

MOCK TEST PAPER

FINAL (NEW): GROUP: II

PAPER – 5: STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION

*Question No. 1 is compulsory*

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

Time Allowed – 3 Hours

Maximum Marks – 100

1. **Krispy Meal** is a fast food joint operating in a very competitive business environment. It is a profitable business with very good prospects for growth. A strategy development meeting is underway to chalk out a plan to improve business growth in a very systematic measurable manner.

The following information is given to you:

Krispy Meal has the following mission statement *“Derive strength to grow in scale using our passion for the craft of cooking and service that will satisfy our customers, employees and other stakeholders.”* Krispy Meal is a closely held partnership firm with five partners. It started at a scale of operations that catered to the local demand within a locality. Reputation for good quality food and service has helped it scale up its operations in the recent years. Most of the key decisions relating to operations like decision about the menu and its method of preparation, product pricing, finance, marketing, administration etc. are centralized. Skilled chefs, managers for various functions and the firm's partners are part of this core team.

A general survey published in a food trade magazine highlighted people's perception about fast food diet. Predominant opinion was that the current food platter available in food joints across the town were not healthy option. People want healthier choices in the menu when they dine out. At the same time, they do not want to compromise on taste or presentation of the food item. The other focal point for improvement was the order taking system. In most food joints, the current system is manual where the order taking staff note down a customer's order on paper, send it to the kitchen and then delivers the order on intimation from the kitchen, which is also done manually by the kitchen staff. This system has problems like errors in taking down orders, most times delivery staff are unaware of the content in an item or its availability, delays in delivery leading to customers complaining about food served cold etc. This problem takes away the pleasure of dining out and is leaving customers dissatisfied. Another scope for improvement is that customers want more payment options other than cash to settle their bills. With the advent of plastic money and mobile e wallet payments carrying cash around has become cumbersome for most of them.

The partners have decided to use this as an opportunity to develop Krispy Meal as the niche food joint addressing the customer's concerns, while managing to remain profitable. Consequently, Krispy Meal plans to expand by providing more choices along with its regular menu to health-conscious customers. Also, revamping its ordering, delivery and payment system would improve customer experience. A reasonable return at the overall firm level would be a return on equity (Net Income / Total Partnership Capital) of 25% each year. Capital structure will remain unchanged. The partners are not interested in diluting their share by bringing in new partners or take external funding with ownership stake. They may however utilize bank financing for expansion, but only if required.

Expansion of business will entail opening new branches in other localities as well as forging franchise with other stakeholders. However, Krispy Meal is not clear how to measure market share since the fast food industry market is not entirely an organized sector. There is no clear information about the overall revenue of the whole sector.

In the past, it was quality of its products that drove growth. The management wishes to maintain high quality standards across branches and franchisee. Therefore, an internal quality control department may be established to look into the same. External certifications from government food inspectors and other

recognized agencies would also be required to be met. Quality refers to both product quality and service quality, in this case, service being an inherent part of customer experience.

The staff at Krispy Meal are also excited at this opportunity. Expansion of the food joint would present a more dynamic work culture. Chefs would have the opportunity to enhance their skill by trying out various ways to cater to the consumer's palate. Ordering and delivery staff would have the opportunity to enhance their people management skills. This learning opportunity would definitely be an impetus for their career growth. With expansion chances of promotion within the organization increase. Financially, better business leads to the expectation of better pay and reward system.

Consequently, the management is intent on developing a performance management system that tracks performance across the organization. Among the different models, the Building Block Model is being considered.

**Required**

ADVISE the partners how the Building Block Model at Krispy Meal could be implemented. **(20 Marks)**

2. X 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%

**Required**

(i) Using the financial data, carry out a Pareto ANALYSIS (80/20 rule) of Sales and Contribution.

**(8 Marks)**

(ii) DISCUSS your findings with appropriate RECOMMENDATIONS.

**(12 Marks)**

3. **History of the Company**

Star Bus Tours Co. Ltd. (SBTCL) is an open top double-decker bus sightseeing company, particularly identified with its special red and cream-colored buses. It commenced operating in small town of Meghalaya in June 2014 with four buses and as of 2018 operated over 44 buses in north east region of India. SBTCL operates five routes with stops at tourist destinations. The company runs hop-on, hop-off bus tours of various hills, with one 24-hour ticket valid for unlimited journeys on the route.

**Budget Process/ Incentive Plan**

As a part of management performance control and incentive scheme it has been following participative budgeting approach. In SBTCL, budgeting is a joint process in which functional divisions develop their plans in conformity with corporate goals for the next financial year. Based on these plans, divisions prepare functional budgets and send to the appropriate management for review and approval. The budgets after the incorporation of the feedback and suggestions received from the said management, are finalised for the implementation. Then, finalised budgets are used as yardstick for performance measurement. Comparing the actual performance with the yardstick, bonus and other performance

related incentives are considered. The higher management believe that this performance control and incentive scheme is very helpful to measure the performance and fixing responsibilities for the responsibility centres.

**Budgeted Income Statement (Rs.'000)**

Revenue	1,13,800
<i>Less:</i>	
Variable Costs-	
Direct Material (Fuel, Lubricants and Sundries)	13,600
Direct Labour	40,500
Variable Overheads	7,700
Fixed Costs-	
Operating Overheads (Buses, Garage, Salaries)	18,100
Marketing and Administration	10,700
Profit/ (Loss) before taxes	23,200

Tabel-1

**Current Year's Income Statement (Rs.'000)**

Revenue	93,500
<i>Less:</i>	
Variable Costs:	
Direct Material (Fuel, Lubricants, and Sundries)	19,600
Direct Labour	37,700
Variable Overheads	6,200
Fixed Costs:	
Operating Overheads (Buses, Garage, Salaries)	20,150
Marketing and Administration	10,100
Profit/ (Loss) before taxes	(250)

Tabel-2

**Other Information**

Surprisingly above given current year's actual results were not up to the mark. Actual results were clearly showing adverse performance in comparison with budgeted figures.

Managers of SBTCL were upset because they did not receive the bonus. Ms. Maggie, Tour Manager of Route No. 3, said –

*"We lost 2 month's revenue and fuel prices are almost doubled. We did our best but these circumstances were beyond our control and we should not penalize at all."*

In support of her statement, Ms. Meggie provided following additional information –

(a) Rain is common in Northern Region. But, the past year set a record in numbers. In July, the expected average was 1,577 mm and received was 1,810 mm, In August the expected average rain was 990 mm and actual received was 1,535 mm. Heavy rain in these two months disrupted normal life of the region.

- (b) The fuel prices have risen almost continuously since last year due to surge in global crude prices.
- (c) Additional operational expenses Rs.22,00,000 also incurred to remove the milky appearance and give the stainless a nice new look effected by heavy rain.

She claimed that –

*"Revised budget with consideration of the above factors would give different results and lead to different conclusions"*

**Required**

ANALYSE the tour manager's view.

**(20 Marks)**

4. (a) N<sub>2</sub>N Co., is engaged in manufacturing many chemical products. It is using many chemicals some of which are fast moving, some are slow moving and few are in non-moving category. The company has a stock of 10 units of one non-moving toxic chemical. Its book value is Rs. 2,400, realizable value is Rs. 3,500 and replacement cost is Rs. 4,200.

One of the customers of the company asks to supply 10 units of a product which needs all the 10 units of the non-moving chemical as an input. The other costs associated with the production of the product are:

Allocated overhead expenses.....	Rs. 16 per unit
Out of pocket expenses.....	Rs. 50 per unit
Labour cost .....	Rs. 40 per hour <i>(for each unit two hours are required)</i>
Other material cost.....	Rs. 80 per unit.

The labour force required for the production of the product will be deployed from among the permanent employees of the company. This temporary deployment will not lead to any loss of contribution.

**Required**

- (i) RECOMMEND the minimum unit price to be charged to the customer without any loss to the company. **(4 Marks)**
- (ii) ANALYSE with reasons for the inclusion or exclusion of each of the cost associated with the production of the product. **(4 Marks)**
- (iii) ADVICE a pricing policy to be followed by N<sub>2</sub>N in perfect competition. **(2 Marks)**

(b) P Ltd. has two Divisions 'Px' and 'Pz' with full profit responsibility. The Division 'Px' produces Component 'X' which it sells to 'outside' customers only. The Division 'Pz' produces a product called the 'Z' which incorporates Component 'X' in its design. 'Pz' Division is currently purchasing required units of Component 'X' per year from an outside supplier at market price.

New CEO for Indian Operations has explored that 'Px' Division has enough capacity to meet entire requirements of Division 'Pz' and accordingly he requires internal transfer between the divisions at marginal cost from the overall company's perspective.

Manager of Division 'Px' claims that transfer at marginal cost are unsuitable for performance evaluation since they don't provide an incentive to the division to transfer goods internally. He stressed that transfer price should be 'Cost plus a Mark-Up'.

New CEO worries that transfer price suggested by the manager of Division 'Px' will not induce managers of both Divisions to make optimum decisions.

**Required**

DISCUSS transfer pricing methods to overcome performance evaluation conflicts.

**(10 Marks)**

5. (a) CNZ Ltd. is engaged in the manufacture of plastic bottles of a standard size and produced by a joint process of machines. The factory has 5 machines and capable of producing 40 bottles per hour. The variable cost per bottle is Rs. 0.32 and the selling price is Rs. 0.80 each. The company has received an offer from another company for manufacture of 40,000 units of a plastic moulded toy. The price per toy is Rs. 30 and the variable, cost is Rs.24 each. In case of the company takes up the job, it has to meet the expenses of making a special mould required for the manufacture of the toy. The cost of the mould is Rs.1,00,000. The company's time study analysis shows that the machines can produce only 16 toys per hour. The company has a total capacity of 10,000 hours during the period in which the toy is required to be manufactured. The fixed costs excluding the cost of construction of the mould during the period will be Rs.10 Lakh.

The company has an order for the supply of 3,00,000 bottles during the period.

**Required**

(i) Do you ADVISE the company to take up the order for manufacturing plastic moulded toys during the time when it has an order in its book for the supply of 3,00,000 bottles. **(3 Marks)**

(ii) If the order for the supply of bottles increases to 4,00,000 bottles, will you ADVISE the company to accept the order for the supply of plastic moulded toys? State the reasons. **(3 Marks)**

(iii) An associate company of CNZ Ltd. has idle capacity and is willing to take up the whole or part of the manufacturing of the plastic moulded toys on sub-contracting basis. The subcontract price inclusive of the cost of construction of mould is Rs. 28 per toy. DETERMINE the minimum expected excess machine hour capacity needed to justify producing any portion of the toy order by the company itself rather than subcontracting. **(4 Marks)**

(b) You are a paid assistant working in SBC LLP – an accounts consultancy firm. You have received the following email from one of SBC's senior partner:

**To: DG**

**From: SB**

**Date: 22/06/20XX**

**Subject: PEL meeting this afternoon**

As you are probably aware, we are meeting with the managers of PEL later this afternoon to discuss several key issues, and I need you to do some research for me. I need a report that covers the following:

Analysis of the new proposal for the period 2017 to 2019 based on

- external effectiveness and
- internal efficiency

To help you with this, I've attached a copy of our forecast of PEL's financial and non-financial data for the period 2017 to 2019. Please read it carefully and email me back as soon as possible so I have time to prepare before the meeting.

Thanks

SB

-----Attachment-----

**Background to PEL**

Precision Engineering Ltd (PEL) specialises in engineering design and manufacture in the automotive and motorsport industry. PEL's design team has many years' experience in the design and development of engine components for the market and high performance engines. PEL has

identified a number of key competitors and intends to emphasize on close co-operation with its customers in providing products to meet their specific engineering design and quality requirements. Efforts will be made to improve the effectiveness of all aspects of the cycle, from product design to after-sales service to customers. This will require data from a number of departments in the achievement of the specific goals of the new proposal. Efforts will be made to improve productivity in conjunction with increased flexibility of methods.

Forecast of PEL's Financial and Non-Financial Data

Particulars	2017	2018	2019
Total Market Size (Rs.lacs)	110	115	120
PEL Sales (Rs.lacs)	18	21	23
PEL Total Costs (Rs.lacs)	14.10	12.72	12.55
Production Achieving Design Quality Standards	95.5%	98.0%	98.5%
Returns from Customers (% of Deliveries)	2.0%	1.0%	0.5%
Cost of After-Sales Service (Rs.lacs)	1.3	1.1	1.0
Sales Meeting Planned Delivery Dates	85%	90%	95%
Average Cycle Time (Customer Enquiry to Delivery) (weeks)	5.0	4.5	4.0
Components Scrapped in Production (%)	6.5%	4.0%	1.5%
Idle Machine Capacity (%)	9%	5%	1%

**Required**

Draft the email as requested by the partner.

**(10 Marks)**

6. (a) Following three independent situations pertaining to environmental management and sustainability are provided to you:

**Situation I**

Wasco Limited is a chemical company which uses chloro-fluorocarbons (CFC) in the production of chemical. As awareness of the environmental damage caused by CFC spread, Wasco Limited stopped using CFC in its production processes and analysed and redesigned its product range much before the legislation controlling use of CFC introduced by the Government.

**Situation II**

Energy drink manufacturer Cool Limited was ordered to submit a yearly report to the Ministry of Environment and Forests on activities, which contains information concerning collection, recovery and recycling of packaging waste, fulfilment of the targets, volume of recovered and recycled packaging waste by type of material and declaration that all compulsory contributions and taxes have been paid.

**Situation III**

KOA Limited has achieved a 25% reduction of energy consumption through its "Go Renewable" initiative. For, the company a 25% reduction represents a cost saving of about Rs. 30,00,000/-.

**Required**

Read the above three situations and EXPLAIN **any 2 items** from (i), (ii) and (iii) below:

(i) Why Wasco Limited stopped using CFC and redesigned its product range much before legislation introduced by Government? **(5 Marks)**

(ii) The risk exposure of Cool Limited. **(5 Marks)**

(iii) How focusing on environmental sustainability provides opportunity to KOA Limited for reducing costs? **(5 Marks)**

(b) LNG Limited has three divisions. Its desired rate of return is 14%. The operating assets and income for each division are as follows:

Divisions	Operating Assets (Rs.)	Operating Income (Rs.)
L	19,20,000	3,45,600
N	10,50,000	1,73,250
G	12,30,000	1,67,280
Total	42,00,000	6,86,130

LNG limited has Rs. 8,00,000 of additional cash to invest in one of its divisions. The divisional managers have identified investment opportunities that are expected to yield the following ROIs

Divisions	Expected ROIs for additional investment
L	16%
N	12%
G	15%

**Required**

(i) CALCULATE ROIs at present for each division and STATE which division manager is currently providing the highest ROI. **(3 Marks)**

(ii) Based on ROI, IDENTIFY the division manager who would be the most eager to accept the additional investment funds. **(1 Mark)**

(iii) Based on ROI, IDENTIFY the division manager who would be least eager to accept the additional investment funds. **(1 Mark)**

(iv) STATE the division that offers the best investment opportunity for LNG limited. **(1 Mark)**

(v) DISCUSS the conflict between requirements (ii) and (iv) above. **(2 Marks)**

(vi) ADVISE how the residual income performance measure could be used to motivate the managers to act in the best interest of the company. **(2 Marks)**

**MOCK TEST PAPER**  
**FINAL (NEW) COURSE: GROUP – II**  
**PAPER – 5: STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION**  
**SUGGESTED ANSWERS/HINTS**

1. Performance management using the Building Block Model poses three questions based on which the performance measurement system is developed:

*What dimensions of performance should the company measure?*

Dimensions are the goals that the company wants to achieve based on its overall strategy, those goals that define its success.

*How to set the standards (benchmarks) for those measures?*

*What are the rewards needed to motivate employees to achieve these standards?*

**Dimensions**

Dimensions (goals) include financial and non-financial goals. Dimensions are further categorized as into results and determinants. Results are tracked as (a) financial performance and (b) competitive performance. Determinants are tracked as (a) quality, (b) flexibility, (c) innovation, and (d) resource utilization. Determinants influence results.

**Results**

- (a) Financial Performance: Krispy Meal is a closely held partnership with 5 partners. Partners are interested in earning profits that have been benchmarked at an overall return on equity of 25% each year. This can be derived from periodic financial statements that get prepared as part of the accounting function. Partners want to retain the current capital structure. This implies that they do not have any plans to go public or have other external funding with ownership stake. They may take loans from banks for funding their expansion.

Consequently, if they want to expand, the firm has to make sufficient profits that will yield ample cash reserves. Therefore, Krispy Meal's financial performance dimensions should also include profitability ratios like gross profit ratio, net profit ratio, operating margin, return of capital employed (if bank loans are taken) etc. Cash profit and changes in cash reserves may also be included as dimensions of performance. These measures should be tracked at the firm's overall level as well at the individual branch/franchisee level.

- (b) Competitive Performance: Krispy Meal was to be a niche joint in a highly competitive segment. However, to measure how it compares with its peers there is a limitation in terms of availability of information due to the unorganized nature of the fast food industry. All the same, one of the measures that can be helpful are the number of branches / franchisees the firm is able to open.

Krispy Meal is also likely to have a competitive edge because it is foraying into providing healthier food choices along with its regular menu. Since this is unique among its segment, it will retain a competitive edge until its peers start replicating the same. Therefore, one other measure for competitive performance could be the spread and uniqueness of Krispy Meal's menu as compared to its peers. Information for this could be gathered from published / researched sources like trade magazines as well as informal sources like customer feedback / word of mouth.

**Determinants**

- (a) Quality: Quality drove past performance and it will continue to drive performance even after expansion. For product quality, the management should track if internal quality checks and

external certifications are met periodically. Quality control should cover all branches and franchisees. Non-compliance may require immediate attention of the management. For service quality, periodic training programs can be initiated to educate the staff with people management skills. Therefore, Krispy Meal should determine parameters that the management would be interested in ensuring that quality standards are met and how non-compliance should be reviewed.

- (b) Innovation: Innovation involves experimenting with the appropriate inputs which make them healthy. At the same time, the healthier option should satisfy the taste and presentation preference of customers. This requires innovative efforts from qualified and skilled chefs. This will give the competitive edge to Krispy Meal. Innovation has to be constant and not a onetime exercise. Therefore, management may review the number of new variants that have been introduced in the menu, regularity of these introductions and customer feedback of the same.
- (c) Flexibility: Growth in scale of operations combined with a competitive business environment implies that Krispy Meal should have some flexibility in its operations. This could mean ability to hire staff quickly, cater to seasonal surges in customer's demand etc.
- (d) Resource utilization: Better utilization of resources help business function efficiently. Revamping the order, delivery and payment system would improve the way resources (kitchen, ordering and delivery staff) operate. Lesser errors and delays would increase capacity utilization, freeing up time to cater to more customers. Consequently, pressure on resources decreases. Therefore, some indicators to be tracked can be overtime / idle time of kitchen, ordering and delivery staff, turnaround time in these functions, table occupancy rate, breakage, or wastage of material etc. Again here, the management should chart out the appropriate dimensions that will help them track resource utilization.

### **Standards**

Standards are the benchmarks or targets related to the performance metric that is being tracked under each dimension. To be useful, standards should have the following characteristics:

- (a) Ownership: It is important to establish who in the organization structure is responsible for achievement which performance metric. Krispy Meal has to consider this very carefully. As explained in the problem, many key management functions like decisions about the menu and its preparation are determined by a core team. Similarly, the centralized core team is handling finance and marketing. However, at the branch level, managers of various operational functions can be held accountable for performance of that specific process. For example, the chief at a particular branch can be held accountable for the quality of food prepared in that branch (Dimension: Quality). Similarly, the head of the order taking staff at a particular branch can be held accountable for the overtime that the staff at putting in at that branch (Dimension: Resource utilization).
- (b) Achievability: Benchmarks and targets will be useful only if they are achievable. The managers who have ownership for the achievement of performance metric have to be involved in setting benchmarks or targets. They should be clearly defined, preferably quantifiable. At the same time, they should be in line with the firm's overall strategy. If the target is set very high staff can get de-motivated. If set too low, will not raise the bar for performance. If not in line with the firm's overall strategy, there will be discord or gap between the firm's performance and what it wants to achieve.
- (c) Equity: Benchmarks should be equally challenging for all parts of the business. Krispy Meal should customize its performance measure for each function like kitchen staff, order and delivery staff, finance staff, advertising staff etc. For example, while turnaround time to meet a customer's order would be relevant metric to the kitchen, ordering and delivery staff, popularity of the advertisement jingle for Krispy Meal would be the relevant metric for the advertisement department. The rigor of the target should be uniform across departments. Otherwise the staff would view the benchmark system as being biased towards select functions within the firm.

## Rewards

This relates to the reward structure within the firm that includes compensation package, bonus, rewards, awards, facilities provided to employees etc. Proper reward system is required for achievement of standards while maintaining costs at optimum levels. Krispy Meal should have a well-defined HR policy for compensation, bonus, promotion, and reward. A good system should have the following characteristics:

- (a) Motivation: Does the reward system drive the people to achieve targets and standards? A low reward system would not induce staff to work towards the goal. Goal clarity and participation in target/benchmark setting can motivate staff to achieve standards.

While some part of compensation may be fixed, other parts can be made variable. For example, bonus of the advertising staff can be aligned to the sales generated, Chefs can be rewarded bonus based on sales as well quality measures etc. Better job prospects in a growing environment would also be a good motivator. Krispy Meal's management should track various metric in this regard. Some of them could be percentage of bonus paid to the overall compensation package categorized staff cadre, attrition rate, internal promotions, cross training programs etc.

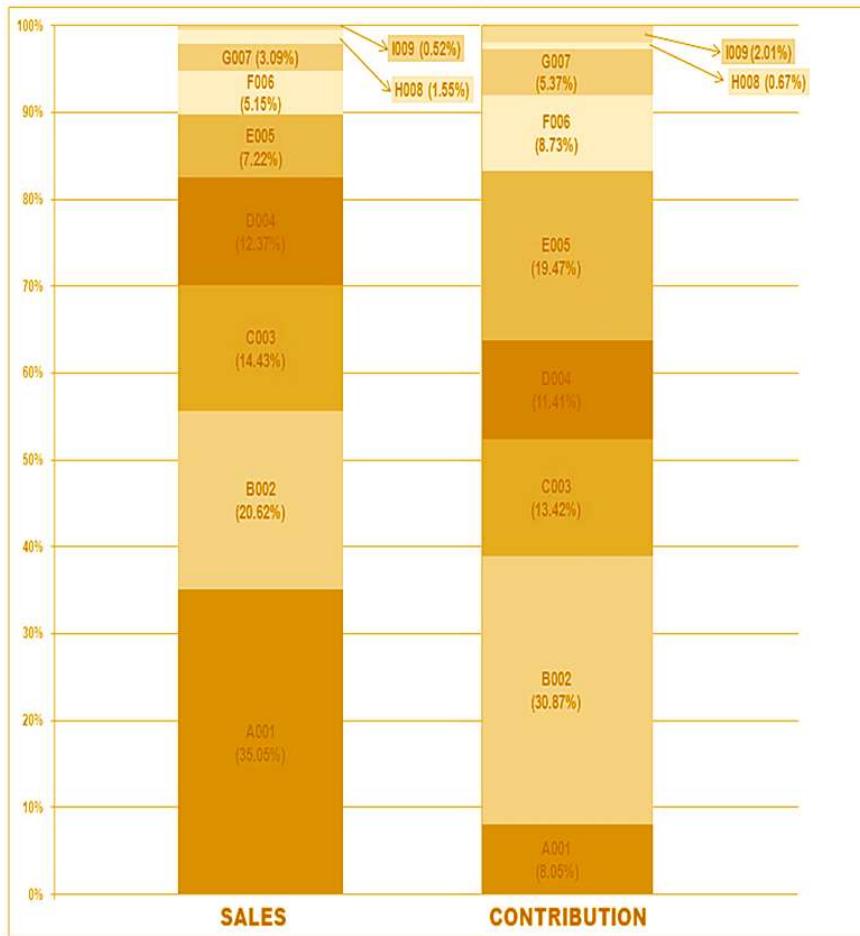
- (b) Clarity: The reward package should be clearly communicated to the staff. It should be understood by the staff concerned. They should be told what kind of performance will be rewarded and how their performance will be measured. Krispy Meal may consider having a dedicated HR team for this purpose.
- (c) Controllability: Unlike the traditional understanding, rewards need not be based only on the financial element that the staff can control. There may be other non-financial elements for which rewards can be given. Both aspects however need to be controllable by the staff concerned. For example, the chef can come up with a popular menu. If the pricing of the product, managed by the central core team, is such that it results in a loss to Krispy Meal, the chef may not get the much-deserved bonus. This is not a good reward system and might lead to attrition.

### 2. (i) “Pareto Analysis”

Model	Sales (₹'000)	% of Total Sales	Cumulative Total	Model	Cont. (₹'000)	% of Total Cont.	Cumulative Total %
<b>Pareto Analysis Sales</b>				<b>Pareto Analysis Contribution</b>			
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”



**(ii) 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. Both 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.

### 3. Analysis of Issue

It appears that SBTCL has been badly hit by the weather – high rain in July and August have led to a slump in business. Revenue have seen a fall of 18% over the budgeted figure. Direct Material (most of the fuel) is 21% of the Sales (compared to 12% of budgeted level) because of hike in fuel price. Variable Overheads are almost same. However, interestingly, there is a saving of Rs.1,50,000 in Operating Overheads as compared to the budgeted figure after catering additional Operational Expenses of Rs.22,00,000 (for removal of milky appearance etc.). Furthermore, there is reduction in Marketing & Administration Cost. The ratio of Salary to Sales rose to 40% in 2018 from 36% (as budgeted). This appears to be atypical. Instead, there should be a cut in this ratio due to slump in business.

*Award of bonus in case of losses is not justified and managers should be held accountable for their operations. However, they should not be held accountable for the events beyond their control.* A manager cannot control movements in fuel price, yet he/ she is supposed to have the most information and he/ she is expected to correctly forecast movements in the prices of fuel. Managers shouldn't be penalized for the uncontrollable events.

Accordingly, in SBTCL, there should be revision in the budget to account *uncontrollable events*. Refer Table-X.

*Revised Budgeted Income Statement (Rs. '000)*

Revenue*	94,833
Less:	
Variable Costs-	
Direct Material** (Fuel, Lubricants, and Sundries)	19,879
Direct Labour	33,750
Variable Overheads	6,417
Fixed Costs-	
Operating Overheads (Buses, Garage, Salaries)	20,300
Marketing and Administration	10,700
Profit/ (Loss) before taxes	3,787

Table-X

\*10 months revenue; \*\* at actual price levels

The Revised Profit Margin has come down to 4% as against the Target Profit Margin of 20%. This clearly indicates that the performance was benchmarked against the higher target. If original budget figure is used to measure the performance, it will punish employees for the reason which are beyond their control.

SBTCL is not too far away from Revised Profit Margin. Therefore, at least some bonus may be considered to be awarded to the employees which may create more *employee loyalty* and may be beneficial for long term.

Further, *continuous monitoring* of Budget Performance (achievement/ failure) in SBTCL is essential to overcome this situation. This helps to identify where *revisions* are required in the budget to account changing conditions, errors, modification to company's plan etc. Monitoring of Budget Performance should be the responsibility of the managers in SBTCL. The essence of the effective monitoring of Budget Performance is that the managers should provide *accurate, relevant, actionable* information on time to the appropriate management level so that budget can give a realistic target to measure the performance.

It is also important to note that at the time of revising the budget, the primary budget as well as past information should not be ignored as they are the basis for preparing all budgets.

4. (a) (i) N<sub>2</sub>N has the opportunity to utilize 10 units of non-moving chemical as input to produce 10 units of a product demanded by one of its customers. The minimum unit price to be charged to the customer would be—

Cost Component	Cost per unit of product (Rs.)
Cost of Material (Realizable value = Rs.3,500 / 10 units of chemical)	350
Out of Pocket Expenses	50
Other Material Cost	80
Minimum Unit Price that can be charged	480

Therefore, the minimum unit price that can be charged to the customer, without incurring any loss is Rs.480 per unit of product. As explained below in point (ii), allocated overhead expenses and labor cost are sunk costs that have been ignored while calculating the minimum unit price to be charged.

(ii) **Analysis**

- (a) Cost of Material: Relevant and hence included at realizable value. N<sub>2</sub>N has 10 units of non-moving chemical input that has a book value of Rs.2,400, realizable value of Rs.3,500 and replacement cost of Rs.4,200. Realizable value of Rs.3,500 would be the salvage value of the chemical had it been sold by N<sub>2</sub>N instead of using it to meet the current order. This represents an opportunity cost for the company and hence included while pricing the product. Book value would represent the cost at which the inventory has been recorded in the books, a sunk cost that has been ignored. Replacement cost of Rs.4,200 would be the current market price to procure 10 units of the input chemical. This would be relevant only when the inventory has to be replenished after use. This chemical is from the non-moving category, that means that it is not used regularly in production process and hence need not be replenished after use. Therefore, replacement cost is also ignored for pricing.
- (b) Labour Cost: Not relevant and hence excluded from pricing. It is given in the problem that this order would be met by permanent employees of the company. Permanent employee cost is a fixed cost that N<sub>2</sub>N would incur irrespective of whether this order is produced or not. No additional labour is being employed to meet this order. Therefore, this cost is a sunk cost, excluded from pricing.
- (c) Allocated Overhead Expenses: These expenses have been incurred at another Cost Centre, typical example would be office and administration costs. Such costs are fixed

in nature that would be incurred irrespective of whether this order is produced or not. Therefore, this cost is a sunk cost, excluded from pricing.

- (d) Out of Pocket Expenses: These are expenses that are incurred to meet the production requirement of this order. These are additional variable expenses, that need to be included in pricing.
- (e) Other Material Costs: These are expenses that are incurred to meet the production requirement of this order. These are additional variable expenses, that need to be included in pricing.

### **(iii) Advice on Pricing Policy**

Under perfect competition conditions, N<sub>2</sub>N can have no pricing policy of its own, here sellers are price takers. It cannot increase its price beyond the current market price. The company can only decide on the quantity to sell and continue to produce as long as the marginal cost is recovered. When marginal cost exceeds the selling price, the company starts incurring a loss.

Since N<sub>2</sub>N cannot control the selling price individually in the market, it can adopt the *going rate pricing* method. Here it can keep its selling price at the average level charged by the industry. This would yield a fair return to the company. An average selling price would help the company attract a *fair market share* in competitive conditions.

- (b) To overcome the ***optimum decision making*** and ***performance evaluation conflicts*** that can occur with ***marginal cost-based transfer pricing*** following methods has been proposed:

#### **Dual Rate Transfer Pricing System**

*“With a ‘Dual Rate Transfer Pricing System’ the ‘Receiving Division’ is charged with marginal cost of the intermediate product and ‘Supplying Division’ is credited with full cost per unit plus a profit margin”.*

Accordingly Division ‘Px’ should be allowed to record the transactions at *full cost per unit* plus a *profit margin*. On the other hand Division ‘Pz’ may be charged only *marginal cost*. Any inter divisional profits can be eliminated by accounting adjustment.

#### **Impact:**

- Division ‘Px’ will earn a profit on inter-division transfers.
- Division ‘Pz’ can chose the output level at which the marginal cost of the component ‘X’ is equal to the net marginal revenue of the product ‘Z’.

#### **Two Part Transfer Pricing System**

*“The ‘Two Part Transfer Pricing System’ involves transfers being made at the marginal cost per unit of output of the ‘Supplying Division’ plus a lump-sum fixed fee charged by the ‘Supplying Division’ to the ‘Receiving Division’ for the use of the capacity allocated to the intermediate product.”*

Accordingly Division ‘Px’ can transfer its products to Division ‘Pz’ at *marginal cost per unit* and a *lump-sum fixed fee*.

#### **Impact:**

- ‘Two Part Transfer Pricing System’ will inspire the Division ‘Pz’ to choose the optimal output level.

This pricing system also enable the Division ‘Px’ to obtain a profit on inter-division transfer.

5. (a) Workings

**Statement Showing “Contribution / Machine Hour”**

	‘Bottle’	‘Toy’
Demand (units)	3,00,000	40,000
Sales (Rs./u)	0.80	30.00
Less: Variable Cost (Rs./u)	0.32	24.00
Less: Specific Fixed Cost (Rs./u)	---	2.50
Contribution (Rs./u)	0.48	3.50
Machine Hours Required per unit	0.025	0.0625
Contribution / Machine Hour	19.20	56.00

**Advice on Supply of 3,00,000/ 4,00,000 Bottles**

- (i) CNZ Ltd. can accept plastic molded toy's order as sufficient number of hrs. i.e. 2,500 hrs. (10,000 hrs. - 3,00,000 bottles × 0.025 hrs.) are available and would be able to generate additional benefit of Rs.3.50 per unit on 40,000 units of toys i.e. Rs.1,40,000.
- (ii) If the order for the supply of bottles increases to 4,00,000 bottles, then 2,500 more hrs. will be required to produce the additional bottles. CNZ Ltd. has to decide whether to utilize 2,500 hrs. for existing bottle order or for toy Order.

Machine time is limiting factor. Therefore, contribution per machine hour from both the activities (i.e. bottles and toys) should be calculated to decide whether the order should be accepted. Contribution per hour is more in case of toys (refer workings). Therefore, CNZ Ltd. should utilize the remaining 2,500 hours for manufacturing toys rather than to fulfil the order for supply of additional bottles.

Prioritizing production based on contribution per machine hour would maximize profits. *However, existing order fulfilment is necessary for building long term and sustainable customer relationship.* Developing and maintaining long term and intimate relationships with the profitable customers provides valuable benefits to the company as the relationships between company and customers grow, a customer who is satisfied with the company's products and services, tends to commit the relationship, and buy more over time. *Cost of keeping the existing customers is less expensive than the cost of acquiring new customers.*

Hence, CNZ Ltd. should be taken into consideration long term supplier relation before accepting the toy order based on financial consideration as contribution per hour is more in case of toys. Further, company may also explore outsourcing opportunities for production of toys.

- (iii) Minimum number of toys needed to be manufactured to justify the increase in fixed cost of Rs.1,00,000 to make the mould is 25,000 toys {1,00,000/ (Rs.28 - Rs.24)}. Thus, as long as company has excess capacity available to manufacture more than 25,000 toys it is cheaper to produce than to buy from subcontractor.

Minimum Expected Excess Capacity hours to justify = 
$$\left( \frac{25,000 \text{ toys}}{16 \text{ toys}} \right) = 1,562.5 \text{ or } 1,563 \text{ hrs.}$$

(b) To: SB

From: DG

Date: 22/06/20XX

Subject: Re: PEL Meeting this afternoon

Please find below my analysis of the points you wished me to examine for PEL. Please let me know if you wish to discuss any of these points in more detail.

Kind regards

DG

**External Effectiveness-** The *marketing success* of the proposal is associated with the achievement of *customer satisfaction*. The success will need an *efficient business operating system* for all aspects of the cycle from product design to after-sales service to customers. Customer satisfaction is linked with *Improved quality and delivery*.

Quantitative measures of these factors are as follows:

- *Quality* is expected to improve. The percentage of production achieving design quality standards is expected to increase from 95.5% to 98.5% between 2017 and 2019. In the same period, returns from customers for replacement or rectification should drop from 2% to 0.5% and the cost of after-sales service should drop from Rs.1.3lacs to Rs.1.0lacs.
- *Delivery efficiency* improvement that is expected may be measured in terms of the rise in the percentage of goods achieving the planned delivery date. This percentage rises from 85% in 2017 to 95% in 2019.

**Internal Efficiency-** The financial success of the proposal is linked to the achievement of high *productivity*. This should be helped through reduced *cycle time* and decreased levels of *waste*.

Quantitative measures of these factors are as follows:

- The average total *cycle time* from customer enquiry to delivery should drop from 5 weeks in 2017 to 4 weeks in 2019.
- *Waste* in the form of idle machine capacity is expected to drop from 9% to 1% between 2017 and 2019. Also, component production scrap is expected to drop from 6.5% in 2017 to 1.5% in 2019.

6 (a) (i) Ever increasing and demanding environmental regulation is forcing companies to change their practices. In many countries, numerous pieces of legislation cover areas such as air quality, climate change, hazardous substances, packaging, waste, and water quality.

The trend is very much in the direction of increased and more stringent legislation. Environment sustainability is not an issue that can be avoided by any organisation.

Organisations need to consider how environmental regulation will impact their operations and the cost of doing business.

By stopping the use of CFC much before the legislation, Wasco Limited gained advantages over its rivals. Wasco's actions were integral to its own strategic success, and instrumental in driving through the subsequent legislation from which the company later benefited.

(ii) Organizations increasingly have to demonstrate that they are managing all of their risks systematically and responsibly. This includes environmental risks- risks that are a result of impacts of the organization on the environment. By assessing the environmental risks associated with their activities, processes, product, and services, organizations can identify their potential legal and business exposure. Non-compliances can cause enormous financial impacts, such as fines, penalties, legal costs, and damages.

Thus, Cool Ltd is exposed to environmental risks.

(iii) Focusing on environmental sustainability will often provide opportunities for reducing costs. For example, reducing carbon impacts often also saves energy costs. Similarly, programmes for reducing wastes improve environmental performance and reduce operating costs.

Reducing environmental impacts can also reduce or eliminate associated tax, levies, and other compliance costs.

Focusing on environmental sustainability thereby making investments in developing clean technologies and more energy-efficient products and processes will not only save the organization money, but could also be patented and/ or sold to other organizations, providing an additional source of income. KOA Limited may have carbon credit for efficiency in reducing energy and sell on the open market, thereby actually generating revenue.

**(b) (i) Present ROI of each division**

Divisions	Operating Assets (Rs.)	Operating Income (Rs.)	ROI
L	19,20,000	3,45,600	18%
N	10,50,000	1,73,250	16.5%
G	12,30,000	1,67,280	13.6%

The division manager of L division is currently providing the highest ROI of 18% among the three divisions.

- (ii) The manager of division G would be most eager to accept the additional fund of Rs. 8,00,000 because of ROI of the proposed investment of Rs. 15% is more than the present ROI of 13.6% and the acceptance of the proposal would increase the division's ROI.
- (iii) The managers of division L and N, both would be reluctant to invest the additional fund of Rs. 8,00,000 because their return on the proposed project that is 16% and 12% respectively for division L and N are lower than their existing ROI of 18% and 16.5%. However, the manager of division N would be least likely to accept the additional investment because the gap of the present ROI and proposed ROI of the project is 4.5% than that of division L of 2%.
- (iv) Division L offers the best investment opportunity of 16% for LNG limited.
- (v) The managers are forced to choose between their personal best interests and the best interests of the company as a whole. When faced with decisions such as these, many managers choose to benefit themselves at the expense of their company, a condition described as sub optimisation.
- (vi) To avoid sub optimisation, the divisional performance measure be based on Residual Income (RI). If RI is used to measure the performance, there is greater probability that managers will be encouraged, when acting in their own best interests, also to act in the best interests of the company. Since, the use of RI does not penalise investment in projects with lower returns than current project returns.

In general, when RI is used as a performance measure, managers are willing to invest in any projects with returns equal to or greater than the required rate of return. However, RI suffers from the disadvantages of being an absolute measure, which means that it is difficult to compare the performance of a division with that of other divisions of a different size.

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE: GROUP – II**  
**PAPER – 6A: RISK MANAGEMENT**

**CASE STUDY: 1**

ABCD Ltd. is a diversified business group. The consolidated Balance Sheet, Statement of Profit & Loss and Cash Flow Statement of ABCD Ltd. prepared in analytical format are given below:

<b>Customer Name: ABCD LTD.</b>	<b>INR (Rs.) Thousand</b>	
	31-Mar-18	31-Mar-19
	12 months	12 months
<b>BALANCE SHEET</b>		
<b>CORE ASSETS</b>		
TOTAL FIXED ASSETS (A)	222,301	214,666
TOTAL CURRENT ASSETS (B)	763,428	679,539
TOTAL CURRENT LIABILITIES (C)	395,337	382,908
OPERATING CAPITAL EMPLOYED (A) + (B) – (C)	590,392	511,297
TOTAL NON-CORE/NON CURRENT ASSETS (D)	71,621	70,838
<b>OVERALL CAPITAL EMPLOYED (A) + (B) - (C) + (D)</b>	<b>662,013</b>	<b>582,135</b>
<b>CAPITAL STRUCTURE</b>		
Ordinary Share Capital	20,000	20,000
Profit and Loss Account	98,278	61,549
Other Reserves	35,080	36,303
Contribution from shareholders	202,248	202,248
Less: Intangibles	-12,112	-9,620
<b>TANGIBLE NET WORTH (E)</b>	<b>343,494</b>	<b>310,480</b>
Minorities	53,422	62,929
Provisions/Other Long Term Liabilities	61,790	56,445
<b>OTHERS (F)</b>	<b>115,212</b>	<b>119,374</b>
<b>EXTERNAL FINANCE (G)</b>		
Bank O/D and Short Term Loans	203,307	152,281
<b>OVERALL CAPITAL EMPLOYED (E) + (F) + (G)</b>	<b>662,013</b>	<b>582,135</b>
Contingent Liabilities	101,000	131,977
Capital Commitments	52,500	50,000
<b>PROFIT AND LOSS ACCOUNT</b>		
Sales	1,446,791	1,469,762
Less: Cost of Goods Sold	-1,117,664	-1,132,857
<b>GROSS PROFIT</b>	<b>329,127</b>	<b>336,905</b>
Less: Distribution and Selling costs	- 156,049	- 160,370

: Administration Costs	-114,623	-106,887
<b>OPERATING PROFIT</b>	<b>58,455</b>	<b>69,648</b>
Share of Profit of Associate Companies	2,030	10,059
Other Income	24,819	13,703
<b>PROFIT BEFORE INTEREST AND TAX</b>	<b>85,304</b>	<b>93,410</b>
Less: Interest Expense	-7,619	-4,777
<b>PROFIT BEFORE TAX</b>	<b>77,685</b>	<b>88,633</b>
Less: Taxation Charge	-6,500	-6,500
<b>PROFIT AFTER TAX</b>	<b>71,185</b>	<b>82,133</b>
Minorities	-11,976	-16,583
<b>PROFIT AVAILABLE FOR APPROPRIATION</b>	<b>59,209</b>	<b>65,550</b>

Additional Information [All amounts in Rs. 000s] :

Turnover comprises: Equipment and Automotive: 28680, Consumer Products: 71400,

Industrial Products: 29800 and Office Equipment: 17100.

Largest inventory item was trading inventory and finished goods, which towards 2019-end, decreased to 19100 (22200 as at 31<sup>st</sup> March, 2018).

Similarly, the figures of Trade Debtors and Creditors was as follows:

	31-Mar-18	31-Mar-19
Trade Debtors	366246	308547
Trade Creditors	217121	230476

Shareholders had purchased long outstanding government receivables, amounting to 4900 of a group company to improve its cash flows. Unused bank facilities as at 31<sup>st</sup> March, 2019 were 16800.

Sales growth of year 2019 is almost in line with the previous years. Trading inventory and finished goods as at 31<sup>st</sup> March, 2019 was 19100 (22200 as at 31<sup>st</sup> March, 2018).

### Descriptive Questions

1.1 Based on the calculation of major financial ratios, prepare a brief analytical report deriving the financial risk involved covering areas of Performance, Profitability, and Working Capital Management etc.

Your answer should be supported with relevant workings. (15 Marks)

### Multiple Choice Questions. Each Question carries 2 marks.

#### Choose the correct answer in the following Multiple Choice Questions

1.2 While uncertainty means the existence of more than one possibility, risk is a state of uncertainty where some of the possibilities may involve an undesirable outcome. Which one of the following statements correctly describes the above statement?

- (A) One may have uncertainty without risk but risk without certainty.
- (B) One may have uncertainty without risk but risk without uncertainty.
- (C) One may have uncertainty without risk but not risk without certainty.
- (D) One may have uncertainty without risk but not risk without uncertainty.

1.3 In respect of an organization, **Reputation risk** means

- (A) Risk of possible financial loss to the organization.
- (B) Risk of a failure which may lead to violation of the regulatory requirements that the organization is supposed to comply with.
- (C) Risk of the organization's reputation in public view which is a key concern in engaged media and social media.
- (D) None of the above.

1.4 Which one is an external factor in respect of risks for an insurance company?

- (A) Financial position
- (B) Machine failure
- (C) Staff Morale
- (D) Earthquake

1.5 If Risk rating is 5, then the risk is called

- (A) Severe
- (B) High
- (C) Moderate
- (D) Low

1.6 RAROC is

- (A) Return on capital adjusted for inflation.
- (B) Risk-based profitability measurement framework.
- (C) Return on gilts
- (D) None of the above

**(2 x 5 = 10 Marks)**

#### **CASE STUDY: 2**

Ms. X is new to operational risk management. While analysing the risks of an established airline based on the Risk Grading /Rating model, she identified the following risks:

- (1) Stagnant business growth resulting from competition from other airlines.
- (2) Aggressive fleet expansion, which may lead to over-capacities. There are about 170 aircrafts under order, which could also result in massive financial commitments. A comprehensive feasibility study has been shared by the Company, justifying the expansion strategy.
- (3) Safety standards resulting in crash/disastrous hijacking.
- (4) Volatile oil prices. There is a risk of failure to address adequately the challenges of fluctuating oil prices. Whilst it is usually rising oil prices that hurt airlines, during 2008, several airlines suffered significant hedging losses as the hedging strategies went awry, when oil prices plummeted from \$147 p/b in July 2008 to \$35-40 p/b level.

#### **Descriptive Questions**

2.1 Please, help Ms. X to classify the above risks, by giving a report to her. **(15 Marks)**

**Multiple Choice Questions. Each Question carries 2 marks.**

**Choose the correct answer in the following Multiple Choice Questions**

**2.2** One of the principles of Basel Committee on Banking Supervision Principles for sound stress testing practices and supervision is:

- (A) Stress testing should form an integral part of the overall governance and risk management culture of the bank.
- (B) Stress testing should be done in case of mergers or take overs only.
- (C) Stress testing should be done at the direction of Reserve Bank of India only.
- (D) None of the above

**2.3** Gini coefficient is an index to measure a country's:

- (A) level of corruption.
- (B) inequality in income distribution.
- (C) level of crimes, violence, military expenditure.
- (D) None of the above

**2.4** The following one is a financial risk:

- (A) The cash flow of an issuer will not be adequate to meet its financial obligation.
- (B) A fisherman starting a sea voyage on fishing expedition.
- (C) An infant climbing on a window pane.
- (D) A student writing the examination.

**2.5** If a long term instrument is rated as "B", this means that instrument carries:

- (A) Highest Safety
- (B) High Risk
- (C) Very High Risk
- (D) None of the above

**2.6** As per the RBI's framework, SMA (Special Mention Account) with sub category 1 (SMA-I) denotes:

- (A) Principal or interest payment overdue between 31-60 days.
- (B) Principal or interest payment overdue between 61-180 days.
- (C) Principal or interest payment not overdue for more than 30 days.
- (D) None of the above

**(2 x 5 = 10 Marks)**

### **CASE STUDY: 3**

You have been recently appointed as Chief Risk Officer of a company which is in Steel Castings business. Name of the Company is ABC Electro Steel Castings Ltd. [in short, ABC].

You have been told that ABC is fully committed to strengthen its risk management capability on continuous basis in order to protect and enhance shareholder value. You have been told that the risk management framework ensures compliance with the requirements of amended Clause 49 of the Listing Agreement. The framework establishes risk management processes across all businesses and functions of the Company. These processes are periodically reviewed to ensure that the Management controls risks through properly defined framework.

You are also made aware that the Company has already undertaken an extensive Risk Management effort that includes introducing Risk Management Manual, compiling a comprehensive profile of the key risks to the Company, identifying key gaps in managing those risks and developing preliminary action plans to address those risks. This effort accomplishes the following goals:

- responds to the Board's need for enhanced risk information and improved mitigation plan;
- provides the ability to prioritize, manage and monitor the risk in the business; and
- formalizes the explicit requirements for assessing risks on an ongoing basis, including an effective internal control and management reporting system.

You are also given information that the Company uses raw materials to manufacture the steel castings. It is faced with the threat of pressure on margins on sales. To counter the threat, the Company has taken various steps which include backward integration which comprises coal mines and iron mines, and brownfield expansions, e.g. sinter plant, sponge iron plant, coke oven plant, power plant from waste head recovery. It also set up an R & D to expand its manufacturing capacities with a view to control costs.

You came to know that the Company is ISO-140001-2004 certified and is adhering strictly to the emission norms applicable for industry.

You are also told that with the thrust given by Government of India on water and water related projects and with the estimated growth in water requirement, the demand of DI Pipes is expected to grow substantially and the Company is confident of retaining its market share.

Labour relations have been excellent throughout the year in spite of number of unions. It is the result of such cordial and harmonious relations that not a single man-day has been lost in the last 8 years. The Company believes that labour relations will continue to remain excellent.

### **Descriptive Questions**

3.1 Now, you have been asked to give a report to the Company's Management, which should contain the key risks affecting the Company. **(15 Marks)**

**Multiple Choice Questions. Each Question carries 2 marks.**

**Choose the correct answer in the following Multiple Choice Questions**

3.2 An excess payment made to a vendor, which is accounted correctly, would be categorized under which of the following risks?

- (A) Financial Reporting risk
- (B) Legal risk
- (C) Reputation risk
- (D) Financial risk

3.3 In Information Technology General Controls, under change management, the risk of incorrect change is NOT mainly due to

- (A) Change being wrongly conceived by the user groups
- (B) Change control audit trail not maintained
- (C) Change is wrongly executed
- (D) Change being carried out without approvals

3.4 Annual Report of the Board of Directors must include a statement indicating the development and implementation of a risk management policy for a company. This is mandated by

- (A) SEBI through 'Issue of Capital and Disclosure Requirements Regulations'

- (B) Information Technology(Amendment) Act, 2008
- (C) Companies Act, 2013
- (D) Prevention of Money Laundering Act, 2002.

3.5 While taking a decision, the category risk profile bucket that would most likely to escape attention of the Management is

- (A) High Impact-Low Probability
- (B) Low Impact-Low Probability
- (C) High Impact-High Probability
- (D) Low Impact-High Probability

3.6 Governance risks mean significant deficiencies that can impact the reputation, existence and continuity of the organization. Such deficiencies would NOT occur because of

- (A) Inappropriate practices adopted by the Board
- (B) Inability of the Board to identify trivial risk facts that can impact business continuity
- (C) Failure of the Board to direct and control the organization
- (D) Collusion of management to override significant internal control mechanism causing financial losses

**(2 x 5 = 10 Marks)**

#### **CASE STUDY: 4**

ABC Co. Ltd. is a manufacturing company and is listed. It has 10000 workers and 1200 employees. The Company is subject to Ind AS 19 in respect of its employee benefits which include gratuity.

Ind AS 19 is an Accounting Standard applicable to companies which are required to measure and disclose the amount of accrued liability (Present Value of Benefit Obligation) in respect of employee benefits in statements of accounts.

As per the Accounting Standard, the accrued liability in respect of, employee benefits can be determined using actuarial principles. Accordingly, the Company engaged an actuary for the purposes of the Ind AS 19.

The Company is, liable to make payment of gratuity benefit to its employees as per Payment of Gratuity Act, 1972. As per the Act, the gratuity benefit is determined using a formula, which is  $[15/26] \times$  monthly salary (which is relevant for gratuity calculation)  $\times$  number of completed years of service at the date of cessation of service of the employee. There are terms and conditions mentioned in the Act for payment of gratuity benefit, which the company is required to comply with the same.

The Company engaged Mr. X, a consultant actuary, to get the actuarial reports certified by Mr. X as per Ind AS 19 for the last two years.

After submission of the actuarial report by Mr. X, in the third year, Auditors (who were recently appointed by the Board) observed that Mr. X does not hold any certificate of fellowship issued by the Indian Actuarial professional body. They pointed out and qualified the Accounts in their Auditors' Report. They also observed that the Mr. X's reports were accepted during last two years.

Since the Management is worried over GRC (Governance, Risk and Compliance), the CRO (Chief Risk Officer) was asked to address the issue pointed out by the Auditors and submit a report to the Company giving details of the risks and how they can be mitigated.

#### **Descriptive Questions**

4.1 Now, you are recently appointed as the CRO and you are asked to draft the Report to be submitted to the Board, and the Report should include:

- (a) What is the type of risk the Company is subjected to?

(b) What is the impact of the risk on the Company's performance? (15 Marks)

**Multiple Choice Questions. Each Question carries 2 marks.**

**Choose the correct answer in the following Multiple Choice Questions**

**4.2** A FICO score of 750 means:

- (A) 1% of chance of default
- (B) 2% of chance of default
- (C) 8% of chance of default
- (D) 61% of chance of default

**4.3** Automated controls are dependent on a:

- (A) Manual check
- (B) Predefined system check
- (C) Predetermined check
- (D) None of the above

**4.4** The following is the Section of the Companies Act, 2013 that instructs that the Audit Committee shall review the risk management procedures implemented by the Management:

- (A) 177
- (B) 134
- (C) 315
- (D) None of the above

**4.5** The following aspect does not indicate the risk maturity of an organization:

- (A) Business objectives are defined and communicated across the organization.
- (B) Risk appetite is defined and communicated across the organization.
- (C) Control environment is strong including tone from the top.
- (D) None of the above

**4.6** Brexit impact scenario has the following associated principal risk:

- (A) Brand, Reputation and Trust
- (B) Data Security and Data Privacy
- (C) Political, Regulatory and Compliance.
- (D) None of the above

**(2 x 5 = 10 Marks)**

#### **CASE STUDY: 5**

Good Morning Ltd. is a start-up company specializing in three-dimensional modelling and solutions. The brainchild behind the company is Mr. Good and Morning who formulated the idea of providing 3D solutions to mid engineering is and engineers.

Before the foundation of the company, the founders hired a consultant to study the feasibility of the project whether they could establish various branches in major cities across the country and, offer solutions throughout the country and also ex- to select' EU and US regions. The consultant after analysing all the aspects of a feasibility study including technical, economic and financial concluded that the project is feasible if the market is tapped within the next 18 months. He had employed various statistical techniques and tools in his detailed analysis.

For the purpose of formation of the company, the founders sold their idea and raised Rs. 20 crores by way of bank loan from Bank of London., Terms of the loan are as follows:

Loan Amount	-	Rs. 20 crores
Rate of Interest	-	11.25 percent
Tenure	-	10 Years

They provided a joint property as collateral Security for an equivalent amount. Further, they also pooled Rs. 10 crores from known sources, from a foreign country. In order to safe guard their investment in the company, the foreign investors wanted a report on;

- (i) RBI's guidelines on Credit Default Swap (CDS),
- (ii) How the Basel II norms were applied in the Indian banking sector and the risk management measures with regard to loans sanctioned by them,
- (iii) risk appetite of the management,
- (iv) how various risks are addressed by management,
- (v) forming of risk management committee by the company
- (vi) uncertainties existing in the industrial climate,
- (vii) periodic audits to be carried out and
- (viii) the BCP mechanism

Expected revenue of the company are as follows:

2020-21	-	Rs. 18 crores
2021-22	-	Rs. 27 crores
2022-23	-	Rs. 32 crores

10% p.a. growth from thereafter.

Also, the founder were informed that the key to measure the success of the project is proper accounting. An ERP was implemented to record the financial transactions and several controls were put in place to prevent/detect any undesired events from occurring.

Recently Mr. Good learnt from a journal that organizations possessing details of EU citizens must comply with the stringent GDPR regulations. In case the organization need to comply with GDPR, there should be proper framework built in the organization.

Further they learnt that the companies Act 2013 requires a company's Board to develop and implement a proper risk management policy to identify those risks that cause a doubt on the going concern assumption of the company.

The company was keen to adopt sound Risk Governance Practices as well as the company grows. However, a major risk that the company faces is the technology that constantly changes.

The company has planned to provide solutions to customers located abroad as well. In that case, the company would be receiving the foreign currency.

The founders are worried about the volatility of the market and thus would like to cover their exposure by taking an appropriate position in the market.

### **Descriptive Questions**

**5.1** Based on the above scenario, answer the following questions:

- (a) Explain briefly the key features of Reserve Bank of India guidelines on CDS. **(6 Marks)**
- (b) Differentiate between Credit Insurance and Credit Default Swaps. **(6 Marks)**
- (c) Explain the methods of Estimating Probability of Credit Default. **(3 Marks)**

**Multiple Choice Questions. Each Question carries 2 marks.**

**Choose the correct answer in the following Multiple Choice Questions**

**5.2** Before commencement of the project, various risks factors have to be considered for feasibility study. In a case where a project feasibility is based on a particular land acquisition and the cost of treating it in terms of legal fees is much higher, the appropriate recommendation the consultant would provide is to:

- (A) Terminate the Project
- (B) Treat the Project
- (C) Transfer the Project
- (D) Continue the Project

**5.3** The Delphi technique is a method which involves getting opinion on a process

- (A) From an Individual
- (B) From Group of Individuals
- (C) From Regulator
- (D) None of the above

**5.4** Which of the following is not an Internal risk ?

- (A) Economic factors as price fluctuations, changes in consumer preferences, inflation, etc.
- (B) Technological factors unforeseen changes in the techniques of production or distribution resulting into technological obsolescence etc.
- (C) Physical factors such as fire in the factory, damages to goods in transit, etc.
- (D) Human factors as strikes and lock-outs by trade unions; negligence and dishonesty of an employee; accidents or deaths in the factory etc.

