **ST** stands for service tax paid on services other than wholly consumed services (used for	The service tax paid on the specified services that are common to the authorized operation in an SEZ and the operation in domestic tariff area [DTA unit(s)] shall be distributed amongst the SEZ Unit/Developer and the DTA unit(s) in the manner as prescribed in rule 7 of the CENVAT Credit Rules, 2004. For the purpose of distribution, the

	both SEZ and DTA Unit) **ET** stands for Export turnover of goods and services of SEZ Unit/Developer **TT** stands for Total turnover for the period	turnover of the SEZ Unit/Developer shall be taken as the turnover of authorized operation during the relevant period. Such amount would be available as refund.
Option not to avail the exemption and instead take CENVAT credit as usual	Earlier scheme did not expressly provide for such an option.	SEZ Unit/the Developer has an option not to avail of this exemption and instead take CENVAT credit on the specified services in accordance with the CENVAT Credit Rules, 2004.
Availability of refund of service tax on the specified services on which *ab-initio* exemption is admissible but not claimed	Refund of service tax on the specified services on which *ab-initio* exemption is admissible but not claimed was not expressly provided in the earlier scheme.	The SEZ Unit or the Developer shall be entitled to the refund of service tax on the specified services on which *ab-initio* exemption is admissible but not claimed.

II. OTHER AMENDMENTS - Threshold limit for e-payment of service tax reduced from ₹ 10 lakh to ₹ 1 lakh

Proviso to rule 6(2) of the Service Tax Rules, 1994 has been amended to reduce the threshold limit for e-payment of service tax from ₹ 10 lakh to ₹ 1 lakh. Henceforth, with effect from 01.01.2014, where an assessee has paid a total service tax of ₹ 1 lakh or more including the amount paid by utilization of CENVAT credit, in the preceding financial year, he shall deposit the service tax liable to be paid by him electronically through internet banking.

[Notification No. 16/2013-ST dated 22.11.2013]

III. CLARIFICATIONS

1. Clarification on issues pertaining to restaurant service

Services provided in relation to serving of food or beverages by a restaurant, eating joint or a mess, other than those having the facility of air-conditioning or central air-heating in any part of the establishment, at any time during the year are exempt from service tax vide mega exemption notification.

In this regard, CBEC, vide *Circular No.173/8/2013 – ST dated 07.10.2013,* has clarified the following:-

A. Services provided (in relation to serving of food or beverages) by air-conditioned as well as non-air-conditioned restaurants, eating joints or mess, operating in a complex

In a complex, air conditioned as well as non-air conditioned restaurants are operational. These restaurants are clearly demarcated and separately named, but food is sourced from a common kitchen.

In such a case, services provided in relation to serving of food/beverages restaurant having the facility of air conditioning or central air heating in any part of the establishment, at any time during the year is liable to service tax. However, such services provided in a non air-conditioned or non centrally air- heated restaurant will be treated as exempted service and thus, will not be liable to service tax.

B. Services are provided by a 'specified restaurant' in other areas e.g. swimming pool or an open area attached to the restaurant

Services provided by restaurant having the facility of air conditioning or central air heating in any part of the establishment, at any time during the year, in other areas of the hotel are liable to service tax.

C. Service tax on goods sold on MRP basis across the counter as part of the Bill/invoice

If goods are sold on MRP basis (fixed under the Legal Metrology Act), they have to be excluded from total amount for the determination of value of service portion.

2. Guidelines for arrest and bail in relation to offences punishable under the Finance Act, 1994.

Powers to arrest is introduced under the service tax law by the Finance Act, 2013. Accordingly, a person who has committed any of the offences specified under section 89(1) and the amount involved in the offence exceeds ₹50 lakh, can be arrested.

Circular No. 171/6/2013-ST dated 17.09.2013 outlines post arrest procedure as follows:-

(i) Procedure in case of non-cognizable and bailable offence:

- The Assistant Commissioner/Deputy Commissioner is bound to release a person on bail against a bail bond. The bail conditions should be informed to the arrested person as well as to the nominated person of the person(s) arrested. The conditions will relate to, *inter alia*, execution of a personal bail bond and one surety of like amount given by a local person of repute, appearance before the investigating officer when required and not leaving the country without informing the officer.
- If the conditions of the bail are fulfilled by the arrested person, he shall be released by the officer concerned on bail forthwith. Otherwise, the arrested person shall be produced before the appropriate Magistrate without unnecessary delay and within 24 hours of arrest. The arrested person may be handed over to the nearest police

station for his safe custody, within 24 hours, during the night under a challan, before he is produced before the Court.

(ii) Procedure in case of cognizable offence:

Only in the event of circumstances preventing the production of the arrested person before a Magistrate without unnecessary delay, the arrested person may be handed over to nearest Police Station for his safe custody, within 24 hours, under a proper challan, and produced before the Magistrate on the next day, and the nominated person of the arrested person may be also informed accordingly.

3. Clarification as to whether "agricultural produce" includes rice and benefits available in respect of rice under mega exemption notification

CBEC vide *Circular No.177/03/2014 – ST dated 17.02.2014,* has clarified that the definition of agricultural produce under section 65(5) of the Finance Act, 1994 covers 'paddy'; but excludes 'rice'. It implies that benefits available to agricultural produce in the negative list [Section 66D(d)] are not available to rice.

However, many such benefits have been extended to rice by way of appropriate entries in the mega exemption notification as follows:-

(i) Services by way of transportation of food stuff by rail/vessel/goods transport agency is exempt from service tax. Food stuff includes rice.

(ii) Services by way of loading, unloading, packing, storage or warehousing of rice are exempt from service tax.

(iii) Carrying out an intermediate production process as job work in relation to agriculture is exempt from service tax. It is clarified that paddy milled into rice, on job work basis is also exempt from service tax since such milling of paddy is an intermediate production process in relation to agriculture.

4. Clarification regarding exemption available to services provided by a Resident Welfare Association (RWA) to its own members

Mega exemption *Notification No. 25/2012-ST dated 20.06.2012* provides exemption to services provided by an RWA to its own members by way of reimbursement of charges or share of contribution up to ₹ 5,000 per month per member for sourcing of goods or services from a third person for the common use of its members.

Certain doubts have been raised regarding the scope of said exemption. CBEC vide *Circular No.175/01/2014 – ST dated 10.01.2014*, has clarified these doubts as follows:

S.No.	Doubt	Clarification
1.	(i) In a residential complex, monthly contribution collected from members is used by the RWA for the purpose of making payments to	Exemption in mega exemption notification is provided specifically with reference to service provided by an unincorporated body or a non–profit entity registered

	the third parties, in respect of commonly used services or goods [Example: for providing security service for the residential complex, maintenance or upkeep of common area and common facilities like lift, water sump, health and fitness centre, swimming pool, payment of electricity Bill for the common area and lift, etc.]. Is service tax leviable on the same? (ii) If the contribution of a member(s) of a RWA exceeds ₹ 5,000 per month, how should the service tax liability be calculated?	under any law for the time being in force such as RWAs, to its own members. However, a monetary ceiling has been prescribed for this exemption, calculated in the form of ₹ 5,000 per month per member contribution to the RWA, for sourcing of goods or services from third person for the common use of its members. If per month per member contribution of any or some members of a RWA exceeds ₹ 5,000, entire contribution of such members whose per month contribution exceeds ₹ 5,000 would be ineligible for the exemption under the said notification. Service tax would then be leviable on the aggregate amount of monthly contribution of such members.
2.	(i) Is Small Service Provider's (SSP) exemption under *Notification No. 33/2012-ST* available to RWA? (ii) Does 'aggregate value' for the purpose of threshold exemption, include the value of exempt service?	SSP exemption under *Notification No. 33/2012-ST* is applicable to a RWA, subject to conditions prescribed in the notification. Under this notification, taxable services of aggregate value not exceeding ₹ 10 lakh in any financial year is exempted from service tax. As per the definition of 'aggregate value' provided in explanation of the notification, aggregate value does not include the value of services which are exempt from service tax.
3.	If a RWA provides certain services such as payment of electricity or water bill issued by third person, in the name of its members, acting as a 'pure agent' of its members, is exclusion from value of taxable service available for the purposes of SSP exemption or exemption provided under mega exemption notification?	In Rule 5(2) of the Service Tax (Determination of Value) Rules, 2006, it is provided that expenditure or costs incurred by a service provider as a pure agent of the recipient of service shall be excluded from the value of taxable service, subject to the conditions specified in the said rule. For example, where the payment for an electricity bill raised by an electricity

		transmission or distribution utility in the name of the owner of an apartment in respect of electricity consumed thereon, is collected and paid by the RWA to the utility, without charging any commission or a consideration by any other name, the RWA is acting as a pure agent and hence exclusion from the value of taxable service would be available. However, in the case of electricity bills issued in the name of RWA, in respect of electricity consumed for common use of lifts, motor pumps for water supply, lights in common area, etc., since there is no agent involved in these transactions, the exclusion from the value of taxable service would not be available.
4.	Is CENVAT credit available to RWA for payment of service tax?	RWA may avail CENVAT credit and use the same for payment of service tax, in accordance with the CENVAT Credit Rules, 2004.

C. CUSTOMS

1. Drawback allowed on milk products and ceasin, caseinates etc. and disallowed on wheat

Earlier, no drawback was allowed on milk products falling under headings 0401, 0402, 0403, 0404, 0405, 0406, rice falling under heading 1006 and casein, caseinates and other casein derivatives; casein glues falling under heading 3501 of the Customs Tariff.

However, **with effect from 21.09.2013**, drawback will not be allowed only in respect of rice falling under heading 1006 and wheat falling under heading 1001 of the Customs Tariff. In effect, drawback will

- be allowed in respect of milk products falling under the above-mentioned headings and ceasin, caseinates etc. falling under heading 3501 (which was not allowed prior to 21.09.2013); and
- not be allowed on wheat falling under heading 1001 (which was allowed prior to 21.09.2013).

Rule 3 of the Central Excise Duties and Service Tax Drawback Rules, 1995 has been amended vide *Notification No. 97/2013 Cus. (NT) dated 14.09.2013* to give effect to this

amendment. Consequential amendments have been made in rule 6(4) and rule 7(5) of the said rules.

2. Import of LCD/LED/Plasma TV as part of free baggage allowance disallowed

With effect from 26.08.2013, Annexure I to the Baggage Rules, 1988 which specifies the items that cannot be allowed duty free clearance as part of free baggage allowance has been amended vide *Notification No. 84/2013 Cus (NT) dated 19.08.2013* to include Flat panel (LCD/LED/Plasma) Television therein.

Therefore, import of flat panel (LCD/LED/Plasma) television as part of free baggage allowance has been disallowed from August 26 and travelers bringing in LCD/LED/Plasma TV as part of baggage will have to pay customs duty at 36.05% (35% + 3% education cesses).

3. Period of 90 days under section 61(2)(ii) of the Customs Act, 1962 commences from the date of deposit of goods in the warehouse

Circular No. 39/2013 Cus dated 01.10.2013 has clarified that the period of 90 days, under section 61(2)(ii) of the Customs Act, 1962 would commence from the date of deposit of goods in the warehouse.

As per section 61(2)(ii) of the Customs Act, 1962 where any warehoused goods (not intended for being used in 100% EOU) *remain in a warehouse beyond a period of ninety days, interest shall be payable for the period from the expiry of the said ninety days till the date of payment of duty on the warehoused goods*. Section 2(44) of the Customs Act, 1962 defines '*warehoused goods*' as '*goods deposited in a warehouse*'.

Thus, a harmonious reading of section 61(2)(ii) and section 2(44) indicates that when the goods deposited in a warehouse remain warehoused beyond a period of ninety days, then the interest starts accruing. In other words, the relevant date when the period of 90 days would commence would be the date of depositing the goods in the warehouse.

4. Guidelines for arrest and bail under Customs Act, 1962

In view of the amendments made in section 104 of the Customs Act, 1962 vide Finance Act, 2013, offences punishable under section 135 of the Act have been made as non-bailable. The following significant guidelines have been issued by CBEC vide *Circular No. 974/08/2013-CX dated 17.09.2013* with regard to implementation of arrest and bail provisions under the amended customs law:

(i) Since arrest takes away the liberty of an individual, the power must be exercised with utmost care and caution in cases where a Commissioner of Customs or Additional Director General has reason to believe on basis of information or suspicion that such person has committed an offence under the Act punishable under the sections 132 or 133 or 135 or 135A or 136 of the Customs Act, 1962.

(ii) The decision to arrest should be taken in cases which fulfil the requirement of the provisions of section 104(1) of Customs Act, 1962 and after considering the nature of offence, the role of the person involved and evidence available.

(iii) Persons involved should not be arrested unless the exigencies of certain situations demand their immediate arrest. These situations may include circumstances:

(a) to ensure proper investigation of the offence;

(b) to prevent such person from absconding;

(c) cases involving organised smuggling of goods or evasion of customs duty by way of concealment;

(d) masterminds or key operators effecting proxy/benami imports/ exports in the name of dummy or non-existent persons/IECs, etc.

(iv) While the Act does not specify any value limits for exercising the powers of arrest, the same should be effected *in respect of bailable offence only in exceptional situations which may include :*

(a) Outright smuggling of high value goods such as precious metal, restricted items or prohibited items or goods notified under section 123 of the Customs Act, 1962 or foreign currency where the value of offending goods exceeds ₹ 20 lakh.

(b) In a case related to importation of trade goods (i.e. appraising cases) involving wilful mis-declaration in description of goods/ concealment of goods/goods covered under section 123 of Customs Act, 1962 with a view to import restricted or prohibited items and where the CIF value of the offending goods exceeds ₹ 50 lakh.