**5.5** The concept of risk-based maintenance is an advanced form of :

- (A) Probability Centered Maintenance
- (B) Risk Centered Maintenance
- (C) Control Centered Maintenance
- (D) Reliability Centered Maintenance

**5.6** Operational risk is an overarching concept interrelated with

- (A) Several other types of risk, and can be viewed in isolation.
- (B) Several other types of risk, and can be viewed with no financial impact.
- (C) Several other types of risk, and cannot be viewed in isolation
- (D) None of the above

**(2 x 5 = 10 Marks)**

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE: GROUP – II**  
**PAPER – 6A: RISK MANAGEMENT**

**Solutions**

**Note: Please note these solutions are for guidance purpose only.**

**ANSWERS TO CASE STUDY: 1**

**1.1 Working Notes:**

**(a) Profitability Ratios**

	31.03.2018	31.03.2019
(i) Gross Profit Ratio	$\frac{\text{Gross Profit}}{\text{Sales}} \times 100$ $= \frac{3,29,127}{14,46,791} \times 100$ $= 22.75\%$	$\frac{\text{Gross Profit}}{\text{Sales}} \times 100$ $= \frac{3,36,905}{14,69,762} \times 100$ $= 22.92\%$
(ii) Net Profit Ratio	$\frac{\text{Net Profit}}{\text{Sales}} \times 100$ $= \frac{85,304}{14,46,791} \times 100$ $= 5.896\%$	$\frac{\text{Net Profit}}{\text{Sales}} \times 100$ $= \frac{93,410}{14,69,762} \times 100$ $= 6.355\%$
(iii) Return on Capital Employed	$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$ $= \frac{58,455}{5,90,392} \times 100$ $= 9.90\%$	$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$ $= \frac{69,648}{5,11,297} \times 100$ $= 13.62\%$

**(b) Performance Ratios**

	31.03.2018	31.03.2019
(i) Inventory Turnover Ratio	$\frac{\text{Cost of Goods Sold}}{\text{Closing Inventory}}$ $= \frac{1,117,664}{22,200}$ $= 50.34 \text{ times}$	$\frac{\text{Cost of Goods Sold}}{\text{Closing Inventory}}$ $= \frac{1,132,857}{19,100}$ $= 59.31 \text{ times}$
(ii) Debtor Turnover Ratio	$\frac{\text{Sales}}{\text{Closing Debtors}}$ $= \frac{14,46,791}{3,66,246}$ $= 3.95 \text{ times}$	$\frac{\text{Sales}}{\text{Closing Debtors}}$ $= \frac{14,69,762}{3,08,547}$ $= 4.76 \text{ times}$

**(c) Liquidity Ratios**

	31.03.2018	31.03.2019
(i) Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$ $= \frac{763,428}{395,337}$ $= 1.93 : 1$	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$ $= \frac{679,539}{382,908}$ $= 1.77 : 1$

***Analytical Report***

To: The Management

From: Chief Risk Officer

Date: 15 October 2019

Subject: Analytical Report on Financial Risks Involved

**Introduction**

This analytical report covers Performance, Profitability, Working Capital Management, Liquidity etc.

**Performance:** Performance of the company has been improved in the year ending 31.03.2019 as the Inventory Turnover and Debtor's Turnover Ratios have been improved.

**Profitability:** So far as the profitability of the company is concerned there is no improvement in the Gross Profit Ratio which is almost same. Though some improvement is there in Net Profit Ratio and Return on Capital Employed.

**Working Capital Management:** On this front company is performing well as company is reducing the investment in the stock or inventory. However, it appears that company is not using the available credit facilities from the supplier by paying off the old payables.

**Liquidity:** From the Current Ratio it appears that company enjoys a comfortable liquidity situation.

**Conclusion:** Presently company is not facing any major risk.

Signed/-

Chief Risk Officer

1.2 (D)

1.3 (C)

1.4 (D)

1.5 (C)

1.6 (B)

**ANSWERS TO CASE STUDY: 2**

2.1 Report to Ms. X

To: Ms. X

From: Chief Risk Officer

Date: 15 October 2019

**Subject: Grading/ Bucketing of Various Risks**

Introduction

This report covers grading/ bucketing of various identified risks by the client.

#### Grading of various Risks

(1) Stagnant business growth resulting from competition from other airlines.

Although this risk has a high impact but has low probability as investment involved in the Airline business is very huge. Accordingly, this risk often skips the management's decision as these type events cannot be foreseen. Hence, this risk is bucked in the category of '**High Impact – Low Probability**'.

(2) Aggressive fleet expansion leading to over-capacities.

Since Airline has already ordered 170 aircrafts there is high probability that it will involve financial commitments and impact will also be high. Hence, this risk is bucked in the category of '**High Impact – High Probability**' and it needs immediate and sufficient attention of management.

(3) Safety Standards resulting in Crash/ disastrous hijacking

Any crash or dangerous hijacking incidents will create negative publicity, poor image resulting in a decline in revenue and similar consequences.

Whilst the probability is low, the strong impact ought to force the seeking of appropriate mitigants. Hence, the impact is high and can be classified as '**Low Probability – High Impact**'. It is suggested to ensure the adequacy of safety systems, to establish the average age of the aircraft and if necessary, to seek the help of an external expert.

(4) Volatile Oil Prices

Oil price fluctuation is a business risk that has serious implications for the profitability of the airline business. However, since this affects almost all competitors, the impact can be considered as low and can be categorized as '**Low Probability – Low Impact**'.

Signed/-

Chief Risk Officer

2.2 (A)

2.3 (B)

2.4 (A)

2.5 (B)

2.6 (A)

#### ANSWERS TO CASE STUDY: 3

3.1 To: The Management

From: Chief Risk Officer

Date: 15 October 2019

**Subject: Key risks affecting the company**

This report covers some of the key risks affecting the Company are illustrated below:

(a) **Economic Risk:** Due to increase in the cost of number of inputs and raw materials used by the Company, it is faced with the threat of pressure on margins on sales. To counter this, the Company has taken various steps including backward integration which comprises own coal mines and iron mines and brownfield expansions e.g. sinter plant, setting up sponge iron plant, coke oven plant, power plant from waste heat recovery, upgrading and expanding manufacturing capacities and increasing efforts on R&D. In addition, cost control measures are an ongoing process.

To avoid price volatility for critical items, the company can attempt to enter into long term contracts.

(b) **Competitor Risk:** The quality improvement efforts have established the brand image of the product as the most preferred brand with the customers. With the thrust given by Government of India on water and water related projects and with the estimated growth in water requirement, the demand of DI pipes is expected to grow substantially, and the company is confident of retaining its market share.

(c) **Foreign Exchange Risk:** Considering the large export and imports of raw material, the Company is exposed to the risk of fluctuation in the exchange rates.

The Company has adopted a comprehensive risk management review system wherein it actively hedges its foreign exchange exposures within defined parameters, through use of hedging instruments such as forward contracts, options and swaps. The company periodically reviews and audits its risk management initiatives through an independent expert.

(d) **Industrial Risk:** The company is exposed to labour unrest risk, which may lead to production slowdown ultimately resulting in plant shutdown.

Labour relations have been excellent throughout the year in spite of number of unions. It is result of such cordial and harmonious relations that not a single man-day has been lost in the last 8 years. The Company believes that labour relations will continue to remain excellent.

(e) **Environment Risk:** The company is exposed to the risk of Environment and Pollution Controls, which is associated with such types of industries.

The Company is committed to the conservation of the environment and has adopted the latest technology for pollution control. The Company is ISO-140001-2004 certified and is adhering strictly to the emission norms applicable for the industry.

(f) **Payment Risk:** The company is exposed to the risk of defaults by the customers in payments.

Since major water infrastructure projects are government founded or foreign aided, the risk involved in payment defaults is minimum. Further, evaluation of the credit worthiness of the customers has minimized the risk of default by other segment customer. Besides, the risk of export receivables is covered under Credit Insurance.

Signed/-

(Risk Manager)

3.2 (D)

3.3 (B)

3.4 (C)

3.5 (A)

3.6 (B)

#### **ANSWERS TO CASE STUDY: 4**

##### **4.1 Report to Board of Directors**

To: The Board of Directors, ABC Co. Ltd.

From: Chief Risk Officer

Date: 15 October 2019

**Subject: Analytical Report on Risks Involved**

This analytical report covers the reply on the various concerns raised by the Board of Directors.

**(a) What is the type of the risk the Company is subject to?**

The risk arising from this lapse is 'Legal Risk' or 'Compliance Risk' as it is resulting from the failure to comply with statutory or legal requirements.

**(b) Impact on Company's Performance**

The various types of impacts on the company's performance are as follows:

- (i) Bringing bad name and reputation for the Company.
- (ii) Over or Under Statement of Profit Loss in Income Statement of Company leading wrong decisions by the Company itself and external parties.
- (iii) Wrong financial position of the Company in the Balance Sheet.
- (iv) Due to wrong calculation of profit company may have paid wrong dividend in previous years.
- (v) Wrong computation of Cash Flows of the previous years and consequently leading to wrong budgeting figures.
- (vi) Wrong decision based on wrong budgeted figures.

Signed/-

Chief Risk Officer

**4.2 (B)**

**4.3 (B)**

**4.4 (A)**

**4.5 (D)**

**4.6 (C)**

**ANSWERS TO CASE STUDY: 5**

**5.1 (a) Key features of RBI guidelines on CDS**

- Participants in the CDS market are classified as either users or market makers. User entities are permitted to buy credit protection (buy CDS contracts) only to hedge their underlying credit risk on corporate bonds. Such entities are not permitted to hold credit protection without having eligible underlying as a hedged item. The users cannot buy CDS for amounts higher than the face value of corporate bonds. This is the most important point of difference, as there was no such limitation in United States of America prior to 2008, and hence many Institutional players had taken huge long positions (in CDS) without having any exposure to reference asset.
- Since the users are envisaged to use the CDS only for hedging their credit risks, assumed due to their investment in corporate bonds, they shall not, at any point of time, maintain naked CDS protection i.e. CDS purchase position without having an eligible underlying bonds held by them and for periods longer than the tenor of corporate bonds held by them.
- The eligible entities under user's category would be Commercial Banks, PDs, NBFCs, Mutual Funds, Insurance Companies, Housing Finance Companies, Provident Funds, Listed Corporates, Foreign Institutional Investors (FIIs) and any other institution specifically permitted by the Reserve Bank of India.
- CDS will be allowed only on listed corporate bonds as reference obligations. However, CDS can also be written on unlisted but rated bonds of infrastructure companies. This is another major area of difference between the US markets and RBI guidelines. In United States of America, the CDS were written on various pass through securities like Mortgage Backed Security (MBS), Collateralized Debt Obligation (CDO) etc, whereas as per the RBI

guidelines, the CDS are specifically restricted for listed corporate bonds, the obvious reason being that there is no big market of pass through securities in India as it is in US.

- The credit events specified in the CDS contract may cover: Bankruptcy, Failure to pay, Repudiation/moratorium, Obligation acceleration, Obligation default, Restructuring approved under Board for Industrial and Financial Reconstruction (BIFR) and Corporate Debt Restructuring (CDR) mechanism and corporate bond restructuring.
- Since, CDS are traded mainly over-the-counter (OTC), the contracting parties therefore have to agree upon the terms and conditions of the CDS individually. In order to facilitate documentation, and to avoid disputes as to whether a credit event had actually occurred and how a contract should best be settled, CDS contracting parties (in the international and US market) generally refer to the International Swaps and Derivatives Association (ISDA) Master Agreement. In India, the RBI guidelines specifically states that Fixed Income Money Market and Derivatives Association of India (FIMMDA) shall devise a Master Agreement for Indian CDS
- Regarding the Settlement procedures, the RBI Guideline states that the parties to the CDS transaction shall determine upfront, the procedure and method of settlement (cash/physical/auction) to be followed in the event of occurrence of a credit event and document the same in the CDS documentation. However it further adds that for transactions involving users, physical settlement is mandatory. For all other transactions, market-makers have been permitted to opt for any of the three settlement methods (physical, cash and auction), provided the CDS documentation envisages such settlement
- Further, the guidelines specifically provide norms for Prevention of mis-selling and market abuse, wherein it requires protection sellers to ensure that CDS transactions shall be undertaken only on obtaining from the counterparty, a copy of a resolution passed by their Board of Directors, authorizing the counterparty to transact in CDS.
- RBI has also incorporated certain reporting requirements in the guidelines which would require market makers to report their CDS trades with both users and other market makers on the reporting platform of CDS trade repository within 30 minutes from the deal time. The users would be required to affirm or reject their trade already reported by the market- maker by the end of the day. In addition to these reporting requirements the participants are also required to report to respective regulators (e.g. IRDA for Insurance companies) information as required by them such as risk positions of the participants vis-à-vis their net worth and adherence to risk limits, etc.

**(b) Difference between Credit Insurance and Credit Default Swaps**

CDS contracts have obvious similarities with insurance, because the buyer pays a premium and, in return, receives a sum of money if an adverse event occurs.

However, there are also many differences, the most important being that an insurance contract provides an indemnity against the losses actually suffered by the policy holder on an asset in which it holds an insurable interest. By contrast a CDS provides an equal payout to all holders, calculated using an agreed, market-wide method. The holder does not need to own the underlying security and does not even have to suffer a loss from the default event. The CDS can therefore be used to speculate on debt objects.

The other differences include:

- The seller might in principle not be a regulated entity (though in practice most are banks);
- The seller is not required to maintain reserves to cover the protection sold (this was a principal cause of AIG's financial distress in 2008; it had insufficient reserves to meet the "run" of expected payouts caused by the collapse of the housing bubble);

- Insurance requires the buyer to disclose all known risks, while CDSs do not (the CDS seller can in many cases still determine potential risk, as the debt instrument being "insured" is a market commodity available for inspection, but in the case of certain instruments like CDOs made up of "slices" of debt packages, it can be difficult to tell exactly what is being insured);
- Insurers manage risk primarily by setting loss reserves based on the Law of large numbers and actuarial analysis. Dealers in CDSs manage risk primarily by means of hedging with other CDS deals and in the underlying bond markets;
- CDS contracts are generally subject to mark-to-market accounting, introducing income statement and balance sheet volatility while insurance contracts are not;
- To cancel the insurance contract the buyer can typically stop paying premiums, while for CDS the contract needs to be unwound

**(c) Types of Estimation of Probability of Credit Default**

1. **Pooling Method:** This method relies on the historical data and assumes that past defaults are a reasonable predictor for future likelihood of losses. Historical Probability Default (PD) is calculated by taking the ratio of the facilities that have defaulted to the total facilities that existed in the concerned time frame, usually a year. In this method, the facilities are divided into different categories/pools based on their risk drivers.

2. **Statistical Method:** Data on characteristics of retail obligors and corporate obligors can be used to estimate their respective probability of defaults. Various statistical techniques can be employed on the data to estimate PD for defined time horizons. The statistical model specifies the relationship between the inputs and the outcome – PD. The parameters determined depend on the data used to develop the model.

One of the most recommended statistical techniques to estimate PD is logistic regression. This method of regression is applicable when the dependent variable is binary i.e. takes one of the two available values i.e. default & non default. This variable indicates whether or not the loan/debt has gone into default over a certain time horizon, usually a year. Some of the common variable sources used to estimate the PD of a corporate are financial statements, owner's data, type of loan, size of loan, and industry of the company. Similarly, for retail obligors, variable sources could be customer demographics, income statistics, age of loan, and number of late payments etc.

3. **Structural Method:** This method is generally applicable for listed corporate entities wherein structural models are used to calculate the probability of default for a corporate based on the value of its assets and liabilities. This technique is a sophisticated approach and requires valuation models to be applied for firm valuation.

Over a period of time, we propose to collate other statistical relevant inputs to explore possibilities of using statistical method for PD calculation as well as to improve portfolio quality.

5.2 (A)  
 5.3 (B)  
 5.4 (A)  
 5.5 (D)  
 5.6 (C)

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE: GROUP II**  
**PAPER 6B: FINANCIAL SERVICES AND CAPITAL MARKETS**

**I. Case Study Question number One**

The following data relates to a Mutual Fund as at 31-3-2018:

	<b>Quantity (Nos.)</b>	<b>Value (Rs.'000)</b>
<b>Unit Capital :</b>		
Outstanding at the beginning of the year	264,31,998.59	2,64,319
Issued during the year	6,85,59,200.117	6,85,592
Redeemed during the year	66,77,620.32	66,776
Outstanding at the end of the year	<b>883,13,578.387</b>	<b>8,83,135</b>
<b>Reserves and Surplus</b>		
Unit Premium Reserve		
Balance at the beginning of the year		(3,396)
Net Premium/Discount on issue/ redemption of units		98,266
Balance at the end of the year		94,870
Unrealized Appreciation		
Reserve Balance at the beginning of the year		7,870
Change in unrealized appreciation in value of Investments		14,972
Balance at the end of the year		22,842
RETAINED SURPLUS		
Balance at the beginning of the year		6,23,319
Transferred to Revenue account		(1,366)
Surplus transferred from revenue account		19,65,669
Balance at the end of the year		25,87,622
Total Reserves		<b>27,05,334</b>
<b>Current Liabilities</b>		
Amount due to AMC for Management Fees		1615
<b>Others</b>		64
Sundry Creditors of units redeemed by investors		
Lateral Shift payable		420
Others		19
Contract for purchase of investments		2,60,840
Inter Scheme Payable		-
Dividend payable on units		-
Dividend Distribution Tax Payable		-

Unclaimed Dividend		-
Unclaimed redemption		
Unit Application pending allotment	70	
Investor education expense provision	60	
Interest on borrowing		
<b>Other Current Liabilities</b>		2878
<b>Investments</b>		
Listed Debentures and Bonds	14,20,321	
Government Securities	<u>20,69,363</u>	
Total	<u>34,89,684</u>	
Deposit with scheduled banks		-
<b>Other Current Assets</b>		
Balances with Banks in Current Accounts	4851	
Sundry debtors for units issued to investors		
-Lateral shift receivable	3	
-Others	2	
Inter-scheme receivables	689	
Margin Deposit with Clearing Corporation of India	-	
Outstanding and accrued income	86,336	
Amount due from AMC	-	
Collateralised Lending	<u>2,72,898</u>	
<b>Total</b>	<u>3,64,779</u>	
Interest		
Money market Instruments	188	
Debentures and Bonds	57,425	
Deposits	-	
Government Securities (including Treasury Bills)	1,17,501	
Collateralised Lending	6,950	
Less: Interest on Borrowing	-	
<b>Total</b>	<b>1,82,065</b>	

The average expenses ratio (including management fees) amounted to 2.65% which also included GST.

(A) Answer the following questions and reason out your answers:

- (i) Under what type of a mutual fund product would you classify the above? Why? **2 Marks**
- (ii) Is the scheme open or close ended? Why? **2 Marks**
- (iii) Can it be assumed without any contradiction that the product is traded in the stock exchange? **2 Marks**
- (iv) Is switching between plans permitted in this mutual fund product ? **2 Marks**

(v) Why is there a nil balance in deposit with scheduled banks ? **2 Marks**

(vi) From the given figures, do you conclude that the scheme has performed well during this year in question ? **2 Marks**

(vii) The fund had invested in Treasury Bills of face value Rs. 1,00,000 each amounting to Rs. 90 crores. If the average annualized yield calculated based on 85 days as on 31<sup>st</sup> March, 2018 was 8.76%, what was the amount of average purchase price ? **3 Marks**

(B) Answer the following as directed: **(2 Marks x 5 = 10 Marks)**

- (i) The type of entity of a mutual fund is:
  - (A) a private limited company
  - (B) a public limited company
  - (C) a partnership firm or LLP
  - (D) none of the above
- (ii) The investments by a mutual fund are controlled by
  - (A) RBI
  - (B) SEBI
  - (C) Registrar of Companies
  - (D) Both (A) and (B)
- (iii) When the holder of units of a mutual fund can sell his units at any time during the year,
  - (A) the fund is an equity fund
  - (B) the fund is a bond fund
  - (C) the fund is a balanced fund
  - (D) nothing can be said about the classification of the fund from the saleability.
- (iv) The following is not true in the context of a mutual fund's payment to its unit-holders :
  - (A) a scheme that invests in equity pays dividends.
  - (B) an exchange traded fund pays dividends.
  - (C) a bond fund pays interest.
  - (D) a G-sec. fund pays dividends.
- (v) Under a Systematic Investment Plan, the following is NOT TRUE:
  - (A) Unit holders can invest on a monthly basis whatever amount they can save.
  - (B) Investors can invest only a pre-specified amount every period, say monthly, quarterly or half yearly.
  - (C) If an investor has subscribed Rs. 3,000 in quarterly payments for a 3 year SIP, he can choose to step up this amount to Rs. 4000 from the second year.
  - (D) Even where the SIP amount in a financial year does not exceed Rs. 50,000 an investor cannot invest in cash.

## **II. Case Study Question Number Two**

You are practicing in the area of advisory services giving opinions on technical issues relating to the capital markets and financial instruments. The following questions have been raised by different clients for whom you need to explain your answers or give your opinion. Your clients range from well informed CFOs of companies to ordinary individuals.

(A) Answer the following:

- (i) What is meant by a recognized stock exchange? Is there any stock exchange which is functional that is not recognized? **3 Marks**
- (ii) In case the promoter is an individual, can his holding be counted for the limit applicable for a retail individual investor? State the regulation in support of your answer. **3 Marks**
- (iii) X is an individual having a surplus of Rs. 5 lacs. He is interested in investing the amount in shares of a company in an initial public offer. He has a preference for A Ltd. which is to open for subscription on 30th May 2018. The market predictions indicate an oversubscription of that issue. If he does not get any allotment or if he is allotted shares for any lesser value, he would like to invest in Company B Ltd. whose offer is to open on July 1<sup>st</sup>. He fears that his money will be blocked in the first issue and may not be refunded to him in time for him to apply for B Co. Ltd.'s issue. If he does not want to borrow any money for that purpose, how will he overcome the problem? Discuss. **3 Marks**
- (iv) S & P BSE Sensex was 32840.5 on a certain day. On the same day, Nifty 50 was 10,287.70. Explain the vast difference between the numbers and the underlying concept. **3 Marks**
- (v) Identify suitable investments (indicate broad category rather than specific instruments) that may ideally fit into the investment objectives of the following individuals :

Investment Objective	Instrument	Instrument
Growth and Appreciation in value		
Regular Income		
Liquidity		

**3 Marks**

(B) Choose the most appropriate answer from the following: **2 Marks x 5 =10 Marks**

- (i) The following is true:
  - (A) An investment Bank needs no licence from RBI
  - (B) SEBI has to approve the draft prospectus within thirty days of submission to it. If no reply is received within 30 days of submission, it is deemed to have no objection and the company may proceed with public issue,
  - (C) A Merchant Banker shall not apply for the shares of its client company,
  - (D) An Asset Management Company is a Banking Company governed by the RBI to deal with a mutual fund's investments in different sections of the financial market.
- (ii) The following commodity is not traded in the Indian Commodity Exchange:
  - (A) Diamonds
  - (B) Tomatoes

- (C) Crude Oil
- (D) Pepper
- (iii) A company has receivables of Rs.150 crores from four borrowers. It converts these into smaller portions of Rs. 500 each and sells these to smaller investors in the secondary market. This fragmentation of the loan is called
  - (A) Debt unit scheme
  - (B) Mutual fund scheme
  - (C) Debt securitization
  - (D) Asset Reconstruction
- (iv) Margin Trading is the following:
  - (A) Stock brokers trade on the client's behalf up to the variation margin maintenance.
  - (B) Stock brokers trade on the clients' behalf even consuming the initial margin.
  - (C) Investors buy more number of shares than they have money for by paying a lower proportion of the cost and getting the balance funded by their bankers.
  - (D) A stock broker keeps a margin in his account with the stock exchange for the netting position shortfall among his clients.
- (v) Settlement of Stock Market trading happens on:
  - (A) T + 1
  - (B) T + 2
  - (C) T + 3
  - (D) On the date of trading

### **III. Case Study Question Number Three**

Krishi Vikas Equipment Ltd. (KVE) is an existing unlisted and successful company engaged in manufacturing and marketing agricultural equipment in India. The Company is family-owned and is now headed by a qualified engineer and a member of the family who is the Managing Director (MD). Though family-owned, the Company employs qualified professionals and is soundly managed. Being a player catering to the agri-sector, the Company's products are in good demand and its profitability is sound. The family owners are keen on new products and expansion. In the past, they have been reluctant to borrow except for genuine working capital requirements on short term basis.

The MD has had various discussions with the in-house professionals who have zeroed in on a set of new agricultural implements and have all related marketing and technical information ready. The key figures in relation to the expansion they have planned are summarized as below :

	(Rs. In lakhs)
Total project cost	2000
Annual sales (upon full implementation)	3000
Earnings before interest, depreciation & tax	900
Annual depreciation	120

The Chief Financial Officer (CFO) went to discuss with the MD (Project Meeting 1) with the following additional information:

- (i) Latest audited Balance Sheet and profitability summary) - Annexure 1
- (ii) Estimated Cash Flow Statement for the next 3 financial years - Annexure 2
- (iii) Earnings Per Share (EPS) data - KVE vs. Market - Annexure 3

At Project Meeting 1, MD explained to the CFO that the family does not wish to invest 'own money' further; but it is keen about expansion; therefore, company should think of external equity without diluting control. He studied the information brought by the CFO and then said that a senior executive of a Private Equity (PE) enterprise will be coming to meet him in three days' time. Before meeting with the PE, the MD wanted to know from the CFO, among other things, the following:

- (a) If the KVE's shares were to be quoted in the secondary capital market, what would be price/share?
- (b) How the price per share will be fixed if KVE comes up with a capital issue?
- (c) What are the advantages and disadvantages of going with the PE?
- (d) Any other suggestions / points relevant to the issue at hand

It was decided then that the MD and the CFO will again meet (Project Meeting 2) the day before the meeting with the PE.

(A) In the above background, kindly deal with the following situations. Your detailed answers may be given to each of the requirements in the question.

- (i) Bearing in mind the views of the present ownership / management on the question of ownership and equity dilution, what would be your recommendations for putting through the project? **3 Marks**
- (ii) Would you like to examine the debt-equity position of the company and suggest a quantum of debt to be raised by the company additionally? It is gathered that the normal debt equity ratio applicable to the business in which the company is engaged is 2:1. **3 Marks**
- (iii) You are required to indicate the possible additional equity issue by the company based on the understanding that the present ownership will relax its stand on dilution. Indicate the alternatives when equity dilution of 40%, 50% or 60% takes place. **3 Marks**
- (iv) Kindly indicate the issue price of the additional equity. You may be aware that though this company's shares are not listed in the exchange, shares of similar sized companies are quoted - details of which all given in the schedule - and this company's valuation may not be vastly different from that of the average company in the quoted / listed group. **3 Marks**
- (v) Kindly prepare an executive summary of the recommendations to be put up to the Board of Directors of the company. **3 Marks**

(B) Choose the most appropriate answer from the following: **2 Marks x 5 =10 Marks**

1. Which of the following is **not true** for Primary Market conditions?
  - (a) In Primary Market, the company directly involved in the transaction for listing

- (b) Primary Market involves relationship between company and prospective investors
- (c) Primary Market involves relationship between investors who are actively involved in the market
- (d) None of the above

2. Nifty Futures expires on.....

- (a) Every Thursday of week
- (b) Last Thursday of the month
- (c) Twice in a month
- (d) Last Friday of the month

3. Which of the following statement is **not true** with respect to exercising call option?

- (a) A call option buyer has limited loss and unlimited profit opportunity
- (b) A call option seller has unlimited loss and limited profit opportunity
- (c) A call option buyer has obligation to exercise the option
- (d) A call option is linked with underlying assets or security

4. Green Shoe Option is used for:

- (a) Under allotment of shares
- (b) Overallotment of shares
- (c) It acts as a price stabilizing mechanism
- (d) Both (b) and (c)

5. Treynor Ratio evaluates the performance of the portfolio on the basis of:

- (a) It evaluates the performance based on total risk of the portfolio
- (b) It considers systematic risk i.e. beta to evaluate the performance
- (c) It calculates performance of portfolio uses standard deviation
- (d) It considers performance of portfolio excess of funds actual return minus expected return

#### ANNEXURE 1

#### KRISHI VIKAS EQUIPMENT LTD.

#### BALANCE SHEET AS AT 31<sup>st</sup> MARCH (Amounts in Rs. lakhs)

	2018	2017	2016
ASSETS			
Non-current Assets			
Property, plant and equipment	1080	1025	1000

Financial assets	330	250	
Other Non-current assets	35	40	40
Sub-total	1445	1315	1040
Current Assets	<u>1985</u>	<u>1881</u>	<u>1750</u>
<b>TOTAL ASSETS</b>	<b><u>3430</u></b>	<b><u>3196</u></b>	<b><u>2790</u></b>
<b>EQUITY &amp; LIABILITIES</b>			
Equity			
Equity Share Capital *	500	500	500
Other Equity	1510	1360	980
Sub-total	2010	1860	1480
Non-current Liabilities	583	581	580
Current Liabilities			
Trade payables	680	600	575
Provisions	15	15	15
Other Current Liabilities	142	140	140
Sub-total	837	755	730
<b>TOTAL EQUITY &amp; LIABILITIES</b>	<b><u>3430</u></b>	<b><u>3196</u></b>	<b><u>2790</u></b>

\*Shares of Rs. 10 each.

#### PROFIT / LOSS SUMMARY

	(Amount in Rs. Lakhs)		
	2018	2017	2016
Profit Before Tax	640	970	450
Taxes	190	290	135
Net profit	450	680	315
Dividend	300	300	250
Retained Profit	150	380	65

#### ANNEXURE 2

#### KRISHI VIKAS EQUIPMENT LTD.

#### ESTIMATED CASH FLOW STATEMENT

Year ended 31<sup>st</sup> March – Amounts in Rs. lakhs

	2019	2020	2021
Cash flow from Operating activities :			
Profit before tax	1750	2012	2515

Adjustments for Depreciation	180	200	220
Dividend & Interest Income	(100)	(120)	(150)
Change in operating assets & liabilities			
Increase/decrease in current assets	(250)	(300)	(400)
Increase/decrease in current liabilities	120	140	160
Cash generated from operations	1700	1932	2345
Income tax paid	(525)	(605)	(755)
Net cash inflow from operating activities	1175	1327	1590
Cash flow from investing activities:			
Dividends & Interest received	100	120	150
Net cash flow from investing activities	100	120	150
Cash flow from financing activities			
Dividends	(300)	(300)	(300)
Dividend taxes	(32)	(32)	(32)
Net cash outflow from financing activities	(332)	(332)	(332)
Net increase/(decrease) in cash & cash equivalents	943	1115	1408
Cash & cash equivalents at the beginning of the year	525	1468	2583
Cash & cash equivalents at the end of the year	1468	2583	3991

**ANNEXURE 3**  
**EARNINGS PER SHARE INFORMATION**

S. No.	Name of company	EPS (Rs.) YE 31/03/2018	Market Price (Rs.)	
			High	Low
1	Agri- Imp Ltd.	4.50	45	41
2	Implements (I) Ltd.	3.20	51	42
3	Beta Products Ltd.	6.00	110	80

**IV. Case Study Question Number Four**

HRS Ltd. is an asset financing company with a proven track record and has been in the business of mainly providing finance to purchase trucks, tractors, farm equipment and commercial vehicles. In the past, it was financing used and new vehicles, but over the recent years, it prefers to concentrate on new vehicles only. Trucks form the major part of the financing business. There is a lot of competition in this field, but due to the increasing norms on pollution control and the decrease in the value of second hand vehicles, the company wants to strategically confine itself only to new vehicles in the coming years. HRS Limited mainly uses debt finance for its operations. The debt-equity ratio is in the range of 5:1 on an average. This is in line with the industry.

The company feels that in addition to truck financing, it can expand its business to finance smaller vehicles such as passenger cars and tempo travellers. The current expansion plan is described in the succeeding paragraphs:

There has been a recent entrant in the country wide market by a mobile application provider who has not only ushered in a revolution in the way cars are being hired by common man, but also in the manner of documentation of bookings, charges, cancellations and in the ownership of vehicles for such hire. This operator has also lured many entrepreneurs to successfully earn money either as drivers or as owners of self-driven cars and be engaged by users of the mobile app. This app has found immense success in the car segment and is also being considered for trucks for transport as well as connections from goods trains to factories so that companies can track the distribution of material and finished goods on an optimal cost.

While discussing with this app provider, HRS Ltd. has discovered a huge potential to finance vehicles to be demanded by virtue of the app users who may be new entrepreneurs, small transport companies, etc. Since the individual entrepreneurs may turn out to be risky and counterproductive for HRS for repossession in the event of failure to repay, the app provider, who has a wide data base and the recovery mechanism for fares realized, has agreed to be the co-borrower for the vehicles. Under such an arrangement, the vehicles financed will be hypothecated to HRS by the entrepreneur who is the principal borrower, fully guaranteed by the app provider. The app provider will also ensure that the used vehicle is also being handed over to another entrepreneur attached to him. Thus, only the repossessed vehicles will form the used vehicle financing segment. Agreements are proposed to be drafted with conditions for repossession within one month of default and redeployment of such vehicles for earning money, by continuing to be hired. GPS system to be installed in the trucks will provide information to the delivery destination and the origin of loading so that better inventory management and production processes are ensured. Thus the whole new business is expected to have a huge success story, going by the success rate in the passenger car booking segment.

In case the app provider or the app itself fails due to technical faults or user- unfriendly situation or in the event of fierce competition that this app provider may face, the large number of vehicles financed would have to be managed by another app provider or alternatives set up in-house. These could take some time.

In the near future, HRS Ltd. would like to cater to vehicle financing as in the earlier line of business, but mainly to the customers targeted through the app provider, who would be entrepreneurs in the categories of first time vehicle owners, repeat vehicle owners, small transport operators, etc. Thus, HRS is not deviating essentially from its vehicle financing activity.

HRS Ltd. has also accepted deposits from the public in the past through its country wide branches.

The financial information relating to HRS Ltd. is given in Tables 1 and 2. HRS Ltd. was promoted by HS Holdings Ltd. which has subscribed to 63% of the equity capital of HRS Ltd. There have been no negative pointers under any law on the company or its directors or management.

The company is professionally managed and has had qualified persons of repute heading the respective operations and the middle level managers are also carefully chosen to be able to manage the country wide operations and to take decisions quickly and efficiently. The managers who have retired have done so only due to age reasons and there have been no adverse publicity in any media about any internal mismanagement or controversy.

The company proposes to issue Rs. 500 crores worth debentures comprising 50,00,000 debentures of Rs. 1,000 each face value, for a period of five years, the full value being payable on application. Most of this issue is to be used for redeeming an earlier issue which is due to mature during the next twelve months.

The company intends to patronize active trading and hence prefers to have tradability of even one debenture. There will be no option for the company to redeem earlier than the committed period nor does it allow the holder to claim redemption earlier than stipulated. Land and buildings worth Rs. 950 crores are the intended security for this offer. The debentures are proposed to be issued and redeemed at par. The rate of interest is fixed at 9.5% p.a. throughout the tenor and interest will be paid on the 30th day of June and December every year.

The company has fulfilled all the conditions under the various regulations and plans for the issue to open on 15th January, 2019 and remain open for only the minimum period required under law.

(A) Choose the correct answers to the following questions: **2 Marks x 5 = 10 Marks**

1. Which of the following is **not true** of Circuit Breaker?
  - (a) It helps in controlling panic during high volatility in market
  - (b) It prevents true price discovery of price during Circuit Breaker imposed
  - (c) It also helps investors to take a rational approach towards the security being imposed
  - (d) It gives an opportunity to assesses the market volatility situation and take appropriate decision
2. Which of the following is not one of the advantages of investing in Mutual fund?
  - (a) Mutual Fund investment is managed by professional fund manager and it helps to create pool of investment
  - (b) It provides guaranteed return over investment
  - (c) It provides benefits of economies of scale
  - (d) Mutual Funds are regulated by SEBI regulation and publish NAV on daily basis
3. Which of the following is the correct definition of Private Equity (PE) firms?
  - (a) PE firms provides initial funding to startups and other enterprises who generates new business idea
  - (b) PE firms are institutional investor to provide capital funding to newly setup enterprises
  - (c) PE firms are investment fund companies who take strategic stake in the enterprises
  - (d) None of the above
4. Which among the following is not a Credit Rating Agency?
  - (a) FITCH
  - (b) ICRA
  - (c) CRISIL
  - (d) CIBIL
5. What an active fund manager expecting the market index to decline will do?
  - (a) Shift to low-beta defensive stocks
  - (b) Shift to high-beta aggressive stocks
  - (c) Shift to high P/E stocks
  - (d) Shift to specified category of stock

(B) Attempt the following questions:

1. You are an analyst at a credit rating agency and are part of the team involved in the rating process of the company. Prepare a report to your director indicating:
  - (a) Assessment of risks; 5 Marks
  - (b) Rating that you would consider appropriate along with a short note on CAMEL criteria considered. 5 Marks
2. Write a short note on the potential benefits of the proposed new unit of business. 5 Marks

**V. Case Study Question Number Five**

The expansion project of BON BON Limited which is under finalization is expected to consist of:

	Rs. Lakhs
Capital assets	200
Working capital	300
<b>Total</b>	<b>500</b>

The initial scheme of raising project finance is:

11% Long term debt	135
12% Bank borrowings for working capital.	225
Internal accruals	<u>140</u>
<b>Total</b>	<b>500</b>

Extracts from the Balance Sheet of the Company as at the end of the last financial year are given in Annexure 1.

The Company's risk-free rate is 9%, market return 14% and relevant company assets beta is estimated at 1.5.

The Company has approached you, a financial and management consultant, to review the above numbers. They have also given you additional information about the project which is given in the Annexure 2.

Upon an initial study of the given information, the first thought that strikes you is that Adjusted Present Value (APV) should be calculated to test whether the project is worth undertaking; also, that the plan of financing should be re-cast.

**Choose the correct answers to the following questions:** 2 Marks x 5 = 10 Marks

- Determine which of the following not part of bank financing is:
  - (a) Term loans
  - (b) Packing credit
  - (c) Overdraft
  - (d) Commercial paper
- Which one of the following does not fall within the scope of credit rating?
  - (a) Opinion in regard to a debt instrument
  - (b) Opinion based on an evaluation of business risks
  - (c) Opinion on the probability of meeting the interest and principal obligations of a business

(d) Opinion on a holding company, its subsidiaries and associates

(3) Which of the following is incorrect as regards the functioning of an investment banker?

- They help in raising capital for the client
- They take deposits from their customers
- They act as an intermediary for their customers in relation to their dealings
- They earn an underwriting commission as part of business.

(4) Which one of the following does not form part of treasury management?

- Cash management
- Management of interest, currency and commodity risks
- inventory control
- Liquidity planning and control

(5) Factoring concerns itself with the management of

- fixed assets
- accounts receivable
- stock in trade
- accounts payable

**In the light of the information supplied above, answer the following:**

(6) Explain briefly Adjusted Present Value (APV). Calculate the APV for the above project and state your view on acceptability. **7 Marks**

(7) Is the debt option as proposed viable for the company? Would you suggest any other alternative? **4 Marks**

(8) State what changes you would like to recommend to the project financing plans, briefly explaining each change. **4 Marks**

**ANNEXURE 1**  
**BON BON LIMITED**

**BALANCE SHEET SUMMARY- ACTUALS FOR THE LAST TWO YEARS**  
**Year ended 31st March (In Rs Lakhs)**

	<b>2018</b>	<b>2017</b>
Share Capital :		
Shares of Rs.10 each	50	50
Reserves	200	140
11% Long Term Debt	250	300
12% Bank borrowings	120	125
<b>Total</b>	<b><u>620</u></b>	<b><u>615</u></b>
Fixed assets	140	150
Net Current assets	480	465
<b>Total</b>	<b><u>620</u></b>	<b><u>615</u></b>

**ANNEXURE 2**  
**PROJECT CASH FLOWS & OTHER DETAILS**

**Amounts in Rs. Lakhs**

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
Sales:					
Domestic	540	780	1320	1500	1350
Exports	360	520	880	1000	900
<b>Total</b>	<b>900</b>	<b>1300</b>	<b>2200</b>	<b>2500</b>	<b>2250</b>
Profit before depreciation	180	350	400	500	450
Less:					
Depreciation	38	38	38	38	38
Interest:					
LT Debt	8	14	12	9	6
Short term debt	7	27	27	27	27
Profit before Tax	127	271	323	426	379
Less: tax	44	95	113	149	133
Profit after Tax	<u>83</u>	<u>176</u>	<u>210</u>	<u>277</u>	<u>246</u>
Cash in-flow:					
PAT + Dep+ Int	136	255	287	351	317
Terminal in flow:					
Capital assets					10
Working capital assets					<b>300</b>
<b>Total</b>	<b>136</b>	<b>255</b>	<b>287</b>	<b>351</b>	<b>627</b>

**PROJECT- INTEREST WORKINGS**

**Amounts in Rs. Lakhs**

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
LT Debt:					
Amount outstanding at the start of the year	-	135.00	121.50	94.50	67.50
Additions during the year	135.00				
Repayment during the year	-	13.50	27.00	27.00	27.00
Amount outstanding end of the year	135.00	121.50	94.50	67.50	40.50
Interest at 11% on average outstanding	7.43	14.11	11.88	8.91	5.94
Rounded off	8.00	14.00	12.00	9.00	6.00
WC borrowing:					
Amount outstanding at the start of the year	112.50	225.00	225.00	225.00	225.00
Interest at 12%	6.75	27.00	27.00	27.00	27.00

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE: GROUP II**  
**PAPER 6B: FINANCIAL SERVICES AND CAPITAL MARKETS**  
**SOLUTIONS**

**Note: Please note that these solutions are for guidance purpose only.**

**Answer to Case Study Number One**

(A) (i) The mutual fund discussed in the Case Study is a debt oriented scheme. The reason is that its investments include Listed Debentures and Bonds and Government securities.

(ii) Although not specifically mentioned in the Case Study, it seems that the scheme is open ended scheme because of following reasons:

- The number of units issued and redeemed during the year has been given in the Case Study.
- The high amount of redemption (about 25% of units outstanding at the beginning of the year) indicates that the scheme is an open ended one.
- No fixed maturity period has been given.
- Lots of changes are happening in the current scheme.

(iii) Only close ended schemes are required to be listed. Since, the present mutual fund scheme is an open ended scheme; it cannot be listed and traded in the stock exchange.

**Alternative Answer**

No, the scheme is not of the ETF (exchange traded fund) category since there is no margin with the Clearing Corporation of India Ltd. (CCIL).

(iv) Yes, plans are permitted as lateral shift receivable and lateral shift payable is given in the Case Study itself, an indication that switching between plans is permitted in this mutual fund product.

(v) Only liquid fund schemes need to hold substantial amounts as deposits with scheduled banks. This is not a liquid fund. It is a Bond Fund. It needs liquidity to the extent of repurchase of units, being open ended. This is available in the current account balances, probably on an estimated basis, depending on the usual redemption demands by investors. Value of units pending allotment should be deposited in a scheduled commercial bank.

**Alternative Answer**

One of the reasons that there is a nil balance in deposit with scheduled banks is that there are many payable items in the liability side of the balance sheet which is an indication that the fund has no cash in the scheduled banks.

(vi) Yes, fund has performed well during this year as surplus transferred from revenue account and increase in reserves is an indication that the mutual fund scheme has performed well during this year.

(vii) Average purchase price

$$= \frac{100000}{1 + 0.0876 \times \frac{85}{365}} = \frac{100000}{1.0204} = 98000$$

**Alternative Answer**

$\text{Yield} = (\text{FV} - \text{Price})/\text{Price} \times 365/85$

$$8.76\% = \frac{(100000 - Price)}{Price} \times \frac{365}{85}$$

$$Price = \frac{429412}{4.381712} = 98000.9640$$

Alternatively, if 360 days assumed in a year, then average purchase price

$$= \frac{100000}{1 + 0.0876 \times \frac{85}{360}} = \frac{100000}{1.0207} = 97972$$

- (B) (i) (D)
- (ii) (D)
- (iii) (D)
- (iv) (C)
- (v) (A)

#### Answer to Case Study Number Two

(A) (i) Recognized stock exchange is a stock exchange which operate under the rules, regulations and guidelines approved by the government. As per section 2(j) of the Securities Contract Regulation Act, 1956, "stock exchange" means any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

Further, no stock exchange is permitted to function as such to trade in the securities of a publicly held company without being recognized.

#### **Alternative Answer**

A stock exchange is a trading platform for securities of different kinds. It has member brokers who facilitate the trade between buyers and sellers. The legal entity of a stock exchange could, prior to the SEBI Act, be a Body of Individuals or a Company. After the SEBI Act came into force, this entity should have been corporatized or demutualized. In order to protect investors from fraudulent activities, the Central Government has appointed SEBI, The Securities and Exchange Board of India as the regulatory authority. SEBI, by virtue of the SEBI Act has the power to recognize stock exchanges upon their fulfilling certain requirements imposed by it. The main requirements are that the legal entity should be a company in which the public are interested to at least the extent of 51% and following certain disciplines regarding membership of brokers, trade and procedures to be complied with, in addition to having members appointed by SEBI on the company's Board. Subject to these formalities stated under section 4 of the Securities Contract Regulations Act (SCRA), the Central Government, through SEBI grants recognition to a stock exchange. If subsequent to the registration, any requirement is not complied with, the Central Government can derecognize the stock exchange under section 5 of the SCRA.

The recognition can be permanent as in the case of BSE, NSE or valid upto a certain period.

However, there are OTC exchange platforms (Over the Counter) platforms for trade of unlisted securities informally. Since, there is no governance of this; there is counterparty risk in abundance. The OTCEI was de-recognized by SEBI due to irregularities.

(ii) In case the promoter is an individual, his holding cannot be counted for the limit applicable for a retail individual investor. The reason is that in Regulation 14(1) of the SEBI (Issue of Capital and Disclosure Requirements), Regulations, 2018, it has been clearly mentioned that minimum promoters' contribution shall be 20% of the post issue capital. And, in regulation 32(1)(a), it has been categorically mentioned that in the net offer to public category, not less than thirty five per

cent shall be allocated to retail individual investors. Further, in regulation 32(4), in the net offer to public category, in an issue made other than through the book building process, minimum fifty per cent shall be allocated to retail individual investors.

From the above discussion, it seems to be clear that promoter's holding cannot be counted towards the limit applicable for a retail individual investor.

#### **Alternative Answer**

Even if the promoter is an individual, his holding cannot be counted under "retail individual investor" since the definition of a retail individual investor or shareholder under Regulation 2(w) and (ww) define him as one who applies for or bids for a value not more than Rs. 2 lacs. Hence, the promoter's holding cannot be reckoned under the retail individual investor or shareholder.

(iii) The ASBA (Application Supported by Blocked Amount) has been made mandatory by SEBI not only for book built issue but to also any public issue of equity shares. Under this arrangement, the investor has to submit an application to the Self-certified Syndicate Bank (SCSB) with whom the bank account to be used for the application money is maintained. By virtue of this ASBA facility, the amount payable on application is merely blocked by the SCSB and released to the company only on allotment, thereby obviating the necessity for a refund on non-allotment and also enabling the investor to have his liquidity for immediate other use of his funds.

#### **Alternative Answer**

It has specifically given in regulation 45(2) of the said regulations that the issuer and merchant bankers shall ensure that specified securities are allotted and/or application moneys are refunded within fifteen days from the date of closure of the issue.

From the above, it can be said that X will be able to get the allotment or refund, as the case may be before the Company B Ltd.'s open offer.

However, if he still have any doubts or fears in his mind, he can proportionately invest his surplus money of Rs. 5,00,000. For example, in company A Ltd., he can invest 50% or 75% of Rs. 5,00,000. And, in case, anything unfavourable happens, he can invest rest of the amount in company B. This way he can overcome the problem to a certain extent.

(iv) The numbers are leading market indices. A market index normally is computed by computing market capitalization of select number of shares chosen to represent market movement. The S & P BSE Sensex was set at 100 on April 1<sup>st</sup>, 1979 and consists of the market cap weighted index of 30 chosen stocks, whereas the Nifty 50 consists of 50 companies' stocks listed on the National Stock exchange. The base period is November 3<sup>rd</sup> 1995 and the base value has been set at 1000. Since the base values are very different, we have a big gap in the updated values on every trade day. However, daily % increases/decreases of the indices are almost the same, indicating the general market movement. Apart from these, there are sectoral indices to track specific sectors.

(v)

Investment Objective	Instrument	Instrument
Growth and appreciation in value	Equity Shares	Equity based Mutual Fund
Regular Income	Debentures	Bonds
Liquidity	Liquid Funds	Money Market Mutual Funds

#### **Alternative Answer**

Investment Objective	Instrument	Instrument
Growth and appreciation in value	Equity Shares, mutual funds in equity	Real Estate, gold

Regular Income	Deposits, debt instruments	Debt funds, Real estate
Liquidity	Bank Deposits	Mutual funds – short term, liquid funds

(B) (i) (A)  
(ii) (B)  
(iii) (C)  
(iv) (C)  
(v) (B)

### **Answer to Case Study Number Three**

(A) (i) An option of looking at external equity without diluting control do not seem feasible because such practices are followed by listed companies after their initial public offerings in which the shares are offered for sale by private shareholders, such as directors or other insiders (like venture capitalists) looking to diversify their holdings. So, in such situations, a company may not benefit at all. And, KVE is an unlisted company.

However, it can be argued that the company can increase its external equity without diluting control by issuing Differential Voting Rights i.e. issuing shares which are having more dividend rights but very less voting rights. Or, it can issue convertible warrants for the time being to avoid diluting its voting rights.

(ii) As regards raising of money through debt, two broad courses are available to the company. Money can be raised through issue of debentures or by way of bank finances. Bonds or debentures are long term debt securities and carry an interest rate dependent on market forces. Movements in the interest rates in a volatile market, viz., and interest rate risks are possibilities in this area, because debentures are long term investments, commitments made are unchangeable once the period of instrument namely 7 to 9 years are through. Interest on bonds is tax-deductible and the feature presents a possibility of adoption in cases of companies having current liquidity, the long term effects are to be considered. Bank financing is an option on medium term plan and often tried when the company is anticipating to make profits in the future to service the loan obligations and to pay off the liability, the prospects are bright for the adoption of bank financing as a distinct possibility.

It has been stated that the ownership/management is reluctant to resort to borrowings except for occasional working capital requirements now not resorting to any loans. This is a bad financial management solution since businesses are expected to maximize their profits by adequate resources – equity and debt. Debt financing done at reasonable level is a good financing option and reasonable from the equity holder's point of view since debt servicing is tax deductible and enhances EPS. A good EPS also encourages good market price for the shares and leads to maximization of an equity holder's shares. It leads to overall financial and economic development.

In the present case, the equity base of the company is Rs. 2010 lakhs against which apparently no debt obligations exist. Even if the non-current liabilities sum at Rs. 583 lakhs were taken as bank loans or outside debts, the debt equity ratio is only around 0.25: 1. The permissible ratio in the financial circles being 2 :1, the unit upto which long and short term debt finances could be of the order of Rs. 4020 lakhs. There is a gap of around Rs. 3400 lakhs which the company can comfortably leverage and the present proposal of additional revenue requirements of Rs. 2000 lakhs could be fully met by such borrowings. Even at Rs. 2000 lakhs of fresh bank advances, the debt equity ratio of the company could be just around 1 :1 which is a very healthy sign, with a 30% tax shield available for interest expense, the effective rate gets reduced to 7% wealth. This could be brought to the notice of the ownership/ management to change their perceptions.

In the circumstances, we could advise the company to go in for debt capital from banks and financial institutions.

### Alternative Answer

It has been given in the Case Study itself that debt equity ratio applicable to the business in which the company is engaged is 2:1. Therefore, the company has to reconsider its debt equity ratio. KVA's equity is almost 4 times that of its debt. Increasing the debt does bring some advantages which are explained as follows:

- (a) The earning per share (EPS) of the company will get increased.
- (b) The company will be able to save more tax.

However, some disadvantages are also there by increasing the debt:

- (a) Default risk i.e. if the company fails to make interest payment in time.
- (b) Too much interest payment may eat into the profits of the company.

Therefore, from the above discussion, it can be suggested to the company that debt should be increased slowly and gradually so that interest burden can be manageable by the company and sound profitability position can also be maintained by the company. This way, KVA can substantially reduce its default risk also.

#### (iii) Additional Equity to be Issued

	40% Dilution	50% Dilution	60% Dilution
Existing No. of Shares (A)	50 lakhs	50 lakhs	50 lakhs
Existing Ownership (B)	100%	100%	100%
Diluted Ownership (C)	60%	50%	40%
Revised Total No. of Shares (D)	<u>50 lakh</u> 0.60 = 83.33 lakh	<u>50 lakh</u> 0.50 = 100 lakh	<u>50 lakh</u> 0.40 = 125 lakh
Additional Equity Shares (A) – (D)	33.33 lakh	50 lakh	75 lakh

#### (iv) Estimated Price Per KVE Share

P/E Multiples of Industry

Name of Company	Market Price per share		Earnings per share	P/E Multiple		
	High	Low		High	Low	Average
Agri-Imp Ltd.	45	41	4.5	10	9	9.5
Implements (I) Ltd.	51	42	3.2	16	13	14.5
Beta Products Ltd.	110	80	<u>6.00</u> <b>4.57*</b>	18	13	<u>15.5</u> <b>13.17*</b>

Calculation of Market Price per Share

= Average P/E Multiple x Average Earnings per share

=  $13.17 \times 4.57 = 60.19$

\* Average P/E Multiple =  $9.5 + 14.5 + 15.5/3 = 13.17$

\* Average Earnings per share =  $4.5 + 3.2 + 6/3 = 4.57$

(v) **Executive summary of the recommendations to be put up to the Board of Directors of the company**

- (a) The company can increase its external equity without diluting control by issuing Differential Voting Rights i.e. issuing shares which are having more dividend rights but very less voting rights. Or, it can issue convertible warrants for the time being time to avoid diluting its voting rights. However, control may get diluted when warrants will be converted into equity shares at a later stage.
- (b) A better option before a company if it wants to issue capital for expansion purpose is to raise capital either through the primary market or a private placement.
  - (i) **Primary Market.** If the company wants equity dilution in the primary market, it shall issue new equity shares to the public. A company can raise large amount of capital through this route. However, it also leads to comparatively higher issue expenses and compliance costs.
  - (ii) **Private Placement.** Further, if the company wants to save issue expenses and future compliance costs, it can consider a private placement of shares. When an issuer makes an issue of shares or convertible securities to a select group of persons not more than 50 but can extend upto 200, and which is neither a rights issue nor a public issue, it is called a private placement. So, Private Placement makes sense if the company wants limited capital for its expansion purpose. Otherwise raising capital through primary market seems to be a better idea.
- (c) A company may also consider increasing its debt-equity ratio slowly and gradually as it will help the company to save tax and increase its earning per share.
- (d) If the company issues additional equity shares, it can quote issue price of the additional equity at Rs. 60.19.

**Alternative Answer**

- Krishi Vikas is in a growing curve.
- The project calling for an investment of Rs. 2000 lakhs is plainly stable.
- The additional revenues expected to be earned will strengthen the company.
- The requirements of funds for the next project are for Rs. 2000 crores.
- Can be raised through additional equity or borrowings.
- Borrowings can be either through bonds or bank finances.
- Interest rate can be competitive and is tax deductible.
- Leveraging on debt equity ratio will still present the company in sound health resulting in higher EPS and maximization of share value.
- The proposal will add considerably to capital base by way of substantial share premium.
- The prospects for the future are good and PE can be offered an exit 4/5 years down the line by way of a buy-out or as IPO.
- The management recommends the PE proposal.

**(B)**

1. (c)
2. (b)
3. (c)
4. (d)

5. (b)

**Answer to Case Study Number Four**

(A) 1 (c)  
2 (b)  
3 (c)  
4 (d)  
5. (a)

(B) (1) **Report to the Director, CRISIL**

(a) **Assessment of Risks**

The various types of risks of HRS Ltd. and their assessments have been briefly discussed in the following paragraphs:

- (i) **Business Risk** –The Company is banking its hopes on clients to be generated by a single app provider. Though the provider of the app has been successful in the small car segment, it is not certain whether it will succeed with truck operators since most of them may be illiterate and unable to use smart phones necessary for the App.
- (ii) **Strategic Risk** – This is high in this business development. Many drivers delegate their duties to someone else. If they are going to be tracked by GPS, they may not switch on their phones and take refuge under the pretext of non-connectivity. They may have to skip rests and may be given stringent targets of travel, which they may try to achieve by driving without sleeping which may lead to accidents.
- (iii) **Solvency, Liquidity and Default Risk** – Although the Debt Equity ratio of HRS Ltd. is in accordance with industry line i.e. 5 :1, it is still quite high. The company has further proposed an issue of Rs. 500 crore which will be utilized for redeeming an earlier issue of debentures. This may lead to default risk if the company fails to pay the interest and the principal amount.