(v) In every case of arrest effected in accordance with the provisions of section 104(1) of the Customs Act, 1962, there should be immediate intimation to the jurisdictional Chief Commissioner or DGRI, as the case may be.

(vi) A person arrested for a *non-bailable offence* should be produced before concerned Magistrate without unnecessary delay in terms of provisions of section 104(2) of the Act.

(vii) However, a Customs officer (arresting officer) is bound to offer release on bail to a person arrested in respect of bailable offence and accept bail bond for bailable offence.

(vii) The guidelines relating to bail prescribed under central excise vide *Circular No. 974/08/2013 CX dated 17.09.2013* (given above from nos. (viii) to no. (xi) under point 5 in Central Excise) will apply in relation to grating of bails under customs law as well.

5. Exemption from Special Additional Duty of Customs (SAD) is not available on goods cleared from the SEZ / FTWZ into the DTA on stock transfer basis.

Notification No. 45/2005-Cus. dated 16.05.2005 exempts all goods produced or manufactured in an Special Economic Zone (SEZ) and brought to Domestic Tariff Area (DTA), from the whole of the additional duty of customs leviable under section 3(5) of the Customs Tariff Act,

1975 [hereinafter referred as SAD]. However, such exemption shall not be available if such goods, when sold in DTA, are exempted by the State Government from payment of sales tax or VAT.

Issue: Would the benefit of exemption from SAD under aforersaid notification be available when the goods are cleared in the nature of stock transfer from an SEZ/ FTWZ unit to its DTA unit for self-consumption.

Clarification: The aforesaid notification clearly states that the exemption shall not be available if such goods, when sold in DTA, are exempt from payment of sales tax/VAT. In case of clearances which are in the nature of stock transfer from SEZ/FTWZ unit to the DTA unit for self-consumption i.e. otherwise than for sale as such, no sales tax/VAT is leviable on such a transaction. Since no sales tax/VAT is leviable on the said transaction, SAD is payable.

Hence, the benefit of exemption from SAD under aforersaid notification would NOT be available when a DTA unit imports goods and routes it through SEZ/FTWZ for self-consumption i.e. in the nature of stock transfer from SEZ/FTWZ.

[Circular No. 44/2013 Cus dated 30.12.2013]

6. Classification of various imported items:

CBEC has clarified with regard to the classification issues arising in the following products:-

S.No.	Circular No.	Product	Disputed tariff entries	Clarification
1.	36/2013 dated 05.09.2013	Bluetooth Wireless Headset for mobile phones / cell phones	**8517** "…; other apparatus for the transmission or reception of voice, images or other data, including apparatus for communication in a wired or wireless network (such as a local or wide area network),…"	Bluetooth Wireless headsets for mobile phones / cell phones is correctly classifiable in heading 8517.
			8518 "…; headphones and earphones, whether or not combined with a microphone,…"	
2.	28/2013 dated 01.08.2013	Cockroach traps and Mosquito Repellent	**3506** –"Prepared glues and other prepared adhesives, not elsewhere specified or included; products suitable for use as glues or adhesives, put up for retail sale as glues or adhesives, not exceeding a net weight of 1 kg"; **3822** –"Diagnostic or laboratory	Such products should merit classification under heading 3808.

			reagents on a backing, prepared diagnostic or laboratory reagents whether or not on a backing, other than those of heading 3002 or 3006; certified reference materials"; **3926** – "Other articles of plastics and articles of other materials of headings 3901 to 3914"; **3808** – "Insecticides, rodenticides, fungicides, herbicides, anti-sprouting products and plant-growth regulators, disinfectants and similar products, put up in forms or packings for retail sale or as preparations or articles(for example, sulphur-treated bands, wicks and candles, and fly-papers)"; **4823** –"Other paper, paperboard, cellulose wadding and webs of cellulose fibers, cut to size or shape; other articles of paper pulp, paper, paperboard, cellulose wadding or webs of cellulose fibers.	
3.	20/2013 dated 14.05.2013	Tablet computers	**8517**- "Telephone sets,……." **8471**- Automatic data processing machines and units thereof; magnetic or optical readers, machines for transcribing data onto data media in coded from and machines for processing such data, not elsewhere specified or included	Tablet Computers are classifiable under heading 8471.
4.	2/2014 dated 09.01.2014.	Transmission shafts / Power takeoff	**8432**-Agricultural, horticultural or forestry machinery for soil preparation or cultivation; lawn or	Transmission shafts / PTO shafts are classifiable under

		(PTO) shafts	sports- ground rollers	heading 8483.
			8433-Harvesting or threshing machinery, including straw or fodder balers; grass or hay mowers; machines for cleaning, sorting or grading eggs, fruit or other agricultural produce, other than machinery of heading 8437".	
			8483-Transmission shafts (including cam shafts and crank shafts) and cranks; bearing housings and plain shaft bearings; gears and gearing; ball or roller screws; gear boxes and other speed changers, including torque converters; flywheels and pulleys, including pulley blocks; clutches and shaft couplings (including universal joints	

Part II : Judicial Update – Indirect Tax Laws

Significant Recent Legal Decisions

"Select Cases in Direct and Indirect Tax Laws – An Essential Reading for the Final Course" is a compilation of the significant decisions of Supreme Court, High Court and Larger Bench of Tribunal. September, 2013 edition of the said publication is relevant for November, 2014 examination. Students may note that in addition to the cases reported in the said publication, following significant recent legal decisions are also relevant for November, 2014 examination:-

CENTRAL EXCISE

Basic concepts of excise

1. Whether bagasse which is a marketable product but not a manufactured product can be subjected to excise duty?

Balrampur Chini Mills Ltd. v. Union of India 2014 (300) ELT 372 (All.)

Background: Bagasse is a residue/waste of the sugarcane which is left behind when sugarcane stalks are crushed to extract their juice during the manufacture of sugar. It is currently used as a biofuel and in manufacture of pulp and paper products and building materials and is classified under sub-heading 2303 20 00 of Central Excise Tariff Act, 1985 as 'Beet-Pulp', 'bagasse' and 'other waste of sugar manufacture' with NIL rate of duty.

Section 2(d) of Central Excise Act, 1944 defines excisable goods. An explanation had been inserted in section 2(d) of the Central Excise Act, 1944 vide Finance Act, 2008 to provide that "goods" include any article, material or substance which is *capable of being bought and sold for a consideration and such goods shall be deemed to be marketable*.

Consequent to this amendment, CBEC issued a Circular dated 28-10-2009 clarifying that 'bagasse' and other like materials would be covered under the definition of excisable goods and chargeable to payment of excise duty post Finance Act, 2008. The Circular further clarified that in case, the rate of duty in respect of such products is 'nil' or they are exempted from duty vide any notification and if CENVAT credit has been taken on the inputs which are used for manufacture of dutiable and exempted goods and no separate accounts have been maintained in this regard, then in terms of rule 6(3) of CENVAT Credit Rules, 2004 (CCR), proportionate credit would be reversed or 5% (now 6%) amount would be paid.

However, Supreme Court in the case of *Balrampur Chini Mills Ltd.* in Civil Appeal No. 2791 of 2005, decided on 21-7-2010 held that bagasse is a waste and not a manufactured product.

Point of dispute: Petitioner contended that since rule 6(3) applies when a manufacturer manufacturers both dutiable as well as exempted final products, the same would not apply in their case in view of the above-mentioned Supreme Court's judgment holding bagasse as a non-manufactured final product. Therefore, the petitioner is not liable to reverse 5% (now 6%) of the amount of bagasse sold.

Department, however, contended that by virtue of the amendment made in the definition of excisable goods vide the Finance Act, 2008, bagasse becomes an 'exempted excisable goods' (bagassee is chargeable at NIL rate of duty in Central Excise Tariff) and hence provisions of rule 6(3) of CENVAT Credit Rules, 2004 (CCR) would apply in the petitioner's case.

Observations of the Court: High Court made the following observations:

(i) Supreme Court in its judgement given vide order dated 21.7.2010 in Civil Appeal No.2791 of 2005 has held that reversal of 8% amount (now 6%) is not applicable in case of bagasse as the same is not a final product, but a waste. Bagasse is never manufactured, but it only emerges as a waste from the crushing of sugarcane for the manufacture of final product, namely, sugar and thus, rule 6(2) and rule 6(3) would not be applicable.

(ii) Explanation added to section 2(d) deems the goods, which are capable of being bought and sold, to be marketable. Earlier also, bagasse was being bought and sold for a consideration and even after the amendment in 2008 it is being bought and sold for a consideration. Hence, it was marketable earlier also and no difference has been made about the marketability of bagasse on account of addition of explanation to section 2(d) of CEA, 1944 inasmuch as it does not cease to be waste and it does not become a manufactured final product for the purposes of rule 6 of CENVAT Credit Rules.

Decision: The High Court concluded that though bagasse is an agricultural waste of sugarcane, it is a marketable product. However, duty cannot be imposed thereon simply by virtue of the explanation added under section 2(d) of the Central Excise Act, 1944 as it does not involve any manufacturing activity. The High Court quashed the CBEC's Circular dated 28-10-2009.

Classification of excisable goods

2. How will a cream which is available across the counters as also on prescription of dermatologists for treating dry skin conditions, be classified if it has subsidiary pharmaceutical contents - as medicament or as cosmetics?

CCEx. v. Ciens Laboratories 2013 (295) ELT 3 (SC)

Facts of the case: The assessee manufactured a cream called as 'Moisturex' which was prescribed by dermatologists for treating dry skin conditions. However, the same was also available in chemist or pharmaceutical shops without prescription of a medical practitioner. The pharmaceutical content of the cream included urea (10%), lactic acid (10%) and propylene glycol (10%). The assessee classified the cream as medicament under Heading 30.03 of the Central Excise Tariff.

Point of dispute: The Department contended that the product 'Moisturex' is mainly used for **care** of the skin and thus, the same ought to be classified as cosmetic or toilet preparations under Heading 33.04. It was further contended that even if such cosmetic products contained certain subsidiary pharmaceutical contents or even if they had certain

subsidiary curative or prophylactic value, still, they would be treated as cosmetics only. It was also contended that since the product can be purchased without prescription of a medical practitioner, it could not be a medicament.

The assessee on the other hand contended that the very presence of pharmaceutical substances changes the identity of the product since such constituents are not used for **care** of the skin, but for **cure** of certain diseases relating to skin.

Observations of the Court: The Apex Court observed that the cream was not primarily intended to protect the skin but was meant for treating or curing dry skin conditions of the human skin. The Apex Court stated that presence of pharmaceutical ingredients in the cream show that it is used for prophylactic and therapeutic purposes.

The Supreme Court made the following further significant observations:

(i) When a product contains pharmaceutical ingredients that have therapeutic or prophylactic or curative properties, the proportion of such ingredients is not invariably the decisive factor in classification. The relevant factor is the curative attributes of such ingredients that render the product a medicament and not a cosmetic.

(ii) Though a product is sold without a prescription of a medical practitioner, it does not lead to the immediate conclusion that all products that are sold over / across the counter are cosmetics. There are several products that are sold over-the-counter and are yet, medicaments.

(iii) Prior to adjudicating upon whether a product is a medicament or not, it ought to be seen as to how do the people who actually use the product, understand it to be. If a product's primary function is **"care"** and not **"cure"**, it is not a medicament. Medicinal products are used to treat or cure some medical condition whereas cosmetic products are used in enhancing or improving a person's appearance or beauty.

(iv) A product that is used mainly in curing or treating ailments or diseases and contains curative ingredients, even in small quantities, is to be treated as a medicament.

Decision: The Supreme Court held that owing to the pharmaceutical constituents present in the cream 'Moisturex' and its use for the cure of certain skin diseases, the same would be classifiable as a medicament under Heading 30.03.

Note: The classification discussed in the above-mentioned case relates to the old Central Excise Tariff. However, the ratio of the judgment will hold good under the current Central Excise Tariff as well.

Valuation of excisable goods

3. Is the amount of sales tax/VAT collected by the asssessee and retained with him in accordance with any State Sales Tax Incentive Scheme, includible in the assessable value for payment of excise duty?

CCEx v. Super Synotex (India) Ltd. 2014 (301) E.L.T. 273 (S.C.)

Facts: Assessee was a manufacturer of manmade fibre yarns which were chargeable to excise duty. The assessee availed the benefit of Sales Tax New Incentive Scheme for Industries, 1989 ('State Incentive Scheme') whereby he could retain 75% of the total sales tax collected from buyer and pay only remaining 25% to the State Government.

Point of dispute: While computing the 'transaction value' for the purpose of payment of excise duty, assessee claimed 100% deduction of sales tax collected from buyer. Department objected to this as effectively, the assessee did not pay excise duty on the additional consideration received towards sales tax collected but not deposited with the State exchequer.

Observations of the Court: Supreme Court observed that amount paid or payable to the State Government towards sales tax, VAT, etc. is excluded as it is not an amount paid to the manufacturer towards the price, but an amount paid or payable to the State Government for the sale transaction. Accordingly, the amount paid to the State Government is only excludible from the transaction value. What is not payable or to be paid as sales tax/VAT, should not be charged from the third party/customer, but if it charged and is not payable or paid, it is a part and should not be excluded from the transaction value. This is the position after amendment w.e.f. 01.07.2000 of section 4 of Central Excise Act, 1944, where "actually paid" is significant.

Supreme Court further observed that unless the sales tax is ***actually paid*** to the Sales Tax Department of the State Government, no benefit towards excise duty can be given under the concept of "transaction value" under section 4(3)(d) of Central Excise Act, 1944, for it is not excludible. As is seen from the facts, 25% of the sales tax collected had been paid to the State exchequer by way of deposit and the remaining amount had been retained by the assessee.