Further, for the year ended 31<sup>st</sup> March, 2018, current liabilities of the company are more than its current assets. It means that the company has got a tight liquidity position. This is a red flag which the company has to manage wisely.

- (iv) **Operating Risk**- The Company has installed GPS System for providing information to delivery destination and origin of loading for better inventory management and production process. This will reduce the company's operating risk to a large extent.

Moreover, the company has made an arrangement for a backup under which if the existing app provider fails, the large number of vehicles financed would be managed by another app provider. Thus, the company has managed it's operating risk well.

- (v) **Legal Risk**–It has been mentioned in the case study itself that there have been no negative pointers under any law on the company or its directors or management. So, it seems that the company has managed its legal risk well.

- (vi) **Compliance Risk**–The Company has fulfilled all the conditions under the various regulations for the proposed debenture issue which is an indication that the company has managed it's compliance risk well.

Moreover, with Traffic Rules by drivers, GST rules for transit of goods by the owners of goods in transit and the truck owners (borrowers), HRS's control on the location of assets hypothecated to it and traceability of borrowers and consequent disclosure compliances by HRS itself are at stake if things do not operate smoothly.

- (vii) **Reputation Risk** –The Company has also managed it's reputation risk well as there

have been no adverse publicity in any media about any internal mismanagement or controversy.

**(2) Note on appropriate rating and consideration of CAMEL criteria**

The most appropriate rating would be Moderate Safety\*.

**Consideration of CAMEL criteria**

- (i) **Capital** – For the year ended 31<sup>st</sup> March, 2018, the Company's reserves and surplus is Rs. 120610 lakhs as compared to its share capital which is Rs. 3270 lakh. The company has a proposed borrowing i.e. debenture issue of Rs. 500 crore. However, company's debt-equity ratio of 5:1 is already high inspite of the fact it is in accordance with industry standards. And, the proposed debenture may affect its solvency position.
- (ii) **Assets** – The proposed issue will not lead to any major asset expansion as most of the amount raised will be utilized for redemption of old debt. And, company's fixed assets comprising of property, plant and equipment showed a sudden decline from the year 2017 to 2018. However, intangible assets have increased. Further, company's non-current investments are manifesting a steep increase due to upsurge in company financing of vehicles. Moreover, the company is accepting deposits from the public and hence is an NBFC PD and is also a systematically important NBFC with asset base crossing Rs. 500 crore. It has to comply with the RBI's capital adequacy ratios and other similar to banking requirements of returns and compliances, thereby monitored on par with a bank.
- (iii) **Management** – The company is professionally managed and has had qualified persons of repute heading the respective operations and the middle level managers are also carefully chosen to be able to manage the country wide operations and to take decisions quickly and efficiently.
- (iv) **Earnings** – Company's revenue has been steadily increasing which is giving an indication that it will be able to service its debts properly. However, it also depends upon the company's liquidity position.
- (v) **Liquidity** – The Company's liquidity position is tight. This is manifested in company's declining cash position especially its current assets which is reducing steeply in comparison to its current liabilities.

Thus, I would recommend an investment grade rating to this security as Moderate Safety and put the company on watch for any possible revision since the new line of financing can either be very successful or a total failure.

**(3) Potential benefits of the proposed new unit of business are as follows:**

- (i) Under the new proposal, vehicles financed will be hypothecated to HRS by the entrepreneur who is the principal borrower, fully guaranteed by the app provider. So, if the principle borrower fails to make the payment to HRS Ltd., the app provider will step in and make good the loss.
- (ii) The used vehicle will also be handed over to another entrepreneur attached to him. Thus, only the reposessed vehicles will form the used vehicle financing segment.
- (iii) Agreements are proposed to be drafted with conditions for repossession within one month of default and redeployment of such vehicles for earning money, by continuing to be hired.
- (iv) The Company has installed GPS System for providing information to delivery destination and origin of loading for better inventory management and production process.
- (v) The company has made an arrangement for a backup under which if the existing app provider fails, the large number of vehicles financed would be managed by another app provider.

## Answer to Case Study Number Five

- (1) (d)
- (2) (d)
- (3) (b)
- (4) (c)
- (5) (b)
- (6) APV is a tool to look at justification of a project based on a cut-off rate that is not influenced by debt and tax shield; it also helps to identify and isolate the impact of debt financing.

### **Working**

#### **(i) Cost of Equity using CAPM**

$$\begin{aligned}
 Re &= R_f + \beta (R_m - R_f) \\
 &= 9\% + 1.5\% + (14\% - 9\%) \\
 &= 16.5\%
 \end{aligned}$$

$$APV = \text{Base NPV} + PV \text{ of Tax Benefit of Debt}$$

#### **(ii) Calculation of Base NPV**

##### Cash Inflow from the project

	Year 1	Year 2	Year 3	Year 4	Year 5
Profit before Depreciation	180	350	400	500	450
Less: Depreciation	<u>38</u>	<u>38</u>	<u>38</u>	<u>38</u>	<u>38</u>
	142	312	362	462	412
Less: Tax	<u>50</u>	<u>109</u>	<u>127</u>	<u>162</u>	<u>144</u>
	92	203	235	300	268
Add: Depreciation	<u>38</u>	<u>38</u>	<u>38</u>	<u>38</u>	<u>38</u>
Cash Flow	<u>130</u>	<u>241</u>	<u>273</u>	<u>338</u>	<u>306</u>
PV @ 16.5%	0.858	0.737	0.632	0.543	0.466
PV	112	178	173	184	143

$$\text{Total PV of Inflows} = 790$$

$$\text{PV of Cash Outflows} = 500$$

$$\text{Base NPV} = 290$$

#### 3. Present Value of Impact of Financing

	Year 1	Year 2	Year 3	Year 4	Year 5
Interest:					
LT Debt	8	14	12	9	6
Short Term Debt	7	27	27	27	27
	15	41	39	36	33
Tax Saving @ 35%	5.25	14.35	13.65	12.6	11.55
PV Factor @ 9%	0.917	0.842	0.772	0.708	0.650
PV	4.81	12.08	10.54	8.92	7.51

Total PV of Tax saving from debt = 43.86

$$\begin{aligned}\text{Now, APV} &= \text{Base NPV} + \text{PV of Tax Benefit from Debt} \\ &= 290 + 43.86 = 336.86 \text{ lakhs}\end{aligned}$$

Alternatively, above PV of Tax Saving can also be computed at Cost of Debt which is as follows:

$$\frac{135}{135+225} \times 0.11 + \frac{225}{135+225} \times 0.12$$

$$= \frac{135}{360} \times 0.11 + \frac{225}{360} \times 0.12$$

$$= 0.04125 + 0.075 = 0.11625 \text{ or say } 11.63\%$$

	Year 1	Year 2	Year 3	Year 4	Year 5
Interest:					
LT Debt	8	14	12	9	6
Short Term Debt	7	27	27	27	27
	15	41	39	36	33
Tax Saving @ 35%	5.25	14.35	13.65	12.6	11.55
PV Factor @ 11.63%	0.896	0.802	0.719	0.644	0.577
PV	4.70	11.51	9.81	8.11	6.66

Total PV of Tax saving from debt = 40.79

Thus, APV = 290 + 40.79 = Rs. 330.79 lakhs.

As the APV of the expansion project of BON BON Limited is positive, the project can be accepted.

### Alternative Answer

#### **What is APV?**

If in an exercise of project viability analysis, a scheme of financing is assumed and the cash flows are then calculated, it would imply that the investment decision and the financing decision are integrated. Such a course of analysis could lead to justification of an otherwise risky project because of choice of finance.

#### **CFO'S CALCULATION OF ADJUSTED PRESENT VALUE (APV)**

#### **Base NPV**

$$R_f + (R_m - R_f) \beta$$

$$\text{That is, } 9\% + (14\% - 9\%) 1.5 = 16.5\%$$

NPV Calculation at cut-off 16.5%

$$(136 \times 0.858) + 255 \times 0.737) + (287 \times 0.632) + (351 \times 0.543) + (627 \times 0.466)$$

Less 500

$$= 468.782$$

#### **Impact of Financing**

Present value of tax shield

$$\begin{aligned}
 &= (44 \times 0.858) + (95 \times 0.737) + (113 \times 0.632) + (149 \times 0.543) + (133 \times 0.466) \\
 &= 322.068
 \end{aligned}$$

### Adjusted Present Value (APV)

$$\begin{aligned}
 &= \text{Base APV} + \text{PV of impact of Financing} \\
 &= 468.782 + 322.068 \\
 &= 790.850
 \end{aligned}$$

### Conclusion:

Based on the initial working and the assumed plan of financing the project is quite acceptable.

#### (7) Viability of the proposed debt option:

The present LT debt/equity ratio of the company is  $250 / (50 + 200)$ , that is, 1.

It will be good to maintain this ratio.

With the proposed financing option the ratio will change as:

$$(250 + 135) / (50 + 200 + 140) = 0.99$$

Hence the proposed LT debt option is quite viable and need not be changed.

#### (8) Suggested Modifications:

- (i) Suggestion to seek downward revision of interest rate on Long Term debt based on the Company's credit rating.  
(Revised workings are given after changing the LT interest rate downward by  $\frac{1}{2}$  per cent)
- (ii) Suggestion to seek post-shipment credit from banks for export receivables at a concession of 1%.  
(Workings of interest on bank borrowings are being revised accordingly).
- (iii) Each year's surplus cash availability to be assessed and bank finance requirements to be revised. This requires movement of working capital numbers and may be re worked at a later time.

### Revised Interest Workings

Amount in Rs. Lakhs

	Year 1	Year 2	Year 3	Year 4	Year 5
<i>LT Debt:</i>					
Amount outstanding start of the year	-	135.00	121.50	94.50	67.50
Additions during the year	135.00	-	-	-	-
Repayment during the year	-	13.50	27.00	27.00	27.00
Amount outstanding end of the year	135.00	121.50	94.50	67.50	40.50
Intst at 10.5% on average outstanding	7.09	13.47	11.34	8.51	5.67
Rounded off	7.00	13.50	11.50	8.50	5.50
<i>WC borrowings:</i>					
Export finance (90 days export sales)	90	130	220	250	225
Balance (clean OD)	22.50	95	5	-	-
Interest on export finance @ 11% (* for $\frac{1}{2}$ year)	4.45*	14.30	24.50	27.50	24.75
Interest on clean OD @ 12%	1.35%	11.40	0.60	-	-
Total	5.80	25.70	24.80	27.50	24.75

**MOCK TEST PAPER 1**

**FINAL (NEW) COURSE : GROUP II**

**ELECTIVE PAPER 6C: INTERNATIONAL TAXATION**

***Attempt any four out of five case study based questions.***

*Each case study carries 25 Marks.*

**Time Allowed – 4 Hours**

**Maximum Marks – 100**

**CASE STUDY - 1**

M/s. Shiva Vishnu LLP is a leading tax consultant based at New Delhi. The firm has four resident partners, Mr. Shiva, Mr. Vishnu, Mr. Ganesh and Mr. Karthik. As per the partnership deed, the profits and losses are shared equally amongst partners. All partners are working partners and salary is paid to all partners as per the terms of the partnership deed.

One of the partners, Mr. Vishnu sold listed equity shares of B Ltd (STT was paid both at the time of purchase and sale) on 23<sup>rd</sup> January, 2019 for Rs.2,70,000. The said shares were purchased by him on 15<sup>th</sup> January, 2018 for Rs.2,75,000. The fair market value of such shares on 31<sup>st</sup> January, 2018 was Rs.2,50,000. He sold residential house owned by him in Pune for Rs.22 lakhs on 24<sup>th</sup> February, 2019. The said land was purchased by him for Rs.11 lakhs on 22<sup>nd</sup> February, 2017.

The LLP provides direct taxes consultancy services. Over the last couple of years, they have taken up few assignments in the area of international taxation. These assignments relate to double taxation avoidance agreements, non-resident taxation, transfer pricing and other international taxation matters.

The details of some of the assignments are as follows -

**Assignment 1 [Client – Ganges Ltd.]**

Ganges Ltd. is an Indian Company in which Nile Inc., a Country E company holds 40% shareholding and voting power. During the previous year 2016-17, the Indian company supplied computers to the Country E based company @CED 1100 per piece. The price of computer supplied to other unrelated parties in Country E is @CED 1400 per piece. During the course of assessment proceedings relating to A.Y.2017-18, the Assessing Officer carried out primary adjustments and added a sum of Rs. 168 lakhs, being the difference between actual price of computer and arm's length price for 700 pieces and it was duly accepted by the assessee. The Assessing Officer passed the order, in which the primary adjustments were made, on 1.6.2018. On account of this adjustment, the excess money of Rs. 168 lakhs is available with Nile Inc, Country E. In this context, Ganges Ltd. wants to know the effect of this transaction for the assessment year 2019-20 on the basis that it declared an income of Rs. 300 lakhs and the excess money is still lying with Nile Inc. till today. Assume the rate of exchange as 1 CED = Rs. 80. [CED stands for Country E Dollars, which is the currency of Country E]

**Assignment 2 [Client – Godavari Ltd.]**

Godavari Ltd., a resident Indian Company, on 01-04-2018 has borrowed Rs. 80 crores from M/s. Mississippi Inc, a Company incorporated in Country F, at an interest rate of 8% p.a. The said loan is repayable over a period of 12 years. Further, loan is guaranteed by M/s Amazon Inc incorporated in Country F. M/s. Colorado Inc, a non-resident, holds shares carrying 40% of voting power both in M/s Godavari Ltd. and M/s Amazon Inc. M/s Colorado Inc has also deposited Rs. 80 crores with M/s Mississippi Inc.

The net profit of M/s. Godavari Ltd. was Rs. 7 crores after debiting the above interest, depreciation of Rs. 4 crores and income-tax of Rs. 2.70 crores. Godavari Ltd. wants to know if interest is allowable as deduction under the head "Profits and gains of business or profession" and if so, to what extent.

### **Assignment 3 [Client – Ms. Sheetal]**

Ms. Sheetal is a resident Individual. She has income from the following sources:

- (i) Taxable income from a sole-proprietary concern in Baroda Rs. 80 lakhs.
- (ii) Share of profit from a partnership firm in Bhopal Rs. 40 lakhs.
- (iii) Agricultural Income (Gross) from coffee estate in Country G which has no DTAA with India, CGD 40000. Withholding Tax on the above income CGD 8000
- (iv) Brought forward business loss of F.Y.2014-15 in Country G was CGD 12000 which is not permitted to be set off against other income as per the laws of that country.

Ms. Sheetal desires to know her total income and tax liability for the A.Y. 2019-20 (Assume 1 CGD = Rs.50). [CGD stands for Country G Dollars which is the currency of Country G]

Based on the above facts, answer the following questions –

#### **Multiple Choice Questions**

**Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.**

1. Would the total income of A.Y.2019-20 of Ganges Ltd. undergo a change if –

- (i) the primary adjustment made was Rs.90 lakhs;
- (ii) the said adjustment pertained to P.Y.2015-16?

The correct answer is -

- (a) No, the total income of A.Y.2019-20 would not undergo any change due to the reasons stated in either (i) or (ii) above.
- (b) Yes, the total income of A.Y.2019-20 would undergo a change due to the reason stated in (i) but not due to the reason stated in (ii) above.
- (c) Yes, the total income of A.Y.2019-20 would undergo a change due to the reason stated in (ii) but not due to the reason stated in (i) above .
- (d) Yes, the total income would undergo a change due to the reasons stated in both (i) and (ii) above.

2. Interest payable by Godavari Ltd. to Mississippi Inc. would be subject to limitation of interest deduction because –

- (i) M/s. Colorado Inc. holds shares carrying 40% voting power in Godavari Ltd.
- (ii) M/s. Colorado Inc. holds shares carrying 40% voting power both in Godavari Ltd. and M/s. Amazon Inc
- (iii) M/s. Amazon Inc. guarantees the loan taken by Godavari Ltd. from M/s. Mississippi Inc.
- (iv) M/s. Colorado Inc. has deposited Rs.80 crores with M/s. Mississippi Inc.

The most appropriate answer is -

- (a) (i) and (iv) above

(b) (ii) and (iii) above  
(c) (i) and (iii) above  
(d) Either (a) or (b)

3. While computing total income of Ms. Sheetal under the Income-tax Act, 1961, brought forward business loss in Country G –

- (i) can be set-off against her business income from sole-proprietorship in Baroda
- (ii) cannot be set-off against her business income from sole-proprietorship in Baroda since such set-off is not permitted as per the tax laws of Country G
- (iii) should not be deducted while computing doubly taxed income for the purpose of deduction under section 91
- (iv) has to be deducted while computing doubly taxed income for the purpose of deduction under section 91

Which of the above statements are correct?

- (a) (i) and (iii)
- (b) (ii) and (iii)
- (c) (i) and (iv)
- (d) (ii) and (iv)

4. If Ms. Sheetal derived share income from a partnership firm in Country G which is taxable under the laws of Country G, then, assuming that the shares of the partners are not specified in the instrument evidencing partnership since the same is not a requirement as per the laws of Country G, which of the following statements would be correct?

- (i) Share income of Ms. Sheetal from the partnership firm would be taxable under the Income-tax Act, 1961
- (ii) Share income of Ms. Sheetal from the partnership firm would be exempt under section 10(2A) of the Income-tax Act, 1961
- (iii) Share income of Ms. Sheetal from the partnership firm would be included in “doubly taxed income” for the purpose of deduction under section 91
- (iv) Share income of Ms. Sheetal from the partnership firm would not be included in “doubly taxed income” for the purpose of deduction under section 91

The correct answer is –

- (a) (i) and (iii)
- (b) (i) and (iv)
- (c) (ii) and (iii)
- (d) (ii) and (iv)

5. In relation to the transaction of sale of shares and land by Mr. Vishnu, which of the following statements are correct, in the context of the facts given in the case study and the provisions contained in the Income-tax Act, 1961 –

- Long-term capital loss (computed) on sale of listed equity shares by Mr. Vishnu cannot be set-off against long-term capital gains on sale of land by him, since loss from an exempt source cannot be set-off against gains from a taxable source.
- Long-term capital loss (computed) on sale of listed equity shares by Mr. Vishnu can be set-off against long-term capital gains on sale of land by him.
- Long-term capital gains (computed) on sale of listed equity shares by Mr. Vishnu is includable in computation of total income but not taxable.
- Long-term capital gains (computed) on sale of listed equity shares by Mr. Vishnu is exempt, and hence not includable while computing total income.

#### **DESCRIPTIVE QUESTIONS**

- (a) Ganges Ltd. wants to know the effect of the transaction of supply of computers to Nile Inc., in respect of which the Assessing Officer carried out primary adjustments in computing the total income for A.Y.2019-20, considering that the excess money is still lying with Nile Inc. **(3 Marks)**  
 (b) Is the interest payable by Godavari Ltd. to M/s. Mississippi Inc. allowable as deduction while computing the total income of Godavari Ltd.? If so, to what extent? **(5 Marks)**
- Compute the total income and tax liability of Ms. Sheetal for A.Y.2019-20. **(7 Marks)**

#### **CASE STUDY - 2**

Mr. Eashwar, an Indian citizen aged 55 years, carries on the business of trading in garments in India. He has also set up a branch office in Country X and Country Y for trading in garments in those countries. He visits Country X and Y frequently for furtherance of his business. During the P.Y.2018-19, he made three visits to Country X from 13<sup>th</sup> May, 2018 to 13th June, 2018, from 18<sup>th</sup> August, 2018 to 5th October, 2018 and from 17<sup>th</sup> January, 2019 to 4<sup>th</sup> February, 2019. He visited Country Y thrice from 3<sup>rd</sup> April, 2018 to 24<sup>th</sup> April, 2018, from 4<sup>th</sup> July, 2018 to 14<sup>th</sup> August, 2018 and 5<sup>th</sup> March, 2019 to 20<sup>th</sup> March, 2019. The number of days of his stay in Country X and Y during the past ten years is as follows –

<b>Previous Year (P.Y.)</b>	<b>No. of days in Country X</b>	<b>No. of days in Country Y</b>
P.Y.2017-18	97	78
P.Y.2016-17	95	85
P.Y.2015-16	98	82
P.Y.2014-15	100	80
P.Y.2013-14	103	75
P.Y.2012-13	110	70
P.Y.2011-12	120	60
P.Y.2010-11	118	60
P.Y.2009-10	115	62
P.Y.2008-09	108	72

He has not visited any other country in the last 10 years. He has a passion for writing and has written two literary books, from which he earns royalty income in Country X. He has purchased agricultural land in Country X. In Country Y, he has purchased a house, which he has let out. He has invested in shares of a company incorporated in Country Y. The following are the particulars of income earned by him in India, Country "X" and Country "Y" for the previous year 2018-19.

Particulars	Rs.
Income from the business of trading in garments	
In India	34,30,000
In Country X	10,45,000
In Country Y	(1,30,000)
Agricultural income in Country "X" (gross) (taxable in Country X)	1,25,000
Dividend received from a company incorporated in Country "Y" (gross) (taxable in Country Y)	40,000
Royalty income from a literary book from Country "X" (gross) (taxable in Country X)	4,00,000
Expenses incurred for earning royalty	40,000
Rent from a house situated in Country "Y" (gross) (taxable in Country Y)	1,80,000
Municipal tax in respect of the above house (not allowed as deduction in country "Y")	10,000

**Note:** Business loss in Country "Y" not eligible for set off against other incomes as per law of that country.

The rates of tax in Country "X" and Country "Y" are 20% and 30%, respectively.

Mr. Eashwar's younger brother, Mr. Karan, aged 48 years, earns income from a business in Country Z.

Mr. Eashwar's elder sister, Mrs. Radha Srinivas, aged 61 years, is married and settled in Calcutta. She is a Hindustani classical singer and composer who gives concerts in India and Country W. She visits Country W every year during the music season in October to participate in the Mega music concert held there. For the rest of the year, she gives concerts in India. She earns Rs.10 lakhs from concerts held in India and CWD 10145 from concerts held in Country W. Tax deducted in Country W in October, 2018 in respect of income earned by her in that country was 2500 CWD. She earns income of CUD 10000 by way of royalty in respect of copyright of her musical compositions in Country U. The royalty is paid to her every year on 25th March after deduction of tax@10%. In India, she has interest income of Rs.4 lakhs from fixed deposits in her name and Rs.25,000 from savings bank account. She pays medical insurance premium of Rs.27,000 to insure her health and Rs.30,000 to insure the health of her husband, a resident aged 64 years. She deposits Rs.1.50 lakhs in public provident fund and Rs.3 lakhs in five-year fixed deposit in the name of her son, Mr. Ramesh. The conversion rates are as follows -

TT buying rate	30.9.2018	31.10.2018	28.2.2019	31.3.2019
Country U dollar (CUD)	Rs.70	Rs.74	Rs.78	Rs.80
Country W dollar (CWD)	Rs.70	Rs.72	Rs.68	Rs.69

Based on the above facts, answer the following questions, assuming that India has –

- (i) no double taxation avoidance agreement with Countries W, X and Y;
- (ii) a double taxation avoidance agreement with Country Z in line with OECD Model Convention, 2017

- (iii) a double taxation avoidance agreement with Country U in line with UN Model Convention, 2017
- (iv) India follows credit method for providing double taxation relief with respect to taxes paid in Countries Z and U.

#### **Multiple Choice Questions**

**Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.**

1. The total income of Mr. Eashwar for the A.Y.2019-20 is -
  - (a) Rs.46,89,000
  - (b) Rs.48,19,000
  - (c) Rs.49,89,000
  - (d) Rs.51,19,000
2. For the purpose of computing deduction under section 91 for A.Y.2019-20, the “doubly taxed income” of Mr. Eashwar in respect of income earned in Country X and Country Y would be –
  - (a) Rs.15,30,000 and Rs.1,59,000, respectively
  - (b) Rs.12,30,000 and Rs.1,59,000, respectively
  - (c) Rs.15,30,000 and Rs.29,000, respectively
  - (d) Rs.12,30,000 and Rs.29,000, respectively
3. The rebate under section 91 available to Mr. Eashwar for A.Y.2019-20 is –
  - (a) Rs.2,53,842
  - (b) Rs.3,48,995
  - (c) Rs.3,13,842
  - (d) Rs.2,88,995
4. As per the India-Country Z DTAA and India-Country U DTAA, royalty, if any, arising to Mr. Karan and Ms. Radha Srinivas in Country Z and Country U, respectively, would be taxable –
  - (a) Only in India
  - (b) Royalty arising to Mr. Karan may be taxed either in India or in Country Z and royalty arising to Ms. Radha Srinivas may be taxed either in India or in Country U
  - (c) Royalty arising to Mr. Karan would be taxable only in India; Royalty arising to Ms. Radha Srinivas may be taxed either in India or in Country U
  - (d) Royalty arising to Ms. Radha Srinivas would be taxable only in India; Royalty arising to Mr. Karan may be taxed either in India or in Country Z
5. Let us suppose that, as per the DTAA between India and Country U, a particular income earned by Mrs. Radha Srinivas in Country U may be taxed in Country U. While computing her total income under the Income-tax Act, 1961, the said income –
  - (a) should not be taken into account at all
  - (b) should be taken into account; thereafter, deduction is to be allowed from the tax payable in India on her total income.
  - (c) may be taken into account in order to compute the amount of tax on the remaining income.

(d) may be taken into account; thereafter, deduction may be allowed from the tax payable in India on her total income.

#### **DESCRIPTIVE QUESTIONS**

1. Determine the residential status of Mr. Eashwar for A.Y.2019-20. **(5 Marks)**
2. Compute the total income and tax liability of Ms. Radha Srinivas for A.Y.2019-10, and determine the foreign tax credit available to her. **(10 Marks)**

#### **CASE STUDY - 3**

Mr. Arjun, aged 52 years, carries on in Mumbai, business of trading of spices grown in his own spice gardens in Munnar. He also has spice gardens in Country Z, and he derives income from Country Z from sale of spices grown therein. He stays in India during the entire month of May, July, September, November, January and March. He stays in Country Z during the months of April, June, August, October, December and February. As per the domestic laws of Country Z, he would be resident of that country if his stay in that country is for 180 days or more. Mr. Arjun owns a flat in Juhu, Bombay, where he lives with his wife, two children, and his parents. He also owns a flat in Thane which he has let out. He owns a residential house in Country Z where he stays when he visits Country Z. Mr. Arjun is passionate artist and has showcased his paintings in art exhibitions in Mumbai. He has saving deposits in SBI from which he earned interest of Rs.42,300 in the P.Y.2018-19. He deposited Rs.1,50,000 in public provident fund and paid Rs.28,000 as mediclaim premium to insure his health and that of his spouse. He also paid Rs.32,000 to insure the health of his parents.

Mr. Arjun holds 100 equity shares in each of the four Indian companies, namely, ABC Ltd., PQR Ltd., EFG Ltd and HIJ Ltd. The particulars of businesses carried on/services provided by these companies are detailed hereunder –

<b>Company</b>	<b>Particulars</b>
ABC Ltd.	It is engaged in manufacturing spices in India and has a branch in Country Z and Country L. It effects sale of spices to customers, P and Q through its branch in Country Z; and customers, J and K through its branch in Country L. In addition, it also effects sale of spices to bulk customers M and N in Country Z and bulk customers O and Q in Country L, directly.
PQR Ltd.	It is engaged in lending business and it also has a branch in Country L and Country Z. It has given a loan to L & Co., a firm located in Country L at interest taxable @ 20% as per the domestic tax laws of Country L. It has also given a loan to Z & Co., a firm located in Country Z, at interest taxable @ 8% as per the domestic tax laws of Country Z.
EFG Ltd.	It is engaged in assembly projects in India. It has also set up assembly projects in Country Z and Country L. In Country Z, the project was set up on 28 <sup>th</sup> March, 2018 and lasted upto 30 <sup>th</sup> March, 2019. In Country L, the project was set up on 5 <sup>th</sup> May, 2018 and lasted upto 31 <sup>st</sup> October, 2018.
HIJ Ltd.	It is engaged in providing technical consultancy services to clients in India and abroad. It provides technical consultancy to clients in Country Z and Country L, respectively, through personnel engaged by it for such purposes. The personnel so engaged for Country Z project stayed in Country Z from 3 <sup>rd</sup> June, 2018 to 25 <sup>th</sup> January 2019 in the P.Y.2018-19. The personnel so engaged for Country L project stayed in Country L from 10 <sup>th</sup> July, 2018 to 24 <sup>th</sup> December 2018 in the P.Y.2018-19.

Mr. Arjun sold part of the equity shares held by him in each of the above companies. The details of the shares are given below -

Name of Co.	No. of shares	Date of acquisition	Cost of acquisition (per share)	Date of transfer	Sale price (per share)	FMV as on 31.1.2018
ABC Ltd.	40	28.12.2017	Rs.1,000	2.1.2019	Rs.7,500	Rs.2,000
PQR Ltd.	25	30.11.2017	Rs.3,000	28.12.2018	Rs.5,000	Rs.6,500
EFG Ltd.	45	1.1.2018	Rs.2,000	15.1.2019	Rs.3,000	Rs.1,500
HIJ Ltd.	10	15.1.2018	Rs.4,000	2.3.2019	Rs.2,500	Rs.6,000

Based on the above facts, answer the following questions, assuming that India has –

- (i) a double taxation avoidance agreement with Country Z in line with OECD Model Convention, 2017
- (ii) a double taxation avoidance agreement with Country L in line with UN Model Convention, 2017
- (iii) India follows credit method for providing double taxation relief with respect to taxes paid in Countries Z and L.

#### Multiple Choice Questions

**Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.**

1. For ABC Ltd., which of the following is a criterion for residency in India's DTAA with Country L but not in India's DTAA with Country Z –
  - (a) Place of management
  - (b) Place of incorporation
  - (c) Neither (a) nor (b)
  - (d) Both (a) and (b)
2. As per the DTAA entered into by India with Country Z and Country L, the assembly projects set up by EFG Ltd. in those countries would –
  - (a) constitute a PE in both countries
  - (b) not constitute a PE in either country Z or Country L
  - (c) constitute a PE in Country Z but not constitute a PE in Country L
  - (d) constitute a PE in Country L but not constitute a PE in Country Z.
3. As regards provision of technical consultancy services by HIJ Ltd. to its clients in Country Z and Country L through personnel engaged by them for such purposes, which of the following statements is correct, as per the DTAAAs entered into by India with those countries?
  - (a) Provision of such services would constitute a PE in both cases
  - (b) Provision of such services would not constitute a PE in either case
  - (c) Provision of such services would constitute a PE in Country Z but not in Country L
  - (d) Provision of such services would constitute a PE in Country L but not in Country Z
4. As regards taxability of profits earned by ABC Ltd. from sale of spices to customers through its branches in Country Z and L and profit from sale of spices to customers in Country Z and L directly, which of the following statements is correct, considering the DTAA entered into by India with such countries ?

- (a) ABC Ltd. will be subject to tax in Country Z and Country L, to the extent of profits earned from sales effected to customers through its branches located therein.
- (b) ABC Ltd. will be subject to tax in Country Z and Country L on entire profits earned from sales effected to customers located therein, whether through its branches or directly.
- (c) ABC Ltd. will be subject to tax in Country Z in respect of profits earned from sales effected to customers through its branch located therein and in Country L on entire profits earned from sales effected to customers located therein, whether through its branch or directly.
- (d) ABC Ltd. will be subject to tax in Country L in respect of profits earned from sales effected to customers through its branch located therein and in Country Z on entire profits earned from sales effected to customers located therein, whether through its branch or directly.

5. As regards taxability of interest received/receivable by PQR Ltd. on loan given to L & Co. and Z & Co., which of the following statements is correct, considering the DTAA entered into by India with such countries?

- (a) Country L and Z can tax such interest in the hands of PQR Ltd. at its domestic tax rates, namely, 20% and 8%, respectively.
- (b) Country L and Z cannot tax such interest in the hands of PQR Ltd. since interest is taxable only in India, being the country of residence of PQR Ltd.
- (c) Country L and Z can tax such interest in the hands of PQR Ltd. at a rate, not exceeding the maximum rate to be established through bilateral negotiations
- (d) Country Z can tax such interest in the hands of PQR Ltd. at a rate of 8%. However, Country L can tax such interest in the hands of PQR Ltd. at a rate, not exceeding the maximum rate to be established through bilateral negotiations.

#### **DESCRIPTIVE QUESTIONS**

1. Examine whether Arjun would be treated as a resident of India or Country Z, as per the relevant article of the DTAA between India and Country Z **(6 Marks)**
2. Compute the capital gains of Arjun, assuming that the equity shares of all four companies are listed, and securities transaction tax has been paid both at the time of purchase and sale of such shares.

Also, compute the tax liability of Mr. Arjun, assuming that income computed under the head "Profits and gains of business and profession" is Rs.18,50,000 and income from house property (computed) is Rs.5,25,000. **(9 Marks)**

#### **CASE STUDY - 4**

Holding Ltd. is the Indian parent company of a group of various multinational companies having diversified business portfolio. Its group companies are spread across Country A, County B, Country C and Country D:

Holding Ltd undertakes various transactions with its subsidiaries situated in the countries mentioned above at a predetermined profit margin. One of its subsidiaries Beyond Ltd. (Country A) is engaged in the business of manufacturing and trading of wagons. Holding Ltd purchased a wagon from Beyond Ltd for \$15,000 which included warranty for 3 months. The identical wagon was purchased by Holding Ltd by paying \$14,000 from completely unrelated party with 1 year of warranty. Fair value of warranty is \$700 for one year. However, Beyond Ltd provided credit of 4 months to Holding Ltd. Arm's length interest rate is 9% p.a. Net profit before tax of Holding Ltd. is Rs.25,00,000. Assume 1 \$ = Rs.50.

Mr. Yatish is the employee of the War Ltd. (Country B). War Ltd is the associate enterprise of Holding Ltd. Mr. Yatish, Citizen of Country B, came on deputation to Holding company. He came to India for the first time on 25<sup>th</sup> April, 2018 and left India on 21<sup>th</sup> October, 2018. For the F.Y. 2018-19, Yatish has earned salary of Rs.15,00,000 in India and Rs.23,00,000 in Country B. Out of that Rs.23,00,000 earned in Country B, Rs. 9,00,000 was received in India and Rs.14,00,000 was received in Country B.

Elizabeth Ltd (Country C) is one of the subsidiary companies of the Holding Ltd. Elizabeth Ltd. has filed a case in a High Court in India regarding interpretation of one of the clauses of the India-Country C DTAA and it has made reference to the decision given by Supreme Court of Justice Country E regarding the interpretation of a similar matter in Country E – Country F DTAA. However, the Income-tax department has contended that such reference of Foreign Court decision cannot be made in an Indian Court for interpretation of treaties.

Statue Ltd (Country D) has office in Pune which undertakes storage, display as well as delivery of the goods to the Indian customers. All sales orders and contracts are executed by the head office in Singapore.

Assume that India has a DTAA with Country A, Country B, Country C and Country D in line with the OECD Model Tax Convention 2017.

Another Indian company, Signature Ltd., has earned following income in Country Y:

Income	Date of Accrual of Income
Dividend	25 <sup>th</sup> May, 2018
Profit of Shipping Business	12 <sup>th</sup> December, 2018
Capital Gain	31 <sup>st</sup> March, 2019

Based on the above facts, answer the following questions –

#### Multiple Choice Questions

**Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.**

1. India-Country B DTAA was signed on 1<sup>st</sup> July, 2016. However, TDS provisions of Goods and Service Tax Act came in force on 1<sup>st</sup> October, 2018. Whether such provisions will be covered in the India-Country B DTAA?
  - (a) Yes, it will be covered
  - (b) No, it won't be covered
  - (c) Will be covered if India-Country B enters into fresh agreement to that effect
  - (d) Will be covered if fresh DTAA is made.
2. Mr. Diana, resident and ordinarily resident, did not disclose foreign asset worth Rs.25 Lakh in income tax return. Calculate the amount of penalty leviable under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015-
  - (a) Rs. 25 Lakh
  - (b) Rs.50 Lakh
  - (c) Rs.10 Lakh
  - (d) Rs.1 Crore

3. In the interpretation of the treaty, the provisions shall be interpreted in such a way that it enables provisions of the treaty to work and to have their appropriate effects. Which of the following basic principle suggest the above:

- Purposive Interpretation
- The principle of effectiveness
- Liberal Construction
- Reasonableness and Consistency

4. Following details are given for Signature Ltd. in respect of Dividend received by it from Country Y:

TTBR on 30<sup>th</sup> April, 2018 – Rs.65/ CYD

TTSR on 30<sup>th</sup> April, 2018 – Rs.66/ CYD

TTBR on 25<sup>th</sup> May, 2018 – Rs.65/ CYD

TTSR on 25<sup>th</sup> May, 2018 – Rs.66/ CYD

State the specified date and rate of exchange respectively for conversion of dividend.

- 30<sup>th</sup> April, 65/CYD
- 30<sup>th</sup> April, 65.5/CYD
- 25<sup>th</sup> May, 65/CYD
- 30<sup>th</sup> April, 66/CYD

5. Holding Ltd has advanced loan to Non-Resident company of Rs. 60 Crores. Is the company required to furnish information in Form 15CA in respect of this transaction and if so, in which part?

- Part B of Form 15CA
- Part C of Form 15CA
- Part D of Form 15CA
- Not required to furnish Form 15CA

#### **Descriptive Questions**

- Calculate Holding Ltd's profit chargeable to tax after transfer pricing adjustments. **(5 Marks)**
- Determine residential status of Mr. Yatish for A.Y. 2019-2020 and calculate Mr. Yatish's income which will be chargeable to tax in India. (Double taxation relief may be ignored) **(6 Marks)**
- Analyse the correctness of contention made by the Income-tax department in the case filed by Elizabeth Ltd. **(2 Marks)**
- State whether, Statue Ltd.'s office in India will constitute Permanent Establishment in India. **(2 Marks)**

#### **CASE STUDY - 5**

Rio Grande Inc, a notified Foreign Institutional Investor (FII), derived the following incomes for the financial year 2018-19:-

- Interest received on investment in Rupee Denominated Bonds of Cauvery Ltd., an Indian company issued in March, 2018 - Rs.4,70,000

(2) Dividend from listed equity shares of Indian companies – Rs.2,80,000  
 (3) Interest on securities – Rs.15,48,000 (Expenses of Rs.13,000 has been incurred to earn such income)  
 (4) **Income from sale of securities and shares:**

(i) **Bonds of Vaigai Ltd.**

**[Date of purchase 7th July 2015; Date of sale 5<sup>th</sup> February, 2019]**

Sale proceeds	Rs. 58,00,000
Cost of purchase	Rs. 29,00,000
Cost Inflation Index: F.Y.2015-16:254; F.Y.2018-19:280	

(ii) **Listed equity shares of Mahanadi Ltd.**

**[Date of purchase – 5<sup>th</sup> June, 2018; Date of sale – 4<sup>th</sup> January, 2019]**

Sale Consideration	Rs. 14,50,000
Purchase cost	Rs. 6,00,000
[STT paid both at the time of purchase and sale]	

(iii) **Unlisted equity shares of Godavari Ltd.**

**[Date of purchase – 2<sup>nd</sup> August, 2018; Date of sale – 29<sup>th</sup> March, 2019]**

Sale Consideration	Rs. 7,80,000
Purchase cost	Rs. 2,65,000

Rio Grande Inc. wants to know its total income and tax liability for the A.Y. 2019-20. It has no other income during the F.Y.2018-19.

Zara Ltd. is a company resident in Country A. It had set-up a liaison office at Calcutta to receive trade inquiries from customers in India. The work of the liaison office is not only restricted to forwarding of the trade inquiries to Zara Ltd. but the liaison office also negotiates and enters into contracts on behalf of Zara Ltd. with the customers in India. Zara Ltd. wants to know whether setting up of a liaison office would constitute business connection in India.

Based on the above facts, answer the following questions –

**Multiple Choice Questions**

**Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.**

1. In respect of interest payable to Rio Grande Inc. on Rupee Denominated Bonds issued outside India by Cauvery Ltd., –
  - (a) tax is deductible at source at the rates in force under section 195
  - (b) tax is deductible at source@5.2%.
  - (c) tax is deductible at source@20.8%
  - (d) no tax is deductible at source.

2. If we assume that Rupee Denominated Bonds were issued outside India by Cauvery Ltd. in October, 2018 and Zara Ltd. has also subscribed to such bonds, then, in respect of interest payable to Zara Ltd. on such rupee denominated bonds,
  - (a) tax is deductible at source at the rates in force under section 195
  - (b) tax is deductible at source@5.2%.
  - (c) tax is deductible at source@10.4%
  - (d) no tax is deductible at source.
3. If we assume that Rio Grande Inc. had purchased listed shares of Vaigai Ltd. (STT paid) and not bonds, the date of purchase and sale remaining the same as given in respect of bonds, the entire capital gains arising on sale of such shares would be -
  - (a) Exempt from tax
  - (b) taxable@20% with indexation benefit.
  - (c) taxable@10% without indexation benefit.
  - (d) None of the above.
4. If the liaison office set up in India by Zara Ltd. does not conclude contracts in India but habitually plays the principal role leading to conclusion of service contracts, then, the activities of the liaison office -
  - (a) would not constitute business connection for attracting deemed accrual provisions under section 9(1)(i), since it does not actually conclude contracts.
  - (b) would not constitute business connection for attracting deemed accrual provisions under section 9(1)(i), since contract is for provision of services by Zara Ltd. and not purchase and sale of goods
  - (c) would not constitute business connection due to reasons states in (a) and (b) above
  - (d) constitutes business connection for attracting deemed accrual provisions under section 9(1)(i).
5. What are the provisions which have been incorporated in Indian tax laws in line with BEPS Action 1?
  - (i) Expansion of scope of business connection to include activities of an agent who habitually plays a principal role leading to conclusion of contracts
  - (ii) Expansion of scope of business connection to include activities which constitute significant economic presence
  - (iii) Introduction of equalization levy
    - (a) Only (iii) above
    - (b) (i) and (iii) above
    - (c) (ii) and (iii) above
    - (d) (i), (ii) and (iii) above.

#### **DESCRIPTIVE QUESTIONS**

1. Compute the total income and tax liability of Rio Grande Inc. for A.Y.2019-20. **(12 Marks)**
2. Would the activities carried out by the liaison office set up in India by Zara Ltd. constitute business connection to attract deemed accrual provisions under section 9(1)? **(3 Marks)**

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE : GROUP II**  
**ELECTIVE PAPER 6C: INTERNATIONAL TAXATION**

**SOLUTION TO CASE STUDY 1**

**I. ANSWERS TO MCQs (Most appropriate answers)**

Q. No.	Answer
1	(a)
2	(d)
3	(c)
4	(a)
5	(b)

**II. Answers to Descriptive Questions**

**Answer to Q.1**

(a) In this case, Ganges Ltd., the Indian company, and Nile Inc., a Country E company, are deemed to be associated enterprises as per section 92A(2) since Nile Inc. holds more than 26% voting power in Ganges Ltd.

On account of the primary adjustment of Rs.168 lakhs made by the Assessing Officer, the total income of Ganges Ltd. for A.Y.2017-18 would increase by Rs.168 lakhs. In this case, secondary adjustment has to be made under section 92CE, since –

- (1) The company has accepted the primary adjustment made by the Assessing Officer;
- (2) The primary adjustment is in respect of A.Y.2017-18; and
- (3) The primary adjustment exceeds Rs.100 lakhs.

Accordingly, the excess money (i.e., Rs.168 lakhs) available with the associated enterprise (i.e., Nile Inc., Country E) not repatriated to India within 90 days of the date of the order of the Assessing Officer would be deemed as an advance made by the Ganges Ltd. to its associated enterprise, Nile Inc. Interest would be calculated on such advance at the rate of six month LIBOR as on 30th September + 3%, since the international transaction is denominated in foreign currency. Such interest computed upto 31.3.2019 would be added to his total income for A.Y.2019-20.

(b) If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds Rs. 1 crore, then, the interest paid or payable by such Indian company in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall not be allowed as deduction as per section 94B.

Further, where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise and limitation of interest deduction would be applicable.

In the present case, since M/s Colorado Inc holds 40% of voting power i.e., more than 26% of voting power in both Godavari Ltd and M/s Amazon Inc, Godavari Ltd. and M/s Amazon Inc are deemed to be associated enterprises.

Since loan of Rs. 80 crores taken by Godavari Ltd., an Indian company from M/s Mississippi Inc, is guaranteed by M/s Amazon Inc, an associated enterprise of Godavari Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s Mississippi Inc shall be considered for the purpose of limitation of interest deduction under section 94B.

**Computation of interest to be allowed in the computation of income under the head profits and gains of business or profession of M/s.Godavari Ltd.**

Particulars	Rs.
Net profit	7,00,00,000
Add: Interest already debited (Rs. 80 crores x 8%)	6,40,00,000
Depreciation	4,00,00,000
Income tax	<u>2,70,00,000</u>
<b>EBITDA</b>	<b>20,10,00,000</b>
Interest paid or payable by Godavari Ltd.	6,40,00,000
Less: Excess interest – Lower of	
Interest paid or payable in excess of 30% of EBITDA	
- Rs. 6,40,00,000 (-) Rs. 6,03,00,000	Rs. 37,00,000
Interest paid or payable to non-resident AE	Rs. 6,40,00,000
	37,00,000
Interest allowable as deduction	<b><u>6,03,00,000</u></b>

**Note –** Since Colorado Inc., an associated enterprise of Godavari Ltd., has deposited a matching amount of Rs. 80 crores with Mississippi Inc., the interest payable by Godavari Ltd. to Mississippi Inc. on loan of Rs. 80 crores borrowed from Mississippi Inc. would be subject to limitation of interest deduction on the basis of this line of reasoning also.

**Answer to Q.2**

**Computation of taxable income and tax payable by Ms. Sheetal for A.Y. 2019-20**

Particulars	Rs.	Rs.
<b>Profits and gains from business and profession</b>		
Income from sole proprietary concern in Baroda	80,00,000	
Share of profit, Rs. 40 lakhs, from a partnership firm in Bhopal is exempt	Nil	
Business profit	80,00,000	

Less: Business Loss <sup>1</sup> in Country G (CGD 12,000 x Rs. 50/CGD)	<u>6,00,000</u>	74,00,000
<b>Income from Other Sources</b>		
Agricultural income from coffee estate in Country G, is taxable in India (CGD 40,000 x Rs. 50/CGD)		<u>20,00,000</u>
<b>Gross Total Income/ Total Income</b>		
<b>Tax on total income</b>		
Tax on Rs. 94,00,000 [30% x Rs. 84,00,000 plus Rs. 1,12,500]		26,32,500
Add: Surcharge@10%, since total income exceeds Rs. 50 lakhs		<u>2,63,250</u>
		28,95,750
Add: HEC@4%		<u>1,15,830</u>
		30,11,580
Average rate of tax in India [i.e., Rs. 30,11,580/Rs. 94,00,000 x 100]	32.04%	
Average rate of tax in Country G [i.e., CGD 8,000/CGD 40,000]	20%	
Doubly taxed income [Rs. 20,00,000 – Rs. 6,00,000]	14,00,000	
Rebate under section 91 on Rs. 14,00,000 @20% (lower of average Indian tax rate and rate of tax in Country G)		<u>2,80,000</u>
<b>Tax payable in India [Rs. 30,11,580 – Rs. 2,80,000]</b>		<b><u>27,31,580</u></b>

**Note:** Since Ms. Sheetal is resident in India for the P.Y.2018-19, her global income would be subject to tax in India. She would be allowed deduction under section 91 since all the following conditions are fulfilled:-

- (a) She is a resident in India during the relevant previous year.
- (b) Agricultural income from coffee estate accrues or arises to her outside India in Country G during that previous year.
- (c) Such agricultural income is not deemed to accrue or arise in India during the previous year.
- (d) Such agricultural income has been subjected to income-tax in Country G in her hands and she has paid tax on such income in Country G.
- (e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country G, where the income has accrued or arisen.

### SOLUTION TO CASE STUDY 2

#### I. ANSWERS TO MCQs

MCQ No.	Answer
1.	a
2.	d

<sup>1</sup> Since the eight year period from A.Y.2015-16, being the assessment year in which such business loss was incurred, has not expired, the business loss can be set-off against current year business income

3.	a
4.	c
5.	b

## II. ANSWERS TO DESCRIPTIVE QUESTIONS

### Answer to Q.1

#### Determination of residential status of Mr. Eashwar for A.Y.2019-20

No. of days of stay in Country X = 32 days + 49 days + 19 days = 100 days

No. of days of stay in Country Y = 22 days + 42 days + 16 days = 80 days

No. of days of stay in India = 365 days – 100 days – 80 days = 185 days

Since Mr. Eashwar's stay in India is for 185 days (i.e., 182 days or more) in the P.Y.2018-19, he is resident in India for A.Y.2019-20.

For determining whether he is resident and ordinarily resident in the A.Y.2019-20, the number of days of his stay in India in the last seven previous years is relevant -

Previous Year (P.Y.)	No. of days in Country X	No. of days in Country Y	No. of days in India
P.Y.2017-18	97	78	365-97-78 = 190
P.Y.2016-17	95	85	365-95-85 = 185
P.Y.2015-16	98	82	366-98-82 = 186
P.Y.2014-15	100	80	365-100-80 = 185
P.Y.2013-14	103	75	365-103-75 = 187
P.Y.2012-13	110	70	365-110-70 = 185
P.Y.2011-12	120	60	366-120-60 = 186
<b>Total number of days in the last seven years</b>			<b>1304</b>

Since his stay in India exceeds 730 days in the last seven previous years and his number of days of stay in India is 182 days or more in all the earlier previous years, he satisfies the condition of being resident in atleast 2 out of the 10 preceding previous years. Therefore, he is resident and ordinarily resident in India for A.Y. 2019-20.

### Answer to Q.2

#### Computation of tax liability of Ms. Radha Srinivas for the A.Y. 2019-20

Particulars	Rs.	Rs.
<b>Profits and gains of business or profession</b>		
From concerts held in India	10,00,000	
From royalty received from Country U [CLD 10000 x 80 (being conversion rate as on 31.3.2019 -Rule 115)]	8,00,000	
From concerts held in Country W [CWD 10145 x 69 (being conversion rate as on 31.3.2019 – Rule 115)]	7,00,005	
		25,00,005

<b>Income from Other Sources</b>		
Income from fixed deposits in her name	4,00,000	
Income from savings bank account	<u>25,000</u>	4,25,000
<b>Gross Total Income</b>		<b>29,25,005</b>
<b>Less: <u>Deduction under section 80C</u></b>		
Deposit in PPF	1,50,000	
Five year fixed deposit in the name of her son (does not qualify for deduction under section 80C)		
<b><u>Under section 80D</u></b>	50,000	
Medical insurance premium to insure her health and health of spouse (Rs.57,000, restricted to Rs.50,000, being the maximum allowable for senior citizens) (See Note 1)		
<b><u>Under section 80TTB</u></b>	50,000	
Interest on bank FD and savings bank account restricted to		2,50,000
<b>Total Income</b>		<b>26,75,005</b>
<b>Total Income (rounded off)</b>		<b>26,75,010</b>
<b>Tax on Total Income</b>		
Income-tax (See Note 2)		6,12,503
Add: Health and Education Cess @4%		24,500
		<b>6,37,003</b>
Average rate of tax in India (i.e., Rs. 6,37,003 / Rs. 26,75,010 × 100)	23.813%	
<b>Foreign Tax Credit</b>		
Lower of tax payable under the Income-tax Act, 1961 on income from profession and foreign tax payable on such income		
Tax covered under India-Country U DTAA under section 90 [Lower of Rs.1,90,504 (i.e., 23.813% x Rs.8,00,000) and Rs.78,000 (Rs. 78, being the conversion rate as on 28.2.2019 as per Rule 128 x CUD 1000)]	78,000	
Income-tax referred to in section 91: Country W [Lower of Rs.1,66,692 (i.e., 23.813% x Rs.7,00,005) and Rs.1,75,000 (Rs. 70, being the conversion rate as on 30.9.2018 as per Rule 128 x CWD 2500)]		<u>1,66,692</u>
<b>Tax payable in India (Rs. 6,37,003 – Rs. 2,44,692)</b>		<u>2,44,692</u>
<b>Tax payable (rounded off)</b>		<b>3,92,311</b>
		<b>3,92,310</b>

**Notes:**

1. Section 80D allows a higher deduction of up to Rs. 50,000 in respect of the medical premium paid to insure the health of a senior citizen. Therefore, in respect of medical insurance premium of Rs.57,000 paid by Mrs. Radha Srinivas to insure the health of herself and her spouse, she will be allowed deduction of

Rs. 50,000 under section 80D, since she and her husband are resident Indians of the age of 60 years or more during the P.Y.2018-19.

2. The basic exemption limit for senior citizens is Rs. 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Mrs. Radha Srinivas is eligible for the higher basic exemption limit of Rs. 3,00,000, since she is 60 years old.
3. As per Rule 115, for computing income from profession of Mrs. Radha Srinivas, the TT buying rate as on 31.3.2019 has to be considered. Royalty income from Country U and income from concerts in Country W constitute her income from profession, since she is a singer and a composer. However, as per Rule 128, for computing foreign tax credit, TT buying rate as on the last day of the month immediately preceding the month in which tax was deducted or paid in that country has to be considered. Foreign Tax Credit has been computed accordingly.
4. Since the DTAA with Country U is in line with UN Model Convention, as per article 12(1), royalty income arising in a Contracting State (Country U, in this case) and paid to a resident of another Contracting State (Mrs. Radha Srinivas, a resident of India, in this case) **may** be taxed in that other State (India, in this case). However, such royalties may also be taxed in the Source State according to its laws, but if the beneficial owner is a resident of another State, then the tax so charged shall not exceed a prescribed percentage to be established through bilateral negotiations (assumed to be 10%, as given in the question, in this case). It is presumed that the rate of 10% is as per domestic tax laws and the negotiated rate as per Article 12(2) of the DTAA of India with Country U. Credit for such tax paid by Mrs. Radha Srinivas in Source State, i.e., Country U, in this case, would be available as per Article 23B(1).

### SOLUTION TO CASE STUDY 3

#### I. ANSWERS TO MCQs

MCQ No.	Answer
1.	b
2.	b
3.	b
4.	c
5.	d

#### II. ANSWERS TO DESCRIPTIVE QUESTIONS

##### Answer to Q.1

The India-Country Z DTAA is in line with OECD Model Convention. Hence, the relevant article i.e., Article 4 of the OECD Convention needs to be looked into for determining the residential status of Mr.Arjun.

As per Article 4(1), the term "resident of a Contracting State" means, *inter alia*, any person who is a resident of a Contracting State in accordance with the taxation laws of that State.

Therefore, for determining whether Mr. Arjun is a resident of India or Country Z, first, the residential status as per the taxation laws of respective countries has to be ascertained.

As per section 6(1) of the Income-tax Act, 1961, an individual is said to be resident in India in any previous year if he has been in India during the previous year for a total period of 182 days or more. Mr. Arjun stays in India for 184 days during the P.Y. 2018-19 (31 days in May + 31 days in July + 30 days in September + 30 days in November + 31 days in January + 31 days in March). Therefore, he is resident in India for P.Y. 2018-19.

For being resident and ordinarily resident, he should fulfil both the following conditions:

- (i) He is a resident in atleast 2 out of 10 years preceding the relevant previous year, and
- (ii) His total stay in India in last seven years preceding P.Y. 2018-19 is 730 days or more.

In this case, since Arjun stays in India for 184 days every year, he is resident in India in every previous year as per the provisions of the Income-tax Act, 1961. Therefore, he satisfies the condition of being resident in India for atleast 2 years out of 10 preceding previous years. Also, he has stayed in India for 1288 days (184 days x 7) during the last seven previous years, which is more than 730 days. Hence, he is resident and ordinarily resident in India for A.Y. 2019-20 as per the provisions of the Income-tax Act, 1961.

As per Country "Z" tax residency rules, Arjun qualifies to be resident for the year 2018-19 in Country "Z", since he stays for 181 days (more than 180 days) in Country "Z" in the Financial Year 2018-19.

Thus, as per the domestic tax laws of India and Country Z, Arjun qualifies to be a resident both in India and Country Z during the year P.Y. 2018-19. Hence, the tie-breaker rule provided in Article 4(2) will come into play.

This Rule provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

From the facts, it is evident that Arjun has been living in his own flat in Juhu, Bombay, with his family. Hence, it can be considered as permanent home for him in India. In Country "Z" also, he owns a residential house which would be considered as permanent home for him. Since he has a permanent home both in India and Country "Z", the next test needs to be analysed.

Arjun owns spice gardens in Munnar in India and in Country Z, from which he earns income. However, he also owns a house property in Thane in India from which he derives rental income. His family also resides in Mumbai, India. He has showcased his paintings in Art exhibitions in Mumbai. Therefore, his personal and economic relations with India are closer, since India is the place where -

- (a) his residential property is located and
- (b) social and cultural activities are closer

Thus, by applying Article 4 of the India-Country "Z" DTAA, Arjun shall be deemed to be resident in India in the P.Y. 2018-19.