Decision: The Apex Court held that such retained amount has to be treated as the price of the goods under the basic fundamental conception of "transaction value" as substituted with effect from 1.7.2000 and therefore, the assessee is bound to pay excise duty on the said sum.

Note – This case establishes that retention of the specified sales tax amount under the relevant State Sales Tax Incentive Schemes ought to be treated as additional consideration and subjected to central excise duty since deduction of sales tax is available only when it is actually paid to the Sales Tax Department (in terms of the definition of transaction value as introduced from July 1, 2000). In other words, the Apex Court has negated the idea that such amounts are in the nature of a subsidy and do not form part of the sale proceeds.

The issue of includibility, or otherwise, of sales tax collected and retained, in terms of Incentive Schemes, in the assessable value has been dealt in the context of both old (existing prior to July 1, 2000) and new section 4 (effective from July 1, 2000) in the above-mentioned case law. However, in the above summary only the observations and conclusion involving new section 4, based on transaction value, have been discussed and the ones relating to old section 4, based on normal price, have been avoided.

With effect from July 1, 2000 the definition of 'transaction value' reads as under:

(d) "transaction value" means the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter; ***but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods****.*

CENVAT credit

4. Can CENVAT credit of duties, other than National Calamity Contingent Duty (NCCD), be used to pay NCCD?

CCEx. v. Prag Bosimi Synthetics Ltd. 2013 (295) ELT 682 (Gau.)

Point of dispute: The assessee contended that though CENVAT credit in respect of NCCD can be utilized only for payment of NCCD duty, NCCD can be paid by using CENVAT credit of basic excise duty also. The Revenue, however, rejected the assessee's contention.

Observations of the Court: The High Court noted that in terms of rule 3(1) of the CENVAT Credit Rules, 2004 [CCR], a manufacturer or producer of a final product is allowed to take CENVAT credit of NCCD. Rule 3(4) of CCR provides that CENVAT credit may be utilized for payment of any duty of excise on any final product. Therefore, CENVAT credit of NCCD may also be utilized for payment of any duty of excise on any final product in terms of rule 3(4) subject to rule 3(7). However, rule 3(7) of CCR limits the utilization of CENVAT credit in respect of NCCD as also other duties mentioned in rule 3(7)(b).

Rule 3(7)(b) provides that CENVAT credit in respect of NCCD and other duties shall be utilized towards payment of duty of excise leviable under various statutes respectively. The High Court stressed upon the importance of the word "respectively" as it confines the utilization of CENVAT credit obtained under a particular statute for payment of duty under that statute only. The High Court, however, categorically added that the converse does not follow from the above discussion.

Decision: The High Court held that merely because CENVAT credit in respect of NCCD can be utilized only for payment of NCCD, it does not lead to the conclusion that credit of any other duty cannot be utilized for payment of NCCD.

Note: Fourth proviso to rule 3(4) of the CENVAT Credit Rules, 2004 provides that in case of mobile phones, credit of only NCCD can be utilised for payment of the NCCD payable thereon. In other words, in the absence of the credit of NCCD, NCCD payable on mobile phones will have to be paid in cash (even if credit of other duties/tax is available) as no other credit can be utilized to pay such duty.

5. Can CENVAT credit be availed on machineries purchased for being used in setting up a sugar plant in foreign country when (i) the same are not used in the factory premises and (ii) no duty is paid on final product viz., the sugar plant?

KCP Ltd. v. CCEx. 2013 (295) ELT 353 (SC)

Facts of the case: The assessee was a manufacturer of machinery for sugar and cement plants and parts thereof falling under Chapter 84 of the Central Excise Act, 1944. It entered into a contract for setting up a sugar manufacturing plant in Vietnam. For this purpose, the assessee manufactured certain machines in its own factory and also purchased certain other machinery from other dealers/manufacturers. Both the machineries (manufactured and bought-out) were then put in a container and transported to Vietnam for setting up the sugar plant.

Point of dispute: The assessee availed CENVAT credit on bought-out machinery describing them as eligible capital goods. The Department, however, contended that the bought-out machinery was not eligible capital goods as the same had not been used by the assessee in its factory premises.

Observations of the Court: The Supreme Court observed that the objective of the scheme of CENVAT credit is to remove cascading effect of duty imposed on the final product. There are two basic conditions for availing CENVAT credit:

(i) Duty must have been paid on inputs and such inputs must be used in manufacture of final product in the factory of the manufacturer,

(ii) Excise duty must have been levied on final product.

The Supreme Court explained that if duty is not levied on the final product, question of grant of any relief would not arise as in that case there would not be any cascading effect on the duty imposed on inputs.

The Supreme Court pointed out that since the sugar plant was set up in Vietnam, it could not be said that the plant was manufactured in the factory of the assessee. Thus, no duty was paid by the assessee on the final product i.e., on sugar plant which had been set up in Vietnam. Therefore, there would not be any question of availing credit of the duty paid on the inputs.

The Supreme Court further observed that the bought-out machinery was not used by the assessee in the manufacture of the machinery (which had been transported along with bought-out machinery to Vietnam for setting up the sugar plant) as the same was not even unpacked or tested, and transported in exact condition along with machinery manufactured by the assessee. The assessee, therefore, merely acted as a trader or as an exporter in relation to the machinery purchased by it, which had been exported and used for setting up a sugar plant in a foreign country.

Decision: The Supreme Court held that CENVAT credit could not be allowed to the assessee as no duty was paid on sugar plant set up in a foreign country. Further, since the bought-out machinery was not used in the assessee's factory premises, the necessary condition for availing CENVAT credit on capital goods could not be fulfilled.

Note: Although the above-mentioned case is based on old MODVAT provisions, the principle enunciated therein will hold good in context of CENVAT Credit Rules, 2004 also. For the sake of simplicity and better understanding, the term MODVAT has been referred to as CENVAT wherever applicable.

6. Whether wrongful availment of 100% CENVAT credit on capital goods in the year of purchase be upheld if wrongly availed credit of 50% is not utilized in the said year?

CCE v. Satish Industries 2013 (298) E.L.T. 188 (Bom.)

Facts of the case: In the instant case, the assessee availed 100% CENVAT credit on capital goods in the year of purchase, i.e. in first year itself. However, he utilized only 50% of the CENVAT credit so availed in the first year. As per Revenue, assessee was entitled to avail 50% of the credit of duty paid on capital goods in the first financial year and avail the balance 50% credit in subsequent financial year.

Decision: The High Court held that if 50% CENVAT credit on capital goods pertaining to subsequent financial year which had been wrongly availed in the first year had not been not utilized till the commencement of the subsequent financial year, no prejudice was caused to the Revenue and thus, the same could be upheld.

Export procedures

7. Can export rebate claim be denied merely for non-production of original and duplicate copies of ARE-1 when evidence for export of goods is available?

UM Cables Limited v. Union of India 2013 (293) ELT 641 (Bom.)

Observations of the Court: The High Court observed that the objective of the procedure laid down in *Notification No. 19/2004 CE (NT) dated 06.09.2004* and CBEC's Manual of Supplementary Instructions 2005 is to facilitate the processing of a rebate claim and to enable the authority to be duly satisfied that the two fold requirement of goods (i) having been exported and (ii) being duty paid is fulfilled.

The High Court referred to the decision of Supreme Court in the case of *Mangalore Chemicals & Fertilizers Ltd.* v. *Deputy Commissioner 1991 (55) E.L.T. 437 (SC)* wherein the Apex Court held that non-compliance of a condition which is substantive and fundamental to the policy underlying the grant of an exemption would result in an invalidation of the claim. However, it would be erroneous to attach equal importance to the non-observance of all conditions irrespective of the purposes which they intend to serve, as some requirements may merely relate to procedures.

Decision: The High Court, therefore, held that the procedure cannot be raised to the level of a mandatory requirement. Rule 18 itself makes a distinction between conditions and limitations subject to which a rebate can be granted and the procedure governing the grant of a rebate. It was held by the High Court that while the conditions and limitations for the grant of rebate are mandatory, matters of procedure are directory.

The High Court ruled that non-production of ARE-1 forms *ipso facto* cannot invalidate rebate claim. In such a case, exporter can demonstrate by cogent evidence that goods

were exported and duty paid and satisfy the requirements of rule 18 of Central Excise Rules, 2002 read with *Notification No. 19/2004 CE (NT)*.

Note: Where any goods are exported, rule 18 of the Central Excise Rules, 2002 empowers the Central Government to grant by way of a notification a rebate of duty paid on such excisable goods or on materials used in the manufacture or processing of such goods. The rebate is subject to such conditions or limitations, if any, and the fulfilment of such procedure as may be specified in the notification. Notification No. 19/2004 CE (NT) dated 06.09.2004 as amended has been issued by the Central Government to grant rebate under rule 18.

The procedure prescribed under the said notification in relation to preparation of ARE-1, its distribution and filing of rebate claim is summarized below:

(i) For the purpose of sealing of goods intended for export, at the place of dispatch, the exporter has to present the goods along with four copies of an application in form ARE-1 to the Superintendent or Inspector of Central Excise having jurisdiction over the factory or the warehouse.

(ii) The Superintendent/Inspector has to verify the identity of the goods mentioned in the application and the particulars of the duty paid or payable, and if found in order, he has to seal each package or the container and endorse each copy of the application.

(iii) The original and duplicate copies of the application are returned to the exporter by the Superintendent of Central Excise. The triplicate copy is sent to the officer with whom a rebate claim is to be filed, either by post or by handing over to the exporter in a tamper proof sealed cover after posting the particulars in the official records.

(iv) On arrival of goods at the place of export, the goods have to be presented together with the original and duplicate copies of the application (the quadruplicate copy being optional) to the Commissioner of Customs or a duly appointed officer.

(v) The Commissioner of Customs or his officer examines the consignment with the particulars cited in the application and upon finding them to be correct and exportable in accordance with the law for the time being in force, he is required to allow the export of the goods and to certify on the copies of the application that the goods have been duly exported, citing the shipping bill number, date and other particulars of export.

(vi) The Commissioner of Customs or his officer shall return the original copy of the application to the exporter and forward the duplicate copy, either by post or by handing over to the exporter in a tamper proof sealed cover, to the officer specified in the application from whom the exporter wants to claim rebate.

(vii) The exporter has to lodge a claim of rebate of duty paid on all excisable goods along with the original copy of the application to the jurisdictional Assistant/Deputy Commissioner or Maritime Commissioner, as the case may be.

(viii) The rebate sanctioning officer is required to compare the duplicate copy of the application received from the Commissioner of Customs or his officer (or from the exporter in a tamper proof sealed cover) with the original copy received from the exporter and with the triplicate copy received from the Central Excise Officer and if he is satisfied that the claim is in order, he has to sanction the rebate.

8. In case of export of goods under rule 18 of the Central Excise Rules, 2002, is it possible to claim rebate of duty paid on excisable goods as well rebate of duty paid on materials used in the manufacture or processing of such goods?

Rajasthan Textile Mills v. UOI 2013 (298) E.L.T. 183 (Raj.)

Facts of the case: The petitioner manufactured M.M. Yarn by using duty paid inputs and cleared the same for export on payment of duty. It claimed rebate of duty paid by it on inputs as well as of duty paid on finished goods under rule 18 of the Central Excise Rules, 2002. The Department rejected the rebate claims on the ground that rule 18 does not permit grant of rebate of duty paid on exported finished goods simultaneously with the rebate of duty paid on inputs.

The petitioner contended that it should be allowed the rebate of the duty paid on both the manufactured goods as well as on materials used in the manufacture of such goods. He submitted that word "or" used in rule 18 should be read as "and" as there is a combined form-Form ARE-2 for claiming the rebate on the manufactured goods as well as rebate on materials used in the manufacture or processing of such goods. Further, since whole of the duty paid on manufactured goods is exempted under rule 19 of the Central Excise Rules, 2002, the petitioner opting for rule 18 cannot be put at a disadvantageous situation in the matter of claiming such rebate.

Observations of the Court: The High Court considering the contentions of the petitioner observed as under:-

(i) On plain reading of rule 18, it is apparent that if the word "or" is taken to be disjunctive, the intention manifested in rule 18 can be given full effect to, i.e. to give the benefit admissible on one of the item, either on finished goods or inputs used in the manufacture or processing of such goods.

(ii) Rule 19 provides benefit on the finished goods i.e. any excisable goods can be exported without payment of duty from the factory of producer. However, it does not provide for rebate of duty paid on the materials used in manufacture or processing of such goods. Thus, the intention of rule 19 is to provide benefit on finished goods and not on raw materials. Merely with the aid of different provision of rule 19, interpreting the word "or" used in rule 18 as "and" to provide benefit for both, would not be permissible.

(iii) It is important to note that *Notification No. 19/2004-Central Excise (N.T.) dated 06.09.2004* provides rebate of the whole of the duty paid on all "excisable goods" while *Notification No. 21/2004-C.E. (N.T.) dated 06.09.2004* provides the rebate of whole of the duty paid on 'materials' *i.e.* inputs used in the manufacture or

processing of export goods. Issuance of two difference notifications further makes it clear that both the benefits cannot be claimed simultaneously.

(iv) Merely by the fact that Form ARE-2 can be used either to claim the rebate on finished goods or on inputs used in manufacture of such goods, it cannot be culled out that the rebate is available on both i.e., finished goods as well as on the inputs. Merely by preparation of any combined form for both the benefits, the word "or" cannot be construed as "and" to be used conjunctively.