## Answer to Q.2

### Computation of total income of Mr. Arjun for A.Y. 2019-20

Particulars	Rs.	Rs.
Income from house property		5,25,000
Profits and gains of business and profession		18,50,000
Capital Gains [See Working Note below]		2,50,000
Income from other sources		<u>42,300</u>
<b>Gross Total Income</b>		<b>26,67,300</b>

<b>Less: Deduction under Chapter VI-A</b>		
Under section 80C [Deposit in PPF]	1,50,000	
Under section 80D [Rs.28,000, restricted to Rs.25,000 + Rs.32,000 (since parents are senior citizens, and Rs.32,000 is within the enhanced limit of Rs.50,000)]	57,000	
Under section 80TTA	<u>10,000</u>	<u>2,17,000</u>
<b>Total Income</b>		<b><u>24,50,300</u></b>
<b>Computation of tax liability</b>		
Particulars	Rs.	Rs.
Tax@10% u/s 112A on LTCG of Rs.1,50,000 [LTCG in excess of Rs.1 lakh]		15,000
Tax on other income of Rs.22,00,300		
Upto Rs.2,50,000	Nil	
Rs.2,50,001 – Rs.5,00,000@5%	12,500	
Rs.5,00,001 – Rs.10,00,000@20%	1,00,000	
Rs.10,00,001 – Rs.22,00,300@30%	<u>3,60,090</u>	
		<u>4,72,590</u>
		4,87,590
Add: Health and education cess@4%		<u>19,504</u>
<b>Total tax liability</b>		<b><u>5,07,094</u></b>
Total tax liability (rounded off)		5,07,090

#### **Working Note-**

The capital gains arising from sale of shares in all the four companies is long-term since the period of holding in each case is 12 months or more.

Company	Particulars	LTCG
ABC Ltd.	In this case, the lower of sale price (Rs.7,500) and FMV as on 31.1.2018 (Rs.2,000) is Rs.2,000. As the actual cost of acquisition of equity shares of ABC Ltd. (Rs.1,000) is less than Rs.2,000, the cost of acquisition of such share would be taken as Rs.2,000. The long-term capital gain would be Rs.2,20,000 (Rs.7,500 – Rs.2,000) x 40 shares.	2,20,000
PQR Ltd.	In this case, the lower of sale price (Rs.5,000) and FMV as on 31.1.2018 (Rs.6,500) is Rs.5,000. As the actual cost of acquisition of equity shares of PQR Ltd. (i.e., Rs.3,000) is less than Rs.5,000, the cost of acquisition would be taken as Rs.5,000. The long-term capital gains would be Nil (Rs.5,000 – Rs.5,000) x 25 shares.	Nil
EFG Ltd.	In this case, the lower of sale price (Rs.3,000) and FMV as on 31.1.2018 (Rs.1,500) is Rs.1,500. As the actual cost of Rs.2,000 is higher than Rs.1,500, the cost of acquisition would be taken as Rs.2,000. Accordingly, the long-term capital gains would be Rs.45,000 (Rs.3,000 – Rs.2,000) x 45	Rs.45,000

HIJ Ltd.	In this case, the lower of sale price (Rs.2,500) and the FMV as on 31.1.2018 (Rs.6,000) is Rs.2,500. Since the actual cost of acquisition (i.e., Rs.4,000) is less than Rs.2,500, accordingly, the actual cost of Rs.4,000 will be taken as the cost of acquisition. The long-term capital loss would be Rs.15,000 (Rs.2,500 – Rs.4,000) x 10 shares.	(Rs.15,000)
<b>Long-term capital gains</b>		<b>2,50,000</b>

### SOLUTION TO CASE STUDY 4

#### I. Answer to MCQs

Q. No.	Answer
1	(b)
2	(c)
3	(b)
4	(a)
5	(d)

#### II. Answers to Descriptive Questions

##### Answer to Q.1

Holding Ltd, the Indian company and Beyond Ltd., Country A, are deemed to be associated enterprises as per section 92A, since Beyond Ltd. is the subsidiary of Holding Ltd.

As per *Explanation* to section 92B, the transactions entered into between these two companies for purchase of wagon is included within the meaning of “international transaction”.

As Holding Ltd. purchased similar product from an unrelated entity at \$14,000, the transactions between Holding Ltd. and such unrelated party can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between Holding Ltd. and Beyond Ltd. Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

However, such figure needs to be adjusted by the functional adjustments:

	Amount (in \$)
Purchase of Wagon from unrelated party	\$14,000
Less: Difference in Warranty (Note-1)	(\$525)
Add: Adjustment for credit extended (Note-2)	\$450
<b>Arm's length price</b>	<b>\$13,925</b>

Therefore, transfer pricing adjustment would be of Rs. 53,750 [(\$ 15,000 - \$ 13,925) x Rs.50]. The profits of Holding Ltd chargeable to tax would be Rs.25,00,000+Rs.53,750 = Rs.25,53,750.

##### Note:

- (1) Beyond Ltd offered warranty only for 3 months while unrelated party provided it for 1 year. Therefore, 9 months' cost of warranty has to be adjusted. (\$700\*9/12)

(2) Beyond Ltd has provided credit for 4 months whereas unrelated party has not provided such credit. Therefore, adjustment for the cost of such credit is needed to be carried out to arrive at arm's length price.  $(\$15000*9%*4/12)$

#### **Answer to Q.2**

As per section 6(1), an individual is said to be resident in India in any previous year if he satisfies the conditions:-

- (i) He has been in India during the previous year for a total period of 182 days or more, or
- (ii) He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

In this case, Mr. Yatish stay in India during the P.Y. 2018-19 is 180 days (i.e., 6+31+30+31+31+30+21 days). Since his stay in India is for less than 182 days, he does not satisfy condition (i). As regards, condition (ii), since Mr. Yatish came India for the first time in the P.Y. 2018-19, he cannot satisfy the second basic condition of stay of atleast 365 days in the four immediately preceding previous years. Hence, his residential status for A.Y.2019-20 is Non-Resident.

#### **Taxability of income**

As per section 5(2), in case of a non-resident, only income which accrues or arises in India or which is deemed to accrue or arise to him in India or which is received or deemed to be received in India in the relevant previous year is taxable in India.

#### **Calculation of income chargeable to tax in the hand of Mr. Yatish**

Particulars	Amount (Rs.)
Salary earned in India	15,00,000
Salary earned outside India but received in India	9,00,000
Salary earned outside India and received outside India (not taxable)	Nil
<b>Amount Taxable in India</b>	<b>24,00,000</b>

#### **Answer to Q.3**

In *CIT v. Vishakhapatnam Port Trust's case [1983] 144 ITR 146*, the Andhra Pradesh High Court observed that, "in view of the standard OECD Models which are being used in various countries, a new area of genuine 'international tax law' is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties. The maintenance of uniformity in the interpretation of a rule after its international adoption is just as important as the initial removal of divergences. Therefore, the judgments rendered by courts in other countries or rulings given by other tax authorities would be relevant." Therefore, stand taken by the Income Tax Department may not be accepted by the court.

#### **Answer to Q.4**

As per the Article-5 of DTAA between India – Country D, the term "permanent establishment" shall be deemed not to include the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise. Therefore, Statue Ltd (Country D)'s office in India will not constitute Permanent Establishment, since its activities are confined only to storage, display and delivery of goods.

## SOLUTION TO CASE STUDY 5

### I. Answer to MCQs

Q. No.	Answer
1	(b)
2	(d)
3	(d)
4	(d)
5	(c)

### II. Answers to Descriptive Questions

#### Answer to Q.1

##### Computation of total income of Rio Grande Inc., a notified FII, for A.Y.2019-20

Particulars	Rs.	Rs.
Interest on Rupee Denominated Bonds	4,70,000	
Dividend income of Rs. 2,80,000 [Exempt under section 10(34)]	Nil	
Interest on securities	15,48,000	20,18,000
[No deduction is allowable in respect of expenses incurred in respect thereof as per section 115AD(2)]		
<b>Long-term capital gains on sale of bonds of Vaigai Ltd.</b>		
Sale consideration	58,00,000	
Less: Cost of acquisition	<u>29,00,000</u>	29,00,000
[Benefit of indexation is not allowable as per section 115AD(3)]		
<b>Short-term capital gains on sale of STT paid equity shares of Mahanadi Ltd.</b>		
Sale consideration	14,50,000	
Less: Cost of acquisition	<u>6,00,000</u>	8,50,000
<b>Short-term capital gains on sale on unlisted equity shares of Godavari Ltd.</b>		
Sale consideration	7,80,000	
Less: Cost of acquisition	<u>2,65,000</u>	5,15,000
<b>Total Income</b>		<b>62,83,000</b>

##### Computation of tax liability of Rio Grande Inc. for A.Y.2019-20

Particulars	Rs.
Tax@5% on interest of Rs. 4,70,000 received from an Indian company on investment in rupee denominated bonds = 5% x Rs. 4,70,000	23,500
Tax@20% on interest on securities of Rs. 15,48,000 =20% x Rs. 15,48,000	3,09,600
Tax@10% on long-term capital gains on sale of bonds of Vaigai Ltd. = 10% x Rs. 29,00,000	2,90,000

Tax@15% on short-term capital gains on sale of listed equity shares of Mahanadi Ltd., in respect of which STT has been paid = 15% of Rs. 8,50,000	1,27,500
Tax@30% on short-term capital gains on sale of unlisted equity shares of Godavari Ltd. = 30% of Rs. 5,15,000	<u>1,54,500</u>
	9,05,100
<i>Add: HEC@4%</i>	<u>36,204</u>
<b>Tax Liability</b>	<b><u>9,41,304</u></b>
<b>Tax Liability (rounded off)</b>	<b>9,41,300</b>

#### **Answer to Q.2**

If a Liaison Office is maintained solely for the purpose of carrying out activities which are preparatory or auxiliary in character, and such activities are approved by the Reserve Bank of India, then, no business connection is established.

In this case, had the liaison office's activities been restricted to forwarding of trade inquiries to Zara Ltd., a Country A based company, its activities would not have constituted business connection. However, the activities of the liaison office in Calcutta extends to also negotiating and entering into contracts on behalf of Zara Ltd. with the customers in India, on account of which business connection is established. Hence, the deemed accrual provisions under section 9(1)(i) would be attracted.

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE: GROUP – II**  
**PAPER – 6D: ECONOMIC LAWS**

*Attempt any **four** out of **five** case study based questions.*

Each Case Study carries 25 Marks.

<b>Time Allowed – 4 Hours</b>	<b>Maximum Marks – 100</b>
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**Case Study 1**

Way back in November, 2011, Mr. Hariharan Reddy, a senior professor of Biology in the University of Hyderabad, booked a 3BHK apartment in Royal Golf Burg - an impressive and integrated housing project proposed to be developed by a reputed builder popularly known as Raj Group. The project was large enough to accommodate 1200 fully-furnished apartments of different sizes spread out in 15 towers; each tower having 80 apartments. In addition, a Golf Course and a three storeyed mall was also to be developed. This project was to come up near Shankar pally Road, Hyderabad, a non-polluting and posh area having all the facilities in close vicinity including ultra-modern cinema halls, markets, schools, colleges, hospitals, etc.

As mentioned above, the Raj Group which undertook to develop Royal-Golf-Burg consisted of Dhanraj and his younger brother Yuvraj, a well-known figure of Hyderabad. Both the brothers were the directors of Eklavya Estates Private Limited (EEPL) which had registered office at Gachibowli, Hyderabad. EEPL owned the plot of land where the proposed housing project including mall was to be developed.

The gated residency with a nice and peaceful environment as provided by Royal Golf Burg was meant for golf lovers who wanted to live a sleek and sporty lifestyle by making golf playing a routine. The glamour which attracted Mr. Reddy the most was that every apartment owner after occupation would feel the ownership of the golf course due to its strategic location vis-à-vis each apartment.

The management team of EEPL comprised seasoned architects and professionals who had, in the past, made luxurious homes possible for every home-buyer and the team was considered to be a dedicated one having will and honesty as its strong pillars which could build integrated properties with excellent infrastructure and services. The builders had completed several giant opulent projects in Guwahati, Mumbai and Bhopal earlier. In case of Royal Golf Burg, the company was to give delivery of fully furnished apartments by December, 2017. Construction cost including the cost of the land was valued at around Rs. 800 crores.

The current project, however, missed the deadline of December, 2017 and on the date of delivery, it was noticed that only six towers were completed; but the apartments in those towers were yet to be furnished. Other three towers had been constructed with a skeletal structure. In other six towers, only the foundation and a negligible wall work had been completed. In other words, the construction work was just at the initial stage and nothing more than that. However, the construction of Mall was almost complete. This angered the home-buyers including Mr. Reddy a lot but their repeated visits to the office of promoters did not evoke any positive response. Six months passed without any significant happening. Nothing was done to furnish the already constructed apartments or to develop the other nine towers. Disappointed, Mr. Reddy and others approached Telangana State RERA authorities for redressal of their grievances including filing of complaints regarding non-delivery of apartments.

Telangana State RERA, after detailed inquiry, found that there were several financial irregularities together with diversion and siphoning of funds. More than two hundred shell companies were floated in the names of peons and drivers to divert money. Further, unaccounted money worth crores of rupees was invested in various other housing projects floated by the Raj Group which sold these flats at throw-away prices on paper but received black money in cash which was laundered through various shell companies operated by the Raj Group. This attracted the provisions of Prevention of Money Laundering Act, 2002.

In case of 250 apartments built in the six towers, double allotment was also detected where the apartments were allotted to the persons more than their entitlement at a very nominal amount. It included the person himself, the spouse or dependent children; and almost in all cases such persons were found to be connected with the promoters. The double allotment deprived the genuine home-buyers who had parted with their hard-earned money from getting even the deserving allotment of apartments despite paying around 80% of the cost. The double allotment was considered to be a form of unfair practice in which the promoters were involved. Enquiry by the RERA Authority also revealed that ten gardeners and drivers of Raj Group who had no means of paying the price of ten apartments were allotted the flats though consideration came from the Raj Group itself.

A show-cause notice was issued by Telangana State RERA authorities to the developers asking them to provide a satisfactory response within a period of 30 days from the date of the notice as to why the project should not be de-registered. The response given by the directors, however, was dismal, lacked substance and was not at all satisfactory.

However, de-registration of a building project is not an ideal choice for the authorities keeping in view the larger interests of the stakeholders as well as the nation as a whole and it is resorted to only when all the possible avenues of reaching a comfortable and plausible solution are shut. Therefore, as a last attempt before going for de-registration, RERA authorities in the interest of the allottees, permitted the developer EEPL to continue with the project and complete it in the next one year at the most subject, however, to the payment of a fine equivalent to 10% of Rs.800 crores within next thirty days.

However, the developers, seemed to be not serious at all so far as completion of housing project was concerned. They did not make use of this golden opportunity, thus, letting the project slip out of their hands. Citing insufficiency of the funds, they did not cough out the required fine of Rs. 80 crores within next thirty days and therefore, the Telangana State RERA authorities were forced to de-register the project and an order to this effect was passed. Thereafter, finally the project was taken over by RERA Authorities.

After take-over, RERA authorities with the concurrence of the State Government imposed various restrictions and controls on the project and the developer. These included:

- Freezing of various bank accounts due to which the developer was not allowed to make any payment or withdraw from these accounts without the authority's approval.
- Debarring the developer EEPL from accessing the web-site of RERA in relation to the project.
- RERA offices in other States and Union Territories were given information about such a revocation.
- As a part of name and shame, the name of the EEPL was mentioned in the list of the defaulters along with the photographs of Dhanraj and Yuvraj and also relevant information about the case was displayed.

The officials of Telangana State RERA opined that after de-registration, there were several options before them to solve the issue in favour of home-buyers. The authority could give the first right of completion of the project to the home-buyers. If case the buyers were not in a position to do so by pooling their resources together and required RERA to supervise the development work which could be undertaken by another trustworthy developer, then the RERA Authority could take steps to develop mechanism to supervise the project.

In case there was not enough money left in the project fund, the Authority could also start proceedings to recover the diverted funds from the EEPL and it could also explore other possibilities to complete the project if the home-buyers so wished.

The response from the Home-buyers' Association of Royal Golf Burg was positive and therefore, a conciliatory committee was formed. President and Secretary of the Home-buyers' Association were nominated to the committee and RERA then appointed Mr. Yudhister Pal, a retired IAS Officer as a conciliator to supervise the operations of the committee. Another developer Uttam Constructions Private Limited was given the charge to complete the project within one year under the supervision of RERA Authority represented by Mr. Yudhishtra Pal.

RERA ordered that all money realised from the sale of Mall as well as remaining dues to be given by the home-buyers would flow into an 'Escrow Account' opened solely for the construction of the project and Mr. Yudhister would release the funds only with the consent of the President and Secretary of Home-buyers' Association. Proceedings to recover the diverted funds from the EEPL were also started. It was hoped that the project would be completed as per the new schedule.

#### **Multiple Choice Questions (MCQs) [2 Marks each]**

1. RERA Authority passed the order of de-registration of Royal Golf Burg Project against its promoter EEPL. Within how many days of receipt of order of de-registration, EEPL, as aggrieved party, can file an appeal with the concerned Real Estate Appellate Tribunal?
  - (a) 30 days
  - (b) 45 days
  - (c) 60 days
  - (d) 120 days
2. The promoter EEPL did not complete the Royal Golf Burg Project within the projected time-frame as shared through declaration with RERA Authorities while seeking registration under Section 4. For such contravention, how much penalty the EEPL is liable to pay?
  - (a) Penalty may extend up to 2% of the project cost
  - (b) Penalty may extend up to 5% of the project cost
  - (c) Penalty may extend up to 10% of the project cost
  - (d) None of the above
3. In case of Royal Golf Burg project, it is seen that it was de-registered by the RERA Authorities due to various irregularities. Choose from the given options as to who shall have the first right of refusal for carrying out the remaining development works in case of such revocation of registration.
  - (a) Home-buyers' Association of Royal Burg Golf
  - (b) EEPL
  - (c) Mr. Yudhister Pal, Head of Conciliatory Committee
  - (d) RERA Authority
4. In the above case study relating to Royal Golf Burg, who is Benamidar?
  - (a) Gardeners and drivers employed by Dhanraj and Yuvraj
  - (b) Dhanraj and Yuvraj themselves
  - (c) Hariharan Reddy
  - (d) None of the above
5. In case the Real Estate Appellate Tribunal admits the appeal of EEPL against de-registration of the Project, then within how much maximum time such appeal must be disposed of?
  - (a) Within 30 days from the receipt of appeal
  - (b) Within 45 days from the receipt of appeal
  - (c) Within 60 days from the receipt of appeal
  - (d) Within 120 days from the receipt of appeal

#### **Descriptive Questions**

1. According to the above case study, the Royal Golf Burg promoted by the Raj Group was de-registered by the Telangana State RERA authorities because the promoters were found to be involved in certain

unfair and fraudulent practices. You are required to state the various reasons due to which registration granted to a project under RERA can be revoked and the project stands de-registered. (5 Marks)

2. In the given case study, the Telangana State RERA authorities resorted to de-registration of the Royal Golf Burg Project due to unfair and fraudulent practices and irregularities followed by its promoters while developing the project and the development was carried out at such a slow pace that ultimately the home-buyers could not get the possession of fully furnished apartments well within the promised time. What are the obligations of the RERA Authority and other matters associated with it if it recourse to de-registration of a project? (5 Marks)
3. The circumstances stated in the above case study require the RERA Authority to revoke the registration of Royal Golf Burg Project instead of its extension. State the provisions under which RERA Authority may be required to extend the registration instead of revoking it. (5 Marks)

### Case study 2

In northern and western part of the country production of sugarcane is reasonably good. But the large amount of pendency of the payments by sugar mills to sugarcane producers is cause of worry. Common platform is essential requirement to provide solution to this problem. **Northwest Agro Produce Cooperative Society** was formed to ensure the timely collection of sale proceeds from sugar mills. Northwest Agro Produce Cooperative Society developed a charter, in form of memorandum for its members, to regulate and control supply, price, term of sales of sugar canes, collection of sale proceed and recovery if required. This memorandum is binding on all the members of society.

Northwest Agro Produce Cooperative Society extend the support to cane grower, by giving them offer; to sell their entire farm produce of canes to society at mutually agreed price; which society will further sell to sugar mills. But farmer who avail this facility have to sell his entire farm produce to Northwest Agro Produce Cooperative Society, means farmer can't sell any portion of his farm produce in open market. In order to trade with the sugar mills, and deals with regulatory authorities, financial institution etc; Northwest Agro Produce Cooperative Society decided to promote Limited Liability Company named **North West Agro Limited**. The extracts from latest audited financial statements of North West Agro Limited are as follows;

Sr. No.	Particular	Amount (In Lakhs INRs)
1	Proceed (Net of taxes) from sale of sugar canes	320000
2	Operating assets	72800
3	Paid –up share capital	48900
4	Net Profit	9600

With Passage of time North West Agro Limited became the big hit, for role it play as intermediary; in incredible transformation in process of sale of sugarcane by cane farmers.

Mr. Vijendra Narang, who is CEO of North West Agro limited, heard about forward integration as method of expansion and growth strategy. Mr. Narang prepared a proposal, which is duly approved by board of directors and then by members of company to takeover **Sun Sugar Limited**, by acquiring controlling stake from open market. Sun Sugar Limited is running sugar mills, with global presence.

Around 60% of sales by Sun Sugar Limited constitute exports of raw sugar, majorly to IRAN. One year back Sun Sugar Limited opened one branch office in IRAN, as IRAN starts buying sugar from India, in order to settle trade balance; because IRAN is blocked from the global financial system; including using U.S. dollars to transact its oil sales. On such branch office, during last financial year, annual recurring expenditure in foreign currency out of EEFC accounts; was equivalent to INRs 14000 lakhs.

For last financial year, turnover of Sun Sugar Limited was recorded at INRs 120000 lakhs which was INRs 10000 lakhs more than year earlier to last financial year; whereas operating assets as on reporting date were INRs 27000 lakhs. Paid-up share capital was INR 12600 lakhs. After acquisition both the entities were not merged, both kept respective separate identity.

Sun Sugar Limited has strong domestic network or tie-up with retail shops and stores through which they sale their sugar, under brand name 'Meetha', which constitute around 40% of sale. Such retail shops and stores are provided with instruction not to charge the price more then what is suggested by Sun Sugar Limited although lower prices can be charged and specific jurisdiction is given to each retailer for resale.

Mr. Nair who is head of marketing at North West Agro Limited, also look after marketing at Sun Sugar Limited, according to him; in order to acquire substantial market share (in term of new customers), Sun Sugar Limited has to sell sugar at the prices lower than cost. Ignoring the resistance from the governing body of Sun Sugar Limited, new pricing policy implemented. Resultantly price decreased from INRs 40 per kilogram to INRs 35 per kilogram. But in order to restrict loss, on account of selling sugar at price lower than cost; Sun Sugar Limited ask to all the shopkeeper and stores, through whose counter they are sale their sugar produce, not to bill more than 2 kg of 'Meetha' sugar per purchase

Northwest Agro Produce Cooperative Society promotes another company named **South West Agro Limited**, whose object clause includes; provide weather research and forecast reports, other necessary technical knowledge or guidance to members of parents society apart from conducting market research for North West Agro Limited.

Out market research conducted by South West Agro Limited, it was found that **Moon Sugar Limited**, hold major stake in retail of packed sugar, around 30% across the nation under brand name 'Aur' (Price of which is INRs 40 per Kilogram); which cause stiff competition among the players who sell packed sugar. Since acquisition of Sun Sugar Limited by North West Agro Limited, remains largely successful; hence showing trust in un-organic growth, a bear-hug letter sent to senior management of Moon Sugar Limited. For latest financial year, turnover of Moon Sugar Limited is recorded at INRs 280000 lakhs where as operating assets are of INRs 56800 lakhs. Paid-up share capital is INR 36400 lakhs.

Since Moon Sugar Limited is already undisputed market leader hence refuse the bear hug offer. North West Agro Limited with help of South West Agro Limited performs hostile acquisition and both the companies acquires around 25.5% stake in voting rights each; by tender notice over the stock exchange. Governing body of Moon Sugar Limited restructured completely. Post acquisitions of Moon Sugar Limited, North West Agro Limited got the dominance over the market. Since new pricing policy introduced principle buyer of North West Agro Limited is multifold. Hence company decided to re-price their product, which is renamed also 'Aur Meetha'. New price is INRs 42 per Kilogram. To support the price rise, North West Agro Limited starts restricting supply.

North West Agro Limited also entered in memorandum of understanding with Star Ethanol Limited, which is \$ 20 million (assets base) company for transfer of technology.

#### **Multiple Choice Questions (MCQs) [2 Marks each]**

1. Takeover (acquisition) of Sun Sugar limited by North West Sugar limited, will be considered as combination if
  - (a) Assets of enterprise created after merger is equal than INRs 1000 crores
  - (b) Turnover of enterprise created after merger is more than INRs 1000 crores
  - (c) Turnover of enterprise created after merger is more than INRs 3000 crores
  - (d) Assets of enterprise created after merger is more than INRs 3000 crores
2. South West Agro Limited and North West Agro Limited will be considered as group because, these are in capacity of
  - (a) Exercise 26% or more of the voting right of Moon Sugar Limited
  - (b) Appoint more than 50% of members of board of directors in the sun limited
  - (c) Control the management or affairs of the sun Limited
  - (d) All of above

3. Exchange Earners' Foreign Currency Account can be open by foreign exchange earner;
  - (a) Who are not resident in India
  - (b) Who are resident in India
  - (c) Which are situated in SEZ
  - (d) Person of Indian Origin, but residing outside India.
4. Decision of North West Agro Limited, on part of Sun Sugar Limited; not to sell more than 2 kg of sugar per purchase can be categorized as;
  - (a) Exclusive supply agreement
  - (b) Exclusive distribution agreement
  - (c) Refusal to deal
  - (d) None of the above
5. Exchange Earners' Foreign Currency Account can be open with
  - (a) Authorised Dealer - Category I
  - (b) Authorised Dealer - Category II
  - (c) Authorised Dealer - Category III
  - (d) Full Fledged Money Changers

### **Descriptive Questions**

1. Is Northwest Agro Produce Cooperative Society can be considered as 'Cartel'. **(3 Marks)**
2. Does North West Agro Limited hold dominance over market, if yes at what instances you feel it abuse its dominant position? **(4 Marks)**
3. Explain briefly regulatory aspects of combination in respect in light of case for North West Agro Limited and regulation thereof under Competition Act, 2002. **(5 Marks)**
4. Mention provisions regarding expenditure on 'maintaining office abroad' under FEMA, 1999 & related rules. Is expenditure done by Sun Sugar Limited is in violation thereto. **(3 Marks)**

### **Case study 3**

APPRAY is the Karta of a Hindu Undivided family (HUF) also consisting of his wife LAXMI DEVI, 3 sons, SUBHASH, GIRISH and RAJESH. The eldest son SUBHASH runs a Sugar Mill taken over from his father APPRAY.

RAJESH, the third son of APPRAY, always feels ignored by his family, looking for some fast easy money, joins hands with MOHANLAL, who is a Real Estate Agent, who promises to pay RAJESH, a commission in cash if he helps MOHANLAL to buy 25 Acres of Land and hold the land in his name on behalf of one of his customers MANORANJAN in good trust and in good faith. RAJESH agrees and a Purchase Agreement for 25 Acres of Land was registered in the name of RAJESH and one MADHAV RAO. Subsequently, Rajesh entered into several similar agreements in his name on behalf of others.

In due course of time, RAJESH also formed a Company XYZ Pvt Ltd, primarily for a Hotel business, but the source of funding was secret drug dealings. The Company accepted illegal monies in cash as legitimate business transactions with fake income and receipts. The monies were then deposited into the Company's Bank accounts as clean money. He kept fraudulent records, which did not demonstrate the current state of his businesses. Monies in the Bank Accounts of XYZ Pvt Ltd were also often transferred as legitimate business transactions, to the Bank Accounts of RDX Pvt Ltd, which is also in the similar businesses like XYZ Pvt Ltd. Original source of money is thus disguised.

The Company XYZ Pvt Ltd also mobilized funds from various investors, but were never utilized for which they were collected. The Funds were transferred to bank accounts of some group companies, which were mainly paper companies, from where they were systematically siphoned off and were used for purchase of various properties in India.

RAJESH has also held some properties purchased in the name of his wife SUGUNA from his known income from legal sources.

MAHESH is a friend of GIRISH, the Second son of APPRAY is a Company Secretary of a listed Public Limited Company ABC Ltd. MAHESH gives Rs. 5 lacs loan to GIRISH, who in his turn gives loan of Rs. 5 Lacs to his friend RAGHU for investment in the shares of ABC Ltd. RAGHU trades in shares of ABC Ltd on behalf of MAHESH.

MAHESH also ensures that some money is passed on to various legitimate Companies to buy the shares of ABC Ltd so that it results in increase in the price of shares. Intention is to show higher valuation of shares before proposing to the investors or to discourage the shareholders from applying to the buyback scheme.

RAGHAV is the brother in law of SUBHASH, employed in UAE and a non resident Indian. RAGHAV purchased some properties in Mumbai for Rs. 75 Lacs. He paid RS. 40 Lacs through his NRE Account, Rs. 10 Lacs through direct transfer from his salaries account in UAE to the sellers account as advance through normal banking channels, complying with all the procedural requirements, but balance Rs. 25 Lacs payment was made through some unknown sources.

RAGHAV also invested in Equity shares of various Listed Companies in India in the name of his wife DIVYA, who is a Resident in India and himself as joint holders from an account not disclosed to tax authorities in India. RAGHAV also purchased a Flat in Mumbai in the name of DIVYA and himself as joint holders from his NRE Account.

SUBHASH has a married daughter MANGALA, who is a UK resident. SUBHASH invested Rs. 1.50 Crores in a Bank Fixed deposit in the name of MANGALA without her knowledge. Later during the course of enquiries by Tax officials MANGALA denies ownership of Bank Fixed Deposit.

Since all of his children are well settled, due to the old age and deteriorating health conditions of APPRAY and LAXMI DEVI, the family decided to sell off the loss making Sugar Mill. Later after much negotiations, the Sugar Mill was sold to a person well known to the real estate agent MOHANLAL, but unknown to the APPRAY Family, at a reasonable price.

#### **Multiple Choice questions (MCQs) [2 Marks each]**

1. Purchase of properties in Mumbai by RAGHAV for Rs. 75 Lacs:
  - (a) Is a Fully valid transaction
  - (b) Is valid to the extent of Rs.40 lacs
  - (c) Fully invalid transaction and to be considered as "Benami"
  - (d) May be Benami to the extent of Rs. 25 lacs, since through some unknown sources.
2. Which one of the following transaction is NOT Benami done by RAJESH?
  - (a) Transaction in respect of a property, where the person providing the consideration to Rajesh is not traceable.
  - (b) An arrangement by Rajesh in respect of a property made in a fictitious name.
  - (c) Property held by Rajesh in the name of his spouse and consideration paid out of known legal sources.
  - (d) A transaction by Rajesh in respect of a property where the owner is unaware of or denies knowledge of the ownership.

3. Share Trading by Raghu on behalf of Mahesh is:
  - (a) Valid transaction since he is not at all connected with ABC Ltd.
  - (b) Can be proved as Benami trading in stock markets by Mahesh, the Company Secretary, who has insider price sensitive information.
  - (c) The transaction is not at all to be considered as Benami.
  - (d) Valid transaction if Girish does the share trading on behalf of Mahesh, out of the loan of Rs. 5 Lacs given by Mahesh
4. Which one among the following statement is correct as per PBPT Act?
  - (a) Resale of the benami property from Rajesh to one of the real owners is a valid transaction.
  - (b) Resale of the Benami property from Rajesh to a person acting on behalf of real owner is a valid transaction
  - (c) The Benami Act prohibits sale of a benami property by Rajesh to a third person
  - (d) PBPT Act prohibits resale of the Benami property from the Benamidar to the real owner or to any person acting on his behalf. Such transactions would be considered as null and void.
5. In respect of transactions done by XYZ Company above, crime money injected into the formal financial system is layered, moved or spread over various transactions in different accounts. This step in money laundering is referred to as:
  - (a) Smurfing
  - (b) Integration
  - (c) Layering
  - (d) Placement

#### **Descriptive questions**

1. In the context of various property dealings in the above case study, critically analyze the statement “the provisions of the Prohibition of Benami Property Transactions Act, 1988 (PBPT Act) need not necessarily applicable only to persons, who try to hide their properties, but may also sometimes apply to genuine properties acquired out of disclosed funds” **(5 Marks)**
2. In case of confiscation of properties of Rajesh in the above example, how “Fair market value” in relation to a property is defined under Sec 2(16) of the PBPT Act? Also interpret the Rule 3 of Prohibition of Benami Transactions Rules, 2016 when the price is not ascertainable? **(5 Marks)**
3. With reference to various transactions by XYZ Co Private Ltd in the above example, what are the provisions relating to attachment of property involved in money laundering under Section 5 of the Prevention of Money laundering Act 2002? **(5 Marks)**

#### **Case study 4**

Alpha Promoter is the promoter of real estate based at New Delhi. The Alpha Promoter proposed to establish the residential project named “**AASHIYANA**” The project plan constituted 50 apartment mix of 3BHK and 2BHK Apartments. It includes 20 3BHK Apartments and 30 2BHK Apartments. The Residential project needs to be registered under RERA. The residential project is based at East Delhi. The Alpha's son a Qualified Chartered Accountant and a RERA Consultant. Mr. Alpha discuss the proposed projects with his son usually once in the month. Mr. Alpha discussed with his son CA Surendar about the newly established project “**AASHIYANA**” based at East Delhi. The Father Mr. Alpha discuss the applicability of various provisions on the new project “**AASHIYANA**” based at East Delhi with his son CA Surendar under the Delhi Real Estate (Regulation & Development) Act, 2016 and rules made thereto. The father inquired about the prior approval before establishment of new project “**AASHIYANA**”, if any required by Delhi Real Estate (Regulation &

Development) Act, 2016. Further Mr. Alpha inquired about the creation of webpage of the Alpha Promoter on the website of DELHI RERA Estate (Regulation & Development) Act, 2016, after getting Login ID and Password.

Also, Mr. Alpha want to publish the advertisement for the residential project “**AASHIYANA**” for which he wants to know the content. The advertisement specifies the condition of advance payment first without entering into agreement for sale. The advance payment (deposit) shall not be less than 15% of the cost of apartment. Only after payment of such advance of 15% of the cost of the apartment, a promoter will enter into agreement for sale with allottee of the particular apartment. The promoter made the policy for non-disclosure of any stage-wise time schedule of the completion of the project, including the provisions for civic infrastructure like water sanitation & electricity at the time of booking and issue of allotment letter to allottee. The promoter forgot to include any terms for cancellation of allotment in the agreement of sale. The construction started and afterwards the promoter make some major alterations in the sanctioned plans & layout plans as well as nature of fittings without the previous approval from allottees. One of the allottee Mr. Abhay ask for minor changes in his allotted apartment which was further also approved by authorised architect and proper declaration and intimation is also made regarding such minor change to the allottee (Mr. Abhay).

Meanwhile, presently the Alpha Promoter intended to transfer the project “**AASHIYANA**” to Beta Promoter (third party) without obtaining any approval.

### **Issue Raised**

- Can Alpha Promoter can transfer the project to the Beta Promoter suo moto?
- Is Alpha Promoter mandatorily required to maintain webpage on the website of DELHI RERA AUTHORITY?
- What are requirements for registration of new residential project “**AASHIYANA**”?
- Can advertisement published with or without mentioning website address?
- Is any possibility of holding right as promoter of not providing any details on stage-wise time schedule of completion of the project at the time of booking to the allottee?
- Is promoter having right to demand more than 15% of the cost of apartment before entering into agreement for sale with the allottee.

Few apartments are purchased in the name of Foreign National (Non-Residents) and few are purchased in joint name of both Indian National (Resident) and Foreign National (non-residents) in light of the provisions of the Prohibition of Benami Property Transactions Act, 1988, the following transactions took place for purchase of Apartment under project “**AASHIYANA**”. The description of such transaction are as follows:

- Mr. X, a non resident in India purchased residential apartment of “**AASHIYANA**” residential project under RERA for INR 50,00,000. The apartment is purchased in the joint name of Mr. X and his sister but the payment is made from unknown source.
- Mr. Y, a non resident in India purchased residential apartment of “**AASHIYANA**” residential project under RERA for INR 60,00,000 in the name of his wife from his NRE Account.
- Mr. Z, a resident in India sold a apartment in India (second hand apartment) of some other RERA registered residential project for INR 50,00,000 which was not in his name and was in unknown person name. But the sale proceed is deposited in his (Mr. Z) personal bank account.
- Mr. P, a non resident in India purchased residential apartment of “**AASHIYANA**” residential project under RERA for INR 50,00,000. The payment is made in parts INR 20,00,000 by P's NRE account, INR 29,50,000 from unknown sources and INR 50,000 in cash. The registry was done at value of INR 45,00,000 which was paid by own cheque (INR 20,00,000) and from unknown sources jointly (INR 25,00,000).

Based on the above mentioned facts of the case and issues raised you are requested to give professional advice as Corporate Consultant to the Alpha Promoter and allottees of the residential apartment on the below-mentioned questions:

**Multiple Choice Questions (MCQs) [2 Marks each]**

1. The Alpha Promoter shall not transfer or assign his majority rights & liabilities in respect of a real estate project to a third party without obtaining:
  - (a) Prior written consent from two-third allottees;
  - (b) Prior written consent from two-third allottees; except the promoters
  - (c) Prior written consent from two-third allottees; except the promoters and prior written approval of the Authority.
  - (d) Prior written consent from two-third allottees; except the promoters and prior written approval of the Authority. However, such transfer or assignment shall not affect the allotment or sale of the apartments.
2. The Alpha Promoter needs to get registration of the new project “**AASHIYANA**” through the operationalise web based online system for submitting application for registration of the project within a period of \_\_\_\_\_.
  - (a) One year from the date of its establishment.
  - (b) One year from the date of its commencement.
  - (c) One year from the date of its initiation.
  - (d) One year from the date of its starting.
3. The promoter Alpha at the time of the booking and issue of allotment letter to the allottee shall be responsible to make available to the allottee the \_\_\_\_\_.
  - (a) Sanctioned Plans
  - (b) Layout Plans
  - (c) the stage-wise time schedule of completion of the project.
  - (d) All of the above.
4. The Alpha Promoter shall be responsible for providing and maintaining the essential services, on reasonable charges, till the taking over of the maintenance of the project “**AASHIYANA**” by \_\_\_\_\_.
  - (a) The allottees;
  - (b) The third party;
  - (c) The association of the allottees;
  - (d) None of the above.
5. Mr. Z, a resident in India sold a apartment in India (second hand apartment) of some other RERA registered residential project for INR 50,00,000 which was not in his name and was in unknown person name. But the sale proceed is deposited in Mr. Z's personal bank account. The given transaction is \_\_\_\_\_ as per the provisions of Prohibition of Benami Property Transactions Act, 1988.
  - (a) Benami Transaction.
  - (b) Not a Benami Transaction
  - (c) May be a Benami Transaction.

(d) May not be a Benami Transaction

### Descriptive Questions

1. In Light of the provisions of the Section 11 of the Real Estate (Regulation & Development) Act, 2016, the Alpha Promoter upon receiving Login ID and password from RERA Authority create webpage on the Website of the authority including all details of the proposed project for public viewing.

Describe in detail what information are required to be disclosed for public view on the webpage of promoter on the Website of the RERA Authority? **(5 Marks)**

2. Under the light of the provisions of "Prohibition of Benami Property Transactions Act, 1988". Examine whether the below mentioned transaction is considered as the Benami Transactions or not?

Mr. P, a non resident in India purchased residential apartment of "AASHIYANA" residential project under RERA for INR 50,00,000. The payment is made in parts INR 20,00,000 by P's NRE account, INR 29,50,000 from unknown sources and INR 50,000 in cash. The registry was done at value of INR 45,00,000 which was paid by own cheque (INR 20,00,000) and from unknown sources jointly (INR 25,00,000). **(5 Marks)**

3. Examine the following:

(i) Alpha Promoter's responsibility when the Real estate Project "AASHIYANA" is developed on a leasehold land. **(2 Marks)**

(ii) Alpha Promoter can cancel the allotment whether or not such terms of cancellation are included in the executed agreement of sale. **(3 Marks)**

### Case study 5

Mr Suresh Agarwal, is a Jaipur based banker who joined the Samradhi National bank in the year 2008 as a clerk. He got his first posting at Jodhpur branch. After five years in job, he was transferred and promoted as assistant manager, Bikaner branch of Samardhi National bank. One day he met Archana in the bank, who visited bank to discuss some loan issues of her company with the bank. Slowly they started meeting each other. Both of them like each other and decided to marry after sometime. Archana is a director in a Newtech Software company. They decided to get married after one year. With the blessing of their parents they got married in 2013.

After marriage Archana need to visit America for some business meeting of the company with foreign client. So, they both planned a tour parallelly with the business trip. Company issued Prepaid Forex Travel Card to Archana for all his expenses abroad. The card is loaded with amount of USD 2,50,000. After two days of prolonged business meetings, Archana finally got free to enjoy trip with her husband. They went to Los Vegas and played some games in casino. They paid USD 2000 with the Forex card. They hardly won any amount out of it. They enjoyed shopping and had all fun. After 10 days they return back to India. Archana returned the business card to the company with remaining USD 100000.

Back to daily routine they both got busy with their respective work schedule. As an assistant manager, Mr Suresh got gifts in form of cash and kind all the year round. He came in contact with many rich and successful business owners from different walks of life. They all were happy with him as mostly they got their work done on a single phone call. In the year 2016 post Demonetization, Mr Suresh helped many of his bank customers to launder their money through their bank accounts. He helped one of the bullion trader, Mr Naval Kishore, account holder in his bank. He suggested him to take money from his customers and issue cheque back for the same amount, less 5 per cent. The bullion dealer gave them a purchase bill to show that he had purchased his gold jewellery or silver utensils from him. Than On the amount of the cheque when they will file their return, the customer will have to pay no capital gains tax as jewellery and silver utensils are of personal use, and capital gains do not arise on sale of personal things.

Mr. Naval Kishore with some agents, in past use to trade illegal gold through illicit shell or front companies using false or incomplete documents. The gold is often then smuggled through third-party countries and ultimately sold to refineries in the United States.

Mr Suresh offers to exchange demonetized banknotes for a charge of 10 per cent. Much of this was managed by using scores of individual PAN and Aadhar details already available with his bank. Mr Suresh helped Mr A.K. Bajaj, to exchange demonetized cash, through his workers ID's at the bank. Mr. Bajaj employed nearly 200 workers of his manufacturing units to get the demonetized notes exchanged. The Demonetization period became a blessing in disguise for Mr. Suresh as he was able to amass huge profits out of it.

Chetan Singh is a director of XYZ Company Ltd. He used to share a good relation with Mr. Agrawal and he also started giving him attention when he visited bank for day today business. Chetan one day came to Mr. Agarwal to sanction him INR 0.50 crores. The documents required to process the loan was incomplete. The branch manager refused to sanction the loan without completing all the formalities. Chetan had a talk with Mr. Agarwal and promised him to pay 5% of total sanctioned loan amount. So, both of them arranged some forged documents to complete the file with help of one person called Piyush Sharma, an accountant friend of Mr. Agarwal. After the completion of all the formalities Mr. Agarwal gave his clearance regarding completion of the documents, after which his branch manager sanctioned the loan. The deal bought all of them close to each other. After that Mr Agarwal, Chetan and Piyush became good friends.

As Piyush was accountant and an employee in financial advising company he used to meet many people. He got some couple of loans sanctioned with the help of Mr Suresh Agarwal. As a result, on performance basis evaluation Mr Agarwal got the promotion as Bank manager and transferred to the other branch of Bikaner.

Archana in 2016, was appointed as a director, in Zippy International Company Ltd, a foreign based Company. For Couple of months she stayed in Italy for board meeting and giving financial advice regarding the business transactions. In lieu of his service and remuneration she received shares of the company worth USD 3,00,000.

During his period of service in bank, Mr Agarwal was able to accumulate INR 20 lakhs from his unauthorized sources. With this money he bought a plot in his home town Jaipur. The cost of the plot is INR 50 lakhs. To cover up his source of income he took a loan of INR 20 lakh from his bank. Likewise, he invested his income got in his mother's name and got the plot registered.

In 2017, Archana again went to London for company related business. She stayed there for a duration of six months. With a view to invest abroad, she bought a flat there through outwards remittance. She remitted USD 2,49,000 via LRS route.

Mr Agarwal and his wife Archana went on a tour to Qatar and Dubai in 2018. They booked the flight tickets online through their credit card, rest all the expense of logging and boarding was borne by Oyster tour and travel agency. The company recently opened his new branch office in Dubai. The company's AD bank is the bank in which Mr. Suresh is branch manager. He made all the transactions of Oyster tour and travels easy. Whenever Exchange is required by the branch office in Dubai he easily released them. The profit earned by Dubai branch, of Oyster tour and travel was invested, in one company of Dubai engaged into real estate business and its profits is deposited in foreign bank.

Mr Chetan has a planned to earn money through a new export and import business. He submitted a fake factory proposal of garment manufacturing to the bank whose branch manager is Mr Agarwal. Mr Chetan had a plot in the outskirts of the city, where he made some construction to give it a factory look. As per the mutual understanding between both of them some loan of INR 2 crores was sanctioned to ship the machines and other products from abroad. Some fake invoices were prepared to show the dispatched of garment orders on record but sent almost nothing in return. Mr Agarwal and Mr Chetan jointly did all the invoice manipulation. As a result siphoning off of foreign exchange against fictitious and bogus imports. The money was invested abroad in mutual funds and buying properties.

**Multiple choice Questions (MCQs) [2 Marks each]**

1. Archana went to Italy regarding his official visits as a company director. She bought a flat in Italy through outwards remittance. Can she continue to hold immovable property outside India which was acquired by her when he was a non-resident?
  - (a) With the permission of Reserve bank of India she can hold the property abroad.
  - (b) Without the permission of Reserve Bank of India she can hold the property abroad.
  - (c) The property needs to be sold and the funds transferred should be repatriate back to India.
  - (d) The property needs to be sold out and transferred should be repatriate to her FCNR account.
2. Let's assumed that the plot is bought by Mr Suresh from his known sourced income in his mother's name. Mr. Tarun an NRI wants to purchase that plot. State your answer.
  - (a) Mr. Tarun can buy the plot only with permission of RBI.
  - (b) Mr. Tarun can buy the plot through normal banking channel of India without RBI permission.
  - (c) Mr. Tarun can purchase the plot in foreign currency with permission of RBI.
  - (d) Mr. Tarun can make part payment in foreign currency and partly through his NRO account in India.
3. Archana was allotted USD 300000 shares in the foreign entity in lieu of the professional services rendered by her in lieu of Director's remuneration. Can she acquire such shares?
  - (a) Archana can acquire USD 300000 shares as it is paid against her remuneration.
  - (b) Archana can acquire USD 300000 shares as her remuneration with permission of RBI.
  - (c) Archana cannot acquire USD 3,00000 shares as it is not in permissible limit of LRS.
  - (d) Archana can acquire USD 3,00000 shares under LRS but needs to repatriate the profits back to India after sale of it.
4. Has Suresh and Archana contravene any provision of law, while they sent USD 2000 playing at the casino? Choose the correct answer.
  - (a) They did not contravene any provision of the law as it was issued to her in official capacity for her trip.
  - (b) They have used the card in violates the provisions of FEMA act and hence liable under it.
  - (c) They did not contravene any provision of the law as it was within the permissible limit of their expenses.
  - (d) They were only liable under FEMA Act if they had won more than USD 2000 and if it is remitted back to India.
5. In post Demonetization period Mr. Suresh helped many of his customers to exchange demonetized currency through various methods. Is he liable for punishment under any provision of the law in India?
  - (a) Mr. Suresh is not liable for any punishment under any provision of law applicable in India.
  - (b) Mr. Suresh is liable to punishment under Part A of the schedule, of prevention of Money Laundering Act.
  - (c) Mr. Suresh is only liable to be punished under Part C of the Schedule, of Money Laundering Act.
  - (d) Mr. Suresh is liable for punishment under Part A, PARAGRAPH 1 and PARAGRAPH 4 of Money Laundering Act.

**Descriptive Questions.**

1. Advise in the above mentioned two situations as per the relevant applicable law in India?

(i) Assuming Mr. Suresh wanted to further lease the plot, he bought in his mother name, to a foreign entity who wants to open his liaison office in India.

(ii) Can Mr. Suresh Agarwal's mother's gift this plot to his niece, an NRI. (8 Marks)

2. Examine the given situations in the light of the PBPT Act:

(i) Explain why the property brought by Mr Agarwal in his mother name is a 'Benami transaction'? (3 Marks)

(ii) If in case a fraudulent transfer is done by Mr Suresh Agarwal, pending the process of inquiry by the Initiating Officer, what will be the consequences? (2 Marks)

(iii) State what will be the effect if property (the plot in the name of Mr Agarwal's mother name) is confiscated by Initiating Officer? (2 Marks)

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE: GROUP – II**  
**PAPER – 6D: ECONOMIC LAWS**

**Suggested Answer**

**Case Study 1**

**Multiple Choice Questions (MCQs)**

1. (c)
2. (b)
3. (a)
4. (a)
5. (c)

**Descriptive Questions**

**Answer 1**

De-registration of a building project is not an ideal choice for the authorities keeping in view the larger interests of the stakeholders as well as the nation as a whole and it is resorted to only when all the possible avenues of reaching a comfortable and plausible solution are shut.

According to Section 7 of the Real Estate (Regulation and development) Act, 2016 (in short 'RERA Act') various reasons responsible for revocation of registration granted to a project under RERA due to which the building project stands de-registered are stated as under:

- (a) **Making of default:** The promoter makes default in doing anything required by or under the RERA Act or the rules or the regulations made thereunder;
- (b) **Violation of terms or conditions of approval:** The promoter violates any of the terms or conditions of the approval given by the competent authority. From the case study it shall be noticed that broadly the following terms or conditions of the approval were violated by the promoters of the Royal Golf Burg:
  - (i) Non-construction of all the apartments in fifteen towers till the due date.
  - (ii) Non-furnishing of apartments though the deadline to handover the furnished apartments passed.
- (c) **Involvement in unfair practice or irregularities:** The promoter is involved in any kind of unfair practice or irregularities.

**Explanation.**— For the purposes of this clause, the term “**unfair practice**” means a practice which, for the purpose of promoting the sale or development of any real estate project adopts any unfair method or unfair or deceptive practice including any of the following practices, namely:

- (A) the practice of making any statement, whether in writing or by visible representation which, —
  - (i) falsely represents that the services are of a particular standard or grade;
  - (ii) represents that the promoter has approval or affiliation which such promoter does not have;
  - (iii) makes a false or misleading representation concerning the services;

(B) the promoter permits the publication of any advertisement or prospectus whether in any newspaper or otherwise of services that are not intended to be offered;

(d) **Fraudulent practices:** The promoter indulges in any fraudulent practices. From the case study it shall be noticed that the fraudulent practices undertaken by the promoters of the Royal Golf Burg included:

- Resorting to double allotment due to which the genuine home-buyers were not allotted the apartments which they very much deserved.
- Diversion of funds meant for constructing the apartments to shell companies.
- Allotment of apartments in the name of the peons and drivers though such allotments were actually meant for the use of the promoters since the consideration flowed from them.

### Answer 2

When a project is de-registered due to revocation of registration, following are the obligations of the RERA Authority and other matters associated with it in terms of Section 8 of the RERA Act:

- Consultation with the Appropriate Government:** The concerned RERA Authority may consult the appropriate Government to take such action as it may deem fit. This will include:
  - the carrying out of the remaining development works by competent authority; or
  - the carrying out of the remaining development works by the association of allottees; or
  - the carrying out of the remaining development works by in any other manner, as may be determined by the Authority.
- When the direction, decision or order of the Authority shall take effect:** It is provided that a direction, decision or order of the Authority under section 8 shall take effect only after the expiry of the period of appeal provided under the provisions of the RERA Act.
- First right of refusal rests with association of allottees:** It is provided that in case of revocation of registration of a project under the RERA Act, the association of allottees shall have the first right of refusal for carrying out of the remaining development works.

### Answer 3

- According to Section 6 of the RERA Act, under the circumstances relating to "force majeure" and where there is no default on the part of the promoter, the registration granted under section 5 of the RERA Act may be extended by the Authority.

The expression "force majeure" means a case of war, flood, drought, fire, cyclone, earthquake or any other calamity caused by nature affecting the regular development of the real estate project.

For the purpose of extension, the Promoter of the building project affected by "force majeure" shall make an application to the Authority in the specified form and shall make payment of the specified fee as prescribed by the RERA Regulations made by the Authority.

The Authority may in reasonable circumstances, without default on the part of the promoter, based on the facts of each case, and for reasons to be recorded in writing, extend the registration granted to a project for such time as it considers necessary. However, the extension of registration shall, in aggregate, not exceed a period of one year.

The Authority shall not reject any application for extension of registration unless it gives the applicant an opportunity of being heard in the matter.

(ii) According to Section 7 (3) of the RERA Act also, the Authority may, instead of revoking the registration under sub-section (1) of Section 7, permit the registration to remain in force subject to such further terms and conditions as it thinks fit to impose in the **interest of the allottees**, and any such terms and conditions so imposed shall be binding upon the promoter.

### Case study 2

#### MCQ

1. c
2. d
3. b
4. d
5. a

#### Descriptive Questions

##### Answer 1

As per section 2(c) “cartel” includes an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services.

Although, Northwest Agro Produce Cooperative Society was formed to ensure the timely collection of sale proceeds from sugar mills. But Northwest Agro Produce Cooperative Society also developed a charter, in form of memorandum for its members, to **regulate and control supply, price, term of sales of sugar canes (even though on behalf cane-growers)**, collection of sale proceed and recovery if required. This memorandum is binding on all the members of society. Hence Northwest Agro Produce Cooperative Society is ‘Cartel’ under Competition Act, 2002.

##### Answer 2

Yes, North West Agro Limited hold dominance, because as per explanation (a) to section 4 “dominant position” means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to (i) operate independently of competitive forces prevailing in the relevant market; or (ii) affect its competitors or consumers or the relevant market in its favour.

#### Instances of abuse of dominance

**Predatory Pricing after acquisition of Sun Sugar Limited** - North West Agro Limited, acquired substantial network of retailer after takeover of sun sugar Limited, help of which they tried to penetrate in the market using predatory pricing [**Section 4(2)(a)(ii)**]. North West Agro Limited reduce the price of its sugar ‘Meetha’ from INRs 40 to 35 per kilogram, where as other player in market like Moon Sugar limited selling sugar at INRs 40 per kilogram.

As per explanation (b) to section 4 “predatory price” means the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of the goods or provision of services, with a view to reduce competition or eliminate the competitors.

**Increase the price after acquisition of Moon Sugar Limited** – After hostile acquisition of Moon Sugar Limited, with help of another group company South West Agro Limited; North West Agro Limited raise the prices of its sugar ‘Aur Meetha’ from INRs 35 to 42 per kilogram; even Moon Sugar Limited, originally selling its sugar ‘Aur’ at INRs 40 per Kilogram. **Section 4(2)(b)(i)** says there shall be an abuse of dominant position under sub-section (1) of section 4, if an enterprise or a group limits or restricts production of goods or market therefore .

### Answer 3

Provision of related to combination detailed in section 5 of Competition Act ,2002

Sr. No	Nature of Combination	Case facts	Criteria	Is combination
1	Acquisition by single acquirer but different goods (Section 5(a)(i))	North West Agro Limited Takeover Sun Sugar Limited	Joint Asset over INRs 1000 crores or Turnover over INRs 3000 crores	<b>Yes, Joint turnover is INRs 4400 crores (3200+1200) which is more than INRs 3000 crores</b> , whereas joint assets base is only INRs 998 crores
2	Acquisition by group with similar goods (Section 5(b)(ii))	North West Agro Limited Acquired Moon Sugar Limited, with help of another group company South West Agro Limited	Group Asset over INRs 4000 crores or Turnover over INRs 12000 crores	<b>No, Joint Asset base of group is only INRs 1566 crores and aggregate turnover is also INRs 7200 Crores</b>
3	<b>Not considered as combination</b>	<b>MOU between North West Agro Limited and Star Ethanol Limited</b>	<b>Not eligible to be considered as combination</b>	<b>Not Applicable</b>

### Regulation of Combinations (Section 6)

No person or enterprise shall enter into a combination which **causes or is likely to cause an appreciable adverse effect** on competition within the relevant market in India and such a combination shall be void.

Any person or enterprise, who enter into a combination, **give notice to the Commission**, disclosing the details of the proposed combination, **within thirty days** of -

(a) **Approval of the proposal** concerned with such merger or amalgamation by the board of directors, or (b) **execution of any agreement** acquiring of control

**No combination shall come into effect until two hundred and ten days** have passed from the day on which the notice has been given to the Commission or the Commission has passed orders whichever is earlier.

### Answer 4

Vide **Foreign Exchange Management (Current Account Transactions) Rules 2000**, some restriction on current account foreign exchange transaction prescribed. A general permission is available for opening of Bank Account for the purpose of meeting the Branch Expenses abroad.

Authorised Dealer Category – I banks may allow remittance up to **ten per cent of the average annual turnover during the last two financial years**. But this restriction shall not be applicable if remittance to account maintained abroad, made out of the funds held in EEF C account.

In given case turnover for relevant 2 years was INRs 120000 lakhs and INRs 110000 lakhs (i.e. INRs 120000 lakhs - INRs 10000 lakhs). Average of which is INRs 115000 lakhs. Maximum permissible amount of branch recurring expenditure in case of normal account was 10% of INRs 115000 lakhs i.e INRs 11500 lakhs. Expenditure incurred by Sun Sugar Limited in given case is INRs 14000 lakhs. But such expenditure will not be considered in violation of Foreign Exchange Management (Current Account Transactions) Rules 2000, because amount expended out of EEFC Account .

### Case study 3

#### Multiple Choice questions (MCQs)

1. (d)
2. (c)
3. (b)
4. (d)
5. (c)

#### Descriptive questions

##### **Answer1**

The general belief is that the provisions of the Prohibition of Benami Property Transactions Act 1988 (PBPT Act) apply only to persons, trying to hide their properties and not to genuine properties acquired out of disclosed funds. But that is not true. Even a property acquired using disclosed funds in a genuine transaction may sometimes be treated as Benami.

“Benami Property” under Sec 2 (8) means any property, which is the subject matter of a Benami transaction and also includes the proceeds from such property. Benami Property means property without a name. Here the person, who pays for the property does not buy it under his own name. The person, who finances the deal is the real owner of the property. The person in whose name the property has been purchased is Benamidar.

As per the provisions of Section 2 (9) a Benami transaction means-

1. A transaction or arrangement where a property is transferred to or held by one person for direct or indirect, immediate or future benefit of another person, who has provided or paid the consideration, except when-
  - (i) An HUF is purchasing a property in the name of a Karta, or any other member from known sources;
  - (ii) A person is holding the property in a fiduciary capacity (e.g. trustee, executor, partner of a partnership firm, director of a company, a depository participant, etc.);
  - (iii) An individual is purchasing a property in the name of his spouse or any child provided the consideration is paid out of the known sources;
  - (iv) Any person is purchasing any property in the name of his brother or sister or lineal ascendant or descendant, where he is one of the joint-owners, provided the consideration is paid out of the known sources; or
2. A transaction or arrangement carried out in a fictitious name; or
3. A transaction or arrangement where the owner of the property is not aware of or denies knowledge of such ownership;
4. A transaction or arrangement, where the person providing the consideration is not traceable or is fictitious.

Any transaction where possession of any immovable property is taken as a part performance of a contract is not a Benami transaction if the contract is registered and consideration as well as stamp duty have been paid.

Property would include asset of any kind, whether movable or immovable, tangible or intangible, and includes rights or interest as well as proceeds from the property.

In the above case study, in one of the cases, SUBHASH invested Rs. 1.50 Crores in a Bank Fixed deposit in the name of his married daughter, MANGALA, who is a UK Resident, without her knowledge. Later during the course of enquiries by Tax officials MANGALA denies ownership of Bank Fixed Deposit. Here, the transaction is Benami, though the FD is generated using disclosed funds in a genuine transaction.

## **Answer 2**

As per the provisions of Section 2(16) of the Prohibition of Benami Property Transactions Act 1988, "fair market value", in relation to a property, means—

- (i) the price that the property would ordinarily fetch on sale in the open market on the date of the transaction; and
- (ii) where the price referred to in sub-clause (i) is not ascertainable, such price as may be determined in accordance with such manner as prescribed in Rule 3 of Prohibition of Benami Transactions Rules, 2016

### **Determination of price in certain cases under Rule 3 of Prohibition of Benami Transactions Rules, 2016**

3. (1) For the purposes of sub-clause(ii) of clause (16) of the section 2 of the Act, the price shall be determined in the following manner, namely:—

- (a) the price of unquoted equity shares shall be the higher of,—
  - (I) its cost of acquisition;
  - (II) the fair market value of such equity shares determined, on the date of transaction, by a merchant banker or an accountant as per the Discounted Free Cash Flow method; and
  - (III) the value, on the date of transaction, of such equity shares as determined in the following manner, namely:—

The fair market value of unquoted equity shares =  $(A+B - L) \times (PV)/(PE)$

where,

A= book value of all the assets (other than bullion, jewellery, precious stone, artistic work, shares, securities and immovable property) as reduced by,-

- (i) any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any, and
- (ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

B= the price that the bullion, jewellery, precious stone, artistic work, shares, securities and immovable property would ordinarily fetch on sale in the open market on the date of transaction;

L= book value of liabilities, but not including the following amounts, namely.—

- (i) the paid-up capital in respect of equity shares;
- (ii) the amount set apart for payment of dividends on preference shares and equity shares;
- (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
- (iv) any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount of income-tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law

applicable thereto;

- (v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
- (vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PE = total amount of paid up equity share capital as shown in the balance-sheet;

PV= the paid up value of such equity shares;

The above provisions of Section 2(16) of the Act Read with Rule 3 is applicable, in case of confiscation of properties of RAJESH.

### **Answer 3**

**Attachment of property involved in money-laundering under Section 5 of the Prevention of Money laundering Act 2002?**

**Section 5 (1)** Where the Director or any other officer not below the rank of Deputy Director authorised by the Director for the purposes of this section, has reason to believe (the reason for such belief to be recorded in writing), on the basis of material in his possession, that—

- (a) any person is in possession of any proceeds of crime; and
- (b) such proceeds of crime are likely to be concealed, transferred or dealt with in any manner which may result in frustrating any proceedings relating to confiscation of such proceeds of crime under this Chapter,

he may, by order in writing, provisionally attach such property for a period not exceeding one hundred and eighty days from the date of the order, in such manner as may be prescribed:

**Provided** that no such order of attachment shall be made unless, in relation to the scheduled offence, a report has been forwarded to a Magistrate under section 173 of the Code of Criminal Procedure, 1973 (2 of 1974), or a complaint has been filed by a person authorised to investigate the offence mentioned in that Schedule, before a Magistrate or court for taking cognizance of the scheduled offence, as the case may be, or a similar report or complaint has been made or filed under the corresponding law of any other country.

**Provided further** that, notwithstanding anything contained in [first proviso], any property of any person may be attached under this section if the Director or any other officer not below the rank of Deputy Director authorised by him for the purposes of this section has reason to believe (the reasons for such belief to be recorded in writing), on the basis of material in his possession, that if such property involved in money-laundering is not attached immediately under this Chapter, the non-attachment of the property is likely to frustrate any proceeding under this Act.

**Provided also** that for the purposes of computing the period of one hundred and eighty days, the period during which the proceedings under this section is stayed by the High Court, shall be excluded and a further period not exceeding thirty days from the date of order of vacation of such stay order shall be counted.

(2) The Director, or any other officer not below the rank of Deputy Director, shall, immediately after attachment under sub-section (1), forward a copy of the order, along with the material in his possession, referred to in that sub-section, to the Adjudicating Authority, in a sealed envelope, in the manner as may be prescribed and such Adjudicating Authority shall keep such order and material for such period as may be prescribed.

(3) Every order of attachment made under sub-section (1) shall cease to have effect after the expiry of the period specified in that sub-section or on the date of an order made under [sub-section (3)] of section 8, whichever is earlier.

(4) Nothing in this section shall prevent the person interested in the enjoyment of the immovable property attached under sub-section (1) from such enjoyment.

*Explanation.*—For the purposes of this sub-section, "person interested", in relation to any immovable property, includes all persons claiming or entitled to claim any interest in the property.

(5) The Director or any other officer who provisionally attaches any property under sub-section (1) shall, within a period of thirty days from such attachment, file a complaint stating the facts of such attachment before the Adjudicating Authority.

#### **Case study 4**

##### **Multiple Choice Questions**

1. (d)
2. (a)
3. (d)
4. (c)
5. (a)

##### **Descriptive Questions**

##### **Answer 1**

As per the provisions of the Section 11 (1) The promoter shall, upon receiving his Login Id and password under clause (a) of sub-section (1) or under sub-section (2) of section 5, as the case may be, create his web page on the website of the Authority and enter all details of the proposed project as provided under sub-section (2) of section 4, in all the fields as provided, for public viewing, including—

- (a) details of the registration granted by the Authority;
- (b) quarterly up-to-date the list of number and types of apartments or plots, as the case may be, booked;
- (c) quarterly up-to-date the list of number of garages booked;
- (d) quarterly up-to-date the list of approvals taken and the approvals which are pending subsequent to commencement certificate; (e) quarterly up-to-date status of the project; and
- (f) such other information and documents as may be specified by the regulations made by the Authority.

Thus, the Alpha promoter are required to be disclosed above mentioned information for public view on the webpage of promoter Alpha on the Website of the DELHI RERA Authority.

##### **Answer 2**

The payment for purchase of the flat by Mr. P, a non resident in India is made in parts. Since, the payment of INR 25,00,000 is made from unknown source for registry of the apartment. So, to the extent of unknown source of the consideration payment, it may be a Benami Transaction.

### **Answer 3**

(i) As per the provisions of the Section 11(4)(c) of the Real Estate (Regulation & Development) Act, 2016, the promoter shall be responsible to obtain the lease certificate, where the real estate project is developed on a leasehold land, specifying the period of lease, and certifying that all dues and charges in regard to the leasehold land has been paid, and to make the lease certificate available to the association of allottees.

Thus, Alpha Promoter have to fulfil all responsibilities as discussed above.

(ii) As per the provisions of the Section 11(5) of the Real Estate (Regulation & Development) Act, 2016, the promoter may cancel the allotment only in terms of the agreement for sale.

Provided that the allottee may approach the Authority for relief, if he is aggrieved by such cancellation and such cancellation is not in accordance with the terms of the agreement for sale, unilateral and without any sufficient cause.

Thus, the Alpha Promoter cannot cancel the allotment without including such terms of cancellation in the executed agreement of sale.

### **Case study 5**

#### **Multiple choice Questions**

1. b
2. b
3. c
4. c
5. b

#### **Descriptive Questions.**

### **Answer 1**

(i) A body corporate incorporated outside India (including a firm or other association of individuals), desirous of opening a Liaison Office (LO) / Branch Office (BO) in India have to obtain permission from the Reserve Bank under provisions of FEMA 1999. Establishment of Project Offices/Liaison Offices in India is regulated in terms of Section 6(6) of Foreign Exchange Management Act, 1999 read with Notification No. FEMA 22/2000-RB dated May 3, 2000.

So if the foreign company wants to establish a Liaison Office in India, it cannot acquire immovable property. However, the company needs to acquire property by way of lease not exceeding 3 years, for its Liaison Office.

(ii) A non-resident Indian (NRI) or person of Indian origin (PIO), can inherit any immovable property in India, whether it is residential or commercial. The FEMA regulations applicable to transfer of immovable property permit a NRI/PIO to acquire an immovable property in India by way of gift from a person resident in India provided the property is not agricultural land/ farm house/ plantation property. All gifts to NRIs will be considered as income accruing in India and would be taxed as per the normal slab rates applicable to resident Indians. This means that the NRI/PIO needs to mandatory pay the applicable tax

A liaison office of a foreign company in India should be established only with requisite approvals wherever necessary, and is eligible to take any immovable property on lease, in India which is

necessary for its activities, provided that all such applicable laws, rules, Regulations or directions in force are duly complied with.

But in the aforementioned both the cases the property is bought in contravention of the provisions of benami act hence it is a benami transaction. It is liable to attract section 3 of Prohibition of Benami Property Transactions Act. The property is liable to attachment by the Adjudicating Authority.

A liaison office of a foreign company in India should be established only with requisite approvals wherever necessary, and is eligible to take any immovable property on lease, in India which is necessary for its activities, provided that all such applicable laws, rules, regulations or directions in force are duly complied with. Since the property liable to be leased is in brought in contravention to the provisions of law applicable in India, it cannot be leased. If any case it is leased without the knowledge of the company the lease stand terminated. In case of gift to an NRI niece the gift stands null and void.

## **Answer 2**

- i. A Benami transaction is an arrangement, where a property is transferred to, or is held by, in the name of a person called Benamidar and the consideration for such property has been provided, or paid by another person called beneficiary; and that property (benami property) is held for the immediate or future benefit, direct or indirect, by that person who has provided the consideration.

In the particular case the consideration is paid by Mr Suresh Agarwal but the property is purchased in his mother's name.

So it is clear that, Mr Suresh Agarwal has done this benami transactions in respect of the holding of the property, with the object of concealing the real owner.

- ii. In case, if after the issuance of the initial notice by the Initiating Officer, the property in question is transferred to a third party secretly, than the said transaction would be null and void and confiscation would take effect, notwithstanding such a transfer.

However, in case where the person proves that, the property is held or acquired by a person from the Benamidar for:

- a. adequate consideration, prior to the issuance of show-cause notice by the Initiating Officer
- b. Without his having knowledge of the benami transaction in such a case the transfer may be valid.

- iii. Effect of confiscation of benami property:

Where an order of confiscation has been made, all the rights and title in such property will vest absolutely in the Central Government. It will be free of all encumbrances and no compensation will be paid in respect of such confiscation.

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE: GROUP – II**  
**PAPER 6E – GLOBAL FINANCIAL REPORTING STANDARDS**

**Question No.1 is compulsory. Candidates are required to answer any four questions from the remaining five questions.**

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

Working notes should form part of the answers.

Time Allowed – 3 Hours	Maximum Marks – 100
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<b>CASE STUDY 1</b>
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You are a Chartered Accountant (CA) employed as a financial accountant with XYZ Ltd. (XYZ), an Indian listed company that manufactures and distributes electronic components for the telecommunications sector. XYZ Ltd is exploring possibilities of listing its securities at an overseas stock exchange, therefore, prepares consolidated financial statements up to 31st March each year under IFRS. Utkarsh hands you a folder (Appendix 1) containing the first draft of the consolidated financial statements for the year ended 31st March 20X6. He wants to pay a dividend this year but, although we have cash in the bank, Rahul, finance director, claims the debit on the consolidated retained earnings prohibits this.

XYZ has formed a strategic partnership with MNO Ltd (MNO). MNO is a newly formed start-up company which has yet to prepare any financial statements. To show our commitment to this partnership we subscribed for 10,000 Rs. 1 ordinary shares in MNO for Rs. 1.20 each. Professional fees of Rs. 3,000 were incurred on this transaction. MNO has 1,00,000 shares in issue and no dividends have been paid during the year. Rahul has informed me that it will not be possible for us to obtain a reliable fair value for this investment until at least another twelve months. Utkarsh wants you to go ahead and prepare some revised figures for me to present at the board in two days' time.

ABC & co confirmed that Rahul works in an office that provides services to MNO and he has no involvement in the services provided. A legal fees of Rs. 25,000 were paid to ABC during the year ended 31st March 20X6. There are following unresolved issues which require your review:

**Outstanding Issues**

1. As a way of improving cash flow, on 1 April 20X5 XYZ entered into a sale and leaseback arrangement in respect of an office building used for administration. The lease was in respect of the building only and there is no land element. The terms of the lease required ten annual rental payments of Rs. 2,16,000, payable in arrears on 31<sup>st</sup> march each year. The payment on 31st March 20X6 was recognised in rental expenses. The interest implicit in the lease was 7% and the fair value of minimum lease payments was Rs. 15,60,000. Present value of minimum lease payments after consideration of variable factors is assumed to be Rs. 15,60,000. The carrying value of the asset on 1 April 20X5 amounted to Rs. 12,00,000, and the sale proceeds were at fair value of Rs. 16,80,000. A profit on disposal of Rs. 4,80,000 was recognised in profit before tax (Appendix 1), in the Draft Consolidated Statement of Comprehensive Income on 1 April 20X5 and the asset was derecognised.
2. On 1 January 20X6, XYZ acquired 25,000 shares at Rs. 1 per share in JKL Ltd., a listed company that supplies raw materials for the manufacture of microchips. At 31st March 20X6, their market

value had risen to Rs. 2 per share, and a gain has been recognised in the consolidated Draft Statement of Comprehensive Income (against operating expenses) for the increase in value.

3. (i) XYZ holds 100% of the ordinary shares of PQR, acquired several years ago. The strategy behind the acquisition was to develop new revenue streams, including the design of new microchips. PQR has performed well but one of its major assets, an item of equipment, suffered a significant and unexpected deterioration in performance. Management expect to be able to use the machine for a further four years after 31st March 20X6, but at a reduced level. The equipment will be scrapped after four years. The financial accountant for PQR has produced a set of cash-flow projections for the equipment for the next four years, ranging from optimistic to pessimistic. Rahul thought that the projections were too conservative and she intended to use the highest figures each year. These were as follows:

	Rs.'000
Year ended 31st March 20X7	276
Year ended 31st March 20X8	192
Year ended 31st March 20X9	120
Year ended 31st March 20Y0	114

The above cash inflows should be assumed to occur on the last day of each financial year. The pre-tax discount rate is 9%. The machine could have been sold at 31st March 20X6 for Rs. 5,04,000, net of selling expenses. The machine had been re valued previously, and at 31st March 20X6 an amount of Rs. 36,000 was held in revaluation surplus in respect of the asset. The carrying value of the asset at 31st March 20X6 was Rs. 660,000. The Indian government has indicated that it may compensate the company for any loss in value of the assets up to its recoverable amount.

(ii) On 1 April 20X1, XYZ acquired a freehold manufacturing building. The land element in the purchase price was Rs. 6,72,000 and the building element Rs. 24,00,000. The useful life of the building was estimated at 20 years. Since 1 April 20X1 there has been no change in the value of land. At the 31<sup>st</sup> March 20X3, the building element was re valued to Rs. 27,00,000 and the remaining useful life was unchanged. On 31<sup>st</sup> March, 20X6, the open market value of the building was determined at Rs. 19,80,000. The remaining useful life again remained unchanged. No accounting entries have yet been made in respect of the freehold building for the year ended 31<sup>st</sup> March 20X6.

4. XYZ issued Rs. 4,80,000 4% redeemable preference shares on 1<sup>st</sup> April 20X5 at par. Interest is paid annually in arrears and the first payment of Rs. 19,200 was made on 31<sup>st</sup> March 20X6 and debited directly to retained earnings. The bonds are redeemable for a cash amount of Rs. 7,20,000 on 31<sup>st</sup> March 20X8. The effective rate of interest on the redeemable preference shares is 18% per annum. The proceeds of the issue have been recorded within equity as this reflects the legal nature of the shares and the board of directors intends to issue new equity shares over the next two years to build up cash resources to redeem the preference shares.

5. One of the senior engineers at XYZ has been working on a process to improve manufacturing efficiency and, consequently, reduce manufacturing costs. This is a major project and has the full support of XYZ's board of directors. The senior engineer believes that the cost reductions will exceed the project costs within twenty four months of their implementation. Regulatory testing and health and safety approval was obtained on 1 June 20X5. This removed uncertainties concerning

the project, which was finally completed on 20 April 20X6. Costs of Rs. 18,00,000, incurred during the year to 31<sup>st</sup> March 20X6, have been recognised as an intangible asset. An offer of Rs. 7,80,000 for the new technology has been received and rejected by XYZ. Utkarsh believes that the project will be a major success and has the potential to save the company Rs. 12,00,000 in perpetuity. Director of research at XYZ, Neha, who is a qualified electronic engineer, is seriously concerned about the long term prospects of the new process and she is of the opinion that competitors will have developed new technology which will have replaced the new process within four years. She estimates that the present value of future cost savings will be Rs. 9,60,000 over this period. After that, she thinks that there is no certainty about its future.

6. M Ltd, another 100% wholly owned subsidiary of XYZ, started speculative office property development in March 20X5. The cost of development to 31<sup>st</sup> March 20X6 was Rs. 27,60,000. A valuer inspected the property at 31<sup>st</sup> March 20X6 and valued it at Rs. 28,80,000 in its condition at that date. The directors intend to sell the property to a buyer outside the group, and so it has been classified as an investment property. The gain has been recognised in the profit before tax in the Draft Statement of Comprehensive Income. A post-it on the page Utkarsh gave you earlier, suggested that Rahul was considering that because the property development was speculative with no contract, the property should not be classified as an investment property.

#### Appendix 1:

<b>Draft Consolidated Statement of Comprehensive Income for the year ended 31<sup>st</sup> March 20X6</b>	<b>Rs.'000</b>
Revenue	14,520
Cost of sales	-7,200
Gross profit	7,320
Operating expenses	(1,200)
Profit from operations	6,120
Finance costs	(600)
Profit on disposal of asset	480
Gains on investment property	<u>120</u>
Profit before taxation	6,120
Income tax	(1,800)
Profit for the year	4,320
<i>Other comprehensive income</i>	-
Total comprehensive income for the period	<u>4,320</u>

#### Draft Consolidated Statement of Financial Position as at 31<sup>st</sup> March 20X6

	<b>Rs.'000</b>
<b>ASSETS</b>	
<u>Non-current assets</u>	
Property, plant and equipment	4,200
Investment property	2,880
Goodwill and other intangibles	2,400
Financial assets (Note 1)	90

<u>Current assets</u>	2,430
Total assets	12,000
<b>EQUITY AND LIABILITIES</b>	
Ordinary share capital	3,600
Revaluation surplus	564
Preference share capital	480
Retained earnings	-360
Equity	4,284
<u>Non-current liabilities</u>	
Borrowings	1,596
<u>Current liabilities</u>	
Total equity and liabilities	12,000

**Note 1:** Rs. 90,000 in respect of financial assets available for resale as outlined in outstanding issue 2 in the case study.

#### I. Multiple Choice Question [2 Marks each]

Choose the best option from the given choices for each of the question or statement below. Reasoning for the answer is not required to be given.

- What is the non-current liability for the lease of office building as at March 31, 20X6?
  - 14,53,200
  - 13,38,924
  - 14,46,000
  - 14,00,000
- What is the recoverable amount of the impaired machine of PQR as at March 31, 20X6?
  - 5,04,000
  - 5,07,600
  - 5,88,230
  - 6,60,000
- What is the impairment loss of the building on 1<sup>st</sup> April 20X6?
  - 2,70,000
  - 3,15,000
  - 3,24,000
  - Nil
- By how much will the equity reduce due to preference shares?
  - Nil
  - 480,000

- (c) 67,180
- (d) 547,200

5. How much intangible asset will be capitalised during the year 20X5-20X6?

- (a) 1,800,000
- (b) 1,500,000
- (c) Nil
- (d) 1,200,000

## II. Descriptive Questions

6. Discuss elaborately the impact of the outstanding issues (1-6) above in the Consolidated Statement of Comprehensive Income and the Consolidated Statement of Financial Position. Also explain their accounting treatment, wherever required. **(15 Marks)**

### CASE STUDY 2

Kapsch Telecom Inc. is an American corporation that outsources some of its product engineering work to SasTech Ltd. in India. Both the parties have a long-term business relationship with each other – probably since more than 15 years.

In those 15 years, there have been multiple changes in management of both the parties. Kapsch has undergone many changes in the ownership and leadership in the last decade or so. In the outsourcing industry, it's a customary practice to request the customers for rate increase due to inflation and other factors that are specific to the contract.

Off-late there have been many instances of dissatisfaction from the customer due to attrition rate. Attrition refers to number of people leaving a company or a team. Attrition in the team is one of the biggest problems for Kapsch due to process-related hassles like interview of the replacement candidates, access to the file-sharing system and a few other factors.

SasTech Ltd. has been pressured for delivery and also forced to cut down the bill rate thereby reducing the profit margins. SasTech has an Offshore Development Centre (ODC) of 500 FTEs (Full-time employees) and an onsite support of Ten FTEs who work at the Kapsch location in USA.

ODC is a specific designated area within the company's premises. It requires special access to both employees and visitors who wish to enter into the ODC area. Even employees who are part of the same company but belong to team(s) other than the ODC can't enter the ODC area with their regular access card. Internet and other IT security is also special to the ODC through a dedicated leased-line which has a probability of 0.4% downtime.

Last contract with Kapsch, reviewed by both the parties, was almost 3 years ago. As a finance prime at SasTech Ltd., you have been asked by the Business Head to work closely with the Delivery Head and the legal team to look into the financial aspects of the contract.

Multiple scenarios were worked out and many rounds of discussion happened but there was no satisfactory response from both the parties towards the closure of negotiation. Finally, after 4 months of continuous follow-up, con-calls and the intervention of SasTech's CEO, the following key terms were agreed and accepted by both the parties: (*simplified extracts*)

1. *The monthly bill rate per FTE shall stand revised to USD 4400 from USD 4200 earlier for standard billing hours of 1920 per annum per ODC FTE.*
2. *Bill rate for Onsite FTEs shall stand revised to USD 11,000 per month from USD 10,500 earlier.*
3. *SasTech shall provide a buffer headcount of 10% (earlier 7%) of the total FTEs working in the ODC.*

(Buffer headcount is usually kept as replacement for any absent FTEs or loss of working hours due to any reason. The Buffer headcount is also trained on the job for the eventuality of attrition in the project. Buffer headcount is not billed to the client but absorbed as direct contract cost.)

4. *Other terms and conditions of the contract shall remain the same except that the following new terms will be inserted through Annexure which shall form an integral part of the contract:*
  - a. *Performance Bonus will be payable to SasTech at the rate of 10% of the quarterly billing done if the average billed hours of the ODC exceed 520 hours per FTE per quarter and the attrition rate is below 5% during that quarter.*
  - b. *Attrition Penalty will be payable by SasTech as per the following table:*

<b>Attrition Rate during the quarter in the ODC</b>	<b>Attrition Penalty as a percentage of Quarterly billing done</b>
6% to 8%	3.5%
8% to 10%	4.5%
10% to 12%	6.0%
More than 12%	10.0%

5. *The process of the timesheet approval shall remain the same except that the Project Manager of Kapsch in USA shall have a final approval authority. (Earlier, ODC manager in SasTech used to aggregate and ratify the timesheet and get the same approved by the Onsite lead of SasTech in USA and the same was counter-approved by the Project Manager from Kapsch. Now the project manager is changed since last 2 years.)*
6. *Billing will continue to be done on a quarterly basis and the credit period shall remain as 45 days from the end of last calendar day of the quarter for which billing is done.*
7. *SasTech shall continue to invoice at standard bill hours on a quarterly basis even when the actual billable hours as per final timesheet are more or less than the standard hours per FTE per month unless the actual billable hours fall below 150 per month per FTE. In that case the billing shall be done on actual billable hours. Actual billable hours are also used for billing in the quarter when SasTech is eligible for performance bonus.*
8. *Performance Bonus, if any, shall be billed separately within 20 working days from the end of the quarter in which such bonus becomes payable as per the contract.*
9. *Penalty, if any, shall be deducted from the latest quarterly bill received by Kapsch after the end of the relevant quarter.*
10. *Both the parties to the contract shall endeavour to close the approval process of billable hours within 7 working days from the end of each quarter.*
11. *Work done by Buffer FTEs, if any, shall not be counted for billing.*

Following is the timesheet and attrition data for four quarters since the renewed contract has come into force.

<b>Period</b>	<b>Hours approved by SasTech</b>	<b>Hours approved by Kapsch</b>	<b>Attrition rate</b>
Quarter 1 Financial Year 2019-2020	2,41,500	2,41,415	6.0%
Quarter 2 Financial Year 2019-2020	2,62,500	2,62,319	4.5%
Quarter 3 Financial Year 2019-2020	2,39,000	2,38,585	9.2%
Quarter 4 Financial Year 2019-2020	2,23,500	2,23,500	7.0%

Revenue from Kapsch accounts for more than 20% of the total revenue of SasTech Ltd. every year. However, Kapsch was not shown as a separate reportable segment until last audited annual financials of the company.

Since SasTech is a listed company on Bombay Stock Exchange as well as National Stock Exchange, the company has to publish quarterly financial information after the limited review of the auditors. The carrying amount of SasTech's ODC asset (for Kapsch) is Rs. 129 Lacs (after considering impact of contract with Kapsch during the year) as on 31<sup>st</sup> March 2020.

As a finance prime your help is required by the head of R2R (Record to report) team during each of the quarter close before the financial information is submitted to the auditors for limited review.

### I. Multiple Choice Question [2 Marks each]

Choose the best option from the given choices for each of the question or statement below. Reasoning for the answer is not required to be given.

1. The Head of R2R was not aware of this latest contract with Kapsch in so much of details. You have discussed with him the main points of the contract including the Performance Bonus and Attrition Penalty. The Consideration agreed by both the parties in this contract is \_\_\_\_\_
  - (a) Variable and requires allocation to distinct performance obligation
  - (b) Variable but does not require specific allocation to distinct performance obligation
  - (c) Composite consideration
  - (d) Composite consideration with distinct performance obligations
2. SasTech Ltd. has decided to make provision for attrition penalty at the beginning of each quarter instead of booking that amount as loss in the case of liability of pay penalty. Historically, Kapsch ODC has seen an attrition rate of 7%. If the same attrition percentage is used for provision of attrition penalty what will be the provision amount for Q1FY19-20? Assume standard billing hours of 1920 per annum per FTE in ODC.
  - (a) USD 2,30,000
  - (b) USD 2,31,000
  - (c) USD 2,32,000
  - (d) USD 2,33,000
3. "Now that the contract has changed substantially and Kapsch accounts for about 20% of company's revenue we may have to show this as a separate operating segment", said the Head of R2R at SasTech Ltd. In view of the principles of IFRS, what is your view?
  - (a) Since there is only one such contract, separate reportable segment treatment is not called for.
  - (b) Head of the R2R team is right. It needs to be reported as a separate segment.
  - (c) Just a disclosure as special contract is required.
  - (d) Provision for Attrition Penalty is required.
4. The company is likely to get performance bonus for Quarter 2 Financial year 2019-2020. The final approval of timesheet has been received from Kapsch on 6<sup>th</sup> working day from the end of the quarter. Compute the amount of performance bonus that can be recognized as revenue before the financial information is passed on to the auditors for limited review.
  - (a) USD 0.72 million
  - (b) USD 0.71 million

- (c) USD 0.73 million
- (d) USD 0.74 million

5. What are the two factors that compelled the organisation to treat Kapsch contract as a separate reportable segment?

- (a) Final approval process for timesheet and attrition
- (b) Performance bonus and attrition penalty
- (c) Threshold for segment recognition and total contract revenue
- (d) Standard hours mentioned in the contract.

## II. Descriptive Questions

6. If SasTech Ltd. has reported this contract as a separate reportable segment “Revenue from special contracts”, prepare “Notes to account” to disclose the amount of adjustments made on account of performance bonus and attrition penalty for Financial Year 2019-2020. Working notes should be part of your answer but not the part of disclosure.

For calculation purposes assume 1 USD = Rs. 65. [6 marks]

7. If final approval for timesheet for Q2FY19-20 was not received as on the date of preparing financials but received subsequently due to delay from Kapsch (as the concerned person was travelling), should the company recognise the performance bonus as Unbilled Revenue (classified as current asset in the balance sheet) or treat it as a revenue? Justify your answer citing specific reference from relevant IFRS and facts of the case. [4 marks]

8. As on 31<sup>st</sup> March 2020, the ODC has no other liability except the provision for attrition penalty for Quarter 4 Financial Year 2019-2020. Disclose the amount of Segment revenue, Segment assets and Segment liabilities under “Revenue from Special Contracts” if there are no other contracts of similar nature for SasTech Ltd. For calculation purposes assume 1 USD = Rs. 65. [5 marks]

## CASE STUDY 3

Sai Caterers Pvt. Ltd., is a Panvel based company in the business of corporate catering since 2005. The Directors of the company are thinking about setting up a Dairy Unit to fulfil the company's need for fresh milk in its daily service to the clients. They thought Karjat, a place between Mumbai and Pune, is the best place for the project site since it has ample of water resources and green feed around.

For its 100+ corporate clients, the company estimates that on an average they need around 2500 litres of milk every day. Currently, the milk is being procured from multiple sources and the average cost per litre works out to be Rs. 38.89

As a finance consultant, you're invited to the Board Meeting of the company where the final decision is to be taken by the Board of Directors. You witness the following during the board meeting: (text marked in *italics*)

Director -1

*“Well, we need to know the economics of cows better before we get into this completely.”*

Director -2

*“A cow gives milk for 6 months during the year so based on our need, we to have double the no. of cows to meet the annual sourcing need.”*

Director -1

*“Double the number? How does that help?”*

Director -2

*"We need to procure half the number who's ready for milking and half the number which will be ready over the next 6 months. Each cow can reproduce at least once 14-18 months depending on the milk production level from the date of calving. Normally, there is dry-run of 60 days before calving. For commercial purpose, let's consider that each cow will have a milking period of 8 months or about 5000 litres per cow per annum. So, based on that we'll do the working with the help of our finance consultant."*

Director-1

*"Alright. Sounds good. If the number of cows increase and the milk produced is more than what we require in business, we might sell the same at market rates"*

Finance Consultant (you)

*"Well, I've a different take on that. Instead of mass-marketing at the market rates, you may consider premium pricing direct-to-home delivery. The advantage you have is, over the last 10 years, you have got good connections with CXOs of many clients. Everybody needs fresh milk. A normal packet milk that is available in mass-market is at least 7 days before it reaches the consumer. We can assure same-day delivery and the premium price can be about Rs. 90 per litre"*

Director -1

*"Fantastic"*

Director- 2

*"Excellent idea! Let me think about the brand."*

The meeting goes and it ends with the following two major decisions:

1. The company will borrow 50% of Capex for setting-up in-house dairy unit and complete the project by 1st Feb 2018.
2. Based on milk production levels being more than the captive consumption, the company shall launch "Godhan" a premium milk brand to market it to upper middle class market.

You come back from the meeting to your office and think through the next steps. In the next week you have gone to the office of the client and have worked out the additional details:

A milking cow costs about Rs. 60k. On an average a cow produces about 20 litres of milk per day, however, a cow can produce milk only for 8 months in a year. The management has decided to buy 200 cows to avoid initial hiccups in procurement target.

The set-up costs are as follows:

	Rs. in lacs
Land	150
Civil structure (useful life 15 years)	65
Milking equipment and other tools (useful life 7 years)	50

The recurring expenses are:

- **Manpower cost** – Rs. 15,000 per month per head.

One person is required for every 10 cows to manage the daily operations.

One project manager will be exclusively appointed for this at a cost of Rs. 65,000 per month.

- **Daily feed to Cows** – Each cow needs a daily intake of green and dry feed worth Rs. 150
- **Medical expenses** – In addition to food, the cows also need a routine medical check-up once in a month it costs about Rs. 200 per cow.
- **Distribution cost** – Clients of the company (both for catering business and Godhan) are located within a radius of 60 kilometres from the project site. A suitable and economic cost of transportation worked out by the operations team with the help of finance team reveals that an average cost of distribution per litre per day works out to be Rs. 2.7.
- **Electricity and other office overheads at the site** – Rs. 25,000 per month

**Case status as on 31<sup>st</sup> March 2018 – Project implemented and in-house procurement plan is working.**

Depreciation on project assets was provided for 2 months as 31<sup>st</sup> March 2018

As on 31<sup>st</sup> March 2019, the no. of cows has gone down to 195 and there are 90 calves of which 54 are female. Each male calf has a market value of Rs. 8,000 and a female calf can fetch Rs. 6,000 with no cost to sell as buyers would come over to the site to buy the calves. 5 cows which died while calving were buried.

The supply of milk during the year was as follows:

Period	Actual production	Requirement for Internal usage
Quarter 1	2,27,505	2,27,500
Quarter 2	2,41,040	2,39,200
Quarter 3	2,42,880	2,39,200
Quarter 4	2,39,400	2,34,000

The milk required for catering business was transferred by the milk procurement unit @ Rs. 35 per litre for accounting purposes.

As per the company's plan, 'Godhan' was launched in June, 2018. Surplus of 1<sup>st</sup> quarter was supplied to the Directors at free of cost. However, from Q2 of Financial Year 2018-2019, 95% of the surplus milk was sold at the premium price.

Direct expenses of Godhan related marketing and manpower was Rs.15 per litre. The remaining 5% of surplus milk was distributed to directors for free.

#### I. Multiple Choice Question [2 Marks each]

**Write the correct answer to each of the following questions by choosing best option out of the four given options. No reasoning is required to be given for choosing the correct option.**

1. What is the carrying amount of Property, plant and Equipment of milk procurement project (rounded off to nearest lacs) as on 31<sup>st</sup> March 2018?
  - (a) Rs. 385 Lacs
  - (b) Rs. 384 Lacs
  - (c) Rs. 383 Lacs
  - (d) Rs. 382 Lacs
2. Assuming that the value of land was appreciated by 10% during fair value exercise, what is the carrying amount of Project PPE (rounded off to nearest lacs) as on 31<sup>st</sup> March 2019?

- (a) Rs. 390 Lacs (approx.)
- (b) Rs. 391 Lacs (approx.)
- (c) Rs. 392 Lacs (approx.)
- (d) Rs. 393 Lacs (approx.)

3. What is sales value of milk sold under the brand "Godhan"?

- (a) Rs. 9.54 Lacs
- (b) Rs. 9.34 Lacs
- (c) Rs. 9.44 Lacs
- (d) Can't be determined

4. If there's any unsold stock of milk packets under the brand "Godhan", its valuation shall be done as per:

- (a) IAS 2 'Inventories'
- (b) IAS 41 'Agriculture'
- (c) IAS 16 'Property, Plant and Equipment'
- (d) IFRS 8 'Operating Segment'

5. The carrying amount of cattle feed as on 31<sup>st</sup> March 2019 would be:

- (a) Cost or NRV whichever is lower
- (b) Fair value less costs to sell
- (c) Cost
- (d) Only fair value

## **II. Descriptive Question [15 marks]**

6. Based on the financial information given in the case, prepare Statement of Profit and Loss of the milk procurement unit ie. the project site for the year ended 31<sup>st</sup> March 2019. Draw the Statement for Profit and Loss till profit before tax level by ignoring the Notes to Accounts.

## **CASE STUDY 4**

Creative Engineering Pvt. Ltd. is a company engaged in the business of making kitchen equipment that are either customized according to customer needs or standardised based on minimum requirement of customers in general.

Right from customization of gas stoves to large utensils there is a range of products manufactured and supplied. Since many institutional buyers do not know what will be the best arrangement for them, the company also does consultancy in this regard and visiting the facility of the buyer is an essential activity in that case.

In the general purpose category most of the customers are either restaurants or hotels although the size varies. In customised category most of the customers are Trusts of Temples, Gurudwaras and NGOs who supply free food to the visitors. Usually these customers also need a consultancy before buying the equipment.

Your firm is a statutory auditor of the company and you're one of the team members who is doing the audit for FY19-20. During the audit you have been provided with customer contracts for verification and audit of revenue. The extracts of some of the customer contracts executed during the year are given below:

- **Contract No. 123: Value – Rs. 51 Lacs**

#### **Contractual rights and responsibilities - Trust**

The trust has a right to terminate the contract any time before the actual equipment is installed in the designated facility. The company can however invoice for the actual cost of the raw material used for the equipment plus 10% of the cost of raw material as cancellation fee.

#### **Termination**

Termination notice by either party shall be given at least 7 days in advance through email followed by a formal notice of termination.

- **Contract no. 134: Value – Rs. 81 Lacs**

#### **Payment terms:**

The trust shall pay the contractual value as follows:

Rs. 5 lacs Consultancy – before final meeting on design

Rs. 35 lacs within 1 month from final meeting on design

Rs. 30 lacs within 2 months from final meeting on design

Balance amount – within 15 days from installation

#### **Exit clause:**

Both the parties to the contract shall be out of the contractual obligations when:

- Installation is complete and successful trial is demonstrated to the NGO
- All payments for contract value has been received by the company
- Sign-off document is signed by both the parties

- **Contract no. 152: Value – Rs. 101 Lacs**

#### **Uncertainty clause:**

1. The NGO intends to commission the project in its entirety. However, there are a few uncertainties with regard to one or two locations where the equipment may not be required if the NGO decides to call off the branch operations in those locations. This will not affect the contract value.
2. Those locations are in the interiors of Rajasthan and Bihar State.
3. In the eventuality of any decision of the NGO in this regard, the same shall be communicated to the company in writing.
4. Any further understanding between the NGO and the company in this regard shall be final and shall not be affecting the rest of this contract.

Since this contract no. 152 involved execution at different locations across the country, the company had tied-up with different vendors who could help in manufacturing and supply of equipment as per the

design specifications given by the company. The aggregate amount payable to such vendors was Rs. 30 Lacs.

The uncertainty clause was indeed invoked during the year. Accordingly, the NGO informed the company that a location in Bihar has been called off. The NGO also requested for a discount of Rs. 10 lacs on the contract value to which the Board of Directors of the company have responded positively and accepted the same.

Apart from the contractual revenue from the Customized Equipment, the company had a revenue of Rs. 2.12 crores from generic customers who did not require any consultancy.

There were 19 contracts during the year where the company could only realise consultancy fee as the customers backed-off on the execution either because they thought the cost was higher or they postponed the implementation. The average consultancy fee for each contract was Rs. 5 lacs and the revenue from consultancy services alone was 12% of the total revenue for FY19-20. The company had executed totally 21 contracts (full-fledged from consultancy to execution) during the year.

### I. Multiple Choice Questions

**Write the correct answer to each of the following questions by choosing best option out of the four given options. Each question carries two marks.**

1. The company's operating segments as per IFRS 8 would be:
  - a. Generic Equipment, Customized Equipment and Consultancy Services
  - b. Generic Equipment and Customized Equipment
  - c. Restaurants, Trusts and NGOs
  - d. Restaurants and Trusts
2. What is the value of Consultancy Segment revenue and the overall revenue of the company (excluding other income if any) for FY19-20?
  - a. Rs. 95 Lacs and Rs. 6.97 crore (approx.)
  - b. Rs. 95 Lacs and Rs. 7.92 crore (approx.)
  - c. Rs. 95 Lacs and Rs. 8.87 crore (approx.)
  - d. Rs. 95 Lacs and Rs. 8.02 crore (approx.)
3. What is the approximate value of revenue from customized equipment segment?
  - a. Rs. 5.80 crore
  - b. Rs. 2.12 crore
  - c. Rs. 4.85 crore
  - d. Rs. 6.97 crore
4. What is the value of revenue recognized from Contract No. 152 if the actual amount received by the company at various dates is Rs. 92 Lacs? The sign-off document is also signed by both the parties before 31<sup>st</sup> March, 2020 and it is established that there are no dues from both the parties.
  - a. Rs. 91 Lacs
  - b. Rs. 92 Lacs
  - c. Rs. 62 Lacs

d. Rs. 61 Lacs

5. If Sign-off document was not signed by both the parties in Contract No.152 as on the date of balance sheet but signed subsequently on 15th April 2020, what would be treatment of Rs. 11 Lacs that was received as last milestone payment on 15th March 2020? As on 14th March 2020 Rs. 81 Lacs was already received and recognised as revenue. Installation and successful trials were done as on 10th March 2020.

- Rs. 10 Lacs as Revenue and Rs. 1 Lac as liability
- Rs. 11 Lacs as liability
- Rs. 11 Lacs as revenue
- Rs. 11 Lacs as 'Advance from customer'

## II. Descriptive Questions [5 marks each]

6. If Contract No. 123 was terminated by the customer with sufficient due notice in writing, what will be the accounting treatment of revenue? The cost incurred by the company for procurement of raw material was Rs. 26 Lacs. Allocable indirect cost was Rs. 5 Lacs.

The customer had already made an advance payment of Rs. 5 Lacs which the company has accounted as revenue from consultancy fee. If the customer has honoured the rest of the contract by exercising the right to terminate before actual installation, compute the revenue from Contract No. 123 and make necessary disclosures as per para 113 of IFRS 15.

7. (i) In case of Contract no. 134, the installation and successful trial was achieved on 20th March 2020 and the last instalment payment of Rs. 11 Lacs was received on 2nd April 2020 and the sign-off document was signed by both the parties on 10th April 2020. Will the revenue of Rs. 11 Lacs be recognized as on 31st March 2020?

(ii) If the company had similar situations of totally 11 contracts and the amount thus received after the balance sheet date was Rs. 101 Lacs what are the necessary disclosures as required by IFRS 15?

8. Make a note, forming part of Notes to accounts, in respect of Operating Segments. Restrict yourself on calculation of only revenue amount from each segment.

## CASE STUDY 5

You are a qualified Chartered Accountant at XYZ Ltd, an Indian listed company which is exploring possibilities of listing its securities at an overseas stock exchange. The financial reporting requirements related to such listing include submission of financial statements as per IFRS. Therefore, XYZ Ltd prepares its financial statements in accordance with International Financial Reporting Standards (IFRS) upto 31 March each year. You report to Anuj, the Financial Controller of XYZ Ltd.

Anuj called you to enquire about the consolidated financial statements. The financials disclosed that on 1 July 20X1, XYZ Ltd acquired 800,000 ordinary shares in ABC Ltd on incorporation at par (Rs. 1 per share). The remaining shares were subscribed for in equal proportions by two other companies: PQR Ltd and MNO Ltd. The issued share capital of ABC Ltd at date of acquisition of the shares was two million shares.

Anuj prescribed the Board of Directors of XYZ Ltd to go into an agreement with the goal that all key working and money related choices would require the consistent assent of each of the three parties. XYZ Ltd had not entered in any past contractual agreements of a comparable sort and, from past discussions,

you realize that Anuj is exploring the possibility to apply proportionate consolidation. You need to guarantee that the accounting treatment embraced will be suitable in future years.

Anuj told you that I noticed your draft statement of comprehensive income has not taken into account the acquisition of the shares in ABC Ltd, although, it looks to me as though it should be treated as an associate company. What do you think? The directors have requested an estimate of consolidated profit for the board meeting next week. Also, I will need some sort of explanation as to why you are making your adjustments: you and I both know that there is a lot of professional judgement involved in the application of some of the IFRS.

**Outstanding Issues:**

1. XYZ Ltd acquired a trade mark at a cost of Rs. 68,00,000 on 1 April 20X1. At that date the patent had an estimated useful life of 20 years. In the draft financial statements at 31 March 20X2, the trade mark is shown at Rs. 88,40,000 as per the advise of a brand valuation firm. An increase in fair value has been recognized in other comprehensive income and carried as a revaluation surplus within equity.
2. On 1 April 20X1, XYZ Ltd acquired 34,000 listed 4% Rs. 1 preference shares at their fair value (which was par value) in RST Ltd that are redeemable on 31 March 20X5. Transactions costs were negligible. The effective interest rate on preference shares is 6% and preference dividends are paid annually on 31 March each year. The market value of one preference share on 31 March 20X2 was Rs. 1.05. The board minute authorizing this investment recorded the decision to hold these preference shares until redemption and instructed cash flow forecasts to be prepared on this basis. Furthermore, the investment has not been made with the intention of making short-term profit.
3. XYZ Ltd acquired a non-current asset on 1 April 20X1. This non-current asset is located in an industrial development area and cost Rs. 1,02,00,000. The asset is expected to last five years. An impairment review was carried out on 31 March 20X2 and the projected cash flows relating to this asset were as follows:

Year ended	31-Mar	31-Mar	31-Mar	31-Mar
	20X3	20X4	20X5	20X6
Cash flows (Rs. '000)	952	1513	1700	1870

XYZ Ltd uses a discount rate of 5% in relation to cash flows and the Indian government have indicated that it may pay compensation for any loss of value of the assets up to 20% of any impairment loss.

4. On 1 April 20X1, XYZ Ltd entered into a six-year lease over one of its properties, the lessee agreeing to pay Rs. 204000 per quarter in advance. XYZ Ltd had acquired the property for use as its administrative offices five years earlier for Rs. 34,00,000 (land element costing Rs. 340000), at which time the useful life of the building was estimated at 34 years. XYZ Ltd vacated the property on 1 April 20X1 and its fair value at that date was estimated at Rs. 64,60,000. At 31 March 20X2, the property's fair value was estimated at Rs. 61,20,000. XYZ Ltd had not leased out any properties in the past.
5. The revenue included in the draft consolidated statement of comprehensive income includes sales to EFG Ltd (subsidiary of XYZ Ltd with 80% shareholding) of Rs. 25,50,000, all invoiced at cost plus 25%. On 31 March 20X2 the inventory included Rs. 6,37,500 in respect of such goods.

6. XYZ Ltd has a corporate office in Mumbai held under an operating lease. A specific requirement of the lease is that the asset is returned in good condition. The operating lease was signed in 20X1-20X2 and will last for four years. In order to meet the requirements of the lease, the board of directors of XYZ Ltd have agreed to refurbish the office building in four years time at a cost of Rs. 42,50,000. This figure includes the renovation of the exterior of the building and is based on current price levels. Due to the severe cold weather, XYZ Ltd will also have to spend Rs. 3,40,000 at the end of the next year on renovating the building. The directors are of the opinion that this expenditure will reduce, by an equivalent amount, the overall refurbishment costs payable at the end of the lease term. Relevant discount rate applicable in this case is 10%. No entries have been made for the above expenditure in the financial statements.

7. On 1 April 20X1, the fair value of the assets of XYZ Ltd's defined benefit plan were valued at Rs. 20,40,000 and the present value of the defined obligation was Rs. 21,25,000. On 31 March the plan received contributions from XYZ Ltd amounting to Rs. 4,25,000 and paid out benefits of Rs. 2,55,000. The current service cost for the financial year ending 31 March 20X2 is Rs. 5,10,000. An interest rate of 5% is to be applied to the plan assets and obligations. The fair value of the plan's assets at 31 March 20X2 was Rs. 23,80,000, and the present value of the defined benefit obligation was Rs. 27,20,000. No accounting entries have been made for the year ended 31 March 20X2.

#### Appendix 1:

#### Draft Consolidated Statement of Comprehensive Income for the year ended 31 March 20X2

	Rs.'000
Revenue	37187.5
Cost of Sales	-21802.5
Gross Profit	15385
Operating expenses	-2082.5
Suspense	-1275
Profit from operations	12027.5
Dividend from ABC Ltd	170
Finance Costs	-8041
Profit before taxation	4156.5
Tax	-1246.1
Profit for the year	2910.4
Other comprehensive income	2040
Revaluation	4950.4
Total comprehensive income for the year	4950.4
Attributable to	
Owners of XYZ Ltd	3961
NCI	989.4
	4950.4

#### Note 1:

The results from ABC Ltd financial statements for the six months ended 31 March 20X2 are as follows:

	Rs.'000
Revenue	5440
Cost of Sales	-2550
Gross Profit	2890
Operating expenses	-1275
Taxation	-263.5
Profit for the period	1351.5

The current draft consolidated statement of comprehensive income includes the dividends received from ABC Ltd during the year. No other amounts have been recognized in respect of ABC Ltd. A dividend of Rs. 4,25,000 was paid by ABC Ltd on 24 March 20X2.

**I. Multiple Choice Question [2 Marks each]**

1. At what carrying value should trademark be recognized on March 31, 20X2?
  - (a) Rs. 88,40,000
  - (b) Rs. 68,00,000
  - (c) Rs. 64,60,000
  - (d) Rs. 83,98,000(2 Marks)
2. What should be the carrying value of Non- current asset at March 31, 20X2 which was acquired on 1 April, 20X1?
  - (a) Rs. 81,60,000
  - (b) Rs. 52,85,000
  - (c) Rs. 1,50,00,000
  - (d) Rs. 1,02,00,000(2 Marks)
3. How much amount of compensation receivable from Indian Government should be recognized on 31 March 20X2?
  - (a) Rs. 5,75,000
  - (b) No provision
  - (c) Rs. 9,83,000
  - (d) Rs. 8,33,000(2 Marks)
4. Which model can be used to calculate the carrying value of one of its property leased under six year lease agreement on 1 April 20X1?
  - (a) Cost model only
  - (b) Fair value model only
  - (c) Either of the two
  - (d) Fair value model if cost is higher than fair value, else cost model(2 Marks)
5. How much amount of provision at March 31, 20X2 should be recognized for the corporate office held on lease in Mumbai?

- (a) Rs. 3,40,000
- (b) Rs. 32,11,810
- (c) Rs. 29,79,590
- (d) Rs. 45,90,000

**(2 Marks)**

## **II. Descriptive Question**

- 6. Prepare the consolidated statement of comprehensive income for the year ended 31 March 20X2 after the incorporation of necessary adjustments w.r.t outstanding issues by providing required workings.

**(15 Marks)**

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE**  
**PAPER 1: GLOBAL FINANCIAL REPORTING STANDARDS**  
**ANSWERS**

**CASE STUDY 1**

**I. Answers to Multiple Choice Question**

**1. Option B**

**Reason**

*IAS 17 Leases stipulates the accounting treatment of sale and leaseback transactions. When an asset is sold and immediately leased back under a finance lease, the substance of the transaction is a financing arrangement, the asset providing security for the loan.*

*Any profit on sale should not be recognised immediately, but should instead be deferred and recognised over the lease term. In this case the profit of Rs. 4,80,000 should be recognised over a ten year period, on a straight line basis. For the year ended 31st March, a profit of Rs. 48,000 should be recognised. The rental expense of Rs. 2,16,000 should be added back to profit and recognised as a reduction in the lease liability.*

*Profit before interest and tax should be reduced by Rs. 4,32,000 (Rs. 4,80,000 of profit transferred to deferred income, net of Rs. 48,000 recognised in the accounting period). The reversal of the rental expense increases profit by Rs. 2,16,000.*

*Deferred income is recognised under liabilities, split between current (Rs. 48,000 in respect of the accounting period year ended 31<sup>st</sup> March 20X6 and long-term (Rs. 384,000).*

*The de recognition of the asset was correct, but as with any other finance lease, the asset should be recognised in non-current assets. Leased assets should be recognised at lower of fair value and the present value of minimum lease payments. In this case the figures are the identical.*

*The non-current asset should be depreciated over the lease term: Rs. 15,60,000/10 = Rs. 1,56,000. The charge therefore reduces profit before interest and tax.*

*The carrying amount of the asset in the statement of financial position at 31<sup>st</sup> March 20X6 should be Rs. 15,60,000 – Rs. 1,56,000 = Rs. 14,04,000. Amounts in respect of the lease liability should be calculated by reference to the 7% interest rate implicit in the lease:*

Date	Balance [1]	Finance cost 7% [2]	Lease payment [3]	Balance [1 + 2 – 3]
	Rs.	Rs.	Rs.	Rs.
31 March 20X6	15,60,000	1,09,200	(2,16,000)	14,53,200
31 March 20X7	14,53,200	1,01,724	(2,16,000)	13,38,924

*Current liability would be next lease payment of Rs. 2,16,000 –Rs. 1,01,724 = Rs. 1,14,276.*

*Long-term liability would be Rs. 14,53,200 - Rs. 1,14,276 = Rs. 13,38,924.*

**2. Option C**

**Reason**

*Impairment of the machine in PQR*

*The appropriate discount rate to use in calculating value in use is 9% pre-tax.*

Year ended	Cash flow Rs.	Discount factor	Amount Rs.
31 March 20X7	2,76,000	0.9174	2,53,202
31 March 20X8	1,92,000	0.8417	1,61,606
31 March 20X9	1,20,000	0.7722	92,664
31 March 20Y0	1,14,000	0.7084	80,758
			<u>5,88,230</u>

The recoverable amount is the higher of value in use and fair value less costs to sell. The recoverable amount is therefore Rs. 5,88,230.

### 3. Option A

#### Reason

Land is not depreciated as it has an indefinite life. Land should be shown in the statement of financial position at its original cost of Rs. 6,72,000. The building element was recognised at cost of Rs. 24,00,000.

Carrying amount before the revaluation on 31st March 20X3 would have been Rs. 21,60,000 (Rs. 24,00,000 – two years depreciation Rs. 2,40,000). The buildings element should then be revalued upwards to Rs. 27,00,000 and the surplus over carrying amount of Rs. 5,40,000 recognised in other comprehensive income and credited to revaluation surplus.

Depreciation would now be Rs. 1,50,000 (Rs. 27,00,000/18). {Note: Management could elect to make an annual transfer of Rs. 30,000 from revaluation surplus to retained earnings through the statement of changes in equity} On the 31<sup>st</sup> March 20X6 the following balances should be included in the Statement of financial position.

	Rs.
Land	672,000
Rs. 27,00,000 – three years' depreciation at Rs. 150,000 per annum)	2,250,000

The buildings element open market value is now only Rs. 19,80,000 and an impairment loss of Rs. 2,70,000 should be recognised.

### 4. – D

#### Reason

The preference shares provide the holder with the right to receive a predetermined amount of annual dividend out of profits of the company, together with a fixed amount on redemption. Whilst the legal form is equity, the shares are in substance debt. The fixed level of dividend is interest and the redemption amount is the equivalent to the repayment of a loan.

Under IAS 32 Financial Instruments: Presentation, these instruments should be classified as financial liabilities because there is a contractual obligation to deliver cash. The preference shares should be accounted for at amortised cost using the effective interest rate of 18%.