Decision: Under rule 18 of the Central Excise Rules, 2002, grant of rebate of duty paid is available either on excisable goods or on materials used in the manufacture or processing of such goods i.e. on raw material. Thus, it is open to claim the benefit of rebate either on manufactured/finished goods or on raw material, but not on both.

*Note: Rule 18 of the Central Excise Rules, 2002 provides that where any goods are exported, the Central Government may, by notification, grant rebate of duty paid on such excisable goods **OR** duty paid on materials used in the manufacture or processing of such goods and the rebate shall be subject to such conditions or limitations, if any, and fulfilment of such procedure, as may be specified in the notification.*

Demand, adjudication and offences

9. Can penalty under section 11AC of the Central Excise Act, 1944 be imposed in a case where there are divergent judicial pronouncements on an issue and the assessee chooses to follow one of those pronouncements?

CCEx. v. Delphi Automotive Systems Ltd. 2013 (292) E.L.T. 189 (All.)

The High Court held that *mens rea* (guilty mind) is an essential part for levy of penalty under section 11AC of the Central Excise Act, 1944. Where a provision of statute is not clear and there are divergent judicial pronouncements, it cannot be said that there is *mens rea* on the part of the assessee if he chooses to follow his course of action in the light of one of the judicial pronouncements.

10. Can a former director of a company be held liable for the recovery of the excise dues of such company?

Delhi High Court in case of *Anita Grover v. CCEx. 2013 (288) E.L.T. 63 (Del.)* [reported on page 184 of Select Cases in Direct and Indirect Tax Laws-Relevant for May, 2014 and November, 2014 Examinations (September, 2013 edition)] had elucidated that a former director of a company cannot be held liable for the recovery of the customs dues of such company.

Bombay High Court has taken a similar view in case of ***Vandana Bidyut Chatterjee v. UOI 2013 (292) E.L.T. 6 (Bom.)***. In this case, Department alleged that the petitioner was liable to pay the arrears of the excise duty and penalty of a company of which her late father was a director and sought to attach the property belonging to the petitioner for recovery of such dues. The said property was gifted to the petitioner by her late father during his lifetime. The company was jointly controlled by Mukherjee Brothers (the petitioner) and Kapoor family. They entered into agreement wherein the latter

transferred their shares to Mukherjee Brothers and placed the responsibility to discharge the excise duty liability of the company on them.

The High Court observed that duty and penalty were the arrears of the company because company was the person engaged in the manufacture of goods and registered as manufacturer. As per section 142 of the Customs Act, 1962 read along with the Customs (Attachment of Property of Defaulters for Recovery of Government Dues) Rules, 1995*, Central Government could recover dues belonging only to a defaulter. Thus, the recovery proceedings could be taken only against the company, as it alone was the defaulter. There was no provision to recover the arrears of the company from its directors and or shareholders under the Customs Act.

Further, there was no provision in the Customs Act as was found under section 179 of the Income Tax Act, 1961 or under section 18 of the Central Sales Tax Act, 1956 where the dues of a private limited company could be recovered from its directors when the private limited company was under liquidation, in specific circumstances. Since a company was a separate person having a distinct identity, independent from its shareholders and directors, company's dues could not be recovered from the directors and/or individual shareholder of the company.

Furthermore, the Department's reliance upon the agreement entered into between Mukherjee Brothers and Kapoor family to fasten the liability of excise duty and penalty arrears of the said company upon the petitioners' father was not sustainable.

Hence, the Court held that in the instant case, the attachment notices issued on the former late director and his daughter were without jurisdiction.

Note: Section 12 of the Central Excise Act, 1944 empowers the Central Government to apply specified provisions of the Customs Act to central excise subject to some modifications. Consequently, section 142 of the Customs Act, 1962 has been made applicable to the Central Excise Act by virtue of Notification No. 68/63-CE dated 4th May, 1963 issued under section 12 of the Central Excise Act.

11. Can Appellate Authorities or Courts permit the assessee to pay reduced penalty of 25% beyond 30 days of the communication of the order of the adjudicating authority as prescribed under section 11AC?

CCEx. V. Ratnamani Metals and Tubes Ltd. 2013 (296) ELT 327 (Guj.)

The High Court answered the aforesaid question of law in affirmative. It held that an option can also be granted to the assessee to deposit the entire dues along with 25% interest and penalty within a period of 30 days of communication of the order of Tribunal.

Note: The Bombay High Court has taken a view contrary to the abovementioned opinion of Gujarat High Court in case of CCEx. v. Castrol India Ltd. 2012 (286) E.L.T. 194 (Bom.). The said case is reported on page 128 of Select Cases in Direct and Indirect Tax Laws - Relevant for May, 2014 and November, 2014 Examinations [September, 2013 edition].

Refund

12. Can refund of an amount mistakenly paid as excise duty be rejected on the ground of limitation under section 11B of the Central Excise Act, 1944?

Karnataka High Court in case of *CCE (A) v. KVR Construction 2012 (26) STR 195 (Kar.)* [reported on page 157 of Select Cases in Direct and Indirect Tax Laws-Relevant for May, 2014 and November, 2014 Examinations (September, 2013 edition)] had held that refund of an amount mistakenly paid as service tax could not be rejected on ground of limitation under section 11B of the Central Excise Act, 1944 (as made applicable in case of service tax vide section 83 of the Finance Act, 1994).

Gujarat High Court has taken a similar view in case of ***Swastik Sanitarywares Ltd. v. UOI 2013 (296) E.L.T. 321 (Guj.)***. In this case, the assessee had erroneously deposited the excise duty twice on the clearance of same goods. However, the burden of the duty paid the second time was not passed on to the consumer. When it applied for the refund of the second deposit of the same amount, the refund claim was rejected on the ground of limitation under section 11B of the Central Excise Act, 1944.

The High Court held that payment made by the assessee the second time could not be considered as duty deposited or paid. Hence, repayment of such amount could not be seen as a refund claim made under section 11B. Consequently, such amount is repayable to the assessee by the Department.

13. Whether filing of refund claim under section 11B of Central Excise Act, 1944 is required in case of *suo motu* availment of CENVAT credit which was reversed earlier (i.e., the debit in the CENVAT Account is not made towards any duty payment)?

ICMC Corporation Ltd.v CESTAT, CHENNAI 2014 (302) E.L.T. 45 (Mad.)

The High Court held that this process involves only an account entry reversal and factually there is no outflow of funds from the assessee by way of payment of duty. Thus, filing of refund claim under section 11B of the Central Excise Act, 1944 is not required. Further, it held that on a technical adjustment made, the question of unjust enrichment as a concept does not arise.

14. Does the principle of unjust enrichment apply to State Undertakings?

CCEx v. Superintending Engineer TNEB 2014 (300) E.L.T. 45 (Mad.)

The High Court relied on the decision of the Constitution Bench of the Apex Court rendered in the case of *Mafatlal Industries Ltd.* v. *Union of India 1997 (89) E.L.T. 247 SC*. The Supreme Court in the said case held as under:

"The doctrine of unjust enrichment is a just and salutory doctrine. No person can seek to collect the duty from both ends. In other words, he cannot collect the duty from his purchaser at one end and also collect the same duty from the State on the ground that it has been collected from him contrary to law. The power of the Court is not meant to be exercised for unjustly enriching a person. The doctrine of unjust enrichment is, however,

inapplicable to the State. State represents the people of the country. No one can speak of the people being unjustly enriched."

Decision: The High Court followed the decision of the Apex Court and held that the concept of unjust enrichment is not applicable as far as State Undertakings are concerned and to the State.

Appeals

15. In a case where an appeal against order-in-original of the adjudicating authority has been dismissed by the appellate authorities as time-barred, can a writ petition be filed to High Court against the order-in-original?

Khanapur Taluka Co-op. Shipping Mills Ltd. v. CCEx. 2013 (292) E.L.T. 16 (Bom.)

Facts of the case: In this case, assessee filed the appeal to the Commissioner (Appeals) and then further appeal to CESTAT against the order-in-original passed by the adjudicating authority. However, the appeals were dismissed as time-barred.

Point of dispute: The assessee filed a writ petition to the High Court challenging the correctness of the order-in-original. It further contended that although the appeal filed by it had been dismissed by the appellate authorities on the ground that same had been time-barred, it was entitled to challenge the correctness of the order-in-original in a writ petition.

Decision: The High Court referred to the case of *Raj Chemicals v. UOI 2013 (287) ELT 145 (Bom.)* wherein it held that where the appeal filed against the order-in-original was dismissed as time-barred, the High Court in exercise of writ jurisdiction could neither direct the appellate authority to condone the delay nor interfere with the order passed by the adjudicating authority. Consequently, it refused to entertain the writ petition in the instant case.

Note: Gujarat High Court has taken a contrary view in case of Texcellence Overseas v. Union of India 2013 (293) ELT 496 (Guj.) as reported below:-

16. Can the High Court condone the delay - beyond the statutory period of three months prescribed under section 35 of the Central Excise Act, 1944 - in filing an appeal before the Commissioner (Appeals)?

Texcellence Overseas v. Union of India 2013 (293) ELT 496 (Guj.)

Facts of the case: The petitioner was granted a refund by way of order-in-original and the same was also upheld by the CESTAT. However, a fresh show cause notice was issued on the ground that refund was erroneously granted. The show cause notice, this time was adjudicated in favour of the Department. The petitioner challenged this order before Commissioner (Appeals) five months after the said order was passed. As per section 35 of the Central Excise Act, 1944, an appeal needs to be filed with the Commissioner (Appeals) within 60 days from the date of the communication of the order sought to be appealed against. However, the Commissioner (Appeals) is empowered to

condone the delay for a period of 30 days if he is satisfied with the sufficiency of the cause of the delay. Therefore, the Commissioner (Appeals) and Tribunal (when the matter was brought before it) rejected the appeal on the grounds of limitation as the same was filed beyond three months from the date of the impugned order.

Observations of the Court: The High Court observed that none of the appellate authorities decided the question on merit after the second round of litigation began and therefore, the question of merger* would not arise until the matter is decided on merits. Treating these circumstances as extraordinary, the High Court sought to uphold the petitioner's challenge to the impugned order.

The High Court noted that Department did not dispute the fact that the petitioner had extremely good case on merit. Further, the petitioner, while challenging the impugned order before the Commissioner (Appeals), had also preferred an application for condonation of delay and substantiated the same with sufficient and acceptable grounds. The High Court, thus, concluded that the petitioner had sufficiently explained the delay from the very beginning, though the appellate forums were bound by the law on the issue.

Decision: The High Court opined that since the total length of delay was very small and the case had extremely good ground on merits to sustain, its non interference at that stage would cause gross injustice to the petitioner. Thus, the High Court, by invoking its extraordinary jurisdiction, quashed the order which held that refund was erroneously granted. The High Court held that such powers are required to be exercised very sparingly and in extraordinary circumstances in appropriate cases, where otherwise the Court would fail in its duty if such powers are not invoked.

Note: The principle enunciated in the afore-mentioned case is that the High Court has extraordinary powers to interfere in appropriate cases even while upholding the contention that there is statutory limitation to which delay can be condoned by the authorities. If an aggrieved person knocks the door of the High Court seeking redressal under writ jurisdiction to obviate extraordinary hardship and injustice, such plea can be entertained even beyond the period of limitation.

What is Doctrine of Merger?

The doctrine of merger is neither a doctrine of constitutional law nor a doctrine which is recognised statutorily. It is the fusion or absorption of a lesser right with a greater right; or merger of the order of lower appellate authority [e.g. Commissioner (Appeals]) with the order of a higher appellate authority [e.g. CESTAT]. Since, there cannot be more than one operative order governing the same subject-matter at one and the same time, the judgment of a lower appellate authority, if subjected to an examination by the higher appellate authority, ceases to have existence in the eye of law and is treated as being superseded by the judgment of the higher appellate authority. In other words, the judgment of the lower appellate authority loses its identity by its merger with the judgment of the higher appellate authority.

However, the doctrine of merger cannot be applied universally. It cannot be said that wherever there are two orders, one by the lower appellate authority and the other by a higher appellate authority, passed in an appeal or revision, there is a fusion or merger of two orders irrespective of the subject-matter of the appellate or revision order and the scope of the appeal or revision contemplated by the particular statute. The application of the doctrine depends on the nature of the appellate or revision order in each case and the scope of the statutory provisions.

17. Can delay in filing appeal to CESTAT for the reason that the person dealing with the case went on a foreign trip and on his return his mother expired, be condoned?

Habib Agro Industries v. CCEx. 2013 (291) E.L.T. 321 (Kar.)

Facts of the case: In this case, the application for filing appeal to CESTAT was filed with a delay of 45 days. The reason for the delay was that the authorised representative who dealt with the case had gone abroad for about a month. On his return, his mother had expired. After attending obsequies, the appeal was filed. However, the Tribunal dismissed the said application holding that there was no sufficient cause shown for condonation of delay.

Decision: The High Court observed that there did not appear to be any deliberate latches or neglect on the part of the authorised representative to file the appeal. It held that the reason for delay in filing appeal to CESTAT, that the person dealing with the case went on a foreign trip and on his return his mother expired, could not be considered as unreasonable for condonation of delay.

18. Which remedy is available against a pre-deposit order passed by CESTAT under section 35F of Central Excise Act, 1944/section 129E of Customs Act, 1962; is it an appeal to High Court under section 35G of Central Excise Act, 1944/section 130 of Customs Act, 1962 or a writ petition before High Court?

Metal Weld Electrodes v. CESTAT 2014 (299) ELT 3 (Mad.)