	1 April, 20X5	Interest @18%	Paid at 4%	31 March, 20X6
	Rs.	Rs.	Rs.	Rs.
20X5-20X6	480,000	86,400	(19,200)	547,200

An amount of Rs. 5,47,200 should be included in borrowings (non-current liabilities) and a finance charge of Rs. 86,400 included within profit or loss. Equity should be reduced by both the Rs. 480,000 proceeds of issue and the Rs. 67,200 i.e. total by 5,47,200.

## 5. B

### Reason

An amount of Rs. 15,00,000 (Rs. 18,00,000 x 10/12) should be capitalised in the SFP representing the expenditure since 1 June. The expenditure incurred prior to 1 June (2/12 x Rs.18,00,000) should be recognised as an expense, retrospective recognition as an asset is not allowed.

## II. Answer to Descriptive Question

### 6. Issue 1

IAS 17 Leases stipulates the accounting treatment of sale and leaseback transactions. When an asset is sold and immediately leased back under a finance lease, the substance of the transaction is a financing arrangement, the asset providing security for the loan.

Any profit on sale should not be recognised immediately, but should instead be deferred and recognised over the lease term. In this case the profit of Rs. 4,80,000 should be recognised over a ten year period, on a straight line basis. For the year ended 31st March, a profit of Rs. 48,000 should be recognised. The rental expense of Rs. 2,16,000 should be added back to profit and recognised as a reduction in the lease liability.

Profit before interest and tax should be reduced by Rs. 4,32,000 (Rs. 4,80,000 of profit transferred to deferred income, net of Rs. 48,000 recognised in the accounting period). The reversal of the rental expense increases profit by Rs. 2,16,000.

Deferred income is recognised under liabilities, split between current (Rs. 48,000 in respect of the accounting period year ended 31<sup>st</sup> March 20X6 and long-term (Rs. 384,000).

The de recognition of the asset was correct, but as with any other finance lease, the asset should be recognised in non-current assets. Leased assets should be recognised at lower of fair value and the present value of minimum lease payments. In this case the figures are the identical.

The non-current asset should be depreciated over the lease term: Rs. 15,60,000/10 = Rs. 1,56,000. The charge therefore reduces profit before interest and tax.

The carrying amount of the asset in the statement of financial position at 31<sup>st</sup> March 20X6 should be Rs. 15,60,000 – Rs. 1,56,000 = Rs. 14,04,000. Amounts in respect of the lease liability should be calculated by reference to the 7% interest rate implicit in the lease:

Date	Balance [1]	Finance cost 7% [2]	Lease payment [3]	Balance [1 + 2 – 3]
	Rs.	Rs.	Rs.	Rs.
31 Mar 20X6	15,60,000	1,09,200	(2,16,000)	14,53,200
31 Mar 20X7	14,53,200	1,01,724	(2,16,000)	13,38,924

Current liability would be next lease payment of Rs. 2,16,000 – Rs. 1,01,724 = Rs. 1,14,276.

Long-term liability would be Rs. 14,53,200 - Rs. 1,14,276 = Rs. 13,38,924.

Finance costs recognised in Statement of Comprehensive Income for 20X5-20X6 should be Rs. 1,09,200

### Issue 2

The gain on holding the shares in JKL is Rs. 1 per share, so Rs. 25,000 for 25,000 shares. However, the gain has been incorrectly recognised. IFRS 9 Financial Instruments requires that where financial assets are classified as equity, gains or losses arising from changes in fair value should be recognised in other comprehensive income. The effect on the financial statements is to remove the gain of Rs. 25,000 from profit before interest and tax, because it will be recognised instead in other comprehensive income. There is no change in equity.

### Issue 3

#### (i) *Impairment of the machine in PQR*

The appropriate discount rate to use in calculating value in use is 9% pre-tax.

Year ended	Cash flow Rs.	Discount factor	Amount Rs.
31 Mar 20X7	2,76,000	0.9174	2,53,202
31 Mar 20X8	1,92,000	0.8417	1,61,606
31 Mar 20X9	1,20,000	0.7722	92,664
31 Mar 20Y0	1,14,000	0.7084	80,758
			5,88,230

The recoverable amount is the higher of value in use and fair value less costs to sell. The recoverable amount is therefore Rs. 5,88,230. Impairment of Rs. 6,60,000-5,88,230= Rs. 71,770

The impairment loss must first be set off against any revaluation surplus in relation to the same asset. Therefore, the revaluation surplus of Rs. 36,000 is eliminated against impairment loss, and the remainder of the impairment loss (Rs. 35,770) is charged to profit and loss.

Any compensation by government would be accounted for as such when it becomes receivable. At this time, the government has only stated that it may reimburse the company and therefore credit should not be taken for any potential government receipt.

#### (ii) *Freehold manufacturing building*

Land is not depreciated as it has an indefinite life. Land should be shown in the statement of financial position at its original cost of Rs. 6,72,000. The building element was recognised at cost of Rs. 24,00,000.

Carrying amount before the revaluation on 31st March 20X3 would have been Rs. 21,60,000 (Rs. 24,00,000 – two years depreciation Rs. 2,40,000). The buildings element should then be revalued upwards to Rs. 27,00,000 and the surplus over carrying amount of Rs. 5,40,000 recognised in other comprehensive income and credited to revaluation surplus.

Depreciation would now be Rs. 1,50,000 (Rs. 27,00,000/18). {Note: Management could elect to make an annual transfer of Rs. 30,000 from revaluation surplus to retained earnings through the statement of changes in equity} On the 31<sup>st</sup> March 20X6 the following balances should be included in the Statement of financial position.

	Rs.
Land	672,000
Rs. 27,00,000 – three years' depreciation at Rs. 150,000 per annum)	2,250,000

The buildings element open market value is now only Rs. 19,80,000 and an impairment loss of Rs. 2,70,000 should be recognised. As the loss is less than the revaluation surplus on the related asset, the entire loss should be recognised in other comprehensive income and set off against the revaluation surplus, so that it now becomes Rs. 2,70,000 (Rs. 5,40,000 – Rs. 2,70,000).

The adjustment necessary is therefore:

	Rs.	Rs.
Depreciation SCI To Accumulated Depreciation SFP	150,000	150,000
Impairment loss (OCI) To Non-current assets	270,000	270,000

#### Issue 4

The preference shares provide the holder with the right to receive a predetermined amount of annual dividend out of profits of the company, together with a fixed amount on redemption. Whilst the legal form is equity, the shares are in substance debt. The fixed level of dividend is interest and the redemption amount is the equivalent to the repayment of a loan.

Under IAS32 Financial Instruments: Presentation- these instruments should be classified as financial liabilities because there is a contractual obligation to deliver cash. The preference shares should be accounted for at amortised cost using the effective interest rate of 18%.

	1 April, 20X5	Interest @18%	Paid at 4%	31 March, 20X6
	Rs.	Rs.	Rs.	Rs.
20X5-20X6	480,000	86,400	(19,200)	547,200

An amount of Rs. 5,47,200 should be included in borrowings (non-current liabilities) and a finance charge of Rs. 86,400 included within profit or loss. Equity should be reduced by both the Rs. 480,000 proceeds of issue and the Rs. 67,200 i.e. total by 5,47,200.

The adjustment necessary is therefore:

	Rs.	Rs.
equity –preference shares (SFP) Dr.	4,80,000	
Finance costs (SCI)/equity retained earnings Dr.	86,400	
To Equity – retained earnings (SFP)		19,200
To Borrowings (SFP)		5,47,200

#### Issue 5

IAS 38 Intangible Assets requires an intangible asset to be recognised if, and only if, certain criteria are met. Regulatory approval on 1 June 20X5 was the last criterion to be met, the other criteria have been met as follows:

- Intention to complete the asset is apparent as it is a major project with full support from board
- Finance is available as resources are focused on project
- Costs can be reliably measured
- Benefits expected to exceed costs – (2 years)
- An amount of Rs. 15,00,000 (Rs. 18,00,000 x 10/12) should be capitalised in the Statement of Financial Position representing the expenditure since 1 June. The expenditure incurred prior to 1 June (2/12 x Rs.18,00,000) should be recognised as an expense, retrospective recognition as an asset is not allowed.

IAS 36 Impairment requires an intangible asset not yet available for use to be tested for impairment annually. A cash flow of Rs. 12,00,000 in perpetuity would clearly have a present value in excess of Rs. 12,00,000 and hence there would be no impairment. However, the research director is technically qualified so impairment tests should be based on her estimate of a four-year remaining life and a present value of the future cost savings of Rs. 9,60,000. This is greater than the offer received (fair value less costs to sell) of Rs. 7,80,000 and should be used as the recoverable amount. The carrying amount should be reduced to Rs. 9,60,000 and an impairment loss of Rs. 5,40,000 recognised in the profit and loss for the year.

The adjustment necessary is therefore:

		Rs.	Rs.
Operating expenses- development expenditure	Dr.	3,00,000	
Operating expenses –impairment of intangible	Dr.	5,40,000	
To Intangible assets – development expenditure			8,40,000

### Issue 6

The office property development is clearly speculative and therefore there is no contractual purchaser. Because of the intent to sell the building upon completion, it should be reclassified as inventory rather than an investment property. It needs to be recognised under IAS 2.

Inventory should be recognised at lower of cost and NRV, so at 31<sup>st</sup> March 20X6 the development should be measured at Rs. 27,60,000 cost. The gain of Rs. 1,20,000 should be derecognised.

The adjustment necessary is therefore:

		Rs.	Rs.
Inventory	Dr.	27,60,000	
Gains on investment property	Dr.	1,20,000	
To Investment property			28,80,000

## ANSWER TO CASE STUDY 2

### I. Answers to Multiple Choice Questions

1. Option (a)-Variable and requires allocation to distinct performance obligation

#### Reason

Para 85 of IFRS 15 Revenue from contracts with customers,

Variable amount should be allocated entirely to a performance obligation or to a distinct good or service as part of single performance obligation if both the following conditions are satisfied:

- a) Variable payment relates specifically to entity's efforts to satisfy performance obligation or transfer the distinct good or service
- b) Such allocation is consistent with the object of Para 73 keeping in mind all of the performance obligations and payment terms in the contract.

Since performance bonus and attrition penalty both are variable in nature, the company needs to allocate the consideration separately for each variable element.

2. Option (b)USD 2,31,000

#### Reason

Monthly billing rate per FTE for standard hours is USD 4400, so for 500 FTEs the billing per quarter would be USD 4400 x 500 x 3 = 66,00,000. Based on the attrition penalty table, applicable percentage for 7% attrition would be 3.5%. So, 66,00,000 x 3.5% = 231,000

3. Option (b)Head of the R2R team is right. It needs to be reported as a separate segment.

#### Reason

As per para 5 of IFRS 8,

An operating segment is a component of an entity:

a) That engages in business activities from which it earns revenues and incur expenses  
 b) Whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance and  
 c) For which discrete financial information is available.

Looking at the substance of the case, this contract calls for a treatment of separate operating segment.

4. Option (a)USD 0.72 million

**Reason**

Hourly bill rate as per standard hours = USD  $4400 \times 12 / 1920 = \text{USD } 27.5$  per hour.

No. of billed hours as per final approval = 262319

Billing for the quarter =  $2,62,319 \times \text{USD } 27.5 = \text{USD } 72,13,772.5$

Performance bonus at the rate of 10% = USD 7,21,377.25 or USD 0.72 million

5. Option (b) - Performance bonus and attrition penalty

**Reason**

The performance bonus and attrition penalty affect the certainty cash flows from the contract which also make the contract significantly different from other customer contracts of the company.

**II. Answers to Descriptive Questions**

6. Notes to Accounts for adjustments on account of variable components:

Contract Value		xxxxxx
Adjustments on account of variable components:		
Less: Attrition Penalty	(4,83,02,719)	
Add: Performance Bonus	<u>4,68,89,521</u>	
Net adjustments		(14,13,198)

**Working Note: (not part of disclosure)**

Quarter (1)	Billable hours in ODC (2)	ODC invoice amount (3)	Performance Bonus (4)	Attrition Penalty (5)
1	$160 \times 500 \times 3 = 2,40,000$	$240000 \times 27.5 \times 65 = 42,90,00,000$	Not eligible	$42,90,00,000 \times 3.5\% = 150,15,000$
2	2,62,319 (as per final approval)	$2,62,319 \times 27.5 \times 65 = 46,88,95,213$	$(3) \times 10\% = 4,68,89,521$	Not liable
3	$160 \times 500 \times 3 = 2,40,000$	$2,40,000 \times 27.5 \times 65 = 42,90,00,000$	Not eligible	$42,90,00,000 \times 4.5\% = 193,05,000$
4	2,23,500 (as per final approval)	$2,23,500 \times 27.5 \times 65 = 39,95,06,250$	Not eligible	$39,95,06,250 \times 3.5\% = 139,82,719$
		<b>1,72,64,01,463</b>	<b>4,68,89,521</b>	<b>483,02,719</b>

7. Since invoice cannot be raised without final approval, the bonus element can't be treated as revenue. However, based on the substance of the case, the company can treat the same as unbilled revenue and show it as part of current assets in the balance sheet as on the end of Quarter 2 Financial Year 2019-2020. However, the unbilled amount and final billed revenue may vary since Kapsch many times approve less hours than the hours approved by SasTech.

**Facts of the case:**

There's a contractual right of the company to be entitled for performance bonus since the company has in-principle satisfied the basic condition and thus has fulfilled its performance obligation under the contract.

**Requirement of relevant IFRS:**

Para 105 of IFRS 15, when either party to the contract has performed, an entity shall present the contract in the balance sheet as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.

**Application and justification:**

Since the company has already provided the services and met the basic conditions of eligibility for performance bonus the same can be recognized as unbilled revenue. The act of getting the formal approval is only a matter of time and hence does not impair the substance of the case. As per the principles of IFRS 15, the company has fulfilled its performance obligations by rendering the required services to the customer and also satisfied the criteria for performance bonus by keeping the attrition lower than the threshold and also by making its employees more than the standard number of working hours.

**8. Segment Information:****Special Contracts:**

This segment consists of contracts with customers which have special performance obligations which are different from other contracts in terms of nature, timing, amount and certainty of revenues and cash flows from the contracts.

Particulars	Rs. in Crores
Segment Revenue	181.08
Segment Assets	1.29
Segment Liabilities	1.40

**Working Notes (not part of disclosure)**

- Segment Revenue

Onsite 10 (FTEs) x 12 (months) x USD 11,000 x 65 (Rs. per USD) =		858,00,000
ODC (as per working notes in answer for Q.6 above) –		
Invoice Value	Rs. 172.64 crore	
Less: Adjustments (net) on account of variable components	<u>(Rs. 0.14 Crore)</u>	
Net ODC revenue (as per para 50-54 of IFRS 15)		Rs. 172.50 Crore
Total Contract Revenue		Rs. 181.08 Crore

- Segment Assets refer to ODC's carrying value of assets as given in the case ie Rs. 129 lacs.
- Segment liability is the provision for Attrition Penalty for Q4FY19-20 which has been worked out as per working notes in answer for Q.6 above ie. 1,39,82,719.

## ANSWER TO CASE STUDY 3

### I. Answer to Multiple Choice Question

#### 1. Option (c) - Rs. 383 Lacs

##### Reason:

Carrying value as on 31<sup>st</sup> March 2018:

		Rs. in lacs
Cows		120
Land		150
Civil structure (useful life 15 years)	$[65 - \{(65 \text{ lacs} / 15 \text{ year} \times 12 \text{ month}) \times 2 \text{ month}\}]$	64.278
Milking equipment and other tools (useful life 7 years)	$[50 - \{(50 \text{ lacs} / 7 \text{ year} \times 12 \text{ month}) \times 2 \text{ month}\}]$	48.81

#### 2. Option (a) – Rs. 390 Lacs (approx.)

##### Reason:

	Opening Balance 1.4.2018	Additions	Deletions	Fair value adjustments	Depreciation for 12 months	Closing balance
	Rs. in lacs	Rs. in lacs	Rs. in lacs	Rs. in lacs	Rs. in lacs	Rs. in lacs
Cows	120	(3.24 + 2.88) 6.12	(5 x 0.60) 3.00	-	-	123.12
Land	150			15		165
Civil structure (useful life 15 years)	64.278				4.33	59.948
Milking equipment and other tools (useful life 7 years)	48.81				7.14	41.67
						389.738

#### 3. Option (b) - Rs. 9.34 Lacs

##### Reason:

Period	Actual production	Target	Surplus	Directors	Sold	Sales value
Q1	2,27,505	2,27,500	5	5	-	-
Q2	2,41,040	2,39,200	1,840	92	1,748	1,57,320
Q3	2,42,880	2,39,200	3,680	184	3,496	3,14,640
Q4	2,39,400	2,34,000	5,400	270	5,130	4,61,700
						9,33,660

Sales value is calculated @ Rs. 90 per litre.

#### 4. Option (a) IAS 2 'Inventories'

##### Reason:

As per para 3 of IAS 41, IAS 41 is applied to agricultural produce, which is the harvested produce of the entity's biological assets, at the point of harvest. Thereafter, IAS 2 Inventories or another applicable Standard is applied. Hence for unsold stock IAS 2 will be applied.

5. Option (b) Fair value less costs to sell

**Reason:**

Since cattle feed is covered under IAS 41 'Agriculture', the valuation shall be fair value less costs to sell.

**II. Answer to Descriptive Question**

6. Statement of Profit and Loss of Sai Caterers Pvt. Ltd. (Milk Procurement Unit)

For the year ended 31<sup>st</sup> March, 2019

	Particulars	Figures as at the end of current reporting period Rs.
I	Revenue from operations:	
	Revenue - From inter-segment transfers	3,28,96,500
	Revenue – Direct sales	9,33,660
II	Other Income	<u>–</u>
III	Total Income (I + II)	<u>3,38,30,160</u>
IV	EXPENSES	
	Cost of materials consumed:	
	Daily feed for cows	1,09,50,000
	Medical expenses on cows	4,80,000
	Employee benefits expense	43,80,000
	Depreciation expenses	11,47,000
	Other expenses:	
	Office overheads	3,00,000
	Distribution cost	25,67,228
	Marketing cost for Godhan	<u>1,55,610</u>
	Total expenses (IV)	<u>1,99,79,838</u>
V	Profit/(loss) before tax (I-IV)	<u>1,38,50,322</u>

**Working Notes:**

1. Employee benefits:

No. of employees required to manage cows = 20

Cost	(Rs. 15,000 x 20 x 12 month)	36,00,000
Add: Cost of project manager	(Rs. 65,000 x 1 x 12 month)	<u>7,80,000</u>
Total employee cost		<u>43,80,000</u>

2. Cost of daily feed:

Rs. 150 x 200 cows x 365 days = Rs. 109,50,000

3. Medical cost:

Rs. 200 x 200 cows x 12 months = Rs. 4,80,000

**4. Distribution cost:**

Rs. 2.7 per litre for internal consumption

Total milk supplied during the year – 9,50,825 litres (2,27,505 + 2,41,040 + 2,42,880 + 2,39,400)

So, cost of distribution = 9,50,825 litres x Rs. 2.7 = Rs. 25,67,228 (rounded off)

**5. Marketing cost related to Godhan:**

Milk sold under the brand – 10,374 litres (1,748 + 3,496 + 5,130)

Marketing Cost per litre (as given) Rs. 15

So, marketing cost = Rs. 15 x 10,374 litres = Rs. 1,55,610

**6. Office overheads:**

Rs. 25,000 per month (given), so annually Rs. 3,00,000

**7. Depreciation:**

Refer answer to MCQ 2 above. According to it depreciation for the year = Rs. 11,47,000 lacs approx.

**8. Revenue**

Revenue from Godhan (direct sales) – Milk sold – 10,374 litres at Rs. 90 per litre = Rs. 9,33,660

Milk consumed internally = 9,39,900 litres.

Inter-segment transfers of milk is @ Rs. 35 per litre

So, internal revenue would be = 9,39,900 litre x Rs. 35.00 = 3,28,96,500

**ANSWER TO CASE STUDY 4**

**I. Multiple Choice Question**

**1. Option a.**

**Reason**

Since there have been many contracts which could not go through beyond the stage of consultancy, the service in itself is an operating segment. And the case study also mentions that revenue from consultancy constituted 12% of the overall revenue for the year. So, by thresholds criteria also, it becomes a reportable operating segment.

**2. Option b.**

**Reason**

Information about consultancy segment is given as 19 contracts and an average revenue of Rs. 5 lacs so it amounts to  $19 \times 5$  lacs = Rs. 95 Lacs

If Rs. 95 lacs is 12% of the total revenue,

Then the total revenue would be  $95 / 0.12 = \text{Rs. } 791.67$  Lacs or Rs. 7.92 crore (approx.)

**3. Option c.**

**Reason**

As calculated above, if the total revenue is Rs. 7.92 crore,

It's given that revenue from Consultancy Services segment is Rs. 95 Lacs and that from Generic Equipment is Rs. 2.12 crore, the balance revenue would pertain to Customized Equipment segment which is  $\text{Rs. } 7.92 \text{ crore} - (\text{Rs. } 0.95 \text{ crore} + \text{Rs. } 2.12 \text{ crore}) = \text{Rs. } 4.85 \text{ crore}$ .

#### 4. Option b.

##### Reason

Total contract value = Rs. 101 Lacs. Discount on account of cancellation of one location was Rs. 10 Lacs so, the actual revenue receivable was Rs. 91 Lacs (101-10).

However, the actual amount received from the client was Rs. 92 Lacs. Since the sign-off documents is signed and there's no obligation from the company's point of view, the extra amount of Rs. 1 lac received can be recognised as revenue as per IFRS 15.

Para 15 of IFRS 15 says the following:

“...the entity shall recognise consideration received as revenue only when either of the following events has occurred:

- a) The entity has no remaining obligations to transfer goods or services to the customer and all or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or
- b) The contract has been terminated and the consideration received from the customer is non-refundable.”

Rs. 30 lacs is the cost of earning revenue and hence should not be deducted from revenue.

#### 5. Option a.

##### Reason

Recognition criteria as per Para 9 are met. Except that the extra Rs. 1 lac received may need to be returned before signing the final Sign-off document.

### II. Answers to Description Questions

#### 6. Original revenue estimate from Contract No. 123 – Rs. 51 Lacs

Actual Cost incurred for raw material	Rs. 26 Lacs
Add: 10% Cancellation fee	Rs. 2.6 Lacs
Actual revenue that can be recognised from Contract No. 123	Rs. 28.6 Lacs
Out of which the company has recognized as Consultancy Revenue since the client has already paid it	Rs. 5 lacs
Remaining revenue to be recognised from the Contract	Rs. 23.6 Lacs

Disclosure as per Para 113 of IFRS 15 ‘Revenue from Contracts with Customers’

“During the year, the company had a contract with a customer for a value of Rs. 51 Lacs.

Due to some unforeseen circumstances the contract was terminated before actual delivery and hence the contractual receivables were impaired substantially.

The actual revenue recognised from the contract was Rs. 28.6 Lacs.

The direct cost incurred for the contract on raw materials was Rs. 26 Lacs and indirect cost allocated for labour and overheads were about Rs. 5 Lacs. Hence the total impairment loss from the contract was as follows:

Revenue recognised		Rs. 28.6 Lacs
Less: Direct cost	Rs. 26.0 Lacs	
Indirect cost	Rs. 5.0 Lacs	Rs. 31.0 lacs
Actual Loss from the contract		Rs. 2.4 Lacs”

7. Looking at the substance over form principle of accounting the revenue of Rs. 11 Lacs should be recognized as on 31st March 2020 because the installation and trial were successful and the contractual value is clear. Just that the sign-off document is to be signed. Since there was no objection from customer from the date of trial till the date of book closure and also the amount has been received on 2<sup>nd</sup> April, 2020, the revenue of Rs. 11 Lacs should be recognized as on the balance sheet date.

#### **Disclosure with respect to IFRS 15**

During the year the company has executed several contract with customers for customized equipment. Contract revenue is recognised when the following criteria are met:

- a) Our contract with the customer is approved and commercial value is clear.
- b) Customized Equipment has been successfully delivered, installed and trial done to the satisfaction of the customer.
- c) It is probable that the customer will pay the due amount within a reasonable time.

The company ensures that the substance of relevant accounting standard is followed while recognising revenue from customer contracts.

During the year, the company has recognized full revenue from contracts which have been successfully executed – goods delivered, installed and trial done successfully to the satisfaction of the client. However, sign-off documents were pending to be signed as on the balance sheet date which were subsequently done on or before 15th of April 2020 for all such contracts where full revenue was recognized by the company.

8. As per para 22 of IFRS 8, following is disclosed about an entity:

*The company operates in mainly 3 segments:*

- *Generic Equipment*
- *Customized Equipment and*
- *Consultancy Services*

*Customers of the Generic Segment are from the similar business environment. They are either restaurants, hotels or resorts who need Equipment of different size and shape and do not need any consultancy services.*

*Customers from Customized Equipment Segment are usually the Trusts of Religious Institutions or Non-Government Organisations (NGOs) that distribute free food to either the visitors or the school children who are supported by such Institutions or NGOs.*

*Consultancy Services constitutes a separate segment because it meets the threshold of 10% or more of the total revenue of the entity. Many of our customers stop at the level of consultancy services although some had to plan for the same and a few customers come with an intention of only consultancy from the company.*

*The segment revenue is disclosed below:*

<b>Reportable Segment</b>	<b>Segment Revenue</b>	<b>% of Total Revenue</b>
<i>Generic Equipment</i>	<i>4,85,00,000</i>	<i>61.24%</i>
<i>Customized Equipment</i>	<i>2,12,00,000</i>	<i>26.77%</i>
<i>Consultancy Services</i>	<i>95,00,000</i>	<i>11.99%</i>
	<i>7,92,00,000</i>	<i>100%</i>

## CASE STUDY 5

### I. Answers to Multiple Choice Question

#### 1. Option (c) Rs. 64,60,000

##### Reason

Trademarks are *intangible assets*. IAS38 *Intangible Assets* rule about measurement subsequent to initial recognition is that an *intangible asset* can only be measured using the *revaluation model* if it is traded in the market where the items are *homogeneous*. Each trademark is by definition *unique*, so IAS38 is explicit that trademarks should not be measured using the *revaluation model*.

The trademark should be measured at its cost of Rs. 68,00,000 and then amortized over twenty years. Rs. 3,40,000 should be recognized as an expense in the profit/loss for the current period and the asset measured at Rs. 64,60,000 in the Statement of Financial Position. The Rs. 20,40,000 increase in fair value should be reversed out of other comprehensive income and the revaluation surplus in respect of this asset should be zero.

#### 2. Option (b) Rs. 52,85,000

##### Reason

IAS 36 states that if an asset's value is higher than its recoverable amount, an *impairment loss* has occurred. The *impairment loss* should be written off to profit and loss for the year.

The carrying value of the non-current assets at 31 March 20X2 is cost less depreciation:

Rs. 1,02,00,000 – (Rs. 1,02,00,000/5) = Rs. 81,60,000

This needs to be compared to the value in use at 31 March 20X2, which using a discount rate of 5%, is calculated as:

Year ended	31-Mar	31-Mar	31-Mar	31-Mar	Total
	20X3	20X4	20X5	20X6	
Cash flows (Rs. '000) [A]	952	1513	1700	1870	
Discount rate [B]	0.9524	0.907	0.8638	0.8227	
Value [A * B]	907	1372	1468	1538	5285

The value in use of Rs. 52,85,000 is below the carrying value, so the carrying value must be written down to Rs. 52,85,000.

#### 3. Option (b) No provision

##### Reason

The treatment of the compensation received in the form of reimbursements is governed by IAS37 *Provisions, Contingent Liabilities and Contingent Assets*. Reimbursements from governmental indemnities are recorded in profit or loss when the compensation becomes receivable, and the receipt is treated as a separate economic event from the item it was intended to compensate for. In this case, receipt is uncertain and this no credit can be taken for compensation of 20% of the impairment loss.

#### 4. Option (c) Either of the two

##### Reason

On 1 April 20X1 when the property was vacated by XYZ Ltd and leased out, it should be reclassified from property, plant and equipment to *investment property* and accounted for under IAS 40 *Investment Property*. Because it has not previously leased out any properties XYZ Ltd should adopt as its accounting policy any of the two options permitted under IAS 40 i.e. *cost model* and *revaluation model*.

## 5. Option (c) Rs. 29,79,590

### Reason

IAS 37 Provisions, Contingent Liabilities and Contingent Assets states that a provision should be recognised only if there is a present obligation resulting from a past event. The terms of the lease contract mean that XYZ Ltd has an obligation to incur expenditure in order to return the buildings to the lessor in good condition. The past obligating event would appear to be the signing of the lease. Thus, there is a strong case for recognising a provision for the expenditure.

Following is the computation of the expense to be recognised:

Payment	PVF @ 10%	Present value
Rs. 3,40,000	0.909	Rs. 3,09,060
-	0.826	-
-	0.751	-
Rs. 39,10,000	0.683	Rs. 26,70,530
<b>Grand total</b>		<b>Rs. 29,79,590</b>

Statement of Comprehensive Income Dr. Rs. 29,79,590

To Provision (SFP) Rs. 29,79,590

## II. Answers to Description Questions

### 6. Revised Consolidated Statement of Comprehensive Income for the year ended 31 March 20X2

	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000
	Draft	WN1	Issue 1	Issue 2	Issue 3	Issue 4	Issue 5	Issue 6	Issue 7		Final
Revenue	37,187.5	2,176				816	-2,550			37,629.5	
Cost of Sales	-21,802.5	-1,020					2,422.5	-2,979.59			-23,379.59
Gross Profit	15,385	1156				816	-127.5	-2,979.59		14,249.91	
Operating expenses	-2,082.5	-510	-340						-510	-3,442.5	
Impairment loss						-2,875				-2,875	
Suspense	-1275									-1275	
Profit from operations	12027.5	646	-340		-2875	816	-127.5	-2979.59	-510	6657.41	
Dividend from ABC Ltd	170	-170								0	
Finance costs	-8041									-4.25	-8043.21
Loss on investment property				2.04			-340				-340
Profit before taxation	4156.5	476	-340	2.04	-2875	476	-127.5	-2979.59	-514.25	-1725.8	
Income tax	-1246.1	-105.4								-1351.5	
Profit (loss) for the year	2910.4	370.6	-340	2.04	-2875	476	-127.5	-2979.59	-514.25	-3077.3	
Other comprehensive income										0	
Revaluations	2040			-2040				3510		3510	
Re-measurement defined benefits										-165.75	-165.75
Total comprehensive income for the period	4950.4	370.6	-2380	2.04	-2875	3986	-127.5	-2979.59	-680	266.95	
Attributable to Owners of XYZ Ltd	3961	370.6	-2380	2.04	-2875	3986	-102	-2979.59	-680	-696.95	
NCI	989.4									963.9	

### Working Notes:

#### 1. Jointly controlled entity

XYZ Ltd subscribed for 40% (800,000 / 20,00,000) of the equity capital of ABC Ltd. The remaining equity interest (30% each) is shared by two other shareholders. Despite the different shareholdings,

all three shareholders have agreed that key decisions require unanimous consent by all three parties. This meets the definition of joint control.

The entity should be classified as a joint venture in accordance with IFRS 11, *Joint Arrangements*. Therefore, XYZ Ltd can reflect its interest in the joint venture at cost plus share of post-acquisition total comprehensive income. No goodwill arises as shares acquired on incorporation of ABC Ltd.

XYZ Ltd's dividend from ABC Ltd of (40% of Rs. 4,25,000) should be removed from Statement of Comprehensive Income and replaced with it's share of profits (40% x Rs. 13,51,500)

#### **Treatment of outstanding issues:**

##### **Issue 1:**

Trademarks are intangible assets. IAS38 Intangible Assets rule about measurement subsequent to initial recognition is that an intangible asset can only be measured using the revaluation model if it is traded in the market where the items are homogeneous. Each trademark is by definition unique, so IAS38 is explicit that trademarks should not be measured using the revaluation model.

The trademark should be measured at its cost of Rs. 68,00,000 and then amortized over twenty years. Rs. 3,40,000 should be recognized as an expense in the profit/loss for the current period and the asset measured at Rs. 64,60,000 in the Statement of Financial Position. The Rs. 20,40,000 increase in fair value should be reversed out of other comprehensive income and the revaluation surplus in respect of this asset should be zero.

##### **Issue 2:**

The shares are listed on a recognized stock market. The board minute provides evidence of the intention and ability to hold these shares until redemption, so they should be held to maturity. This asset should initially be measured at fair value being the cost of Rs. 34,000 (shares issued at par). Subsequently they should be measured at amortized cost using the effective interest rate.

Preference shares balance as at 31<sup>st</sup> March should be measured at initial amount recognized plus any income less any payments of principal sum (including dividend receipts)

	Rs.
Fair value at acquisition (34,000 x Rs. 1)	34,000
Add interest income at effective rate (34,000x6%)	2,040
Less interest/dividends received (34,000 x 4%)	(1,360)
	34,680

In the consolidated Statement of Financial Position at 31 March 20X2 the held to maturity asset should be presented within non-current assets (redemption is still 3 years away) and measured at Rs. 34,680.

##### **Issue 3:**

IAS 36 states that if an asset's value is higher than its recoverable amount, an impairment loss has occurred. The impairment loss should be written off to profit and loss for the year.

The carrying value of the non-current assets at 31 March 20X2 is cost less depreciation:

Rs. 1,02,00,000 – (Rs. 1,02,00,000/5) = Rs. 81,60,000

This needs to be compared to the value in use at 31 March 20X2, which using a discount rate of 5%, is calculated as:

Year ended	31-Mar 20X3	31-Mar 20X4	31-Mar 20X5	31-Mar 20X6	Total
Cash flows (Rs. '000) [A]	952	1513	1700	1870	
Discount rate [B]	0.9524	0.907	0.8638	0.8227	
Value [A * B]	907	1372	1468	1538	5285

The value in use of Rs. 52,85,000 is below the carrying value, so the carrying value must be written down giving rise to an impairment loss of Rs. 28,75,000.

**Issue 4:**

Under the revaluation model, the property should be measured at fair value at 1 April 20X1. Depreciation on the property is  $(\text{Rs. } 34,00,000 - \text{Rs. } 3,40,000)/34 = \text{Rs. } 90,000$ . On 1 April 20X1, the property's carrying value is Rs. 29,50,000 ( $\text{Rs. } 34,00,000 - (\text{Rs. } 90,000 \times 5)$ ) and the surplus of Rs. 35,10,000 ( $\text{Rs. } 64,60,000 - \text{Rs. } 29,50,000$ ) should be recognized as revaluation surplus under IAS16 in other comprehensive income. No depreciation should be recognized under this model but the decrease in fair value over the year of Rs. 3,40,000 ( $\text{Rs. } 64,60,000 - \text{Rs. } 61,20,000$ ) should be recognized in profit/loss, along with the rental income of Rs. 8,16,000.

**Issue 5:**

The inter-group sales of Rs. 25,50,000 should be eliminated from both revenue and cost of sales. The unrealised profit of Rs. 1,27,500 ( $25/125 \times 6,37,500$ ) should be included in XYZ Ltd cost of sales.

**Issue 6:**

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* states that a provision should be recognised only if there is a present obligation resulting from a past event. The terms of the lease contract mean that XYZ Ltd has an obligation to incur expenditure in order to return the buildings to the lessor in good condition. The past obligating event would appear to be the signing of the lease. Thus, there is a strong case for recognising a provision for the expenditure.

Following is the computation of the expense to be recognised:

Payment	PVF @ 10%	Present value
Rs. 3,40,000	0.909	Rs. 3,09,060
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Rs. 39,10,000	0.683	Rs. 26,70,530
<b>Grand total</b>		<b>Rs. 29,79,590</b>

Statement of Comprehensive Income Dr. Rs. 29,79,590

To Provision (SFP) Rs. 29,79,590

**Issue 7:**

**Reconciliation of assets and obligation**

	Asset	Obligation
	Rs.	Rs.
Fair value/present value at 1 April 20X1	20,40,000	21,25,000
Interest @ 5%	1,02,000	1,06,250
Current service cost		5,10,000
Contributions received	4,25,000	
Benefits paid	-2,55,000	-2,55,000
Return on gain (assets) (balancing figure)	68,000	
Actuarial Loss (balancing figure)		2,33,750
Closing balance as at March 31,20X2	23,80,000	27,20,000

**In the Statement of Comprehensive Income, the following amounts will be recognised:**

	Rs.
Current service cost	5,10,000
Net interest on net defined liability (106250–102000)	4,250

**In the Statement of Financial Position**

	Rs.
Net defined liability (Rs. 27,20,000 – Rs. 23,80,000)	3,40,000

**Defined benefit re-measurements recognised in other comprehensive income**

	Rs.
Loss on defined benefit obligation	(2,33,750)
Gain on plan assets	68,000
	(1,65,750)

**MOCK TEST PAPER 1**

**FINAL (NEW) COURSE: GROUP – II**

**PAPER – 6F: MULTIDISCIPLINARY CASE STUDY**

*Attempt any **four** out of **five** case study based questions.*

Each Case Study carries 25 Marks.

**Time Allowed – 4 Hours**

**Maximum Marks – 100**

**CASE STUDY 1**

**Para I**

Mars Construction Ltd. is an Indian construction & manufacturing conglomerate having net worth of Rs. 900 crore during the immediately preceding financial year. It addresses the needs of infrastructure industry for the customers by having several branch offices and a supply chain extending throughout the country. The company is also engaged in executing civil contracts through tenders from various companies, Central Government and State Governments. Every aspect of the company's businesses is characterised by expertise and high standards of corporate governance. The company was correspondingly declared as one of India's Most Honoured Companies in the Institutional Investor Survey because it also has the concern for the community. It contributes to inclusive progress by empowering communities and accelerating growth through interventions in sanitation, health and education. Even before the enactment of provisions relating to Corporate Social Responsibility under the Companies Act, 2013, the company started eradicating hunger, poverty and malnutrition; promoting health care; contributing to the Swach Bharat Kosh for the promotion of sanitation; promoting education, including employment enhancing vocation skills especially among children, women, elderly and the differently abled.

The Financial Statements of the company for the year ended 31<sup>st</sup> March, 2019 reveals a net profit (before tax) amounting to Rs. 35,50,00,000 after debiting/crediting the following items:

- (i) Interest of Rs. 3,00,000 due to a public financial institution for the last quarter of the financial year 2018-19 paid on 20<sup>th</sup> October 2019.
- (ii) Rs. 6,00000 paid in India to Mr Philip, a non-resident towards fee for technical services without deduction of tax at source. TDS was, however, paid on 30<sup>th</sup> October, 2019.
- (iii) Damages amounting to Rs. 15,00,000 paid to the Government of West Bengal as per the terms of contract for defects found in construction of a flyover after 5 years of its construction.
- (iv) Depreciation charged Rs. 20,00,000.
- (v) Marked to market loss amounting to Rs. 6,00,000 in respect of an unsettled derivative contract. The contract was settled in May, 2019 with a gain of Rs. 1,00,000.

- (vi) Profit of Rs. 10,00,000 on sale of land to Neptune Inc., U.S.A, which is a wholly owned subsidiary company.
- (vii) Retention money amounting to Rs. 10,00,000 held by a public sector undertaking which can be released on the satisfaction of certain performance criteria as per the terms of contract. The contract was completed during the previous year 2018-19.
- (viii) Rs. 3,00,000 being interest on fixed deposit made with a bank as margin money for obtaining a guarantee required by a State Government for particular contract.
- (ix) Dividend of Rs. 10,00,000 received from a Real Estate Investment Trust (REIT) the break-up of which is as follows:
  - Component of short-term capital gain on sale of development properties by the REIT Rs. 6,00,000.
  - Component of rental income from properties owned by the REIT Rs. 4,00,000.

#### **Other Information**

- (i) Depreciation as per Income-tax Rules Rs. 25,00,000.
- (ii) Land sold to Neptune Inc was acquired at a cost of Rs. 38,00,000 in the financial year 2013-14 Value on the date of sale assessed by the Stamp Valuation Authority was Rs. 50,00,000 (Cost Inflation Index-Financial Year 2013-14 : 220; Financial Year 2018-19 : 280).
- (iii) During the year 20 new employees were recruited. All these new employees contribute to recognized provident fund. 15 employees out of 20 employees joined on 01-05-2018 and the other 5 employees joined on 15<sup>th</sup> November, 2018. 10 employees, who joined on 1<sup>st</sup> May, 2018 were offered salary of Rs.24,500 per month and the other employees who joined on the same date drew salary of Rs.32,000 per month. All the employees were paid through single account payee cheque except the one employee who joined on 1<sup>st</sup> May, 2018 at salary of Rs. 24,500 per month who drew his salary by bearer cheques of Rs. 12,500 and Rs. 12,000 every fortnight in a month.
- (iv) The company's accounts are required to be audited under section 44AB of the Income-Tax Act.

#### **Para II**

**The extract of Independent Auditors' Report to the members of Mars Construction Ltd. is given below:**

#### **Key Audit Matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the Individual Financial Statements of the current period. These matters were addressed in the context of our audit of the Individual Financial Statements as a whole and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

The Company has material uncertain tax positions including matters under dispute which involves significant judgment to determine the possible outcome of these disputes. Notes on accounts (a) and (b) are relevant in this regard.

**(a) Taxes on income**

Tax on income for the current period is determined on the basis of taxable income and tax credits computed in accordance with the provisions of the Income Tax Act, 1961 and based on the expected outcome of assessments/appeals.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the Company's financial statements and the corresponding tax bases used in computation of taxable profit and quantified using the tax rates and laws enacted or substantively enacted as at the Balance Sheet date.

Deferred tax liabilities are generally recognised for all taxable temporary differences including the temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets are generally recognised for all taxable temporary differences to the extent that is probable that taxable profits will be available against which those deductible temporary differences can be utilised. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets relating to unabsorbed depreciation/business losses/losses under the head "capital gains" are recognised and carried forward to the extent of available taxable temporary differences or where there is convincing other evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of reporting period, to recover or settle the carrying amount of its assets and liabilities.

Transaction or event which is recognised outside Profit or Loss, either in Other Comprehensive Income or in equity, is recorded along with the tax as applicable.

**(b) Provisions, Contingent Liabilities and Contingent Assets**

Provisions are recognised only when:

- (i) the Company has a present obligation (legal or constructive) as a result of a past event;
- (ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (iii) a reliable estimate can be made of the amount of the obligation.

Provision is measured using the cash flows estimated to settle the present obligation and when the effect of time value of money is material, the carrying amount of the provision is the present value of those cash flows. Reimbursement expected in respect of expenditure required to settle a provision is recognised only when it is virtually certain that the reimbursement will be received.

Contingent Liability is disclosed in case of:

- (i) a present obligation arising from past events, when it is not probable that an outflow of resources will be required to settle the obligation; and
- (ii) a present obligation arising from past events, when no reliable estimate is possible.

Contingent Assets are disclosed where an inflow of economic benefits is probable. Provisions, contingent liabilities and contingent assets are reviewed at each Balance Sheet date.

Where the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under such contract, the present obligation under the contract is recognised and measured as a provision.

## **QUESTIONS**

### **Part A- Multiple Choice Questions (2 Marks each)**

1. What amount shall be considered as the full value of consideration for the purpose of calculation of income under the head Capital Gain as per Income Tax Act, 1961?
  - (a) Rs. 48,00,000
  - (b) Rs. 50,00,000
  - (c) Rs. 38,00,000
  - (d) Rs. 50,40,000
2. Which of the following employee's' salary shall be considered for the purpose of calculation of additional deduction allowed in respect of emoluments paid to new employees under the Income Tax Act, 1961?
  - (a) All of the new employees shall be considered as the company has generated new employment in the era of retrenchment.
  - (b) Five employees who joined on 01-05-2018 and drew salary within the range i.e. exceeding Rs. 25,000 per month but below Rs. 35,000 per month.
  - (c) Only one employee who joined on 01-05-2018 whose monthly emolument is within the limit of Rs. 25,000 and onetime payment does not exceed Rs. 15,000 each through bearer cheques.
  - (d) Nine employees who joined on 01-05-2018 whose monthly emolument is within the limit of Rs. 25,000 and payment is made through account payee cheque.

3. The Companies Act, 2013 lays down the provisions requiring certain specified companies to mandatorily spend a prescribed percentage of their profits on certain specified areas of social upliftment in discharge of their social responsibilities. Broadly, CSR implies a concept, whereby companies decide voluntarily to contribute to a better society and a cleaner environment – a concept, whereby the companies integrate social and other useful concerns in their business operations for the betterment of its stakeholders and society in general in a voluntary way.

In the context of above para, state which of the following statement is correct.

- (a) Mars Construction Ltd. is not mandatorily required to empower communities because of the exemption given to construction companies.
- (b) Mars Construction Ltd. is mandatorily required to empower communities because it need to make good the loss of defects found in the construction of one of its flyovers.
- (c) Mars Construction Ltd. is not mandatorily required to constitute a Corporate Social Responsibility Committee of the Board as it is having net worth less than Rs. 1000 crore.
- (d) Mars Construction Ltd. is mandatorily required to constitute a Corporate Social Responsibility Committee of the Board as it is having net worth more than Rs. 500 crore.

4. How much additional deduction shall be allowed in respect of emoluments paid to new employees under the Income Tax Act, 1961?

- (a) Rs. 7,27,650
- (b) Rs. 9,70,200
- (c) Rs. 24,25,500
- (d) Rs. 26,95,000

5. How much gain/ loss would be chargeable to tax under the head 'Capital Gain' as per Income Tax Act, 1961?

- (a) Rs. 2,03,636
- (b) Rs. 1,63,636
- (c) Rs. 10,00,000
- (d) Rs. (36,364)

#### **Part B- Descriptive Questions**

6. From the information given in Para I, compute Profits and Gains from Business or Profession for the Assessment Year 2019-20 indicating reasons for treatment of each item and ignoring the provisions relating to minimum alternate tax (MAT).

The due date for filing of return of Income Tax for Assessment Year 2019-20 be taken as 30-09-2019. **(10 Marks)**

7. From the information given in Para II, where key audit matters have been addressed by the auditors, describe principal audit procedures that may have been followed by the auditor regarding material uncertain tax positions. **(5 Marks)**

## **CASE STUDY 2**

### **Background**

VayuSanchar Limited is a leading telecommunications company of India headquartered in Delhi. The Company ranks among the top four network service providers. It offers 2G, 3G and 4G wireless services under post-paid and pre-paid connectivity, fixed line telephone services and mobile commerce. It operates more than 2,260 telecom towers across 12 telecom circles.

The Company's dream is to boost the lives of customers. Its passion is to win customers for life through an exceptional experience. During the current year, the company also launched Unified Payments Interface (UPI) enabled digital payments allowing payments to any bank account of different merchants through smartphones, to beat the rivalries. This bitter relationship between VayuSanchar Limited and HawaSanch Limited, Lucy Limited & Magadh Limited (the rivalries) in network service providers, has spilled over to the high-speed broadband to corporates segment, as all the four companies battle for monopoly in market share.

VayuSanchar Limited launched its hyper speed VS Fibre broadband service, matching the price of other network service providers. This plan comes with unlimited landline calls along with premium online membership to the latest movies released through VS Fibre Application (the App).

### **Employees' Wellbeing**

In addition to boosting the lives of its customers, the company also believe in looking after the wellbeing of its employees. For this, it has established a Code of Conduct, Human Rights Policies demonstrating its commitment towards protection of Human Rights. In addition to this, the company has set up Internal Complaint Committee, to prevent sexual harassment at workplace, comprising a Presiding Officer who is a senior level woman employee, two employees who are committed to the cause of women having experience in social work along with legal knowledge, one independent member from outside the organization who expertise in dealing with such matters. All the members need to hold office for a period not exceeding three years from the date of nomination as member. The Committee is responsible for dealing with all matters related to the subject.

Besides having an Internal Complaint Committee, company went through an intermittent vacancy of the woman director on 19<sup>th</sup> June, 2018, the vacancy of which was filled on 18<sup>th</sup> September, 2018 by the Board, though, the immediate Board meeting held on 18<sup>th</sup> August, 2018.

## Accounting and Auditing Perception

The Balance Sheet of VayuSanchar Limited as at 31<sup>st</sup> March is given below:

ASSETS	2019 Amount (Rs.)	2018 Amount (Rs.)
<b>Non-Current Assets</b>		
Property, Plant and Equipment	8,44,00,000	7,17,40,000
Other Non-Current Assets	3,92,00,000	2,79,40,000
<b>Current Assets</b>		
Financial Assets:		
Investments	1,95,00,000	2,12,00,000
Cash and Cash Equivalents	74,00,000	1,44,60,000
Trade Receivables	1,35,00,000	1,26,60,000
<b>Total</b>	<b>16,40,00,000</b>	<b>14,80,00,000</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Equity Share Capital	4,30,00,000	4,30,00,000
Other Equity:		
Reserve and Surplus	3,56,00,000	2,25,00,000
<b>Liabilities</b>		
Non-Current Liabilities:		
Long Term Borrowings	2,25,00,000	3,90,00,000
Current Liabilities:		
Financial Liabilities		
Trade Payables	2,55,00,000	1,70,00,000
Payables for Expenses	2,24,00,000	1,49,00,000
Other Current Liabilities	1,50,00,000	1,16,00,000
<b>Total</b>	<b>16,40,00,000</b>	<b>14,80,00,000</b>

Other information: The company made a net profit after tax of Rs. 1,40,00,000 during the current year and paid interim dividend of Rs. 9,00,000. The value of Property, Plant and Equipment have been arrived after deducting Rs. 15,00,000 on account of depreciation. However, the company also sold one of its Property, Plant and Equipment for Rs. 9,00,000, the carrying amount of which was Rs. 8,00,000 at the end of the year 2019.

The company has the practice of releasing quarterly reports containing financial and operating highlights, key developments, results of operations, stock market highlights, ratio analysis, summarised financial statements, etc. These reports are submitted to the Delhi Stock Exchange, where it has listed security receipts, and are also hosted on the Company's website.

The 23<sup>rd</sup> Annual General Meeting of the company held on 8<sup>th</sup> August, 2019 at Sky Force Auditorium, Delhi where statutory auditor's report were adopted.

**The extracts of Independent Auditor's Report to the members of Vayu Sanchar Limited for the Financial Year 2018-19 along with Notes to the Individual Financial Statements and Annexures are given below:**

### **Report on the Individual Financial Statements**

We have audited the Individual Financial Statements of VayuSanchar Limited ("the Company"), which comprise the balance sheet as at March 31, 2019, and the Statement of Profit & Loss (including Other Comprehensive Income), Statement of Changes in Equity and the Statement of Cash Flows for the year then ended, and Notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

### **Responsibilities of Management for the Individual Financial Statements**

The Company's Board of Directors are responsible for the matters stated in Section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation of these Individual Financial Statements that give a true and fair view of the financial position, financial performance including other comprehensive income, cash flows and changes in equity of the Company in accordance with the Indian Accounting Standards (Ind AS) prescribed under section 133 of the Companies Act, 2013 read with the Companies (Indian Accounting Standards) Rules, 2015, as amended, and other accounting principles generally accepted in India.

This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding of the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error. In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

### **Auditor's Responsibilities for the Audit of the Individual Financial Statements**

Our responsibility is to express an opinion on these Individual Financial Statements based on our audit. In conducting our audit, we have taken into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the

provisions of the Act and the Rules made thereunder and the Order issued under section 143(11) of the Act.

We conducted our audit of the Individual Financial Statements in accordance with the Standards on Auditing specified under section 143(10) of the Act. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Individual Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and the disclosures in the Individual Financial Statements. The procedures selected depend on the auditor's judgment, including identifying and assessing the risks of material misstatement of the Individual Financial Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal financial control relevant to the audit in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of the accounting estimates and related disclosures made by management. It further describes the auditor's responsibilities to conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

We believe that the audit evidence obtained by us is sufficient and appropriate to provide a basis for our audit opinion on the Individual Financial Statements.

### **Opinion**

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid Individual Financial Statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the Ind AS and other accounting principles generally accepted in India, of the state of affairs of the Company as at March 31, 2019, its profit, total comprehensive income, changes in equity and its cash flows for the year ended on that date.

### **Emphasis of Matter**

We draw attention to **Note 18** to the Individual Financial Statements which describes the uncertainties related to the legal outcome of Department of Telecommunications demand with respect to one-time spectrum charges.

Our opinion is not modified in respect of this matter.

### **Report on Other Legal and Regulatory Requirements**

As required by the Companies (Auditor's Report) Order, 2016 ("the Order") issued by the Central Government in terms of Section 143(11) of the Act, we give in "**Annexure C**" a statement on the matters specified in paragraphs 3 and 4 of the Order, to the extent applicable.

**Notes to Individual Financial Statements stated as follows:**

**18.** On February 9, 2014, Department of Telecom issued a demand for Rs. 24,00,000 towards levy of one-time spectrum charge. The demand includes a prospective charge of Rs. 20,00,000 for GSM spectrum held beyond 3.5 MHz for the period from February 1, 2014, till the expiry of the initial terms of the respective licenses along with retrospective charge of Rs. 4,00,000 for GSM spectrum held beyond 5.1 MHz for the period from February 1, 2010 to December 31, 2013.

In view of the Company, said demand amounts to modification of financial terms of the licenses issued in the past. A petition being filed by the Company, the Hon'ble High Court of Delhi, vide its order dated February 28, 2014, has directed the Department of Telecom to respond and not to take any coercive action until the next date of hearing. The DoT has filed its reply and the matter is currently pending with the Hon'ble High Court of Delhi.

**25. Contingent Liabilities- Claims against the Company not acknowledged as debt**

**Customs Duty**

During the current Financial Year, the custom authorities issued a demand notice for custom duty with regard to import of certain software on the basis of the fact that the software was preloaded in the hardware at the time of import. In response to that, the company filed an application to the Hon'ble Central Excise and Service Tax Appellate Tribunal ('CESTAT') opposing the demand of custom authorities, contending that such imports shall not be subject to custom duty as it is an operating software which is exempted from any custom duty. However, the CESTAT has passed an order in favour of the custom authorities. Consequently, the Company has filed an appeal with the Hon'ble Supreme Court against the CESTAT order, which is still unheard.

**Annexure C to the Independent Auditor's Report**

(ii) As elucidated to us, the inventories, except for those lying with the third parties, were physically verified during the year by the Management at reasonable intervals and no material discrepancies were noticed.

(iii) As elucidated to us, the Company has not granted any loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013.

(xi) In our opinion and as elucidated to us, the Company has paid managerial remuneration in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act, 2013, except that the commission of Rs. 34,570 to non-executive directors is in excess by Rs. 18,200, basis the lower limits approved by the Shareholders of the Company.

**QUESTIONS**

**Part A- Multiple Choice Questions (2 Marks each)**

1. While reporting on Companies (Auditor's Report) Order, 2016 (the Order) under the head Other Legal and Regulatory Requirements, the auditor included a statement on payment of

managerial remuneration in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act, 2013. State whether the reporting is in accordance with the reporting requirement under the Order.

- (a) Yes, the auditor has reported as per the reporting requirement which requires stating the amount involved in case of qualified answer.
- (b) No, the auditor has not reported as per the reporting requirement which requires stating the steps taken by the company for securing refund of the same.
- (c) No, the auditor has not reported as per the reporting requirement which requires stating the period of default upto the date of seeking Shareholders' approval for which excess commission was paid.
- (d) No, the auditor has not reported as per the reporting requirement which requires stating the compliance of section 198 of the Companies Act, 2013.

2. Every listed company shall appoint at least one woman director on the Board in compliance of the provisions of the Companies Act, 2013 read with the Companies (Appointment and Qualification of Directors) Rules, 2014. In the given case, the company went through an intermittent vacancy of the woman director, which was filled later on. State whether the appointment of another women director by the Board to fill the intermittent vacancy is valid.

- (a) The intermittent vacancy of a woman director can only be filled by the shareholders not later than coming annual general meeting. Thus, the appointment is invalid.
- (b) The intermittent vacancy of the woman director shall be filled by the Board. There is no such compliance for time limit. Thus, the appointment is valid.
- (c) The intermittent vacancy of a woman director can only be filled by the Board not later than immediate next Board Meeting or two months from the date of such vacancy whichever is later. Thus, the appointment is invalid.
- (d) The intermittent vacancy of a woman director can only be filled by the Board not later than immediate next Board Meeting or three months from the date of such vacancy whichever is later. Thus, the appointment is valid.

3. The Securities and Exchange Board of India (SEBI) has issued the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations"). The objective of the LODR Regulations are streamlining and consolidating the provisions of various listing agreements in operation for different segments of the capital markets. State which of the following companies is not covered under LODR Regulation for the purpose of its compliances.

- (a) VayuSanchar Limited which has established a Code of Conduct, Human Rights Policies towards protection of Human Rights. In addition to this, the company has also set up Internal Complaint Committee to prevent sexual harassment at workplace.
- (b) HawaSanch Limited, a public company, which has a paid up capital of Rs. 100 crore.

- (c) Lucy Limited which has a paid up capital of Rs. 10 crore and listed non-convertible debt securities.
- (d) Magadh Limited which has listed securitised debt instruments on a recognised stock exchange.

4. Regarding demand notice for custom duty from the custom authorities, state, whether the company needed to provide for the provision/ liability/ contingent liability in the books of VayuSanchar Limited.

- (a) A provision is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. Thus, provision shall be made in the financial statements, instead of showing it to the notes to financial statements.
- (b) It is a liability of uncertain timing and amount, thus, the demand shall be recognised as a liability.
- (c) It is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. Thus, the presentation as contingent liability under notes to financial statements is correct.
- (d) It is a present obligation that arises from past events but is not recognised because (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or (ii) the amount of the obligation cannot be measured with sufficient reliability. Thus, the presentation as contingent liability under notes to financial statements is correct.

5. Referring the Independent Auditor's Report to the members of VayuSanchar Limited, the auditor has included a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements.". Elucidate, what shall not be stated under this section of the Auditor's Report.

- (a) Auditor's responsibilities for identifying and assessing the risks of material misstatement of the financial statements.
- (b) Auditor's responsibilities for obtaining an understanding of internal control relevant to the audit in order to design audit procedures.
- (c) Auditor's responsibilities for assessing the entity's ability to continue as a going concern.
- (d) Auditor's responsibilities for evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates.

#### **Part B- Descriptive Questions**

6. Referring the presentation made by the auditor regarding Emphasis of Matter paragraph in the Auditor's Report, state the conditions for including such paragraph. Also give certain examples of cases where the auditor may consider necessary to include an Emphasis of Matter

paragraph. Consequently, state, whether the reporting made by the auditor in the Auditor's Report is in accordance with the relevant Standards on Auditing. **(7 Marks)**

7. Considering the Balance Sheet of VayuSanchar Limited and 'Other information' as provided along with the facts mentioned below, construct a statement of cash flows under indirect method.

- (i) Income tax paid during the current year is Rs. 30,00,000.
- (ii) Other Non-Current Assets and Current Liabilities do not contain any element of Financing and Investing Activities. **(8 Marks)**

### **CASE STUDY 3**

Akhil, Nikhil and Sahil are partners of **Soil Elements LLP**. They have started a new business in 2018 based on their experience of more than 10 years in chemicals industry.

Soil Elements LLP is based on the concept that soil quality in terms of fertility and its nutritional values to the plant differ every few yards even in the same plot of land. So, the partners at Soil Elements will do essential testing of soil, plant stem, leaf and the fruit on non-evasive and non-destructive basis. The test results and analysis will help the farmers in optimal use of plant nutrients in order to not only maximise the yield but also to preserve the soil fertility from excess use of fertilisers which deplete the soil fertility.

Precision farming is a new concept in the field of agriculture which aims at providing the essential nutrients to plants based on the need both in terms of nature and quantity of such nutrient. Agriculturally advanced countries like Israel, parts of USA and Netherlands have achieved much more through precision farming than just a traditional farming.

India has been an agrarian economy since eons. In the recent years the agricultural land has been shrinking due to construction and many other reasons but the population is increasing faster than the shrinkage of fertile land. In such a situation, India has no option but to indulge in precision farming sooner than later.

You're a CA friend of Sahil who has approached you with his other partners to help them out with the finances and initial handholding in accounts.

Based on your multiple meetings with the partners and potential vendor partners of the LLP, you've gathered the following additional information about the business.

Farmers will be on-boarded through Mobile Application which will be able to capture location-mapped images of the farmland, display information about their sample results and also get important news on weather in their area.

Samples will be collected by the sales representatives from the farms based on specific guidelines by the LLP.

Samples are tested, analysed and reported based on special purpose machines (SPMs) which are imported from Netherlands. Each SPM will cost 96000 Euros. The cost of shipping and installation would be around 10% of the cost of the machine. SPM, in order to be usable in the business should

be calibrated for each category of plants like Mango. The cost of calibration varies based on the duration of the plant, season of the year and its target market like exports or domestic as follows:

Crop/Plant	Duration	Season of the year	Target Market	Cost (Rs.)
Mango	Perennial	Summer	Domestic	5 Lacs
Mango	Perennial	Summer	Exports	8 Lacs
Tomato	6 to 9 months	All season	Domestic	3 Lacs
Tomato	6 to 9 months	All season	Exports	7 Lacs
Pomegranate	Perennial	Winter & Summer	Domestic	6 Lacs
Pomegranate	Perennial	Winter & Summer	Exports	9 Lacs
Grapes	Perennial	Feb to April	Domestic	4 Lacs
Grapes	Perennial	Feb to April	Exports	6 Lacs

Calibration exercise of each domestic SPM takes about 6 months' time. The partners have decided to focus only on perennial crops in domestic markets except for Mango as Export market is far more attractive for Mango. Accordingly, 3 SPMs were ordered. 1 Euro was equal to Rs. 79.12 on the date of order when 50% payment was done. The remaining 50% payment was done after receiving the machines in India when the exchange rate was Rs. 80.24.

You were invited by the partners for the meeting with potential vendors for Mobile App development. Going through multiple meetings, finally a vendor by name **Indosys** is selected on the following terms:

3 resources will be allocated by Indosys to Soil Elements who will be directly reporting to Nikhil. Anurag from Indosys will be the project manager and single point of contact (SPOC) for the App Development.

Average resource cost of Indosys is Rs. 75,000 per month per head. The Application is expected to be ready in 4 months as per the Statement of Work (SOW) signed by the parties. The profit margin of Indosys is 40% for all domestic projects. Once the application is ready, the ongoing support will be provided by Indosys through an Annual Maintenance Contract (AMC) which is usually 5% of the development cost.

Miscellaneous fixed assets (MFA) like Office furniture, computers, laptops etc. is expected to cost Rs. 5 lacs.

Budget for each sales representative salary is Rs.25,000 p.m. per head and 6 people will be hired initially from 1<sup>st</sup> October, 2018 and this headcount is expected to remain the same for first 6 months. This headcount is expected to increase by 6 every 6 months in the first 3 years and then stabilize at that level for year 4 and year 5. Salary increment every year can be assumed at 10%.

Office rent and other overheads are expected to be Rs. 80,000 p.m. One-time cash outflow for Office Rent Deposit is Rs. 3 Lacs. The partners have agreed to remain unpaid for initial 3 years. From year 4 and 5, each partner will draw a remuneration of Rs. 2 lacs p.m. as salary.

Akhil is in-charge of the marketing campaign. Marketing budget given by him is as follows: (Rs.)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Van Campaign	5 Lacs	10 Lacs	10 Lacs	12 Lacs	15 Lacs
Wall Painting	3 Lacs	5 Lacs	6 Lacs	8 Lacs	10 Lacs
Farmers Meeting	3 Lacs	4 Lacs	5 Lacs	6 Lacs	8 Lacs
Marketing collaterals	1 Lac	1.5 Lacs	2 Lacs	3 Lacs	3 Lacs

Van Campaigning, Wall Painting and Farmers meetings these are some of the age-old marketing practices for agricultural business. Even though farmers in recent times have started using smart phones and internet, these practices are still yielding results, especially for new brands coming into the market. Moreover, these practices also ensure continuity of employment opportunities for people engaged in painting etc. who normally live nearby major village clusters.

The revenue model of the firm has been kept simple for now. Farmers need to subscribe the test-packages through mobile application. Anyone can download the App but only paid members will be able to access advanced features like taking geo-location based pictures of the land, requesting for test reports etc.

The subscription plans of the firm are as follows (per sample basis):

2-test package	Rs. 2000
8-test package	Rs. 5000
16-test package	Rs. 10000

Barely, 3 months into the operations, the firm has already started getting attracted towards angel investors in Mumbai, Bangalore and Chennai. As a finance consultant you have advised your friend Sahil to wait for some more time before actually responding to any investors or trying to approach one on his own.

This is so because with time the valuations get better and better. Also, if there are any issues in the minimum viable product (MVP) during the trial run, the same can be fixed and a new version can be launched in the market.

During the first year of operations, the LLP incurred the following cost:

Direct Cost – Rs. 19,00,000

Indirect Cost – Rs. 75,32,500 (which includes depreciation and amortization of intangible asset)

## QUESTIONS

### Part A- Multiple Choice Questions (2 Marks each)

1. The Mobile Application that is being developed by Soil Elements LLP can be classified as \_\_\_\_\_ subject to criteria in the specified IND AS. Successful trial of on-boarding a few pilot customers has been done by the firm.

- (a) R & D cost.
- (b) Intangible Asset.
- (c) Revenue Expenditure.
- (d) Deferred Revenue Expenditure.

2. The special purpose machines imported from the Netherlands, can't put to use directly without calibrating the same for crop-specific pre-set information and conditioning. Cost of calibration should be treated as \_\_\_\_\_.

- (a) Revenue expenditure.
- (b) Calibration expenses.
- (c) Capitalized as part of SPM cost in PPE.
- (d) Deferred Revenue Expenditure.

3. There has been a fluctuation in the foreign exchange rate of Euro. What will be the treatment of foreign exchange difference between the time of order and the time of balance payment for SPMs?

- (a) Will be treated as exchange loss and debited to P&L Account.
- (b) Will be ignored.
- (c) Will be treated as part of preliminary expenses to be written off over next 5 years.
- (d) Will be added to the cost of SPM to be capitalized.

4. In year 3, the firm is approached by an investor for 10% stake and with an exit plan of 5 years from there. If the investment is to be taken from the investor what is the first compliance required?

- (a) Private Placement Offer.
- (b) Increase in contribution.
- (c) Conversion of LLP into company.
- (d) Filing of PAS-3 and PAS-4 with the Registrar of Companies (RoC).

5. What is the total cost of calibration of SPMs purchased?

- (a) Rs. 15 Lacs
- (b) Rs. 16 Lacs
- (c) Rs. 17 Lacs
- (d) Rs. 18 Lacs

## Part B- Descriptive Questions

6. What is the cost of SPM used for Mango, if all the SPMs were funded by bank (invoice value only) at a cost of 10% p.a.? Assuming that it took 13 months for the machines to get ready for the intended use? **(5 Marks)**
7. Special Purpose Machines (SPM) have been the major capex for the firm. What are the disclosure requirements as per relevant IND ASs in respect of SPMs? **(5 Marks)**
8. If the firm wants to achieve break even in the first year of operation, what would be break-even no. of farmers subscribing to the App? Assume that each farmer will buy 10 numbers of only the 2-test package in the first year? **(5 Marks)**

## CASE STUDY 4

### Live Green, Love Green, Be Green.....

With this thought in mind, Rahul Jain, an Environmental Engineer innovated the idea of setting up a Venture for providing “**Gardening Services**” as a Start-up in his home city of Ludhiana. Since childhood, he had heard many a times that Ludhiana is the Manchester of India, an industrial hub and wondered how much his city needs to be Green for its Beautification and a Pollution- Free Environment. He discussed the idea of this start-up with his school friend Riya, a Commerce Graduate and Rohan Pai, a college friend living in Bengaluru - a Software Engineer & Application Developer. The three of them discussed several times over this idea and finally decided to go ahead with the venture. They Knew that before proceeding forward with anything, they had to be clear with the research and set clear objectives.

“**New India Green India**” being the need of the hour, this start-up business idea of theirs would cater to the following products & services:

1. The Business of their start-up would be to provide Pots, Flowers, Seeds, Saplings and other Plants of utility or having aesthetic value at the door-step of the Customer.
2. The Business would also include providing Gardening services to the Customers by employing Gardeners either directly or on Contract Basis.
3. They would advertise and take orders via Website, Mobile App, Phone Calls and they would need to develop an appropriate Payment & Feedback Policy.

They divided all the Preliminary Work among themselves. They were apprehensive that they need to opt for a suitable Business Structure for their Start-up keeping in mind various compliances, so Rohan took the task of researching on this and for the development of the necessary e-infrastructure, i.e., the Website and Mobile Application as well. Riya, being a Commerce graduate took the charge of looking into the Taxation Compliance of the Business and Rahul himself took upon the task of looking into the design and costing process for the proposed Start-up.

## LEGAL STRUCTURE & DESIGN

Rohan, being an Application Developer himself would easily design the Mobile App, Website and other necessary e-infrastructure. However, for giving their start-up a suitable legal form, he consulted Mr. Lamba, a Practising Chartered Accountant. On being approached, Mr. Lamba suggested him that if they are a Start-up, then they must opt for a Private Limited Company because of more benefits available but lesser and easy to follow compliances. He briefed Rohan on the following points:-

1. They would need to think of an innovative and catchy name whose availability will be checked with the Ministry of Corporate Affairs, Govt. Of India.
2. The Country is Passing through a "**Start-Up India Movement**" and a host of benefits will be available to their Start-Up.
3. He will Carry out the whole Incorporation Process for them.
4. Rahul, Riya & Rohan would be the subscribers to the MOA of the Co. and therefore would be its First directors. They would need to apply for Director Identification Number(DIN) and all the Provisions w.r.t. a Private Co. for Board Meetings, General Meetings, Maintenance of Books of Accounts, Statutory Registers, Filing of Periodic & Annual Forms would apply mutatis mutandis to their start-up as well.
5. Under the Incentive of Doing Business initiatives of the Government of India, the Government in order to ease the incorporation process, has set up a mobile application as well as a dedicated web portal whereby:
  - (a) A simplified form can be filled for registration of start-up with various government agencies. Importantly, this mobile application has been integrated with the Ministry of Corporate Affairs for seamless integration.
  - (b) Filing for compliances and obtaining information on the status of various clearances and approvals has also been made possible on the app.

## TAXATION

Riya, herself had read about start-ups and their taxation during her study and training time. She researched more on this aspect and found about the taxation policies and incentives relating to their Start-Up. On this aspect, she found the following important considerations necessary:-

1. Their start-up would be liable to taxation under the head PGBP like any other Normal Business.
2. However, with the present govt. supporting and motivating the growth of start-ups, they will be eligible for Tax- Incentives u/s 80-IAC in order to aid their growth in the early phase of their business.
3. A deduction of 100% of the Profits & Gains derived by them from this Proposed Business, being an eligible business for section 80-IAC, is allowed for any 3 consecutive Assessment Years out of 7 years beginning from the year in which their eligible Start-up company is incorporated.

4. She got to Know about the meaning of Eligible Business and Eligible Start-up under 80-IAC of the Income Tax Act, 1961.

<b><u>Company or LLP engaged in Eligible Business is an Eligible Start-Up for claiming Deduction if :-</u></b>
1. Incorporated during the Period from 01.04.2016 - 31.03.2021
2. Total Turnover $\leq$ Rs. 25 crores in the P.Y. relevant to the A.Y. in which deduction is claimed.
3. Holds a certificate of eligible business from the notified IMBC.

5. A CBDT notification also exempted Start-ups from taxation in respect of Share Premium received from Resident investors. This means that their Start-up may receive funding from Resident investors without having to pay income-tax on the amount of Share Premium received on the shares issued to investors.

6. Also, Capital Gains arising from the sale of Residential Property by an Individual & HUF have been made exempt u/s **54GB** of the Income Tax Act, 1961 when such gains are invested to subscribe equity shares of an eligible Start-up subject to certain terms and conditions.

### **COSTING & REVENUE ASPECTS**

Rahul, an Environmental Engineer was thought to be fit to take upon this aspect. He would need to carry out detailed Operational Analysis, Investment involved, Costing Technique and Methods to be adopted and how to induce the investors to fund their business for they being low on Budget. The most important task was the Strategic Analysis of the Operating Income, they could expect to generate from their Start-up in early years and in Future. He evaluated various Costing techniques to evaluate Profitability and found the ABC method to be the best suitable for their start-up. For analyzing Operating income, he spread his analysis into 3 main areas of **Growth Component, Price Recovery Component & Productivity Component** and to cover both revenue and cost-effect on these Components separately.

Rahul found that a well-Designed ABC system is a powerful aid to management evaluation & decision making to improve organizational performance. ABC, with its emphasis on activities and their cost-drivers, helps cost to be identified more easily & effectively. However, in their case, **Customer Profitability Analysis** was more important because to cost customers was more important than to cost their products/ services. Being a relatively new technique, ABC creates Cost pools for activities based upon the customers' different activity profiles. All customers may not cost the same owing to distance variations w.r.t. delivery to various customers, rush orders, after-sales services, contract-based services, etc. Their cost included Flower Pots, Plants and Saplings cost, Designing, Order Processing costs, Delivery Costs, Gardeners' Salary/ Daily Wages for Gardening Services provided to Customers on a Periodic or Contract basis, etc.

After gaining full knowledge of the tasks assigned amongst themselves, they all met again with their respective research findings and decided to go ahead with their eligible start-up under the name &

style of '**Haryali Private Limited**', which is a technology driven start-up, with the tagline 'Greener than Ever' to make the city of Ludhiana beautifully green than ever. The registered Office of the Company was set up in Ludhiana itself and starting operations to be carried at Ludhiana level only. It was also decided to expand the business Pan- India once it is successful in Ludhiana.

## QUESTIONS

### Part A- Multiple Choice Questions (2 Marks each)

1. Rohan, one of the Directors of Haryali Pvt Ltd., residing in Bengaluru, usually attends the Board Meetings through Video-Conferencing. However, he is not allowed to attend the Meeting of Board of Directors through Video-Conferencing or other audio visual means but IN PERSON only for-
  - (i) Approval of Annual Financial Statements.
  - (ii) Approval of Board's Report.
  - (iii) Approval of Managerial Remuneration.
  - (iv) Approval of Prospectus.
  - (v) Approval of Buy-Back of Shares.
  - (vi) Approval of Appointment of New Directors.
  - (a) (i), (ii) & (vi)
  - (b) (ii), (iv) & (v)
  - (c) (i), (ii) & (iv)
  - (d) (iii), (iv) & (v)
2. Rahul, Riya & Rohan need to decide on the Maximum Managerial Remuneration they can get as Directors. So, on a reading of section – 197 of the Companies Act, 2013 read will Schedule V, the maximum percentage of Net Profits of the Company they can get in the form of Managerial Remuneration is -
  - (a) 11%
  - (b) 10%
  - (c) 5%
  - (d) Sec.-197 not applicable to their Company
3. The Management of Haryali Pvt Ltd. would need to file Form \_\_\_\_\_ for submitting Financial Statements and Form \_\_\_\_\_ for filing their Annual Return respectively with ROC every year.
  - (a) AOC – 4, MGT – 7
  - (b) MGT – 9, AOC – 4

- (c) AOC – 4, DIR – 8
- (d) AOC – 4, MGT – 9

4. As per a CBDT notification, a start-up is exempt from taxation w.r.t. Share Premium received From Resident investors. Here, Share Premium refers to-

- (a) Aggregate consideration received for issue of shares as exceeds the fair market value of such shares.
- (b) Aggregate consideration received for issue of shares as exceeds the paid-up value of shares.
- (c) Aggregate consideration received for issue of shares as exceeds the Face Value of such shares.
- (d) Fair market value of Shares as exceeds the Face Value of shares issued.

5. Mr- X sold a Residential Property and wants to invest his Capital Gains in the Shares of Haryali Pvt. Ltd. for claiming exemptions u/s 54GB . He is subject to the condition that he holds more than 50% Shares of Haryali Pvt Ltd., a technology driven start-up, and such amount is further utilised by the Company to purchase-

- (a) Land or Building.
- (b) Flower Pots & other items.
- (c) Computer or Computer Software.
- (d) Floral park.

### **Part B- Descriptive Questions**

6. Haryali Private Ltd.'s total turnover & Profits and gains from its eligible Start-up Business turn out to be as follows for the P.Y. 2018-19 to P.Y. 2024-25:

<b>PARTICULARS</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>	<b>2021-22</b>	<b>2022-23</b>	<b>2023-24</b>	<b>2024-25</b>
Profit/Loss (in Rs. Lakhs)	(2.52)	(1.37)	6.52	8.13	9.87	7.59	9.42
Turnover (in Rs. Lakhs)	15.42	18.36	20.21	22.72	24.95	23.52	24.68

- (a) Explain what is an 'Eligible Business' as per section 80 – IAC of the Income Tax Act, 1961. **(2 Marks)**
- (b) By what time does Haryali Pvt Ltd. need to file its Return of Income for the A.Y.2019-20 to claim deduction u/s 80 – IAC ? **(1 Mark)**
- (c) Explain in respect of which year the company can avail benefit under section 80 – IAC and how much? **(3 Marks)**

7. List the provisions of the Companies Act, 2013 w.r.t. holding of Board Meetings by Haryali Pvt. Ltd. **(3 Marks)**

8. 'X' and 'Y' are two Prime Customers of Haryali Pvt. Ltd. who purchase a special category of Plant Saplings from the Company to distribute in various societies of the city under 'Green India Initiative' through their respective NGO's. The Selling Price per Sapling is Rs. 540 and its cost to Haryali Ltd. is Rs. 442.

The Additional costs are:

Order Processing Cost : Rs. 20 per Order

Delivery Cost : Rs. 35 per Delivery

Details of X & Y's Purchase for the Period is as Follows:

Particulars	X	Y
Pots Purchased (in No.)	35	50
No. Of Orders	5 (each of 7 units)	10 (each of 5 units)
No. Of Deliveries	5	0

Haryali Pvt. Ltd. has devised a Policy to give a Discount of 5% on the S.P. on order for 5 Units or more and to further give 8% discount on the Undiscounted Selling Price if a Customer places order through their Mobile App & uses his own transport to collect the order.

Required :-

(a) Analyse the Profitability by Comparing Profit per unit for each Customer. **(4 Marks)**

(b) Comment on the Discount Policy on Delivery. **(2 Marks)**

## CASE STUDY 5

### **'INDIA - THE BUDDING INVESTMENT HUB'**

Gone are the days when India used to be known as an underdeveloped nation and then, a slowly developing nation which could only cater to the demands of its own Population barely. Time changes and so does the global image. With the hard work of its huge Population and tremendous growth opportunites, India is slowly becoming a favorite destination for investments from outside of its boundaries. It has become one of the most progressive countries in the world which possesses immense human potential, both as the Producer and as the Consumer. With such a buzzing name in

the Foreign Investment world, there has been huge amounts of FDI into the country and trends reveal that every year the FDI inflow in India is increasing due to a host of foreign businesses starting their operations in the country.

One such foreign business is of '**Ahuja Designs Incorporated**' based in U.K and headed by an India-born UK citizen Mr. Ramesh Ahuja. Mr. Ahuja had migrated to the U.K. in the 80's with his family and set up a business over there which flourished over so many years and is now a big Brand name in the UK market in the business of Furniture Designing and its Uniquely Designed High Quality Products. Now Mr. Ahuja is eyeing on investing in Indian market and he has asked the General Manager of his company Mr. Tandon to work out the feasibility of investing in India in Business and all related Procedural Compliances.

Mr. Tandon has approached CA Vishal in India for Consultancy purposes and assigning all the work relating to setting up of their business in India. CA Vishal is a Partner in the Partnership firm M/s G & Co. since the past 6 years. On being approached, he assured Mr. Tandon that their firm would give them the best services possible in setting up of their business in India. CA Vishal after due discussions with his Partners in the firm has prepared a detailed report to be sent to Mr. Tandon for consideration and quoting fee to be charged by their firm from time to time for the services to be rendered in the due course time as follows:-

**M/s G & Co.**

**ABC Road, New Delhi**

**REPORT ON PROCEDURAL & TAXATION COMPLIANCES W.R.T SETTING UP OF BUSINESS  
IN INDIA**

It is indeed a Pleasure for our Firm to assist your reputed company in setting up your business in India, a buzzing destination for overseas investments. We, hereby provide you with all the details as requested by you:-

**LEGAL FORM & PROCEDURE**

Foreign businesses can adopt 2 strategies for entry into Indian market – One is by registration of a company or other is by establishing a branch/liaison office in India. The former is the easiest way and the fastest also because it falls under the Automatic route for FDI in India and in such case, no special permission is required from the Central Govt. in India. The latter case however requires RBI and/or Government approval and therefore, we suggest you to opt for the Private Company route because the cost and the time which is required for the registration of a Branch/Project/Liaison office

in India is higher than the time & cost attached to the incorporation of a Private Limited Company as a Foreign Company in India.

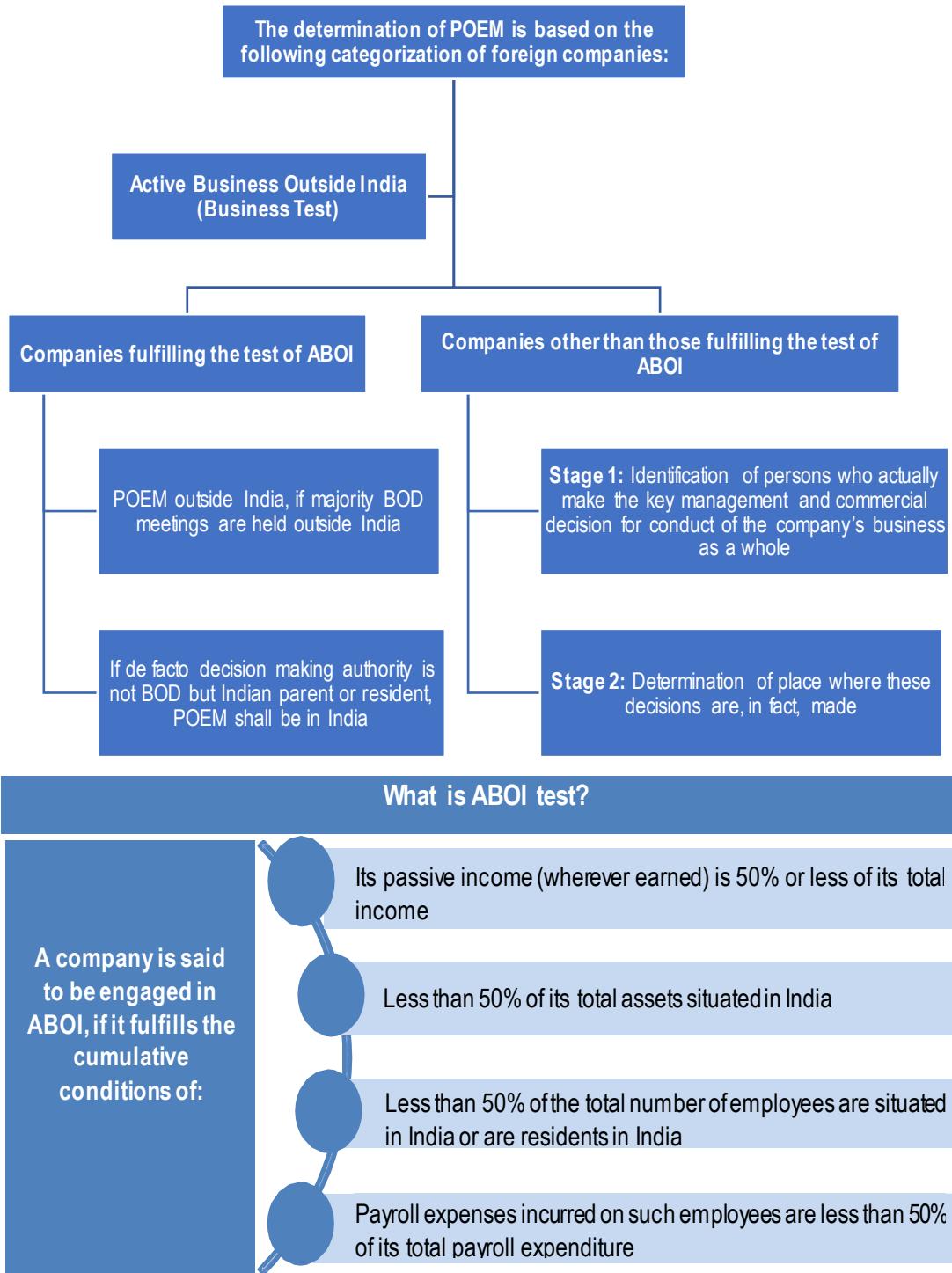
The Indian law defines a 'Foreign Company' as any company or body corporate incorporated outside India and which has a place of business in India whether by itself or through an agent, physically or through electronic mode and it conducts any business activity in India in any other manner. Further, every Foreign company has to deliver to its Jurisdictional Registrar of Companies, all the required documents (to be prepared by us) within 30 days of establishing its place of business in India in the requisite form.

In order to start a company in India, a minimum of two individuals and an address is required in India. If we are talking about a Private Limited Company, it should have at least two directors (individuals) and a minimum of two shareholders (can be individuals or even corporate entities). Furthermore, one of the Director of the Company must be an Indian Citizen and also an Indian Resident. As per the rules, the preferred legal entity structure for the Foreign companies is to preferably establish a company which consists of three Directors, out of which two directors can be foreign nationals belonging to the Parent company and one of the directors have to be an Indian citizen. There are no such rule of minimum shareholding of the Indian Director. It is mandatory to have an address in India which can be served as the registered office address of the company. Most of the foreign companies setup their registered offices in the metro cities in India like Mumbai, Delhi, Bangalore, Chennai, Hyderabad etc.

All other issues w.r.t. issue of Prospectus and further Procedural Compliances like Accounts, Audit, etc. can be dealt at a later stage once we finalise with the Registration Process. However, it is necessary to bring to your kind notice that there are Fines/Punishments under the Indian Companies Law for the contravention of its provisions by a Foreign Company too as laid down under Section-392. But, you may note that the Foreign Company's failure to comply with such provisions of the Chapter-XXII of the Companies Act,2013 would not affect the validity of its contracts, etc.

### **TAXATION COMPLIANCES**

Taxation of Cross-border transactions in India is generally based on Residence and Source of Income. The overview of these rules is contained in Sections-5,6,8,9 of the Income tax Act,1961. While Residents are taxable on Global income, Non-residents are taxed on their Indian sourced income or income received or accrued or deemed to accrue or arise in India. The residential status of any Non-Indian Company in India is determined w.r.t. its **POEM - Place of Effective Management** of the Company. If POEM of the Company in any year is in India, then it is a Resident in India for that particular year. Further, the process of determination of POEM would be primarily based on the fact as to whether or not the company is engaged in Active Business Outside India (ABOI) as follows:-



Hence, where a Foreign Company's income –taxation is based upon its POEM, its Employees or Director's who might come on frequent basis in India to transact business are governed by the provisions w.r.t. Residential Status of Individuals as contained in the Indian Income-tax law. Further, Taxation Provisions as regards to the Business of the Company can be discussed later on, once of the Company Starts Operating its business in India.

We, at M/s G & Co. will be very delighted to render our services to your prestigious company and help you grow to achievable heights in India. We hope that in the beginning –this much of information is beneficial for your decision making purposes. Please let us know if any further information is required at your end or any clarity you feel to seek, we shall be happy to help.

Please refer to the attachment with this e-mail for the fee quotes w.r.t. the services to be rendered by our firm to your good self in due course of time.

Thanks

CA Vishal

Partner

M.No.- XXXXX

M/s G & Co.

Chartered Accountants

## **QUESTIONS**

### **Part A- Multiple Choice Questions (2 Marks each)**

1. If Ahuja Designs Incorp. conducts any business activity in India through Electronic mode, it means carrying out electronically based, whether main server is installed in India or not, including, but not limited to-

- (i) B2B & B2C transactions, data interchange and other digital supply transactions.
- (ii) Offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India.
- (iii) Online services such as telemarketing, telecommuting, telemedicine, education and information research.
- (iv) All related data communication services.

- (a) (i) & (ii)
- (b) (ii) & (iii)
- (c) (i), (ii), (iii) & (iv)
- (d) (ii), (iii) & (iv)

2. 'Ahuja Designs Ltd.' would require to file all the information & documents with the jurisdictional ROC within 30days of the establishment of its place of business in India in FORM:

- (a) FC-2
- (b) FC-1
- (c) FDI-1
- (d) FDI-2

3. Foreign Nationals or entities can hold \_\_\_\_\_ of the shares in Ahuja Designs Ltd. if incorporated as a Foreign Co. In India.

- (a) 100%
- (b) 75%
- (c) 57%
- (d) 25%

4. "Passive Income" as referred to in the ABOI test for a Foreign Company's taxation refers to:

- (a) Income from the transactions where both the purchase and sale of goods is from/to its associated enterprises.
- (b) Income by way of royalty, dividend, Capital Gains, interest or rental income whether or not involving associated enterprises.
- (c) Aggregate of (a) & (b).
- (d) Net income obtained by deducting (b) from (a).

5. 'Head office' of Ahuja Designs Ltd. would be the place where the company's Senior management and their direct support staff are predominantly located and not where the majority of its employees work or where its board typically meets. Which of the following officers of the company doesn't fall under the definition of 'Senior Management'?

- (a) Managing Director or CEO.
- (b) Financial Director or CFO.
- (c) Chief Operating Officer (COO).
- (d) Debenture Trustee/ Nominated Director.

#### **Part B- Descriptive Questions**

6. Ahuja Designs Ltd., sets up its Indian Principal Place of business in New Delhi. It is required to deliver various documents to ROC under the provisions of the Companies Act,2013:

(a) You are required to state, where the said company should deliver such documents.

**(1 Mark)**

(b) In case, it fails to do so, state the Penalty prescribed under the said Act, which can be levied.

**(3 Marks)**

7. To handle the growing Indian Business more effectively, Mr. Ramesh Ahuja decides to permanently shift to India with his family and decides to manage the UK business from India itself. He returned to India on 12th June, 2018 for permanently residing in India after a stay of about 20 years in UK and provides the following sources of his various income & seeks your opinion to know about his liability to income tax thereon in India in Assessment Year 2019-20:

(a) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2018.

(b) Dividends on the shares of three UK Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

(c) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying in London and not coming to India with him. Each of his sons is having income of Rs. 75,000 in U.K. in foreign currency (not received in India) and of Rs. 20,000 in India.

(d) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at Rs. 37,500 while in terms of Indian Rupee it was Rs. 50,000.

**(8 Marks)**

8. Examine with reasons whether the following statements are correct/incorrect:-

(a) Amount paid by the Govt. of India for use of a Patent developed by 'Ahuja Designs Incorp.'(UK) is taxable in India U/s 9 of the Income Tax Act, 1961.

**(2 Marks)**

(b) As per CBDT Circular no. 8/2017, dated 23-02-2017, POEM guidelines shall not apply to Ahuja Designs Ltd. if its Turnover or Gross receipts are Rs. 100 Crores or less in a Financial Year.

**(1 Mark)**

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE: GROUP – II**  
**PAPER – 6F: MULTIDISCIPLINARY CASE STUDY**  
**SUGGESTED ANSWERS / HINTS**

**CASE STUDY 1:**

**Part A**

1. (a) Rs. 48,00,000

**Reason:** As per section 50C of the Income Tax Act, 1961, the consideration received i.e. Rs. 48 Lakhs or stamp duty value (SDV) i.e., Rs. 50 Lakh, whichever is higher, shall be considered as full value of consideration. However, where SDV does not exceed 105% of the consideration, the consideration received shall be deemed as full value of consideration.

2. (d) Nine employees who joined on 01-05-2018 whose monthly emolument is within the limit of Rs. 25,000 and payment is made through account payee cheque.

**Reason:** As per section 80JJAA of the Income Tax Act, 2019, only nine employee's salary shall be considered for the purpose of calculation of additional deduction allowed in respect of emoluments paid to new employees as follows-

Total new employees = 20

- (a) Amount paid to 5 employees, joined in November 2018, are not eligible for computation of deduction since they are employed for less than 240 days in the relevant Previous Year.
- (b) Amount paid to other 5 employees, joined in May, 2018, are not eligible for computation of deduction since their total emolument exceeds Rs. 25,000 per month.
- (c) Amount paid to another 1 employee, who is paid by bearer cheque, his salary is not eligible for deduction under section 80JJAA. Since the condition to claim deduction is that payment of salary should be made by account payee cheque or through banking channel.
- (d) Amount paid to remaining 9 employees are eligible for claiming deduction.

3. (d) Mars Construction Ltd. is mandatorily required to constitute a Corporate Social Responsibility Committee of the Board as it is having net worth more than Rs. 500 crore.

**Reason:** As per section 135 of the Companies Act, 2013 on Corporate Social Responsibility, every company having net worth of Rs. 500 crore or more, or turnover of Rs. 1,000 crore or more or a net profit of Rs. 5 crore or more during the immediately preceding financial year is required to constitute a Corporate Social Responsibility Committee of the Board.

4. (a) Rs. 7,27,650

**Reason:** Calculation of deduction section 80JJAA of the Income Tax Act, 1961-

Particulars	Amount (Rs.)
Total number of New Employees = 20	
(a) Amount paid to 5 employees, joined in November 2018, are not eligible for computation of deduction since they are employed for less than 240 days in the relevant Previous Year.	
(b) Amount paid to other 5 employees, joined in May, 2018, are not eligible for computation of deduction since their total emolument	

exceeds Rs. 25,000 per month.	
(c) Amount paid to another 1 employee, who is paid by bearer cheque, his salary is not eligible for deduction under section 80JJAA. Since the condition to claim deduction is that payment of salary should be made by account payee cheque or through banking channel.	24,25,500
(d) Amount paid to remaining 9 employees are eligible for claiming deduction i.e. 9 employees x Rs. 24,500 x 11 months	
<b>Deduction under section 80JJAA (30% of Rs. 24,25,500)</b>	<b>Rs. 7,27,650</b>

5. (d) Rs. (36,364)

**Reason: Calculation of gain/ loss chargeable to tax under the head 'Capital Gain'-**

Particulars	Amount (Rs.)
Value of consideration	48,00,000
<b>Less:</b> Indexed Cost of Acquisition Rs. 38 Lakh x 280/220	48,36,364
<b>Capital Gain/ Loss</b>	<b>(36,364)</b>

#### Part B

6. Calculation of Profits and Gains from Business or Profession of Mars Construction Ltd. for Assessment Year 2019-20

S.No.	Particulars	Amount (Rs.)	Amount (Rs.)
	<b>Net Profit as per Profit &amp; Loss Account</b>		<b>35,50,00,000</b>
	<b>Add:</b>		
(i)	<b>Interest to public financial institution</b> [Disallowance under section 43B would be attracted for A.Y.2019-20, since the interest is paid after 30.9.2019, being the due date of filing of return]	3,00,000	
(ii)	<b>Fees for Technical services paid to Non-Resident</b> [Disallowance of 100% of the amount paid towards fees for technical services to a non-resident without deduction of tax at source would be attracted under section 40(a)(i). Tax deducted subsequently was also paid after the due date 30.9.2019]	6,00,000	
(iii)	<b>Damages paid to State Government for defects in construction of flyover</b> [Payment of damages as per the terms of the contract for defects in construction is compensatory in nature and incurred in the normal course of construction business, and hence, such expenditure is deductible under section 37. Since such payment is debited to the statement of profit and loss, no further adjustment is required].	Nil	
(iv)	<b>Depreciation</b>	20,00,000	

	Depreciation as per Books of Account has to be added back. Depreciation computed as per Income Tax Act is allowed as deduction		
(v)	<b>Marked to Market Losses</b> [As per ICDS I, marked to market losses cannot be recognized unless the recognition of such loss is in accordance with the provisions of any other ICDS. Since such losses have been debited to the statement of profit and loss, they have to be added back for computing business income]	6,00,000	<b>35,00,000</b>
			<b>35,85,00,000</b>
	<b>Less:</b>		
(vi)	<b>Profit on sale of Land to Neptune U.S.A., a wholly owned subsidiary company</b> [Income/ Loss is chargeable to tax under the head "Capital Gains". Since the same has been credited to statement of profit and loss, it has to be reduced while computing business income]	10,00,000	
(vii)	<b>Retention Money held by Public Sector Company</b> [ICDS III requires recognition of contract revenue, including retention money, on percentage of completion method. Since such amount has been credited to the statement of profit and loss, no adjustment is required]	Nil	
(viii)	<b>Interest on FDR with Bank</b> [Since the fixed deposit has been made with a bank as margin money for obtaining a guarantee required by a State Government for a particular contract, interest income of such deposit is inextricably linked to the business of the assessee and hence has to be treated as business income and not as income from other sources. Since the same has been credited to the statement of profit and loss, no adjustment is required]	Nil	
(ix)	<b>Dividend from RIET</b> (a) Component of Short Term Capital Gains [Short-term capital gain component of Rs.6 lakhs is taxable in the hands of REIT and hence, exempt in the hands of the unit holder under section 10(23FD). Since Rs. 6 lakhs has been credited to the statement of profit and loss, the same has to be deducted for computing business income]  (b) Component of Rental income [As per section 115UA(3), such income would be deemed income in the hands of unit holder. By virtue of section 115UA(1), income distributed by REIT to]	6,00,000  Nil	

	a unit holder would be deemed to be of the same nature and same proportion in the hands of the unit holder as it had been received by or accrued to the REIT. Accordingly, rental component of income would be taxable under the head "Profits and gains of business and profession", since REIT is engaged in the business of letting out real estate properties. Since Rs. 4 lakhs has been credited to the statement of profit and loss, no adjustment is required]		16,00,000
			35,69,00,000
(x)	<b>Less: Depreciation as per Income Tax Act</b>		25,00,000
	<b>Profits and Gains from Business or Profession</b>		35,44,00,000

7. **Principal Audit Procedures:** The audit procedures may include the following-

- (a) Obtaining understanding of key uncertain tax positions;
- (b) Obtaining details of completed tax assessments and demand for the current year from the management,
- (c) Along with internal tax experts -
  - (i) Discussing with appropriate senior management and evaluate the Managements' underlying key assumptions in estimating the tax provision;
  - (ii) Assessing management's estimate of the possible outcome of the disputed cases; and
  - (iii) Considering legal precedence and other rulings in evaluating management's position on these uncertain tax positions.
- (d) Considering the effect of new information in respect of uncertain tax positions as at the beginning of the year to evaluate whether any change is required to management's position on these uncertainties.

#### CASE STUDY 2:

##### Part A

1. (b) No, the auditor has not reported as per the reporting requirement which requires stating the steps taken by the company for securing refund of the same.

**Reason:** As per clause (xi) of Para 3 of CARO, 2016, the auditor of a company has to report whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same.

2. (d) The intermittent vacancy of a woman director can only be filled by the Board not later than immediate next Board Meeting or three months from the date of such vacancy whichever is later. Thus, the appointment is valid.

**Reason:** As per section 149(1) of the Companies Act, 2013 read with the Companies (Appointment and Qualification of Directors) Rules, 2014, the Board shall fill the vacancy by 18<sup>th</sup> August, 2018 or by 18<sup>th</sup> September, 2018 (i.e. 3 months from the date of such vacancy) whichever is later. In the given case, it has been filled on 18<sup>th</sup> September, 2018, thus the appointment is valid.

3. (b) HawaSanch Ltd., a public company, which has a paid up capital of Rs. 100 crore.

**Reason:** The LODR Regulations shall apply to the listed entity who has listed designated securities on recognised stock exchange.

4. (c) It is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. Thus, the presentation as contingent liability under notes to financial statements is correct.

**Reason:** As per Ind AS 37, a contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. In the given case, the appeal is pending before the court which is a possible obligation because the liability for payment arising or not is dependent on the outcome of court decision.

5. (c) Auditor's responsibilities for assessing the entity's ability to continue as a going concern.

**Reason:** As per SA 700, the auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements.". This section of the auditor's report shall describe management's responsibility for assessing the entity's ability to continue as a going concern.

#### Part B

6. SA 706 'Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report', provides that if the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:

- The auditor would not be required to modify the opinion in accordance with SA 705 'Modifications to the Opinion in the Independent Auditor's Report' as a result of the matter; and
- When SA 701 'Communicating Key Audit Matters in the Independent Auditor's Report' applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

In the given case, the auditor has included a paragraph on Emphasis of Matter which describes the uncertainties related to the legal outcome of Department of Telecommunications demand with respect to one-time spectrum charges. Further, the opinion is also not modified in respect of this matter.

Thus, all the conditions and circumstances have been considered by the auditor while including a paragraph on the Emphasis of Matter.

Therefore, the reporting is in accordance with SA 706.

**Statement of Cash Flows of VayuSanchar Limited**

<b>Particulars</b>	<b>Amount (Rs.)</b>	<b>Amount (Rs.)</b>
<b>Cash Flows from Operating Activities</b>		
Net Profit after Tax	1,40,00,000	
Add: Income Tax Paid	30,00,000	
Net Profit before Tax	<b>1,70,00,000</b>	
Add: Depreciation	15,00,000	
Less: Gain on Sale of Machine	(1,00,000)	
	<b>1,84,00,000</b>	
Change in Operating Assets and Liabilities		
Less: Increase in Other Non-Current Asset (Rs. 3,92,00,000 – Rs. 2,79,40,000)	(1,12,60,000)	
Less: Increase in Trade Receivables (Rs. 1,35,00,000 - Rs. 1,26,60,000)	(8,40,000)	
Add: Increase in Other Current Liabilities (Rs. 1,50,00,000 - Rs. 1,16,00,000)	34,00,000	
Add: Increase in Trade Payables (Rs. 2,55,00,000 - Rs. 1,70,00,000)	85,00,000	
Add: Increase in Payables for Expenses (Rs. 2,24,00,000 - Rs. 1,49,00,000)	75,00,000	
	<b>2,57,00,000</b>	
Less: Income Tax Paid	(30,00,000)	
<b>Cash inflow from Operating Activities</b>	<b>2,27,00,000</b>	2,27,00,000
<b>Cash Flows from Investing Activities</b>		
Sale of Property, Plant and Equipment during the year	9,00,000	
Purchase of Property, Plant and Equipment during the year [Rs. 8,44,00,000 – (Rs. 7,17,40,000 - Rs. 15,00,000 - Rs. 8,00,000)]	(1,49,60,000)	
Sale of Investments (Rs. 2,12,00,000 - Rs. 1,95,00,000)	17,00,000	
<b>Cash outflow from Investing Activities</b>	<b>(1,23,60,000)</b>	(1,23,60,000)
<b>Cash Flows from Financing Activities</b>		
Interim Dividend paid	(9,00,000)	
Long Term Borrowings paid (Rs. 3,90,00,000 - Rs. 2,25,00,000)	(1,65,00,000)	
<b>Cash outflow from Financing Activities</b>	<b>(1,74,00,000)</b>	(1,74,00,000)
<b>Net Cash outflow from all the Activities</b>		<b>(70,60,000)</b>
Add: Opening Cash and Cash Equivalents		1,44,60,000
<b>Closing Cash and Cash Equivalents</b>		<b>74,00,000</b>

### CASE STUDY 3:

#### Part A

##### 1. (b) Intangible Asset

**Reason:** Para 8 of IND AS 38 defines an intangible asset as an identifiable non-monetary asset without physical substance.

Further, para 21 and 22 give guidance on recognition of intangible asset.

Accordingly, an intangible asset shall be recognised if an only if-

- (i) It is probable that the expected future economic benefit that are attributable to the asset will flow to the entity; and
- (ii) The cost of the asset can be measured reliably.

In the instant case, the App is going to be used as a sales channel and the economic benefits are expected to flow to the company for more than one accounting period. The cost of developing the App can be measured reliably.

##### 2. (c) Capitalized as part of SPM cost in PPE.

**Reason:** Para 16 of Ind AS 16 say that-

The cost of an item of property, plant and equipment comprises:

- (i) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- (ii) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

Since the imported equipment can't be put to use directly without calibration by the company, the cost of such calibration can be capitalized as part of the main asset.

##### 3. (a) Will be treated as exchange loss and debited to P&L Account.

**Reason:** Although the cost of exchange difference is associated with the property plant & equipment (PPE), it is a matter of payment schedule and hence does not impact the usability of the concerned asset, hence such cost cannot be capitalized as part of the asset.

##### 4. (c) Conversion of LLP into company

**Reason:** Since a LLP can't issue shares or other securities, the first compliance required is to convert the LLP into a company limited by shares.

##### 5. (d) Rs. 18 Lacs

**Reason:** Domestic and Perennial combination –

Pomegranate Rs. 6 lacs + Grapes Rs. 4 Lacs = Rs. 10 Lacs

Exports and Perennial combination –

Mango Rs. 8 Lacs

So, total cost of calibration = Rs. 18 lacs

## Part B

6.

Cost of SPM for Mango	
Euro	96000
Exchange rate on the transaction date	79.12
INR cost	75,95,520
Add: Cost of shipping & installation	7,59,552
Calibration cost (as given)	8,00,000
Borrowing cost@ 10% for 13 months	8,22,848
<b>Total cost capitalized for SPM Mango</b>	<b>99,77,920</b>

(Calculation of borrowing cost =  $75,95,520 \times 10\% \times 13/12$ )

As per Para 21 of Ind AS 21 the exchange rate on the date of transaction shall be used for translation in the functional currency. Further, as per Appendix B of Ind AS 21, date of advance payment will be the date of transaction.

7. As per IND AS 16, the following disclosures are made in respect of each class of Property Plant & Equipment:

### Special Purpose Machine

Gross carrying amount is determined based on cost of purchase as increased by the cost of making the asset ready to use. These costs are as follows:

- Cost of shipping and installation at the place of business.
- Cost of calibrating the SPM for the desired level of performance of the machine to suit the business requirement.
- Borrowing cost which is incurred wholly for the purpose of buying the SPM and since the same was required to be calibrated for a period of 13 months, it satisfied the criteria of qualifying asset as per IND AS 23
- The assets in this class are depreciated over the useful life from the date of being ready to use.
- The method of depreciation used is straight line method.

8. **Operational break-even level in year 1:**

Year -1 will operationally break-even at a revenue of Rs. 94.33 Lacs (adding all the costs) which means total no. of packages that need to be subscribed are:

$Rs. 94.33 \text{ Lacs} / Rs. 2000 = 4716.5$  – since fractional package can't be subscribed, this number would be 4717 packages.

So, if each farmer buys on an average 10 packages, then the no. of farmers would be approximately:

$4717/10 = 471.7$  or 472 farmers.

## CASE STUDY 4:

## Part A

1. (c) (i), (ii) & (iv)

**Reason:** As per Rule-4 of the Companies (Meetings of Board and its Powers) Rules, 2014, above said matters shall not be dealt with in any meeting held through Video-Conferencing or other audio visual means.

2. (d) Sec.-197 not applicable to their Co.

**Reason:** Sec.-197 lays down the max. remuneration payable to Managerial Personal of a Public Co. and is not applicable to a Private Ltd. Co.

3. (a) AOC – 4, MGT – 7

**Reason:** Form AOC-4 is used for filing Annual Accounts & MGT-7 is used for filing Annual details w.r.t. Management of the Company with ROC annually.

4. (a) Aggregate consideration received for issue of shares as exceeds the fair market value of such shares.

**Reason:** As per the relevant CBDT notification, this Exemption has been provided to Start-ups from taxability under Section-56(2)(viib) of Income tax Act,1961.

5. (c) Computer or Computer Software.

**Reason:** The Company has to utilize this amount to purchase Computer or Computer Software.

### Part B

6. (a) **Meaning of eligible business:** A business carried out by an eligible start-up engaged in –

- Innovation, development or improvement of products or processes or services or  
- a scalable business model with a high potential of employment generation or wealth creation.

(b) Section 80AC stipulates compulsory filing of return of income on or before the due date specified under section 139(1), as a pre-condition for availing benefit of deductions under any provision of Chapter VI-A under the heading “C. – Deductions in respect of certain incomes”. Hence, Haryali Pvt. Ltd. should file its IT Return on or before 30.09.2019.

(c) Haryali (P) Ltd. is an eligible start-up, since –

- (1) it is a company engaged in eligible business of innovation of new products/services.
- (2) it is incorporated during the period 1.4.2016 to 31.3.2021.
- (3) its total turnover does not exceed Rs. 25 crores in the P.Y. 2018-19.
- (4) it holds a certificate of eligible business from the notified IMBC.

Therefore, Haryali (P) Ltd., being an eligible start-up, is eligible for deduction under section 80-IAC of 100% of the profits and gains derived by it from an eligible business for any three consecutive assessment years out of seven years beginning from the year in which the eligible start up is incorporated i.e., P.Y.2018-19.

In the first and second year i.e., P.Y.2018-19 and P.Y.2019-20, Haryali (P) Ltd. has incurred a loss. In the P.Y. 2020-21, Haryali (P) Ltd. earns profits from eligible business and can hence, claim 100% of its profits as deduction for any three consecutive assessment years under section 80-IAC from the P.Y.2020-21 to P.Y.2024-25. However, for P.Y.2020-21, the profits eligible for deduction would be the profits after set-off of brought forward losses of P.Y.2018-19 and P.Y. 2019-20.

7. Section 173 of the Companies Act, 2013 provides for Meetings of Board. According to this section:

#### Frequency of Board Meetings [Section 173 (1)]:

- (a) **First Board meeting:** Every company shall hold the first meeting of the Board of Directors within 30 days of the date of its Incorporation.
- (b) **Subsequent Board meetings:** Every company shall hold minimum of 4 meetings every year provided that the gap between two consecutive board meetings shall not be more than 120 days.

However, the Central Government may by notification, direct that these provisions will not apply in relation to any class or descriptions of companies or will apply in relation thereto subject to such exceptions, modifications or conditions as may be specified in the notification. The same provisions are applicable in the case of Haryali (P) Ltd.

**8. (a) Customer's Profitability Statement**

Particulars	Customer- X	Customer - Y
<b>Sales (units)</b>	<b>35</b>	<b>50</b>
	(Rs.)	(Rs.)
Selling Price per unit	540	540
Less: Discount (Quantity)	27 ( $540 \times 5\%$ )	27 ( $540 \times 5\%$ )
Less: Discount (Delivery)	---	43.20 ( $540 \times 8\%$ )
Selling Price (Net of Discounts) per unit	513.00	469.80
Less: Variable Cost per unit	442.00	442.00
Contribution per unit	71.00	27.80
Total Contribution	2,485 ( $71 \times 35$ units)	1,390 ( $27.80 \times 50$ units)
Less: Additional Overheads		
Delivery Cost	175 ( $5 \times 35$ )	---
Order Processing Cost	100 ( $5 \times 20$ )	200 ( $10 \times 20$ )
Profit per customer*	2,210	1,190
Profit per customer per unit	63.14	23.80

**Analysis:** Even though X has lower sales volume (30% lesser from Y), it is contributing more than double profit that is being contributed by Y as overall discount offered to customer X is quite less.

**(b) Comments on the “Discount Policy on Delivery”:** Discount on delivery offered to customer Y is Rs.43.20 per unit. If transport for delivery is provided to customer Y then the cost would have been Rs.7 per unit ( $10 \text{ deliveries} \times \text{Rs.}35 / 50 \text{ units}$ ), which is lesser by Rs.36.20. It may also be noted that delivery cost in case of customer X is only Rs.5 per unit ( $\text{Rs.}175 / 35 \text{ units}$ ). Hence, company needs to review discount policy on delivery but significance of profitability of customer Y should also be kept in mind while doing so.

**CASE STUDY 5:**

**Part A**

**1. (c) (i),(ii),(iii) & (iv)**

**Reason:** According to the Companies (Registration of Foreign Companies) Rules, 2014, “electronic mode” means carrying out electronically based, whether main server is installed in India or not, including, but not limited to -

- (i) business to business and business to consumer transactions, data interchange and other digital supply transactions;
- (ii) offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India;

- (iii) financial settlements, web based marketing, advisory and transactional services, database services and products, supply chain management;
- (iv) online services such as telemarketing, telecommuting, telemedicine, education and information research; and
- (v) all related data communication services, whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

2. (b) FC-1

**Reason:** According to the Companies (Registration of Foreign Companies) Rules, 2014, the required informations shall be filed with the Registrar within 30 days of the establishment of its place of business in India, in Form FC-1 along with prescribed fees and documents required to be furnished as provided in section 380(1).

3. (a) 100%

**Reason:** There are no such rule of minimum shareholding of the Indian Director.

4. (c) Aggregate of (a) & (b)

**Reason:** It is the aggregate of, -

- (i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and
- (ii) income by way of royalty, dividend, capital gains, interest or rental income.

However, any income by way of interest shall not be considered to be passive income in case of a company which is engaged in the business of banking or is a public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation.

5. (d) Debenture Trustee/ Nominated Director

**Reason:** "Senior Management" in respect of a company means the person or persons who are generally responsible for developing and formulating key strategies and policies for the company and for ensuring or overseeing the execution and implementation of those strategies on a regular and on-going basis. While designation may vary, these persons may include:

- (i) Managing Director or Chief Executive Officer;
- (ii) Financial Director or Chief Financial Officer;
- (iii) Chief Operating Officer; and
- (iv) The heads of various divisions or departments (for example, Chief Information or Technology Officer, Director for Sales or Marketing).

**Part B**

6. (a) The Companies Act, 2013 vide section 380 requires every foreign company to deliver to the Registrar for registration, within 30 days of the establishment of office in India, documents which have been specified therein. According to the Companies (Registration of Foreign Companies) Rules, 2014, any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi.

(b) The Companies Act, 2013 lays down the governing provisions for foreign companies in Chapter XXII which is comprised of sections 379 to 393. The penalties for non filing or for contravention of any provision for this chapter including for non filing of documents with the Registrar as required by section 380 and other sections in this chapter are laid down in section 392 of the Act which

provides that if a foreign company contravenes the provisions of this Chapter, the foreign company shall be punishable with a fine which shall not be less than Rs. 1,00,000 but which may extend to Rs. 3,00,000 and in the case of a continuing offence, with an additional fine which may extend to Rs. 50,000 for every day after the first day during which the contravention continues and every officer of the foreign company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5,00,000, or with both.