As per section 35G(1)/130(1) of the relevant Acts, an appeal lies to the High Court from **every order** passed in appeal by the Appellate Tribunal (not being an order relating, among other things, to the determination of any question having a relation to the rate of duty of excise/customs or to the value of goods for purposes of assessment), if the High Court is satisfied that the case involves a substantial question of law. Sub-section (2) of section 35G/130 *inter alia* provides that the Commissioner of Central Excise or the other party aggrieved by **any order** passed by the Appellate Tribunal may file an appeal to the High Court.

The assessee contended that only a writ petition, and not an appeal, can be filed against the pre-deposit orders of CESTAT on account of following reasons:

(i) Only an order determining the **final issues** arising between the parties in the appeal before the Appellate Tribunal is appellable before the High Court. However, a pre-deposit order is an **interim order not passed in appeal** but in appeal proceedings.

The term **"every order"** (as mentioned above) does not include interim order under section 35F/129E.

(ii) A substantial question of law cannot arise out of an interlocutory order that deals only with *prima facie* nature of the case; it can arise only from the order, which finally decides the rights of the parties in controversy.

(iii) A period of 180 days have been granted in the statute for filing an appeal. However, very short time is granted to comply with the pre-deposit orders and therefore, such order cannot be construed as an order to be appealed against.

The assessee submitted that when a remedy is not available under the Act, remedy under Article 226 of the Constitution of India (writ petition) has to be permitted.

Observations of the Court: The High Court made the following significant observations:

(i) There is a vital difference between sub-sections (1) and (2) of section 35G/130. While sub-section (1) reads that an appeal shall lie to the High Court from **"every order passed in appeal by the Appellate Tribunal"**, sub-section (2) further contemplates that the Commissioner of Central Excise or the other party aggrieved may file an appeal to the High Court against **"any order passed by the Appellate Tribunal"**. The words **"in appeal"** is conspicuously absent under sub-section (2).

(ii) The legislature at its wisdom thought fit to enlarge the scope of appeal by providing sub-section (2) with a specific expression "any order passed by the Appellate Tribunal". The words "in appeal" cannot be confined to mean only final orders passed in appeal. Interim orders are also orders passed in appeal; they are not passed outside the scope of appeal or as independent or parallel orders.

(iii) Unless the statute specifically prohibits the filing of an appeal against interlocutory orders or there is an express provision saying only a final order of the Tribunal is appealable, the scope of filing appeal contemplated under sections 35G and 130 cannot be narrowed down or restricted.

(iv) Whether a substantial question of law would arise in case of interim orders would depend upon facts/circumstances of each case and there cannot be any uniform presumption that no substantial question of law would arise in all pre-deposit orders.

(v) The contention of the petitioners that granting of short time to comply with the pre-deposit orders would prevent them from filing an appeal before the High Court cannot be countenanced. Prescribing a period of limitation for filing an appeal does not mean that within such period of limitation, the said order cannot be put into operation unless a statutory bar is provided against doing so. Further, the party intending to file appeal need not wait till the last date of limitation to file appeal.

Decision: Finally, the High Court held that the order passed by the CESTAT in terms of section 35F of the Central Excise Act, 1944 or section 129E of the Customs Act, 1962 is appealable in terms of section 35G of the Excise Act, 1944 or section 130 of the Customs Act, 1962.

Note: Supreme Court in the case of Raj Kumar Shivare's v. Assistant Director, Directorate of Enforcement 2010 (253) ELT 3 SC had held that writ petition is not ordinarily maintainable to challenge an order of the Tribunal. Though the said decision was rendered in context of Foreign Exchange Management Act, 1999 (FEMA), the High Court in the above case clarified that the ratio laid down in the said case would apply in respect of the cases covered under Central Excise Act and Customs Act also. Recently the Andhra Pradesh High Court in M/s Patel Engineering Ltd v. CCEx Cus & ST 2013-TIOL-997-HC-AP-ST has also followed the Madras High Court decision and has held that an order passed under section 35F is appealable under section 35G and that a writ petition against the same is not maintainable.

Exemption based on value of clearances (SSI)

19. Where clearances of a dubious company are clubbed with clearances of the original company, whether penalty can be imposed on such dubious company if all the clearances have been made by the original company?

CCEx v Xenon 2013 (296) ELT 26 (Jhar.)

Facts of the case: In the instant case, the Department found that the assessee had set up a dubious company of another company to mis-utilize the benefits of SSI exemption notification. It was established that the dubious company did not manufacture and clear any goods and that all the transactions shown by it were, in fact, the transactions undertaken by the original company. Thus, the manufacture and clearances shown by the two units separately were clubbed together as manufacture and clearances of a single unit viz. original company in terms of the applicable SSI exemption notification and the differential duty and penalty was imposed on such original company. At the same time, penalty was also imposed on the dubious company.

Point of dispute: The issue which came up before the High Court was whether separate penalty could be levied on the dubious company, as the same was, in fact, a non-existent company. The Department contended that since there existed two companies, which had different registrations and availed separate SSI exemptions, the dubious company could not be said to be a non-existent company. Therefore, the said dubious company should also be liable to penalty for taking wrong benefits of the SSI exemption.

Observations of the Court: The High Court observed that merely because the dubious company was in existence, it could not be said that it undertook the transactions. Its existence could not itself create any liability; the liability could arise only when the transactions were actually undertaken by the dubious company. If the transactions shown by the dubious company were not undertaken by the same but by the original company, then such transactions would be taken to be the transactions of the original company and clubbed with the transactions of the original company.

Decision: The High Court held that when it had been established that dubious company did not undertake any transactions, penalty could not be levied on the same for the transactions undertaken by the original company. The High Court emphasized that penalty could not be imposed upon the company who did not undertake any transaction.

Note: Though the above-mentioned case relates to the old provisions of law, the ratio of the judgment will also hold good in the context of present position of law as applicable to SSI exemption.

Notifications, departmental clarifications and trade notices

20. Where a circular issued under section 37B of the Central Excise Act, 1944 clarifies a classification issue, can a demand alleging misclassification be raised under section 11A of the Act for a period prior to the date of the said circular?

S & S Power Switch Gear Ltd. v. CCEx. Chennai-II 2013 (294) ELT 18 (Mad.)

Observations of the Court: The High Court observed that similar issue had been considered by the Supreme Court in the case of *H.M. Bags Manufacturer* v. *Collector of Central Excise 1997 (94) ELT 3 (SC)* wherein the Apex Court held that a demand under section 11A of the Act cannot be raised for any date prior to the date of the Board Circular and the time-limit as provided under section 11A of the Act is not available to the Department.

Decision: The High Court, thus, held that once reclassification Notification/Circular is issued, the Revenue cannot invoke section 11A of the Act to make demand for a period prior to the date of said classification notification/circular.

Note: The principle enunciated in this judgment is that a Departmental Circular, issued under section 37B of the Central Excise Act, 1944, which clarifies a classification issue, can only apply prospectively from the date of the Circular and that the same cannot be applied retrospectively. In other words, demands cannot be raised for mis-classification i.e., not following the classification specified by the said Circular, for a period prior to the date of the Circular.

Section 37B – Instructions to Central Excise Officers: *The Central Board of Excise and Customs constituted under the Central Boards of Revenue Act, 1963, may, if it considers it necessary or expedient so to do for the purpose of uniformity in the classification of excisable goods or with respect to levy of duties of excise on such goods, issue such orders, instructions and directions to the Central Excise Officers as it may deem fit, and such officers and all other persons employed in the execution of this Act shall observe and follow such orders, instructions and directions of the said Board :*

Provided that no such orders, instructions or directions shall be issued—

a) so as to require any Central Excise Officer to make a particular assessment or to dispose of a particular case in a particular manner; or

b) so as to interfere with the discretion of the Commissioner of Central Excise (Appeals) in the exercise of his appellate functions.

Settlement Commission

21. (i) Where a settlement application filed under section 32E(1) of the Central Excise Act, 1944 (herein after referred to as 'Act') is not accompanied with the additional amount of excise duty along with interest due, can Settlement

Commission pass a final order under section 32F(1) rejecting the application and abating the proceedings before it ?

(ii) In the above case, whether a second application filed under section 32E(1), after payment of additional excise duty along with interest, would be maintainable?

Vadilal Gases Limited v Union of India 2014 (301) E.L.T. 321 (Guj.)

Observations of the Court: The High Court observed as under:

(i) Clause (d) of the first proviso to sub-section (1) of section 32E of the Act clearly lays down that no application under section 32E(1) shall be made unless the applicant has paid the additional amount of excise duty accepted by him along with interest due under section 11AB. Therefore, if an application is made without complying with the first proviso, it would be defective and not maintainable.

(ii) Settlement Commission in its discretion may allow time to the applicants to remove the defects or may direct that the applications be returned. Such discretionary power must be deemed to have been conferred on Settlement Commission.

(iii) Under section 32F(1) only valid applications which do not suffer from any bar created by the first proviso to section 32E(1) can be considered and decided according to the procedure provided in the section. Therefore, the applications which are defective and non-maintainable in terms of the first proviso to section 32E(1) cannot be decided or rejected or declared to have abated under section 32F(1).

(iv) Rejection of application cannot be taken as amounting to a final order, as that would render the mandatory bar created by clause (d) of proviso to section 32E(1) nugatory, redundant and otiose. Order rejecting the application for non-compliance with clause (d) of proviso to section 32E(1) would amount to administrative/technical order and it would not bar the second application filed by the petitioner. In other words, principle of *res judicata* would not apply as matter was not determined on merits.

(v) Moreover, second application would not be barred under section 32-O as no direction had been issued under section 32L (the application was rejected as not entertainable).

Decision: High Court held that since the earlier application was dismissed on technical defect for non-compliance of the provisions of clause (d) of the proviso to section 32E(1) of the Act and the same was not considered and decided on merits, the second application filed after depositing the additional excise duty and interest would be maintainable.

Notes: Res judicata means the principle that a matter may not, generally, be relitigated once it has been judged on the merits.

The relevant extracts of provisions of section 32-O and 32L of the Act are given hereunder:

Section 32-O: Bar on subsequent application for settlement in certain cases

Where,

(i) an order of settlement passed under sub-section (5) of section 32F provides for the imposition of a penalty on the person who made the application under section 32E for settlement, on the ground of concealment of particulars of his duty liability; or

(ii) after the passing of an order of settlement under the said sub-section (5) of section 32F in relation to a case, such person is convicted of any offence under this Act in relation to that case; or

(iii) the case of such person is sent back to the Central Excise Officer having jurisdiction by the Settlement Commission under section 32L,

then, he shall not be entitled to apply for settlement under section 32E in relation to any other matter.

Section 32L: Power of Settlement Commission to send a case back to the Central Excise Officer

The Settlement Commission may, if it is of opinion that any person who made an application for settlement under section 32E has not co-operated with the Settlement Commission in the proceedings before it, send the case back to the Central Excise Officer having jurisdiction who shall thereupon dispose of the case in accordance with the provisions of this Act as if no application under section 32E had been made.

SERVICE TAX

Basic concepts of service tax

22. Can service tax be levied on the services rendered in connection with a chit fund business?

Delhi Chit Fund Association v. UOI 2013 (30) S.T.R. 347 (Del.)

In this case, the petitioner is an association of chit fund companies based in Delhi. As per the petitioner, services rendered in connection with chit fund business are not taxable. As per the definition of service under section 65B(44), transaction in money is not a service. Further, the exclusionary part of the said definition excludes a transaction in money. Since, a provision cannot exclude something from the definition unless it is included in the definition, the intention of legislature would have been to exclude services rendered in relation to transaction in money. Therefore, the chit fund business being a transaction in money, the services rendered in connection with the said business are excluded from the definition.

Explanation 2 in the said section further provides that the only service in relation to a transaction in money or actionable claim, which is taxable, is the activity relating to the use of money or its conversion from one form, currency or denomination to another for which a separate consideration is charged. Resultantly, all other services rendered in connection with a transaction in money or actionable claim, including the services rendered by the foreman of a chit business, stand excluded from the definition.

It further submitted that since chit fund business is not a service, *Notification No. 26/2012 dated 30.06.2012* granting an abatement of 30% to services provided in relation to chit should be quashed as question of exempting a part of the consideration received for the services in chit fund business could not arise when the law provided that such services were not taxable at all.

Observations of the Court: The High Court observed that as per the opening words of the definition of 'service', an activity cannot be charged with service tax unless following four aspects or characteristics are present:-

(i) the person who provides the service,

(ii) the person who receives the service,

(iii) the actual rendering of the service and

(iv) the consideration for the service.

A 'mere transaction in money' cannot be considered as 'service' as it lacks the above four constituent elements. The High Court elucidated that even though 'mere transaction in money' is not service in the first place, the intention of the legislature in excluding it from the definition might be that the legislature deemed it fit, *ex abundanti cautela,* to exclude it.

A clue to proper interpretation of the exclusionary part of the definition is embedded in Explanation 2 which provides that except an activity for which a separate consideration is charged and which relates to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination to another form, currency or denomination, all other cases of transaction in money shall stand excluded from the charge of service tax, including the consideration charged for the services of a foreman in a chit business.

Decision: The High Court inferred that since in a chit fund business, the subscription is tendered in any one forms of money as defined under section 65B(33), it would be a transaction in money and would fall in the exclusionary part of the definition. Otherwise also, in view of Explanation 2 read along with the exclusionary part, the services rendered by the foreman of the chit business for which a separate consideration is charged would be out of the clutches of the definition. Thus, either way, the services of a foreman of a chit business do not constitute a taxable service.

Consequently, the High Court quashed *Notification No. 26/2012-S.T. dated 20.06.2012* to the extent of the entry in serial No. 8 thereof.

Note: A brief account of the operations of a chit fund business is provided hereunder:-

Lets suppose 50 persons, each contributing ₹ 1,000/- per month, have come together to organize a chit for a period of 50 months. Number of subscribers should be equal to number of months for which chit would operate. At the end of each month, an amount of ₹ 50,000/- (₹ 1,000/- × 50) would be available in the kitty of the chit fund. The said

amount is put to auction and those subscribers who are interested in drawing the money early because of their needs may participate in the auction.

The auction is organized by a foreman who conducts its proceedings. The successful bidder who is normally the person who offers the highest discount is given the chit amount. From this discount amount, after deducting a fixed amount representing the commission payable to the "foreman", balance becomes the dividend which is to be distributed to all the subscribers. The auction would be repeated in the subsequent months and the same procedure is followed. Any subscriber who delays the bidding or does not bid at all stands to gain the maximum discount.

Service tax procedures

23. Whether tax is to be deducted at source under section 194J of the Income-tax Act, 1961 on the amount of service tax if it is paid separately and is not included in the fees for professional services/technical services?

CIT v. Rajasthan Urban Infrastructure 2013 (31) STR 642 (Raj.)

The High Court held that if as per the terms of the agreement between the payer and the payee, the amount of service tax is to be paid separately and is not included in the fees for professional services or technical services, the service tax component would not be subject to TDS under section 194J of the Income-tax Act, 1961.[1]

Note: Section 194J of the Income-tax Act, 1961 provides for deduction of income tax equal to 10% of any sum paid as fees for professional services/technical services, by any person, not being an individual or HUF, who is responsible for paying such sum to a resident, at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

24. Is rule 5A(2) of the Service Tax Rules, 1994 *ultra vires* the Finance Act, 1994?

A.C.L. Education Centre (P) Ltd. v. UOI 2014 (33) S.T.R. 609 (All.)

Facts of the case: Central Excise Department issued intimation under rule 5A(2) of the Service Tax Rules, 1994, demanding necessary documents from the petitioners for making a reference to conduct an audit. The petitioners objected and also challenged the *vires* of rule 5A(2), *inter alia,* on the ground that the provisions of rule 5A(2) are contrary to the provisions of section 72A of the Finance Act, 1994.

The petitioner further submitted that as per rule 5A(2), assessee is required to provide record for audit to the audit party deputed by Commissioner or by CAG for carrying out audit of the records of assessee. However, there is no provision in the Finance Act, 1994 which empowers Central Government to frame rules in respect of the audit of the accounts of private person or companies or firms who are paying service tax by self assessment. Thus, rule 5A(2) empowering the departmental officers as auditor is arbitrary, illegal and *ultra vires* to the provisions of the Finance Act, 1994.

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[1] *Students may note that the view taken in the said judgment has been incorporated by CBDT in Circular No. 1/2014 dated 13.01.2014.*

Observations of the Court: The High Court observed that in case of private assessee, the Commissioner will refer the matter to an officer or Chartered Accountant, to collect the material for the purpose of audit. Thus, the material can be collected either by the officer authorized by the Commissioner or by the auditor himself, but audit will be conducted by the audit party headed by the Chartered Accountant/Cost Accountant, as deputed by the Commissioner. The manner for conducting the audit is as per the accounting standards provided by the Institute of Chartered Accountant of India and the audit report will be made available to the assessee, as per law.

So, it is pious duty of every assessee to make available, to the authorized officer/ audit party, the records, trial balance and income-tax audit report, if any, for the scrutiny of the officer or the audit party.

Decision: In the light of the aforesaid discussion, the High Court held that section 5A(2) is not *ultra vires.* It is in consonance with section 72A of the Finance Act, 1994.

Note: Rule 5A(2) of the Service Tax Rules, 1994 stipulates that every assessee shall, on demand, make available to an officer authorised by the Commissioner or the audit party deputed by the Commissioner or CAG, within a reasonable time not exceeding 15 working days from the day when such demand is made, or such further period as may be allowed by such officer or the audit party, as the case may be, -

(i) the records as mentioned in rule 5(2);

(ii) trial balance or its equivalent; and

(iii) the income-tax audit report, if any, under section 44AB of the Income-tax Act, 1961,

for the scrutiny of the officer or audit party, as the case may be.

Further, as per section 72A, the Commissioner of Central Excise may direct a person to get his accounts audited by a chartered accountant or cost accountant nominated by him, to the extent and for the period as may be specified by him in certain specified cases. Chartered accountant or cost accountant would submit an audit report duly signed and certified by him to the said Commissioner and shall give an opportunity of being heard to such person (whose accounts are being audited) in respect of any material gathered on the basis of the audit.

Demand, adjudication and offences

25. Is it justified to recover service tax during search without passing appropriate assessment order?

Chitra Builders Private Ltd. v. Addl. Commr. of CCEx. & ST 2013 (31) STR 515 (Mad.)

Facts of the case: A search was conducted at a branch office of the petitioner company and at the residence of director wherein a sum of ₹ 2 crores was collected by the Department from the petitioner. The petitioner filed a writ petition requesting the Court to direct the Department to return the money so collected.

Points of dispute: The petitioner's major contentions were as follows:-

(i) Since the petitioner was not liable to pay service tax, collection of said amount from the petitioner, was arbitrary and illegal.

(ii) Department had no jurisdiction to search the premises of the petitioner, or of its Directors, as it was neither carrying on its business nor was not registered, within the jurisdiction of the Commissionerate who had issued the search warrant.

(ii) The petitioner further alleged that as per a deposition recorded under coercion on the date of search, the sum of ₹ 2 crores had been paid to the Department, voluntarily, as part of the arrears of service tax due from the company. However, tax could not be collected from the petitioner without a proper assessment order being passed, in accordance with the procedures established by law.

The Department counterargued that since the petitioner was actually liable to pay a larger amount of service tax, it could not claim for return of the said amount which was paid by him during the search as the said amount was paid by it voluntarily and not under coercion to mitigate the offence committed by it, under section 73(3) of the Finance Act, 1994.

Observations of the Court: The Court observed that it is a well settled position in law that no tax can be collected from the assessee, without an appropriate assessment order being passed by the authority concerned and without following the procedures established by law. However, in the present case, no such procedures had been followed.

Further, although Department had stated that the said amount had been paid voluntarily by the petitioner in respect of its service tax liability; it had failed to show that the petitioner was actually liable to pay service tax.

Decision: Thus, the High Court held that the amount collected by Department, from the petitioner, during the search conducted, could not be held to be valid in the eye of law, and directed the Department to return to the petitioner the sum of ₹ 2 crores, collected from it, during the search conducted.

26. Can extended period of limitation be invoked for mere contravention of statutory provisions without the intent to evade service tax being proved?

Infinity Infotech Parks Ltd. v. UOI 2013 (31) STR 653 (Cal.)

The High Court observed that as per proviso to section 73(1), extended period of limitation can be invoked if the service tax has not been levied or paid or has been short-levied or short-paid or erroneously refunded by reason of fraud or collusion or wilful mis-statement or suppression of facts or contravention of any of the provision of Chapter V or of rules made thereunder with the intent to evade the payment of service tax.

Decision: It held that mere contravention of provision of Chapter V or rules framed thereunder does not enable the service tax authorities to invoke the extended period of

limitation. The contravention necessarily has to be with the intent to evade payment of service tax.

27. Would service tax collected but not deposited prior to 10.05.2013 be taken into consideration while calculating the amount of ₹50 lakh as contemplated by clause (ii) of section 89(1) of the Finance Act, 1994?

Kandra Rameshbabu Naidu v. Superintendent (A.E.), S.T., Mumbai-II 2014 (34) S.T.R. 16 (Bom.)

Facts of the case: The assessee was arrested on 22.01.2014 on the ground that he had collected service tax of ₹ 2.59 crores during the period between financial years 2010-11 and 2013-14, but had deposited only ₹ 15 lakh with the Government.

The assessee did not dispute the liability to pay the service tax to the Government. However, he contended that only the amount collected between 10.05.2013 and 21.07.2013 (six months prior to his arrest) should be considered while calculating the amount of ₹ 50 lakh as contemplated by clause (ii) of section 89(1) of the Finance Act, 1994. He submitted that since penal provisions could not be made effective retrospectively, amended section 89(1) and newly introduced sections 90 and 91 of the Finance Act, 1994 (as introduced by the Finance Act, 2013) could not be made effective for a period prior to 10.05.2013 [i.e. the date on which Finance Act, 2013 came into effect]. Assessee further submitted that since the amount collected between 10.05.2013 and 21.07.2013 was much less than ₹ 50 lakh, provisions of amended clause (ii) of section 89(1) were not applicable in his case.

Revenue contended that since failure to deposit service tax with Central Government after collecting it from the customers was a continuing offence, entire amount of arrears of service tax was required to be construed as liable to be deposited with the Central Government when it became due and it being a continuing offence, the assessee was liable to deposit the entire arrears which was more than ₹ 50 lakh.

Decision: The High Court held that since the said offence is a continuing offence, entire amount of service tax outstanding [which is required to be deposited with the Central Government] as on 10.05.2013, would be taken into consideration while calculating the amount of ₹ 50 lakh as contemplated by section 89(1)(ii) of the Finance Act, 1994.

Note: In the aforesaid case law, the assessee collected service tax but did not deposit it for a period between financial years 2010-11 and 2013-14. The relevant legal provisions pertaining to said default during this period are as follows:-

Prior to 08.04.2011, in case of failure to pay service tax to the credit of the Central Government, only interest and penal provisions were attracted.

With effect from 08.04.2011, prosecution provisions were introduced in service tax law by the Finance Act, 2011 vide section 89 whereby, inter alia, said offence (where the amount involved exceeded ` 50 lakh) was also made punishable with a maximum imprisonment of 3 years. Further, it was a non-cognizable and bailable offence.

With effect from 10.05.2013, section 89(1) of the Finance Act, 1994 was amended by the Finance Act, 2013 to enhance the punishment for said offence (where the amount involved exceeds ` 50 lakh) from a maximum imprisonment of 3 years to 7 years. Further, new sections 90 and 91 were introduced to make said offence cognizable and liable to arrest provisions.

28. Whether best judgment assessment under section 72 of the Finance Act, 1994 is an ex-parte* assessment procedure?

N.B.C. Corporation Ltd. v. Commissioner of Service Tax 2014 (33) S.T.R. 113 (Del.)

The High Court held that section 72 could per se not be considered as an ex parte assessment procedure as ordinarily understood under the Income-tax Act, 1961. Section 72 mandates that the assessee must appear and must furnish books of account, documents and material to the Central Excise Officer before he passes the best judgment assessment order. Thus, said order is not akin to an ex parte order.

Such an order will be akin to an ex parte order, when the assessee fails to produce records and the Central Excise Officer has to proceed on other information or data which may be available.

**Note: The term ex-parte means of the one part; from one party. This term is applied in law to a proceeding by one party in the absence of, and without notice to, the other.*

Other provisions

29. Can the Committee of Commissioners review its decision taken earlier under section 86(2A) of the Finance Act, 1994, at the instance of Chief Commissioner?

C.C.E. & S.T. (LTU), Bangalore v. Dell Intl. Services India P. Ltd. 2014 (33) S.T.R. 362 (Kar.)

The Karnataka High Court held that once the Committee of Commissioners, on a careful examination of the order of the Commissioner (Appeals), did not differ in their opinion against the said order of the Commissioner (Appeals) and decide to accept the said order, the matter ends there. The said decision is final and binding on the Chief Commissioner also. The Chief Commissioner is not vested with any power to call upon the Committee of Commissioners to review its order so that he could take decision to prefer an appeal. Such a procedure is not contemplated under law and is without jurisdiction.

Note: The aforesaid case law analyses sub-section (2A) of section 86 of the Finance Act, 1994, which provides that a Committee of Commissioners may, if it objects to any order passed by the Commissioner of Central Excise (Appeals) under section 85, direct any Central Excise Officer to appeal on its behalf to the Appellate Tribunal against the order. Further, where the Committee of Commissioners differs in its opinion against the order of the Commissioner of Central Excise (Appeals), it shall state the point or points on which it differs and make a reference to the jurisdictional Chief Commissioner who shall, after considering the facts of the order, if is of the opinion that the order passed by the

Commissioner of Central Excise (Appeals) is not legal or proper, direct any Central Excise Officer to appeal to the Appellate Tribunal against the order.

30. Whether the question of chargeability or levy of service tax on a particular activity would be covered within the term "determination of any question having relation to rate of service tax or value of a service for the purpose of assessment" as contemplated under sections 35G and 35L of the Central Excise Act, 1944?

Commissioner of Service Tax v. Ernst & Young Pvt. Ltd. 2014 (34) S.T.R. 3 (Del.)

Point of dispute: The precise and significant issue which arose for consideration of the High Court was whether chargeability or levy of service tax on a particular activity would be covered within the term ***'determination of any question having relation to rate of duty of excise (or service tax) or value of goods (or service) for the purpose of assessment'*** as contained in sections 35G and 35L of the Central Excise Act, 1944, so as to decide whether the order of Tribunal relating to such issue is appealable to High Court or Supreme Court.

Observations of the Court: The High Court observed that determination of any question relating to rate of tax would necessarily directly and proximately involve the question, whether activity falls within the charging section and service tax is leviable on the said activity. The reason for the same is that in case service tax is not to be leviable under the charging section, rate of tax will be nil.

Further, all assessments necessarily have to determine and decide the rate of tax after determining and deciding whether or not activity is chargeable to tax or tax can be levied. Assessment of the assessee would decide the rate of tax applicable once it is held that the activity is chargeable to service tax. The words 'rate of tax' would include the question whether or not the activity is exigible to tax under a particular or specific provision.

Decision: Thus, the High Court held that question of chargeability or levy of service tax on a particular activity would be covered within the term "determination of any question relating to rate of service tax or value of a service for the purpose of assessment".

Note: Section 35G of the Central Excise Act, 1944 containing the provisions in respect to appeals to High Court and section 35L of the Act containing the provisions in respect to appeals to Supreme Court are applicable in case of service tax vide section 83 of the Finance Act, 1994. Section 35G read along with section 35L provides that an appeal against ***"an order of Tribunal relating to the determination of any question having a relation to the rate of duty of excise/service tax or to the value of goods/service tax for purposes of assessment"*** *shall not lie to High Court. Appeal against such an order can be filed to Supreme Court.*

The High Court, in the aforesaid case, has interpreted as to whether the question of chargeability or levy of service tax on a particular activity would be covered within the said term so as to determine if the order of Tribunal relating to such issue would be appealable to High Court or Supreme Court.

CUSTOMS

Demand and Appeals

31. Is the adjudicating authority required to supply to the assessee copies of the documents on which it proposes to place reliance for the purpose of re-quantification of short-levy of customs duty?

Kemtech International Pvt. Ltd. v. CCus. 2013 (292) E.L.T. 321 (S.C.)

The Apex Court elucidated that for the purpose of re-quantification of short-levy of customs duty, the adjudicating authority, following the principles of natural justice, should supply to the assessee all the documents on which it proposed to place reliance. Thereafter the assessee might furnish their explanation thereon and might provide additional evidence, in support of their claim.

32. Can delay in filing appeal to CESTAT due to the mistake of the counsel of the appellant, be condoned?

Margara Industries Ltd. v. Commr. of C. Ex. & Cus. (Appeals) 2013 (293) E.L.T. 24 (All.)

In this case, CESTAT rejected the appellant's application for condonation of delay in filing the appeal before CESTAT on the ground that the reasons given for filing the appeal beyond stipulated time were not convincing. The Counsel of the appellant filed his personal affidavit stating that the appeal had been filed with a delay due to his mistake.

Decision: The High Court held that the Tribunal ought to have taken a lenient view in this matter as the appellant was not going to gain anything by not filing the appeal and the reason for delay in filing appeal as given by the appellant was the mistake of its counsel who had also filed his personal affidavit.

33. Can a writ petition be filed against an order passed by the CESTAT under section 9C of the Customs Tariff Act, 1975?

Rishiroop Polymers Pvt. Ltd. v. Designated Authority 2013 (294) E.L.T. 547 (Bom.)

Facts of the case: In the instant case, the CESTAT upheld a notification issued by the Central Government imposing definitive anti-dumping duty on certain products originating from specified countries pursuant to the findings recorded by the Designated Authority in a review of anti-dumping duty. The assessee filed a writ petition under Article 226 of the Constitution to challenge the said order passed by the CESTAT under section 9C of the Customs Tariff Act, 1975.

Point of dispute: The Department contended that an appeal, and not a writ petition, would lie against the order passed by the CESTAT.

Observations of the Court: The High Court observed that section 9A(8) of the Customs Tariff Act, 1975 specifically incorporates all the provisions of the Customs Act, 1962 relating to appeal as far as may be, in their application to the anti-dumping duty chargeable under section 9A. The order of the CESTAT passed in appeal would, therefore, clearly be subject to appeal, either to this Court under section 130 or to the

Supreme Court under section 130E of the Customs Act, 1962 if the appeal relates to the rate of duty or to valuation of goods for the purposes of assessment.

The assessee submitted that under section 130(2), an appeal can be filed by the Commissioner of Customs or the other party. However, in case of anti-dumping duty, Commissioner of Customs would have no occasion to file an appeal since proceedings are against the designated authority.

Against this submission, the High Court clarified that since appellate provisions of the Customs Act, 1962 have been incorporated in section 9A(8) of the Customs Tariff Act, 1975, they necessarily apply in a manner that would make the same intelligible and workable.

Decision: The High Court, therefore, held that it would not be appropriate for it to exercise the jurisdiction under Article 226 of the Constitution, since an alternate remedy by way of an appeal was available in accordance with law. The High Court thus, dismissed the petition leaving it open to the assessee to take recourse to the appellate remedy.

Note: The statutory provisions discussed in the above case law are given hereunder:

Section 9C(1) provides that an appeal against the order of determination or review thereof regarding the existence, degree and effect of any subsidy or dumping in relation to import of any article shall lie to the CESTAT constituted under section 129 of the Customs Act, 1962.

Section 9A(8) of the Customs Tariff Act, 1975 provides that the provisions of the Customs Act, 1962 and the rules and regulations made thereunder, including those relating to the date for determination of rate of duty, assessment, non-levy, short levy, refunds, interest, appeals, offences and penalties shall, as far as may be, apply to the duty chargeable under this section as they apply in relation to duties leviable under that Act.

Under section 130 of the Customs Act, 1962, an appeal can be filed to the High Court from every order passed in appeal by the Tribunal on a substantial question of law (not being an order relating, among other things, to the determination of any question having a relation to the rate of duty of customs or to the value of goods for purposes of assessment). Section 130E(b) of the Customs Act provides that an appeal shall lie to the Supreme Court from an order passed by the Tribunal relating, among other things, to the determination of any question having a relation to the rate of duty of customs or to the value of goods for the purposes of assessment.

The afore-mentioned case reaffirms the settled position of law that writ petitions should not be entertained by the High Court under Article 226 of the Constitution of India when alternate remedies are available under the relevant statute. Courts have held that where a hierarchy of appeals is provided under the relevant statues, taxpayers must exhaust the statutory remedies before resorting to writ jurisdiction.

A writ is a directive from a higher court ordering a lower court or government official to take a certain action in accordance with the law. Writs are usually considered to be extraordinary remedies which are permitted only when there is no other adequate remedy, such as an appeal. In other words, a writ can be filed to contest a point that cannot be raised in an appeal.

Since, writ petitions are heard more quickly than appeals, the same are preferred by the assessees to secure a speedy review of some issue when the matter is urgent. Writ petition can also be filed when a final judgment has not yet been made in the lower court, but the party seeking the writ needs relief at once to prevent an injustice or unnecessary expense.

34. Can customs duty be demanded under section 28 and/or section 125(2) of the Customs Act, 1962 from a person dealing in smuggled goods when no such goods are seized from him?

CCus. v Dinesh Chhajer 2014 (300) E.L.T. 498 (Kar.)

Facts of the case: Department's investigation revealed that the assessee was dealing in smuggled goods though no smuggled goods were seized from the assessee. Duty was demanded from the assessee under section 28 and 125(2) of the Customs Act, 1962.

The Tribunal, when the matter was brought before it, held that duty can be demanded under section 28 only from the person chargeable with duty, who is the importer as defined under section 2(26) of the Act. Further, it held that if the smuggled goods are seized, confiscated and then an option to pay fine is given to the person from whose possession the goods were seized or to the owner of the goods, duty could be demanded from such person under section 125(2) of the Act, apart from fine and penalty. However, since in the instant case, the assessee was not the importer and goods were also not confiscated, the demand of duty on the assessee was unsustainable in law. The matter was then taken before the High Court.

Observations of the Court: The High Court observed as under:

(i) Section 28 applies to a case where the goods are imported by an importer and the duty is not paid in accordance with law, for which a notice of demand is issued on the person. In case of notice demanding duty under section 125(2), firstly the goods should have been confiscated and the duty demandable is in addition to the fine payable under section 125(1) in respect of confiscated goods. Thus, notices issued under sections 28 and 125(2) are not identical and fall into completely different areas.

(ii) The material on record disclosed that the assessee did not import the goods. He was not the owner of the goods but only a dealer of the smuggled goods and therefore, there was no obligation cast on him under the Act to pay duty. Thus, the notice issued under section 28 of the Act to the assessee is unsustainable as he is not the person who is chargeable to duty under the Act.

(ii) Since no goods were seized, there could not be any confiscation and in the absence of a confiscation, question of payment of duty by the person who is the owner of the goods or from whose possession the goods are seized, does not arise.

Decision: The High Court held that Tribunal was justified in holding that no duty is leviable against the assessee as he is neither the importer nor the owner of the goods or was in possession of any goods.

Refund

35. Whether interest is liable to be paid on delayed refund of special CVD arising in pursuance of the exemption granted vide *Notification No. 102/2007 Cus dated 14.09.2007?*

KSJ Metal Impex (P) Ltd. v. Under Secretary (Cus.) M.F. (D.R.) 2013 (294) ELT 211 (Mad.)

Facts of the case: Section 3(5) of the Customs Tariff Act, 1975 (CETA) provides for levy of special additional duty (special CVD) in addition to duty leviable under section 3(1) of the CETA to counterbalance sales tax, value added tax, local tax or any other charges. *Notification No. 102/2007 Cus dated 14.09.2007,* issued under section 25(1) of the Customs Act, 1962, grants exemption in respect of such special CVD subject to certain conditions. The exemption under the said notification is being granted by way of refund of the special CVD. In other words, exemption is not given *ab initio* but duty has to be paid first and thereafter, refund for the same needs to be claimed.

The assessee paid the special CVD and applied for the refund of the same under section 27 of the Customs Act, 1962 along with interest in pursuance of the above-mentioned notification. The Department, however, rejected the assessee's claim for the interest in view of paragraph 4.3 of *CBEC Circular No. 6/2008 Cus. dated 28.04.2008* which stipulated that interest could not be granted as *Notification No. 102/2007-Cus*. did not have any specific provision for payment of the same on refund of duty. The Department was of the view that since such refund of special CVD was an automatic refund by virtue of *Notification No. 102/2007 Cus,* it could not be considered as a refund under section 27 of the Customs Act, 1962 so as to claim interest under section 27A of the Customs Act, 1962.

Observations of the Court: The High Court was of the view that paragraph 4.3 of *Circular No. 6/2008 Cus* was totally inconsistent with the provisions of the Customs Act, 1962 and the CETA. The High Court observed that grant of exemption under section 25(1) of the Customs Act, 1962 is an independent exercise of power by the Central Government. *Notification No. 102/2007 Cus.,* issued in exercise of such powers, provides exemption by way of refund of special CVD and imposes certain conditions for seeking refund. However, the procedure for such refund will be governed in terms of section 3(8) of the CETA. Therefore, provisions of section 27 of the Customs Act, 1962 in relation to refund of duty [made applicable to refund of special CVD vide section 3(8) of CETA] would be applicable to such refund of special CVD also.

The High Court further stated that a conjoint reading of section 25(1) and section 27 of

the Customs Act makes it clear that the refund application of special CVD should only be filed in accordance with the procedure specified under section 27 of the Customs Act, 1962 and that there is no method prescribed under section 25 of the Customs Act, 1962 to file an application for refund of duty or interest.

Decision: The High Court, therefore, held that :

(i) It would be a misconception of the provisions of the Customs Act, 1962 to state that notification issued under section 25 of the Customs Act, 1962 does not have any specific provision for interest on delayed payment of refund.

(ii) When section 27 of the Customs Act, 1962 provides for refund of duty and section 27A of the Customs Act, 1962 provides for interest on delayed refunds, the Department cannot override the said provisions by a Circular and deny the right which is granted by the provisions of the Customs Act, 1962 and CETA.

(iii) Paragraph 4.3 of the *Circular No. 6/2008 Cus. dated 28.04.2008* being contrary to the statute has to be struck down as bad.

Note: This case clarifies that refund of special CVD arising as a result of exemption granted by way of exemption notification is governed under section 27 of the Customs Act, 1962 and thus, the provisions relating to payment of interest on delayed refund of duty as contained in section 27A of the Customs Act also become applicable in respect of delayed refunds of special CVD which is granted to give effect to the exemption contained in an exemption notification. Thus, it appears that the provisions applicable to normal refunds of duty/tax may apply to refunds of duty/tax arising as a result of exemption granted by way of exemption notifications as well.

Provisions relating to illegal import, illegal export, confiscation, penalty & allied provisions

36. Can penalty for short-landing of goods be imposed on the steamer agent of a vessel if he files the Import General Manifest, deals with the goods at different stages of shipment and conducts all affairs in compliance with the provisions of the Customs Act, 1962?

Caravel Logistics Pvt. Ltd. v. Joint Secretary (RA) 2013 (293) ELT 342 (Mad.)

Facts of the case: In the instant case, the steamer agent (assessee) authored Import General Manifest and acted on behalf of the master of the vessel (the person-in-charge) before Customs Authorities to conduct all affairs in compliance with the Customs Act, 1962. The assessee filed Import General Manifest, affixed the seal on the containers and took charge of the sealed containers. It also dealt with the customs department for appropriate orders that had to be passed in terms of section 42 of the Customs Act. Penalty under section 116 of the Customs Act was imposed by the Department on the steamer agent for short landing of goods.

Observations of the Court: The High Court noted that section 116 of the Act imposes a penalty on the **person- in-charge** of the conveyance *inter alia* for short-landing of the goods at the place of destination and if the deficiency is not accounted for to the

satisfaction of the Customs Authorities. Section 2(31) defines "person-in-charge" to *inter alia* mean in relation to a vessel, the master of the vessel. Section 148 provides that the agent appointed by the person-in-charge of the conveyance and any person who represents himself to any officer of customs as an agent of any such person-in-charge is held to be liable for fulfillment in respect of the matter in question of all obligations imposed on such person-in-charge by or under this Act and to penalties and confiscation which may be incurred in respect of that matter.

The High Court observed that if assessee affixed seal on containers after stuffing and took their charge, he stepped into shoes of/acted on behalf of master of vessel, the person-in-charge.

Decision: The High Court held that conjoint reading of sections 2(31), 116 and 148 of Customs Act, 1962 makes it clear that in case of short-landing of goods, if penalty is to be imposed on person-in-charge of conveyance/vessel, it can also be imposed on the agent appointed by him. Hence, duly appointed steamer agent of a vessel, would be liable to penalty. However, steamer agent, if innocent, could work out his remedy against the shipper for short-landing.

The High Court also clarified that in view of section 42 under which no conveyance can leave without written order, there is an automatic penalty for not accounting of goods which have been shown as loaded on vessel in terms of Import General Manifest. There is no requirement of proving *mens rea* on part of person-in-charge of conveyance to fall within the mischief of section 116 of the Customs Act.

Note: Steamer agent is a person who undertakes, either directly or indirectly,-

(i) to perform any service in connection with the ship's husbandry or dispatch including the rendering of administrative work related thereto; or

(ii) to book, advertise or canvass for cargo for or on behalf of a shipping line; or

(iii) to provide container feeder services for or on behalf of a shipping line.

The statutory provisions discussed in the case law are given hereunder:

Section 42 - No conveyance to leave without written order: *(1) The person-in-charge of a conveyance which has brought any imported goods or has loaded any export goods at a customs station shall not cause or permit the conveyance to depart from that customs station until a written order to that effect has been given by the proper officer.*

(2) No such order shall be given until –

(a) the person-in-charge of the conveyance has answered the questions put to him under section 38;

(b) the provisions of section 41 have been complied with;

(c) the shipping bills or bills of export, the bills of trans-shipment, if any, and such other documents as the proper officer may require have been delivered to him;

(d) all duties leviable on any stores consumed in such conveyance, and all charges and penalties due in respect of such conveyance or from the person-in-charge thereof have been paid or the payment secured by such guarantee or deposit of such amount as the proper officer may direct;

(e) the person-in-charge of the conveyance has satisfied the proper officer that no penalty is leviable on him under section 116 or the payment of any penalty that may be levied upon him under that section has been secured by such guarantee or deposit of such amount as the proper officer may direct;

(f) in any case where any export goods have been loaded without payment of export duty or in contravention of any provision of this Act or any other law for the time being in force relating to export of goods,

(i) such goods have been unloaded, or

(ii) where the Assistant Commissioner of Customs or Deputy Commissioner of Customs is satisfied that it is not practicable to unload such goods, the person-in-charge of the conveyance has given an undertaking, secured by such guarantee or deposit of such amount as the proper officer may direct, for bringing back the goods to India.

37. Where goods have been ordered to be released provisionally under section 110A of the Customs Act, 1962, can release of goods be claimed under section 110(2) of the Customs Act, 1962?

Akanksha Syntex (P) Ltd. v Union of India 2014 (300) E.L.T. 49 (P & H)

Facts of the case: In the instant case, an order for provisional release of the seized goods had been made under section 110A of the Act pursuant to an application filed by the petitioner in this regard. However, the petitioner claimed unconditional release of its seized goods in terms of sections 110(2) and 124 of the Act as no show cause notice had been issued within the extended period of six months (initial period of six months was extended by another six months by the Commissioner of Customs in this case).

As per section 110(2) of the Customs Act, 1962 where any goods are seized under sub-section (1) and no notice in respect thereof is given under clause (a) of section 124 within six months of the seizure of the goods, the goods shall be returned to the person from whose possession they were seized. However, the aforesaid period of six months may, on sufficient cause being shown, be extended by the Commissioner of Customs for a period not exceeding six months.

Point of dispute: It was the contention of the Department that once an order for provisional release of goods has been made under section 110A of the Act, in view of judgment of the Bombay High Court in *Jayant Hansraj Shah* v. *Union of India and Others 2008 (229) E.L.T. 339 (Bom.),* goods cannot be released under sections 110(2) and 124 of the Act. The only recourse available to the petitioner was either to comply with the order of provisional release and in case, the petitioner was unable to abide by the terms of the provisional release then in view of the judgment of the Bombay High Court in *Jayant Hansraj Shah's* case, the prayer for return of goods unconditionally could not be made.

Observations of the Court: The High Court observed that the object of enacting section 110(2) of the Act is that the Customs Officer may not deprive the right to property for indefinite period to the person from whose possession the goods are seized under sub-section (1) thereof. Sub-section (2) of section 110 strikes a balance between the Revenue's power of seizure and an individual's right to get the seized goods released by prescribing a limitation period of six months from the date of seizure if no show cause notice within that period has been issued under section 124(a) for confiscation of the goods.

The High Court opined that a plain and combined reading of sections 110(2), 124 and 110A spells out that any order for provisional release shall not take away the right of the assessee under section 110(2) read with section 124 of the Act. Where no action is initiated by way of issuance of show cause notice under section 124(a) of the Act within six months or extended period stipulated under section 110(2) of the Act, the person from whose possession the goods were seized becomes entitled to their return.

The High Court did not accept the contrary interpretation of the Bombay High Court in *Jayant Hansraj Shah's* case. The High Court was of the view that the said interpretation was not borne out from the plain reading of the aforesaid provisions.

Decision: The remedy of provisional release is independent of remedy of claiming unconditional release in the absence of issuance of any valid show cause notice during the period of limitation or extended limitation prescribed under section 110(2) of the Customs Act, 1962.

Notes:

(i) Delhi High Court has also taken a similar view in the case of Jatin Ahuja vs Union of India 2013 (287) E.L.T. 3 (Del.) and held that any effort to say that provisional release of seized goods under section 110A would extinguish the operation of the consequence (of not issuing show cause notice, within the statutory period) spelt out in section 110(2) would be contrary to the plain meaning and intendment of the statute. This is because section 110A is an interim order enabling release of goods, (for instance, where they are fast moving, or perishable). The existence of such power does not in any way impede or limit the operation of the mandatory provision of section 110(2). There are no internal indications in section 110A that the amplitude of section 110(2) is curtailed. Thus, the effect of the statute, by virtue of section 110(2), is that on expiration of the total period of one year (in the absence of a show cause notice) the seizure ceases, and the goods which are the subject matter of seizure, are to be released unconditionally. There is nothing in section 110A to detract from this consequence.

(ii) In Jayant Hansraj Shah's case the Bombay High Court took a contrary view and rejected the plea of the petitioner of unconditional release of the seized goods with the following observations :-

"The procedure for confiscation of the goods can be resorted to if the goods are not provisionally released. If the owner in terms of section 110A applies for provisional release

and an order is passed it can be said that the goods continue to be under seizure as the order under section 110A is a quasi judicial order. Section 110(2) would not be operative. It is only in the case where no provisional order is passed for release of the seized goods and if no notice is issued under Section 124(a) for confiscation of the goods only then would section 110(2) apply and the respondent would be bound to release the goods.

Any other reading of the section would mean that a person whose goods are seized would seek a provisional release of the goods, get an order of provisional release, allow the authorities to proceed to believe on that basis that such person seeks to release the goods provisionally and on the expiry of the period of six months if notice is not issued under section 124(a) then contend that the terms for provisional release of the goods are no longer binding as the period of six months has expired and no notice has been served. The period of notice is only when the respondents seek to confiscate the goods. If there be a provisional release order it is not within the jurisdiction of the respondents to proceed to issue the notice under section 124. At the highest they can proceed under section 110(1A) by following the procedure set out therein. In our opinion, therefore, as procedure for confiscation could not have been initiated pursuant to the order of provisional release the contention urged by the petitioners that the goods should be released under section 124(2) has to be rejected."

(iii) *Punjab and Haryana High Court also departed from Jayant Hansraj Shah case in the case of Rama Overseas v. Union of India 2013 (293) ELT 669 (P & H).*

Settlement Commission

38. Does Settlement Commission have jurisdiction over baggage cases?

CCus.v. Ashok Kumar Jain 2013 (292) ELT 32 (Del.)

Points of dispute: In this case the Department contended that the Settlement Commission lacks the jurisdiction to entertain the baggage cases.

Decision: The High Court opined that the provisions that conferred jurisdiction on the Settlement Commission (Section 127B) cannot be construed as narrowly as it sought to be urged by the Revenue. A plain reading of the provisions of sections 127A and 127B reveals that there is no bar/express or implied on the Settlement Commission - in respect of entertaining applications by the passengers which brought in goods through their baggage.

It further noted that section 127B enumerates the kinds of cases which could not be entertained by the Settlement Commission. Had the intention of the Parliament been to exclude adjudication by Customs Authorities in respect of baggage claim from the purview of the Commission's jurisdiction, such intention would have been more clearly manifested as it had been mentioned in provisos to section 127B(1).

39. Is judicial review of the order of the Settlement Commission by the High Court or Supreme Court under writ petition/special leave petition, permissible?

Saurashtra Cement Ltd. v. CCus. 2013 (292) E.L.T. 486 (Guj.)

While examining the scope of judicial review in relation to a decision of Settlement Commission, the High Court noted that although the decision of Settlement Commission is final, finality clause would not exclude the jurisdiction of the High Court under Article 226 of the Constitution (writ petition to a High Court) or that of the Supreme Court under Articles 32 or 136 of the Constitution (writ petition or special leave petition to Supreme Court). The Court would ordinarily interfere if the Settlement Commission has acted without jurisdiction vested in it or its decision is wholly arbitrary or perverse or mala fide or is against the principles of natural justice or when such decision is ultra vires the Act or the same is based on irrelevant considerations.

The Court, however, pronounced that the scope of court's inquiry against the decision of the Settlement Commission is very narrow, i.e. judicial review is concerned with the decision-making process and not with the decision of the Settlement Commission.

Note: Apart from the appellate remedies available under the customs law, the Constitution of India also provides remedies in the form of Special Leave Petitions (SLPs) and Writs. The Supreme Court of India is empowered under Article 136 of the Constitution of India to grant special leave to any of the parties to appeal, aggrieved by any order or judgment passed by any Court or Tribunal in India. The applications under Article 136 are termed as Special Leave Petitions (SLPs) as these can be admitted only with special leave (permission) of Supreme Court. The High Courts, within the territory of its jurisdiction, have powers, vide article 226 of Constitution, to issue orders or writs for enforcement of any fundamental right and for any other purpose. The Supreme Court, under Article 32 of the Constitution of India, is also empowered to issue writs for enforcement of fundamental rights.

Miscellaneous provisions

40. Whether any interest is payable on delayed refund of sale proceeds of auction of seized goods after adjustment of expenses and charges in terms of section 150 of the Customs Act, 1962?

Vishnu M Harlalka v. Union of India 2013 (294) ELT 5 (Bom)

Facts of the case: In the instant case, the Settlement Commission ordered to release the seized goods of the assessee on payment of a specified amount of fine and penalty adjudicated by it. However, since the seized goods had already been auctioned by the Department, the Commission directed the Revenue to refund to the assessee, the amount remaining in balance after adjustment of expenses and charges as payable in terms of section 150 of the Customs Act, 1962 and further adjustment of fine and penalty as adjudicated by it. The refund was however, not granted despite several representations. The response to the RTI query showed that refund was sanctioned but it was not paid till filing of this writ petition.

During the pendency of this writ petition, the principal amount of the sale proceeds was paid to the assessee but the interest on the same was not paid. It was the contention of the Department that the amount paid to the assessee represented the balance of sale proceeds of the goods auctioned or disposed of after adjustments under section 150 of

the Act. Since the amount paid did not represent the amount of duty or interest, the provisions of sections 27 and 27A of the Customs Act relating to claim for refund of duty and interest on delayed refunds respectively would not be applicable.

Observations of the Court: The High Court observed that though no period was stipulated in the order of the Settlement Commission for the grant of refund, the entire exercise ought to have been carried out within a reasonable period of time. All statutory powers have to be exercised within a reasonable period even when no specific period is prescribed by the provision of law. The High Court noted that there was absolutely no reason or justification for the delay in payment of balance sale proceeds.

Decision: The High Court held that Department cannot plead that the Customs Act, 1962 provides for the payment of interest only in respect of refund of duty and interest and hence, the assessee would not be entitled to interest on the balance of the sale proceeds which were directed to be paid by the Settlement Commission. The High Court clarified that acceptance of such a submission would mean that despite an order of the competent authority directing the Department to grant a refund, the Department can wait for an inordinately long period to grant the refund. The High Court directed the Department to pay interest from the date of approval of proposal for sanctioning the refund.

Note: Section 27(1) inter alia provides that a person claiming refund of duty and interest, if any, paid or borne by him may make an application for such refund before the expiry of one year from the date of payment of such duty or interest. Section 27(2) inter alia requires an order to be passed on the receipt of such application, subject to the satisfaction of the Assistant/Deputy Commissioner of Customs, that the whole or part of the duty or interest paid by the applicant is refundable. Section 27A stipulates that if any duty ordered to be refunded under section 27(2) to an applicant is not refunded within three months from the receipt of the application under section 27(1), interest shall be paid at such rate not below 5% and not exceeding 30% p.a. as fixed by the Central Government. Currently, the notified rate of interest on delayed refunds is 6%.

Where any goods, not being confiscated goods, are sold under the provisions of the Act, the manner of application of sale proceeds thereof is provided under section 150(2). The proceeds have to be applied for the payment of (i) expenses of sale, (ii) freight and other charges to the carrier, (iii) duty, if any; (iv) charges to the person having custody of the goods; and (v) any amount due to the Central Government from the owner of the goods, under the provisions of the Act or under any law relating to customs. The balance is to be paid to the owner of the goods.

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