7. Ramesh returned to India on 12th June 2018 for permanently residing in India after staying in UK for 20 years. During the P.Y.2018-19, he stays in India for 293 days. Since he has stayed in India for a period of 182 days or more during the previous year 2018-19, he would be a resident in India for the A.Y.2019-20. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2018-19 and his stay in India during the seven previous years is less than 730 days. The residential status of Ramesh for A.Y.2019-20 is, therefore, Resident but Not Ordinarily Resident.

As per section 5(1), only income which is received/ deemed to be received/ accrued or arisen/ deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

- (a) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.
- (b) Dividends from shares of three UK Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.
- (c) As per section 64(1A), all income accruing or arising to a minor child is includable in the hands of the parent, after providing for deduction of Rs.1,500 per child under section 10(32). Accordingly, income of Rs. 20,000 accruing to his minor son, aged 12 years, in India is includable in the income of Ramesh, after providing deduction of Rs. 1,500. Therefore, Rs. 18,500 is includable in the income of Ramesh. Income accruing to the minor child outside India (which is also received outside India) is not includable in the income of Ramesh. Since the other son is major, his income is not includable in the income of Ramesh.
- (d) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Ramesh was a non-resident, is not taxable in the A.Y.2019-20 since it is not the income of the P.Y.2018-19.

Consequently, only the income includable under section 64(1A) would form part of the total income of Mr. Ramesh Ahuja for A.Y.2019-20. Since his total income (i.e., Rs. 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2019-20.

8. (a) The statement is correct. As per section 9(1)(vi), income by way of royalty payable by the Government of India is deemed to accrue or arise in India. "Royalty" means consideration for, inter alia, use of patent. Therefore, the amount paid by Government of India for use of patent developed by 'Ahuja Designs Incorp.'(UK), a non-resident, is deemed to accrue or arise in India. Hence, it is taxable in India in the hands of the Company.

(b) The statement is incorrect. The CBDT vide Circular no. 8/2017 dated 23.02.2017 clarified that POEM guidelines shall not apply to a company having turnover or gross receipts of Rs. 50 crores or less in a financial year.

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE: GROUP - II**  
**PAPER – 7: DIRECT TAX LAWS AND INTERNATIONAL TAXAXTION**

*Working Notes should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of a note. However, in answers to Question in Division A, working notes are not required.*

*All questions relate to Assessment Year 2019-20, unless stated otherwise in the question.*

**Time Allowed – 3 Hours**

**Maximum Marks – 100**

**Division A – Multiple Choice Questions**

***Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions in this division are compulsory.***

1. Mr. A, aged 59 years, won Rs. 60 lakh and Mr. B, aged 50 years, won Rs. 8 lakh from lotteries. Tax deductible at source under section 194B was duly deducted. Assuming that this is the only source of income of Mr. A and Mr. B for A.Y.2019-20, are Mr. A and Mr. B liable to pay advance tax for that year?
  - (a) No, Mr. A and Mr. B are not liable to pay advance tax as tax deductible at source under section 194B has been fully deducted.
  - (b) Yes, Mr. A and Mr. B are liable to pay advance tax on the balance tax liability arising out of levy of higher education cess.
  - (c) Mr. A is liable to pay advance tax but Mr. B is not liable to pay advance tax
  - (d) Mr. B is liable to pay advance tax but Mr. A is not liable to pay advance tax

**(2 Marks)**

2. Mr. Vallish, employed as Manager with ABC Ltd. pays rent of Rs. 50,000 per month to his landlord. Which of the following statements are correct?
  - (a) Mr. Vallish is liable to deduct tax@10% under section 194-I, since his annual rent exceeds Rs. 1,80,000.
  - (b) Mr. Vallish is liable to deduct tax@5% under section 194-IB every month, since he pays rent of Rs. 50,000 per month.
  - (c) Mr. Vallish is liable to deduct tax@5% under section 194-IB on the annual rent in the month of March, since he pays rent of Rs. 50,000 per month.
  - (d) Mr. Vallish is not liable to deduct tax at source

**(1 Mark)**

3. Mr. Sanjay, a resident, and Mr. Andrew, a British citizen and a non-resident in India, are both sports commentators deriving income of Rs. 5 lakh from sports commentaries in India for A.Y. 2019-20.
  - (i) Tax is deductible u/s 194J from remuneration payable to Mr. Sanjay
  - (ii) Tax is deductible u/s 194E from remuneration payable to Mr. Andrew
  - (iii) Tax is deductible u/s 195 from remuneration payable to Mr. Andrew
  - (iv) Mr. Andrew is not required to file his return of income u/s 139, if tax deductible at source is fully deducted.
  - (v) Mr. Sanjay is not required to file his return of income u/s 139, if tax deductible at source is

fully deducted.

Which of the above statements are correct, assuming that this is the only source of income for Mr. Sanjay and Mr. Andrew?

- (a) (i), (ii) and (iv)
- (b) (i), (ii), (iv) and (v)
- (c) (i) and (iii)
- (d) (i), (iii) and (iv)

**(2 Marks)**

4. Mr. X is aggrieved by an order passed under section 143(3) by the Assessing Officer. Mr. Y is aggrieved by an order passed under section 272A by the Director General. What is the remedy available to Mr. X and Mr. Y and the time limit within which they should exercise the remedy?

- (a) Both Mr. X and Mr. Y have to file an appeal before Commissioner (Appeals) under section 246A within 30 days from the date on which the order sought to be appealed against is communicated to them.
- (b) Both Mr. X and Mr. Y have to file an appeal before the Appellate Tribunal under section 253 within 60 days from the date on which the order sought to be appealed against is communicated to them.
- (c) Mr. X has to file an appeal before Commissioner (Appeals) under section 246A within 30 days from the date of service of the notice of demand relating to the assessment. Mr. Y has to file an appeal before the Appellate Tribunal within 60 days from the date on which the order sought to be appealed against is communicated to him.
- (d) Mr. Y has to file an appeal before Commissioner (Appeals) under section 246A within 60 days from the date on which the order sought to be appealed against is communicated to him. Mr. X has to file an appeal before the Appellate Tribunal within 30 days from the date of service of the notice of demand relating to the assessment.

**(2 Marks)**

5. Mr. Ram Mohan, a non-resident, operates an aircraft between Malaysia and Cochin. He received the following amounts while carrying on the business of operation of aircrafts for the year ended 31.3.2019:

- (i) Rs. 2 crores in India on account of carriage of passengers from Cochin.
- (ii) Rs. 1 crore in India on account of carriage of goods from Cochin.
- (iii) Rs. 3 crores in India on account of carriage of passengers from Malaysia.
- (iv) Rs. 0.50 crore in Malaysia on account of carriage of passengers from Cochin.
- (v) Rs. 1.30 crores in Malaysia on account of carriage of passengers from Malaysia.
- (vi) Rs. 1.20 crore in Malaysia on account of carriage of goods from Malaysia.
- (vii) Rs. 0.50 crore in Malaysia on account of carriage of goods from Cochin.

The total expenditure incurred by Mr. Ram Mohan for the purposes of the business during the year ending 31.3.2019 was Rs. 3 crores. What is the income of Mr. Ram Mohan chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y.2019-20?

- (a) Rs. 35 lakh
- (b) Rs. 30 lakh
- (c) Rs. 20 lakh
- (d) Rs. 47.50 lakh

**(2 Marks)**

6. Alpha Ltd., an Indian company, provides contract R & D services relating to generic pharmaceutical drug, to Beta Inc., a Swiss company which guarantees 17% of the total borrowings of Alpha Ltd. The aggregate value of such transactions entered into in the P.Y.2018-19 is Rs. 40 crores and the operating expenses are Rs. 30 crores. Assuming that Alpha Ltd. has exercised a valid option for application of safe harbour rules, what is the minimum operating profit margin to be declared by it, which can be accepted by the income-tax authorities?

- (a) Rs. 5.4 crores
- (b) Rs. 6.30 crores
- (c) Rs. 7.20 crores
- (d) Rs. 9.60 crores

**(2 Marks)**

7. As per section 245N(a)(iv), advance ruling means determination by the Authority for Advance Rulings or decision whether an arrangement, which is proposed to be undertaken by a person is an impermissible avoidance arrangement as referred to in Chapter X-A or not. For making an application in this regard, the applicant has to be -

- (a) Only a Non-resident
- (b) Only a Resident
- (c) Only a Resident falling within such class or category of persons as notified by the Central Government
- (d) Either a resident or a non-resident

**(1 Mark)**

8. Gamma Ltd. has distributed on 15/12/2018 dividend of Rs. 460 lakhs to its shareholders. On 12/11/2018, Gamma Ltd. has received dividend of Rs. 120 lakhs from its domestic subsidiary company Phi Ltd., on which Phi Ltd. has paid dividend distribution tax under section 115-O. Compute the additional income-tax payable by Gamma Ltd. under section 115-O.

- (a) Rs. 59,40,480
- (b) Rs. 66,76,800
- (c) Rs. 69,88,800
- (d) Rs. 80,37,120

**(2 Marks)**

9. Mr. Hari has income of Rs. 52 lakhs under the head "Profits and gains of business or profession". One of his businesses is eligible for deduction@100% of profits under section 80-IA for A.Y.2019-20. The profit from such business included in the business income is Rs. 35 lakhs. Compute the tax payable (rounded off) by Mr. Hari for A.Y.2019-20, assuming that he has no other income during the P.Y.2019-20 and credit for alternate minimum tax, if any, to be carried forward -

- (a) Rs. 3,35,400; AMT credit to be carried forward is Nil.
- (b) Rs. 10,00,480; AMT credit to be carried forward is Rs. 6,65,080
- (c) Rs. 11,00,530; AMT credit to be carried forward is Rs. 7,65,130
- (d) Rs. 11,50,550; AMT credit to be carried forward is Rs. 8,15,150

**(2 Marks)**

10. A charitable trust was created on 1.4.2016 with the objective of relief of poor. It applied for registration in 1st November, 2017. The application was not disposed of by the Commissioner even after the expiry of period of 6 months stipulated under section 12AA(2). Which of the following statements are correct -

- (a) Since the application has not been disposed of by the Commissioner, the trust is not deemed to be registered and hence, is not entitled to benefit of exemption under section 11 and 12 for any of the assessment years
- (b) Since the application has not been disposed of by the Commissioner within the stipulated period, the trust is deemed to be registered with effect from 1.4.2016, being the date of creation of trust, and is entitled to benefit of exemption under sections 11 and 12 w.e.f. A.Y.2017-18.
- (c) Since the application has not been disposed of by the Commissioner within the stipulated period, the trust is deemed to be registered with effect from 1.11.2017, being the date of application for registration, and is entitled to benefit of exemption under sections 11 and 12 w.e.f. A.Y.2018-19.
- (d) Since the application has not been disposed of by the Commissioner within the stipulated period, the trust is deemed to be registered with effect from 1.6.2018, being the date immediately following the expiry of the six month period, but is entitled to benefit of exemption under sections 11 and 12 w.e.f. A.Y.2018-19.

**(2 Marks)**

11. In the P.Y.2018-19, Mr. Ganguly, a resident individual aged 60 years, earned income from profession (computed) Rs. 1,45,000, winnings from card games Rs. 1,50,000 (gross). He also has interest of Rs. 40,000 on fixed deposit with banks and Rs. 9,000 on savings bank account with banks. He deposited Rs. 1,50,000 in PPF. What is the total income of Mr. Ganguly for P.Y.2018-19?

- (a) Rs. 1,45,000
- (b) Rs. 1,50,000
- (c) Rs. 1,85,000
- (d) Rs. 1,90,000

**(1 Mark)**

12. Dinesh, a resident individual of age of 47 years, has not furnished his return of income for the A.Y. 2019-20. However, his total income for such year as assessed u/s 144 is Rs. 18 lakhs. Is penalty under section 270A attracted and if so, what is the quantum of penalty?

- (a) No; penalty under section 270A is not attracted since he has not filed his return of income, hence, this is not a case of underreporting or misreporting of income.
- (b) Yes; penalty is Rs. 3,66,600, assuming it is a case of underreporting of income
- (c) Yes; penalty is Rs. 1,83,300, assuming it is a case of underreporting of income
- (d) Yes; penalty is Rs. 1,44,300, assuming it is a case of underreporting of income

**(1 Mark)**

13. The assessment of M/s. Epsilon Associates for A.Y.2017-18 was made u/s 143(3) on 28<sup>th</sup> July, 2019. The Assessing Officer added Rs. 3 lakh being 30% of Rs. 10 lakh, for non-deduction of tax at source and Rs. 4 lakh on account of unexplained investments. The assessee contested the addition on account of unexplained investments in appeal before Commissioner (Appeals). The appeal was decided against the assessee in December, 2019. What is remedy available to the assessee in respect of disallowance under section 40(a)?

- (a) The assessee can file an application for revision to the Commissioner under section 264
- (b) The assessee can file an application for rectification under section 154, if it is a mistake apparent from the record
- (c) The assessee can opt for either (a) or (b)
- (d) The assessee can neither opt for remedy stated in (a) nor for remedy stated in (b)

**(1 Mark)**

14. The Assessing Officer within his jurisdiction surveyed a popular Cyber Café at 1 a.m. in night for the purpose of collecting information which may be useful for the purposes of the Income-tax Act, 1961. The Cyber Café is kept open for business every day between 2 p.m. and 2 a.m. He impounded and retained in his custody, books of account and other documents inspected by him, after recording his reasons for doing so, for 12 days. Which of the following statements are correct?

- (a) The Assessing Officer's action in entering the cyber café at 1 a.m. and impounding books of account and documents inspected by him are in order.
- (b) The Assessing Officer's action in entering the cyber café at 1 a.m. is not in order, since he can enter the cyber café only after sunrise but before sunset
- (c) The Assessing Officer's action in entering the cyber café at 1 a.m. and in impounding books of account and documents inspected by him are not in order, since he can enter the cyber café only after sunrise but before sunset and he does not have the power to impound books of account under section 133B
- (d) The Assessing Officer's action in entering the cyber café at 1 a.m. is in order but impounding books of account and documents inspected by him is not in order, since he does not have the power to impound books of account under section 133B

**(1 Mark)**

15. Mr. X made a fixed deposit of Rs. 12,000 with a non-banking finance company (NBFC) on 1.4.2018 in cash. Thereafter, he made another fixed deposit of Rs. 7,500 with the same NBFC on 1.8.2018 by bearer cheque. On 31.3.2019, he made yet another fixed deposit of Rs. 8,000 with the same NBFC by an account payee cheque. Which of the following statements are correct?

- (a) Penalty under section 271D is attracted at the time of acceptance of first deposit on 1.4.2018
- (b) Penalty under section 271D is attracted at the time of acceptance of second deposit on 1.8.2018
- (c) Penalty under section 271D is attracted at the time of acceptance of third deposit on 31.3.2019
- (d) Penalty under section 271D is not attracted.

**(1 Mark)**

16. Mr. Kamesh completed his studies in April, 2007 and started his export business in Mumbai in July 2007. He purchased a flat in Mizoram in the January, 2008, a plot of land in UAE in February, 2011 and a flat in New York in September, 2015. In April, 2019, the Assessing Officer issued notice under section 148 in respect of AY2008-09 to AY2018-19. Which of the statements is correct?

- (a) The action of the Assessing Officer is not correct, since notice u/s 148 can be issued only in respect of A.Y.2016-17 to A.Y.2018-19.
- (b) The action of the Assessing Officer is not correct, since notice u/s 148 can be issued only in respect of A.Y.2013-14 to A.Y.2018-19.

- (c) The action of the Assessing Officer is not correct, since notice u/s 148 can be issued only in respect of A.Y.2011-12 to A.Y.2018-19.
- (d) The action of the Assessing Officer in issuing notice u/s 148 in respect of A.Y.2008-09 to A.Y.2018-19 is correct, since notice u/s 148 can be issued within 16 years from the end of the relevant assessment year, in case income in relation to any asset outside India has escaped assessment. In this case, income chargeable to tax is deemed to have escaped assessment since Mr. Kamesh owns assets located outside India.

**(1 Mark)**

17. Mr. Rajesh is engaged in the profession of technical consultancy and his gross receipts for the P.Y.2018-19 is Rs. 45 lakhs. He does not maintain books of account. He is also a partner of a LLP, Rajesh LLP, which carries on the profession of technical consultancy. The gross receipts of Rajesh LLP during the P.Y.2018-19 is Rs. 48 lakhs. Which of the following statements are correct?

- (a) Mr. Rajesh and Rajesh LLP have to pay entire advance tax on or before 15<sup>th</sup> March, 2019
- (b) Mr. Rajesh does not have to pay advance tax. However, Rajesh LLP has to pay the entire advance tax on or before 15<sup>th</sup> March.
- (c) Mr. Rajesh does not have to pay advance tax. However, Rajesh LLP has to pay advance tax in four instalments.
- (d) Mr. Rajesh has to pay entire advance tax on or before 15<sup>th</sup> March and Rajesh LLP has to pay advance tax in four instalments.

**(2 Marks)**

18. Mr. Rajan purchased 300 shares in Vaigai Ltd. on 12.1.2017 at a cost of Rs. 2,500 per share. The Fair Market Value (FMV) of the share as on 31.1.2018 is Rs. 1,800. Mr. Vaigai sold all the shares of Cauvery Ltd. on 15.7.2018 for Rs. 3,200. Mr. Rajan's brother Mr. Ravi purchased 600 shares in Tapti Ltd. on 25.1.2017 at a cost of Rs. 1,900 per share. The FMV of the share as on 31.1.2018 is Rs. 2,400. Mr. Ravi sold all the shares of Tapti Ltd. on 31.1.2019 for Rs. 1,700 per share. What is the chargeable capital gains on sale of shares of Vaigai Ltd. and Tapti Ltd. in the hands of Mr. Rajan and Mr. Ravi, respectively, for A.Y. 2019-20?

- (a) Long-term capital gains of Mr. Rajan Rs. 2,10,000; Long-term capital loss of Mr. Ravi Rs. 4,20,000
- (b) Long-term capital gains of Mr. Rajan Rs. 4,20,000; Long-term capital loss of Mr. Ravi Rs. 4,20,000
- (c) Long-term capital gains of Mr. Rajan Rs. 4,20,000; Long-term capital loss of Mr. Ravi Rs. 1,20,000.
- (d) Long-term capital gains of Mr. Rajan Rs. 2,10,000; Long-term capital loss of Mr. Ravi Rs. 1,20,000.

**(2 Marks)**

19. The Settlement Commission passed an order on 25.6.2018 under section 245D(4). The applicant noticed a mistake apparent from the record and filed an application for rectification on 3.7.2018. Under section 245D(6B), the Settlement Commission can amend its order on or before -

- (a) 25.12.2018
- (b) 31.12.2018
- (c) 3.1.2019
- (d) 31.1.2019

**(1 Mark)**

20. Under which of the following methods, arm's length price shall be the arithmetical mean of all values included in the dataset, irrespective of the number of entries in the dataset. It may be assumed that the variation between the arm's length price computed and the transaction price is 5%.

- (a) Profit split method
- (b) Resale price method
- (c) Cost plus method
- (d) Transactional net margin method

**(1 Mark)**

### **Division B – Descriptive Questions**

*Question No. 1 is compulsory*

*Attempt any **four** questions from the remaining **five** questions*

1. The statement of profit & loss of TrustMe Private Ltd., a resident company engaged in manufacturing, shows net profit of Rs. 77,00,000 for the financial year ended on 31<sup>st</sup> March, 2019, after debit/credit of the following items.

A. Credited to the Statement of Profit and Loss:

- (i) Rent received from vacant land Rs. 2,05,000
- (ii) Rent received (gross) from a commercial property owned by the company Rs. 4,30,000 (Tax deducted by tenant @ 10%)
- (iii) Interest received on income tax refund Rs. 42,000
- (iv) Profit on sale of unused land Rs. 2,00,000.

B. Debited to the Statement of Profit and Loss:

- (i) Depreciation Rs. 11,75,000.
- (ii) Donation of Rs. 70,000 paid to Swachh Bharat Kosh by account payee cheque.
- (iii) Contribution to Political Party amounting to Rs. 1,50,000 paid in cash.
- (iv) Payment made to transporter Rs. 60,000 by account payee cheque, but no tax has been deducted at source. (Transporter is having PAN and furnished declaration that he is covered under section 44AE and not having more than 10 goods carriages at any time during the previous year).
- (v) Bonus to employees Rs. 3,20,000 provided. However, payment was made on the occasion of Diwali festival on 2<sup>nd</sup> November, 2019.
- (vi) Provision made for income-tax Rs. 4,20,000 (including interest of Rs. 70,000 thereon)
- (vii) Contribution of Rs. 1,00,000 to a University approved and notified under section 35(1)(ii)
- (viii) Loss of Rs. 1,80,000 incurred by way of trading in derivatives in shares in a recognized stock exchange.

**Additional information:**

- (1) The company during the financial year 2017-18 made a provision for an outstanding bill of Rs. 90,000 for purchase of raw material. Out of such outstanding amount, the company has paid Rs. 45,000 in cash on 20<sup>th</sup> August, 2018.

- (2) During the year, the company has issued 1,00,000 equity shares of face value of Rs. 10 each at premium of Rs. 90 each. The fair market value is Rs. 60 per share at the time of issue of shares.
- (3) Unused land which was sold in March, 2019 for Rs. 52,00,000 was acquired by the company in January, 2017 for Rs. 50,00,000.
- (4) Depreciation as per Income-tax Act, 1961 Rs. 18,00,000. However, while calculating such depreciation, rate applicable to computers has been adopted for (i) accessories like printers and scanners, and (ii) EPABX. The written down value of these items as on 01.04.2018 is given below:
  - (a) Printers and Scanners Rs. 3,00,000
  - (b) EPABX Rs. 5,00,000
- (5) Additional depreciation on plant and machinery purchased for Rs. 34,00,000 on 18<sup>th</sup> November, 2018 has not been considered while calculating depreciation as per Income-tax Act, 1961 as above.
- (6) Provision for audit fee Rs. 1,00,000 was made in the books for the year ended on 31<sup>st</sup> March, 2018 without deducting tax at source.

Such fee was paid to auditors in September 2018 after deducting tax at source under section 194J and tax so deducted was deposited on 6<sup>th</sup> October, 2018.

Cost Inflation Index – FY 2016-17: 264; FY 2018-19: 280

Compute total income of the company for the Assessment Year 2019-20 stating reasons for treatment of each item. Ignore provisions relating to Minimum Alternate Tax. **(14 Marks)**

2. (a) M/s. Jeevan Pvt. Ltd., a closely held company, is in the business of growing rubber. The profit & loss account for the year ended 31-03-2019 of the company shows a net profit Rs. 37.65 crores after debiting depreciation of Rs. 30 crores.

The company has provided the following additional information:

- (i) The company has deposited Rs. 30 crores in a special account with NABARD on 29-04-2019.
- (ii) The company has brought forward losses of Rs. 6 crores pertaining to Assessment Year 2016-17. Mr. Alok who continuously held 60% of shares carrying voting power since incorporation of the company, had sold his entire holding to Mr. Bhola on 01-08-2018.
- (iii) The company had an accumulated balance of Rs. 200 crores in the special account with NABARD as on 01-04-2018. It has withdrawn Rs. 40 crores and utilized the same for the following purposes:
  - Purchase of a new machine for use in its operation Rs. 10 crores,
  - Purchase of office appliances for corporate office at Hyderabad Rs. 10 crores.
  - Purchase of computers and accessories Rs. 5 crores.
  - Construction of a godown at a cost of Rs. 1 crore near the rubber estate to store raw rubber.
  - Repairs to machinery Rs. 35 lakhs.
- (iv) Depreciation allowable as per Tax Audit Report is Rs. 28 crores.

Compute Taxable and Exempt income of M/s. Jeevan (P) Ltd.

**(8 Marks)**

(b) Compute total income and tax payable by Madhuvan, a senior citizen for the A.Y. 2019-20, from the following information:

- Taxable income from a sole-proprietary concern in Ranchi Rs. 50 lakhs.
- Share of profit from a partnership firm in Bhopal Rs. 30 lakhs.
- Agricultural Income from rubber estate in Country T which has no DTAA with India, USD 70000 (Gross). Withholding Tax on the above income USD 10500.
- Brought forward Business Loss of A.Y. 2016-17 in Country T was USD 10000 which is not permitted to be set off against other income as per the laws of that country.

**Note:** 1 USD = Rs 64

**(6 Marks)**

3. (a) (i) Seva charitable trust registered under section 12AA of the Income-tax Act, 1961 has, out of its income of Rs. 4,90,000 for the year ending 31.3.2019 and sale proceeds of a capital asset, held by it for less than 24 months, amounting to Rs. 10,60,000, purchased a building during the year ending 31.3.2019 for Rs. 15,50,000. The capital asset was sold during the year ending 31.3.2019. The building is held only for charitable purposes.

The trust claims that the purchase of the building amounts to application of its income for charitable purposes and that the capital gain arising on the sale of the capital asset is deemed to have been applied to charitable purposes. Is the claim made by the charitable trust valid in law?

**(4 Marks)**

(ii) A Mannat charitable trust registered under Section 12AA, for the previous year ending 31.3.2019, derived gross income of Rs. 21 Lacs, which consists of the following:

	<b>(Rs. in Lacs)</b>
(a) Income from properties held by trust (net)	10
(b) Income (net) from business (incidental to main objects)	4
(c) Voluntary contributions from public	7

The trust applied a sum of Rs. 11.60 lacs towards charitable purposes during the year which includes repayment of loan taken for construction of orphanage Rs. 3.60 lacs. Determine the taxable income of the trust for the assessment year 2019-20.

**(4 Marks)**

(b) (i) Examine the tax consequence for Assessment Year 2019-20 in respect of fees for technical services (FTS) received by Mr. Richard Grill, a non-resident, from Trim Ltd., an Indian company, in pursuance of an agreement approved by the Central Government, if -

- India has no Double Tax Avoidance Agreement (DTAA) with Country F
- India has a DTAA with Country F, which provides for taxation of such FTS @5%.
- India has a DTAA with Country F, which provides for taxation of such FTS @15%.

Assume that Richard Grill is a resident of Country F and he has no fixed place of his profession in India. The technical services are utilised by Trim Ltd. for its business in Indore.

**(3 Marks)**

(ii) If Zing Inc., a UK based company has a permanent establishment in India and the contract/agreement with Swing Ltd. for rendering technical services is effectively connected with such PE in India, examine the taxability based on the following details provided -

	Particulars	Amount
(1)	Fees for technical services received from Swing Ltd.	Rs. 3.5 crore
(2)	Expenses incurred for earning such income	Rs. 10 lakhs
(3)	Fees for technical services received from other Indian companies in pursuance of approved agreement entered into between the years 2005 to 2010	Rs. 5.5 crore
(4)	Expenses incurred for earning such income	Rs. 12 lakhs
(5)	Expenditure not wholly and exclusively incurred for the business of such PE [not included in (2) & (4) above]	Rs. 6 lakhs
(6)	Amounts paid by the PE to Head Office (not being in the nature of reimbursement of actual expenses)	Rs. 12 lakhs

What are the other requirements, if any, under the Income-tax Act, 1961 in this case?

**(3 Marks)**

4. (a) (i) T Ltd., a manufacturer of automobiles, sells premium model cars, the value of which ranges from above Rs. 10 lakh to Rs. 50 lakh and small cars, value of which ranges from Rs. 5 lakh upto Rs. 10 lakh to its dealers across the country. Examine whether T Ltd. is liable to collect tax at source under section 206C on sale of these cars to the different dealers across the country.

Also, examine the liability, if any, of dealers to collect tax at source on sale of these cars to the retail customers, if no part of the consideration is received in cash. **(4 Marks)**

(ii) M/s Fitband Limited entered into an agreement for the warehousing of its products with Star Warehousing and deducted tax at source as per provisions of section 194C out of warehousing charges paid during the year ended on 31.03.2019. The Assessing Officer, while completing the assessment for A.Y. 2019-20 of Fitband Limited in April 2020, treated the warehousing charges as rent as defined in section 194-I and asked the company to make payment of difference amount of TDS with interest. It was submitted by the company that the recipient had already paid tax on the entire amount of warehousing charges and therefore, now the difference amount of TDS cannot be recovered. However, it will make the payment of due interest on the difference amount of TDS. Examine critically in the context of provisions contained in Income-tax Act, 1961 as to the correctness of the submission of M/s. Fitband Ltd. **(4 Marks)**

(b) Examine whether transfer pricing provisions under the Income-tax Act, 1961 would be attracted in respect of the following cases -

(i) Scientific research services provided by L Inc., an Italian company to X Ltd., an Indian company. L Inc. is a "specified foreign company" as defined in section 115BBD, in relation to X Ltd.

(ii) Ms. Chiya, a resident Indian, is a director of T Ltd, an Indian company. T Ltd. pays salary of Rs. 40 lakhs per annum to Samya, who is Ms. Chiya's daughter.

(iii) Transfer of technical knowhow by Y Ltd., an Indian company, to A Inc, a French company, which guarantees 15% of the borrowings of Y Ltd. **(6 Marks)**

5. Attempt either 5(a)(i) OR 5(a)(ii)

(a) (i) The Commissioner of Income-tax issued notice to revise the order passed by an Assessing Officer under section 143. During the pendency of proceedings before the Commissioner, on the basis of material gathered during survey under section 133A after issue of the first notice, the Commissioner of Income-tax issued a second notice, the contents of which were different from the contents of the first notice. Examine whether the action of the Commissioner is justified as to the second notice. **(4 Marks)**

**OR**

(ii) (I) In an order of assessment for the A.Y. 2018-19, the assessee noticed a mistake for which application under section 154 was moved and the order was rectified. Subsequently, the assessee moved further application for rectification under section 154 which was rejected by the Assessing Officer on the ground that the order once rectified cannot be rectified again. Examine the correctness or otherwise of the contention of the Assessing Officer. **(2 Marks)**

(II) The return for A.Y.2019-20 was filed on time as per section 139(1) and proceedings were taken up for assessment under section 143(3). Later on, the assessee, noticed certain omissions and therefore filed a revised return on 20.4.2020. The Assessing Officer ignoring the revised return so filed framed the order on 25.4.2020. Is the action of Assessing Officer correct? Examine. **(2 Marks)**

(iii) Theory Diagnostics is a diagnostic laboratory in Kanpur and has a branch at Lucknow. A survey under section 133A was conducted, consequent to which the assessee filed return of income. On the basis of certain incriminating documents and materials unearthed during the survey, a notice under section 148 was issued. Subsequently, the incomes were assessed for assessment years 2017-18 and 2018-19 under section 143(3) read with section 147.

The assessee raised additional jurisdictional grounds before the Appellate Tribunal. The assessee contended that for the relevant assessment years, the assessment was completed under section 143(3) read with section 147. However, a notice under section 143(2) was not issued by the Assessing Officer for those years. The Tribunal held that in view of section 292BB, the assessee's participation in the reassessment proceedings would condone the omission to issue a notice.

Discuss, with the aid of a Supreme Court case law, whether failure to issue notice under section 143(2) would vitiate the assessment notwithstanding the assessee's participation in the proceedings. Would section 292BB come to the rescue of the Revenue authority if they omit to issue notice under section 143(2)? Examine. **(4 Marks)**

(b) What is the meaning of, and difference between, a hybrid mismatch and branch mismatch? Briefly mention the reasons why hybrid mismatch arrangements arise. Which Action Plan of BEPS gives recommendations in this regard? **(6 Marks)**

6. (a) (i) Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act, 1961.

(I) Harish & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.

(II) Sunshine Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of Rs. 10,000. They have not furnished the requisite information in spite of various reminders.

**(4 Marks)**

(ii) (I) The merger of a loss making company with a profit making one results in losses setting off profits, a lower net profit and lower tax liability for the merged company. Would the losses be disallowed by applying GAAR?

(II) In the above facts, let us presume, the profit making company merges with a loss making one. This results in losses setting off profits, a lower net profit and lower tax liability for both companies taken together. Can this be examined under GAAR?

**(4 Marks)**

(b) (i) LMN Ltd., an Indian company, is carrying on the business of manufacture and sale of Indo-western Apparels under the brand name "STYLE&SHINE". In order to expand its overseas sales/exports, it launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of Xylo Inc., a London based company. During the previous year 2018-19, LMN Ltd. paid Rs. 15 lakhs to Xylo Inc. for such services. Discuss the tax implications/TDS implications of such payment and receipt in the hands of LMN Ltd. and Xylo Inc., respectively, if Xylo Inc. has no permanent establishment in India.

**(3 Marks)**

(ii) Mr. Sarthak, a non-resident, made an application to the Authority for Advance Rulings on 10.8.2018 in relation to a transaction proposed to be undertaken by him. On 13.9.2018, he decides to withdraw the said application. Can he withdraw the application on 13.9.2018? Examine.

**(3 Marks)**

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE: GROUP – II**  
**PAPER – 7: DIRECT TAX LAWS & INTERNATIONAL TAXATION**  
**SOLUTIONS**

**Division A – Multiple Choice Questions**

1. (c)
2. (d)
3. (c)
4. (c)
5. (a)
6. (c)
7. (d)
8. (c)
9. (c)
10. (d)
11. (b)
12. (c)
13. (b)
14. (a)
15. (d)
16. (c)
17. (d)
18. (d)
19. (d)
20. (a)

**Division B – Descriptive Choice Questions**

**1. Computation of Total Income of TrustMe Private Ltd. for the A.Y.2019-20**

	Particulars	Amount (Rs.)
I	<b>Income from house property</b> [Rental income from commercial property] Gross Annual Value <sup>1</sup> /Net Annual Value <sup>2</sup> Less: Deduction under section 24(a) 30% of Net Annual Value	4,30,000  <u>1,29,000</u>  3,01,000

<sup>1</sup> Rent received has been taken as the Gross Annual Value (GAV) in the absence of information relating to Municipal Value, Fair Rent and Standard rent.

<sup>2</sup> Since the question does not contain information about municipal taxes paid, the net annual value is the same as the GAV.

II	<b>Profits and gains of business and profession</b> Profits from manufacturing business [See Working Note below] Less: Set-off of losses from trading in derivatives in shares in a recognized stock exchange [allowed to be set-off against profits from the business of manufacturing as per section 70(1) since it is not speculative in nature [See Note below]]	70,88,000  <u>1,80,000</u>	69,08,000
III	<b>Capital Gains</b> Sale consideration Less: Indexed Cost of Acquisition [Rs. 50,00,000 × 280/264]	52,00,000  <u>53,03,030</u>	
IV	<b>Long-term capital loss to be carried forward to A.Y.2020-21 for set-off against long-term capital gains, if any, in that year</b> <b>Income from Other Sources</b> Rent received from vacant land Interest received on income-tax refund Excess of issue price of shares over the fair market value of shares is taxable as per section 56(2)(viib) in the case of TrustMe Private Ltd., not being a company in which public are substantially interested [Rs. 40 (i.e., Rs. 100 – Rs. 60) × 1,00,000 shares]	(1,03,030)  2,05,000 42,000 40,00,000  —	42,47,000
	<b>Gross Total Income</b> <b>Less: Deductions under Chapter VI-A</b> <b>Deduction under section 80G</b> Donation to Swachh Bharat Kosh [qualifies for 100% deduction – assuming that the same has not been spent in pursuance of corporate social responsibility under section 135(5) of the Companies Act, 2013]		<b>1,14,56,000</b>
	<b>Deduction under section 80GGB</b> Contribution to Political Party [Not allowable as deduction since the contribution is made in cash]	70,000 Nil	70,000
	<b>Total Income</b>		<b>1,13,86,000</b>

**Working Note:**

**Computation of profits and gains from the business of manufacturing**

Particulars	Amount (Rs.)
<b>Net profit as per statement of profit and loss</b>	77,00,000
<b>Add: Items debited but to be considered separately or to be disallowed</b>	
<b>B(ii) Donation paid to Swachh Bharat Kosh, considered separately</b> [Not an expenditure incurred wholly and exclusively for the manufacturing business. Hence, not allowable under section 37]	70,000
<b>B(iii) Contribution to political party</b> [Not an expenditure incurred wholly and exclusively for the manufacturing business. Hence, not allowable u/s 37]	1,50,000

<b>B(iv) Payment to transport contractor</b> [As per section 194C(6), no tax is required to be deducted at source since the payment is to a transport contractor not having more than 10 goods carriages at any time during the previous year and he has given a declaration to that effect along with his PAN. Hence, disallowance under section 40(a)(ia) for non-deduction of tax at source is not attracted. Also, since payment is made by account payee cheque, no disallowance under section 40A(3) is attracted].	-
<b>B(v) Bonus to employees</b> [Since the payment is made after the due date of filing return of income, disallowance under section 43B is attracted]	3,20,000
<b>B(vi) Provision for income-tax (including interest of Rs. 70,000 thereon)</b> [Not allowable as deduction. Disallowance under section 40(a)(ii) is attracted]	4,20,000
<b>B(viii) Loss from trading in derivatives in shares in a recognized stock exchange [See Note below]</b> [Since loss from trading in derivatives in shares is not related to the business of manufacturing, the same is not incurred wholly and exclusively for this business, and hence, is not allowable as deduction under section 37 while computing profits from the business of manufacturing]	1,80,000
	11,40,000
	88,40,000
	45,000
	88,85,000
<b>Add: Cash Payment for purchase of raw material deemed as income</b> AI(1) [Since the provision for outstanding bill for purchase of raw material has been allowed as deduction during the P.Y.2017-18, cash payment in excess of Rs. 10,000 against such bill in the P.Y.2018-19 would be deemed as income of P.Y.2018-19 as per section 40A(3A)]	5,00,000
<b>Less: Expenditure to be allowed</b> B(i) & AI(4) Depreciation [Difference between the normal depreciation of Rs. 16.75 lakhs as per Income-tax Act, 1961 [See Note below] and depreciation charged to the statement of profit and loss of Rs. 11.75 lakhs].	
<b>Note</b> – <sup>3</sup> Printers and scanners form an integral part of the computer system and they cannot be used without the computer. Hence, they are part of the computer system, they would be eligible for depreciation at the higher rate of 40% applicable to computers including computer software. However, EPABX is not a computer and is, hence, not entitled to higher depreciation@40% <sup>4</sup>	
<b>Particulars</b>	<b>Rs.</b>
Depreciation computed as per Income-tax Act, 1961	18,00,000

<sup>3</sup> CIT v. BSES Yamuna Powers Ltd (2013) 358 ITR 47 (Delhi)

<sup>4</sup> Federal Bank Ltd. v. ACIT (2011) 332 ITR 319 (Kerala)

Less: Depreciation@40% wrongly provided in respect of EPABX = 40% of Rs. 5,00,000	<u>2,00,000</u>		
Add: Depreciation@15% on EPABX = 15% of Rs. 5,00,000	16,00,000		
<b>Correct Depreciation as per Income-tax Act, 1961</b>	<u>75,000</u>		
	<b>16,75,000</b>		
<b>AI(5) Additional depreciation on new plant and machinery</b>		3,40,000	
Since plant and machinery was purchased only on 18.11.2018, it was put to use for less than 180 days during the year. Hence additional depreciation is to be restricted to 10% (i.e., 50% of 20%) of Rs. 34 lakhs. <sup>5</sup>		30,000	
<b>AI(6) Audit Fees relating to P.Y.2017-18</b>			
[Rs. 30,000, being 30% of audit fees of Rs. 1,00,000 provided for in the books of account of F.Y.2017-18 would have been disallowed due to non-deduction of tax at source. Since tax has been deducted in September, 2018 and paid on 6.10.2018, the amount of Rs. 30,000 is deductible while computing business income of P.Y.2018-19].			
<b>B(vii) Contribution to University</b>			
[Contribution to a University approved and notified under section 35(1)(ii) would qualify for weighted deduction@150%. Since Rs. 1,00,000 has already been debited to the statement of profit and loss, the balance Rs. 50,000 has to be deducted while computing business income]	<u>50,000</u>	9,20,000	
		79,65,000	
<b>Less: Items credited to statement of profit and loss, but not includable in business income.</b>			
A(i) Rent received from vacant land [Chargeable to tax under the head "Income from other sources"]	2,05,000		
A(ii) Rent received from commercial property owned by the company [Chargeable to tax under the head "Income from house property"]	4,30,000		
A(iii) Interest received on income tax refund [Chargeable to tax under the head "Income from other sources"]	42,000		
A(iv) Profit on sale of unused land [Chargeable to tax under the head "Capital Gains"]	<u>2,00,000</u>		
		8,77,000	
<b>Profits and gains from the business of manufacturing</b>		<b>70,88,000</b>	

**Note:** As per section 43(5), an eligible transaction of trading in derivatives in shares in a recognized stock exchange is not a speculative transaction.

In this case, the company is engaged in the business of manufacturing and hence, the loss on account of trading in derivatives is not incurred wholly and exclusively in relation to such business and hence, has to be disallowed while computing profits from the business of manufacturing. Trading in derivatives in shares is also not incidental to the business of manufacturing. Therefore, it has to be

<sup>5</sup> Balance additional depreciation of Rs. 3.40 lakhs can be claimed in the next year i.e., A.Y.2020-21

assumed that the company is also carrying on the business of trading in derivatives in shares in addition to its manufacturing business.

In this case, the loss has to be disallowed at the first instance while computing income from the business of manufacturing since it is not wholly and exclusively incurred for the said business and thereafter, loss from trading in derivatives has to be set-off against the profits from manufacturing business applying the provisions of section 70(1) permitting inter-source set-off of losses.

2. (a) Computation of Taxable and Exempt Income of M/s Jeevan Pvt Ltd. for the A.Y. 2019-20

Particulars	Rs.
Net profit as per Profit and Loss Account	37,65,00,000
<b>Add: Excess depreciation as per books of account</b>	Rs.
Depreciation as per books of account	30,00,00,000
Less: Depreciation allowable as per the Income-tax Act, 1961	<u>28,00,00,000</u>
<b>Net profit before allowing deduction under section 33AB</b>	<u>2,00,00,000</u>
Less: Deduction under section 33AB would be the lower of:	39,65,00,000
- <b>Amount deposited in Rubber Development Account</b> on or before 30.9.2019 [i.e., Rs. 30,00,00,000]	
- <b>40% of profits of such business</b> [i.e., Rs. 15,86,00,000, being 40% of Rs. 39,65,00,000]	<u>15,86,00,000</u>
<b>Net profit after allowing deduction under section 33AB</b>	<b>23,79,00,000</b>
<b>Add:</b> Amount withdrawn from special account with NABARD, which is deemed as profits and gains of business or profession	
(i) <b>Purchase of a new machine for use in its operation for Rs. 10 crores</b> , would <u>not</u> be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme.	Nil
(ii) <b>Purchase of office appliances for corporate office at Hyderabad for Rs. 10 crores</b> , out of the amount withdrawn from the deposit account, would be deemed as profits and gains of business or profession, since the said utilisation is not permissible.	10,00,00,000
(iii) <b>Rs. 5 crores utilised for purchase of computers and accessories is permissible.</b> Thus, such amount would <u>not</u> be deemed as profits and gains of business or profession.	Nil
(iv) <b>Rs. 1 crore utilised for construction of a godown near rubber estate to store raw rubber</b> , would <u>not</u> be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme.	Nil
(v) <b>Rs. 35 lakhs utilised for repairs to machinery</b> would not be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme.	Nil
<b>Note -</b> However, no deduction would be allowed in respect of such expenditure mentioned in (i), (iii), (iv) and (v) during the P.Y. 2018-19, since amount is spent out of the amount deposited in special account with NABARD, which has already been allowed as deduction in an earlier	

	assessment year.	
(vi)	The remaining amount of Rs. 13.65 crores {Rs. 40 crores less Rs. 26.35 crores [utilised above in (i) to (v)]}, which is <u>not</u> utilised during the previous year in which such amount is withdrawn, would be deemed as profits and gains of business or profession.	<u>13,65,00,000</u>
	<b>Total Composite business profits</b>	<b>47,44,00,000</b>
	Less: 65% of Rs. 47,44,00,000, being agricultural income exempt	<u>30,83,60,000</u>
	<b>Business income</b>	<b>16,60,40,000</b>
	Less: Brought forward business loss of Rs. 6 crores pertaining to A.Y.2016-17 not allowed to be set-off against the business profits of the P.Y. 2018-19, since as on 31.3.2019, the shares of M/s Jeevan Pvt Ltd carrying 60% (i.e., not less than 51%) of the voting power is held by Mr. Bhola and not by Mr. Alok, being the person who held such shares as on 31.03.2016, being the last day of previous year 2015-16, in which such loss was incurred.	<u>-</u>
	<b>Business income chargeable to tax</b>	<b>16,60,40,000</b>

**(b) Computation of total income and tax payable of Madhuvan for A.Y. 2019-20**

Particulars	Rs.	Rs.
<b>Profits and gains from business and profession</b>		
Income from sole proprietary concern in India	50,00,000	
Share of profit from a partnership firm in India of Rs. 30 lakhs, is exempt	<u>Nil</u>	
Business profit	50,00,000	
Less: Business Loss in Country T (USD 10,000 x Rs. 64/USD)	<u>6,40,000</u>	43,60,000
<b>Income from Other Sources</b>		
Agricultural income from rubber estate in Country T, is taxable in India (USD 70,000 x Rs. 64/USD)	<u>44,80,000</u>	
<b>Gross Total Income/ Total Income</b>		<b>88,40,000</b>
<b>Tax on total income</b>		
Tax on Rs. 88,40,000 [(30% x Rs. 78,40,000 plus Rs. 1,10,000) applicable for an individual, resident in India who is of the age of 60 years or more]	24,62,000	
Add: Surcharge@10%, since total income exceeds Rs. 50 lakhs	<u>2,46,200</u>	
Add: Health & Education cess @4%	<u>1,08,328</u>	28,16,528
Average rate of tax in India [i.e., Rs. 28,16,528/Rs. 88,40,000 x 100]	31.86%	
Average rate of tax in Country T [i.e., USD 10,500/USD 70,000]	15%	
Doubly taxed income [Rs. 44,80,000 – Rs. 6,40,000]	38,40,000	
Rebate under section 91 on Rs. 38,40,000 @15% (lower of average Indian tax rate and rate of tax in Country T]	<u>5,76,000</u>	

<b>Tax payable in India [Rs. 28,16,528 – Rs. 5,76,000]</b>	<b>22,40,528</b>
<b>Tax payable (rounded off)</b>	<b>22,40,530</b>

**Note:**

Since Madhuvan, is resident in India for the P.Y.2018-19, his global income would be subject to tax in India. He would be allowed deduction under section 91 provided all the following conditions are fulfilled:-

- (a) He is a resident in India during the relevant previous year.
- (b) 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 Country T in his hands and he has paid tax on such income in Country T.
- (e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country T, where the income has accrued or arisen.

Madhuvan is eligible for deduction under section 91 since all the conditions specified thereunder stand fulfilled by him during the previous year.

3. (a) (i) Section 11(1)(a) stipulates that in order to avail exemption of income derived from property held under trust wholly for charitable or religious purposes, the trust is required to apply for charitable or religious purposes, 85% of its income from such property. In this case, the trust has earned income of Rs. 4,90,000 for the year ended 31.3.2019. It has also earned short term capital gain from sale of capital asset for Rs. 10,60,000. The trust had utilized the entire amount of Rs. 15,50,000 for the purchase of a building meant for charitable purposes.

The Supreme Court, in *S.R.M. M. CT. M. Tiruppani Trust v. CIT (1998) 230 ITR 636*, ruled that the assessee-trust, which applied its income for charitable purposes by purchasing a building for use as a hospital, was entitled to exemption under section 11(1) in respect of such income.

The ratio of the decision squarely applies to the case of the charitable trust in question. Therefore, the charitable trust is justified in claiming that the purchase of the building amounted to application of its income for charitable purposes.

Under section 11(1A), where the whole of the sale proceeds of a capital asset held by a charitable trust is utilised by it for acquiring another capital asset, the capital gain arising therefrom is deemed to have been applied to charitable purposes and would be exempt. Section 11(1A) does not make any distinction between a long-term capital asset and a short-term capital asset. The claim of the charitable trust to the effect that the capital gain is deemed to have been applied to charitable purposes is tenable in law.

(ii) **Computation of taxable income of Mannat charitable trust**

	<b>Particulars</b>	<b>Rs.</b>
(i)	Income from property held under trust (net)	10,00,000
(ii)	Income (net) from business (incidental to main objects)	4,00,000
(iii)	Voluntary contributions from public Voluntary contribution made with a specific direction towards corpus are alone to be excluded under section 11(1)(d). In this case, there is no such direction and hence, included.	<u>7,00,000</u>
		21,00,000

	Less: 15% of the income eligible for retention / accumulation without any conditions	<u>3,15,000</u> 17,85,000
	Less: Amount applied for the objects of the trust	
	(i) Amount spent for charitable purposes (Rs. 11,60,000 - Rs. 3,60,000)	8,00,000
	(ii) Repayment of loan for construction of orphan home	3,60,000
	<b>Taxable Income</b>	<b>6,25,000</b>

(b) (i) As per section 9(1)(vii)(b), income by way of fees for technical services payable by a resident is deemed to accrue or arise in India, except where the fees is payable, *inter alia*, in respect of services utilized in a business or profession carried on by such person outside India. In this case, since Trim Ltd. utilizes the technical services for its business in Indore, the fees for technical services payable by Trim Ltd. is deemed to accrue or arise in India in the hands of Mr. Richard Grill.

In accordance with the provisions of section 115A, where the total income of a non-corporate non-resident includes any income by way of royalty or fees for technical services other than the income referred to in section 44DA(1), received from an Indian concern in pursuance of an agreement made by him with the Indian concern and the agreement is approved by the Central Government, then, the special rate of tax at 10% of such fees for technical services is applicable. No deduction would be allowable under sections 28 to 44C and section 57 while computing such income.

Section 90(2) makes it clear that where the Central Government has entered into a DTAA with a country outside India, then, in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. Therefore, if the DTAA provides for a rate lower than 10%, then, the provisions of DTAA would apply.

- (I) In this case, since India does not have a DTAA with Country F, of which Richard Grill is a resident, the fees for technical services (FTS) received from Trim Ltd., an Indian company, would be taxable @10%, by virtue of section 115A.
- (II) In this case, the FTS from Trim Ltd. would be taxable @5%, being the rate specified in the DTAA, even though section 115A provides for a higher rate of tax, since the tax rates specified in the DTAA are more beneficial. However, since Richard Grill is a non-resident, he has to furnish a tax residency certificate from the Government of Country F for claiming such benefit. Also, he has to furnish other information, namely, his nationality, his tax identification number in Country F and his address in Country F.
- (III) In this case, the FTS from Trim Ltd. would be taxable @10% as per section 115A, even though DTAA provides for a higher rate of tax, since the provisions of the Act (i.e. section 115A in this case) are more beneficial.

(ii) Where Zing Inc., a UK company, has a PE in India and rendering technical services is effectively connected with the PE in India.

Since Zing Inc. carries on business through a PE in India, in pursuance of an agreement with Swing Ltd. or other Indian companies entered into after 31.3.2003, and the income by way of fees for technical services is effectively connected with the PE in India as per section 44DA, such income shall be computed under the head "Profits and gains of business or profession" in accordance with the provisions of the Income-tax Act, 1961.

Accordingly, expenses of Rs. 22 lakhs (Rs. 10 lakhs + Rs. 12 lakhs) incurred for earning fees for technical services of Rs. 9 crore (Rs. 3.5 crore + Rs. 5.5 crore) is allowable as

deduction therefrom. However, expenditure of Rs. 6 lakhs which is not incurred wholly and exclusively for the business of the PE and the amount of Rs. 12 lakhs paid by the PE to the Head Office is not allowable as deduction.

Zing Inc. is required to maintain books of account under section 44AA and get the same audited under section 44AB and furnish report along with the return of income under section 139.

4. (a) (i) Section 206C(1F) provides for collection of tax at source@1% by the seller from the buyer, at the time of receipt of consideration for sale of motor vehicle, the value of which exceeds Rs. 10 lakhs. CBDT Circular No.22/2016 dated 8.6.2016 clarifies that this section has been inserted to cover all transactions of retail sales and accordingly, it will not apply to sale of motor vehicles by manufacturers to dealers. Hence, car manufacturers are not liable to collect tax at source under section 206C(1F).

In respect of sale of premium model cars (of value ranging above Rs. 10 lakhs and upto Rs. 50 lakhs) by dealers to retail customers, tax has to be collected at source@1% under section 206C(1F), even if no part of the consideration is received in cash.

As regards small cars of value ranging from Rs. 5 lakhs upto Rs. 10 lakhs, there is no requirement to collect tax at source.

(ii) The first proviso to section 201 provides that the payer (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident payee shall not be deemed to be an assessee-in-default in respect of such tax if such resident payee –

- (1) has furnished his return of income under section 139;
- (2) has taken into account such sum for computing income in such return of income; **and**
- (3) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the resident payee.

However, where the payer fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident and is not deemed to be an assessee-in-default under section 201(1) as mentioned above, interest under section 201(1A)(i) i.e., @1% p.m. or part of month, shall be payable by the payer from the date on which such tax was deductible to the date of furnishing of return of income by such resident payee.

Therefore, M/s Fitband Limited shall not be required to pay the difference tax in case the above mentioned conditions are fulfilled. However, the company shall be liable to make payment of interest from the date on which such tax was deductible to the date of furnishing of return of income by Star Warehousing.

Therefore, the submission of the assessee company, in this case, is correct.

(b) (i) Clause (i) of *Explanation* to section 92B amplifies the scope of the term “international transaction”. According to the said *Explanation*, international transaction includes, *inter alia*, provision of scientific research services. L Inc. is a specified foreign company in relation to X Ltd. Therefore, the condition of X Ltd. holding shares carrying not less than 26% of the voting power in L Inc. is satisfied, assuming that all shares carry equal voting rights. Hence, L Inc. and X Ltd. are deemed to be associated enterprises under section 92A(2). Since the provision of scientific research services by L Inc. to X Ltd. is an “international transaction” between associated enterprises, transfer pricing provisions are attracted in this case.

- (ii) In this case, salary payment has been made to a related person referred to in section 40A(2)(b) i.e., relative (i.e., daughter) of Mrs. Chiya, who is a director of T Ltd. However, with effect from A.Y.2018-19, section 92BA has been amended to exclude such transactions from the scope of "specified domestic transaction". Consequently, transfer pricing provisions would not be attracted in this case.
- (iii) The scope of the term "intangible property" has been amplified to include, *inter alia*, technical knowhow, which is a technology related intangible asset. Transfer of intangible property falls within the scope of the term "international transaction". Since A Inc., a French company, guarantees not less than 10% of the borrowings of Y Ltd., an Indian company, A Inc. and Y Ltd. are deemed to be associated enterprises under section 92A(2). Therefore, since transfer of technical knowhow by Y Ltd., an Indian company, to A Inc., a French company, is an international transaction between associated enterprises, the provisions of transfer pricing are attracted in this case.

5. (a) (i) The action of the Commissioner in issuing the second notice is not justified. The term "record" has been defined in clause (b) of Explanation to section 263(1). According to this definition "record" shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at the same time, in view of the express provisions contained in clause (b) of the Explanation to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner,

Issuance of a notice under section 263 succeeds the examination of record by Commissioner. In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was issued could not be said to be "record" available at the time of examination as emphasized in Explanation (b) to section 263(1).

- (ii) (I) It has been held by the Apex Court in the case of *Hind Wire Industries Ltd. v. CIT* (1995) 212 ITR 639 that the order once amended can also be rectified subsequently provided the mistake apparent from record is rectifiable under section 154. The Apex Court enlarged the scope of the words used in that section by stating that it does not necessarily mean the original order. It could be any order including the amended or rectified order. The action of the Assessing Officer is, therefore, incorrect.
- (II) The original return for A.Y.2019-20 was filed in time and the proceedings were already taken up for assessment under section 143(3). A revised return was filed by the assessee after the end of the relevant assessment year. The action of the Assessing Officer in making the assessment in disregard of the revised return filed on 20.4.2020 is correct because as per the provisions of section 139(5) the assessee can file the revised return only within the end of the relevant assessment year to which the return relates or before completion of the assessment, whichever is earlier.
- (iii) The issue under consideration in this case is, whether omission to issue notice under section 143(2) is a defect not curable in spite of section 292BB

This issue came up before the Apex Court in *Asstt. CIT v. Hotel Blue Moon* (2010) 321 ITR 362, wherein it was held that without the statutory notice under section 143(2), the Assessing Officer could not assume jurisdiction. In that case, the Assessing Officer recorded his inability to generate a notice due to certain reasons. Such defect cannot be cured subsequently, since it is not procedural but one that goes to the root of the jurisdiction. Even though the assessee had participated in the proceedings, in the absence of mandatory notice, section 292BB cannot help the Revenue officers who have no jurisdiction, to begin with. Section 292BB helps Revenue in countering claims of assessees who have participated in proceedings once a due notice has been issued.

Applying the rationale of the Supreme Court ruling to the case on hand, the failure to issue notice under section 143(2) would vitiate the assessment proceedings notwithstanding the assessee's participation in the proceedings. Section 292BB would not come to the rescue of the Revenue Authority if they omit to issue notice under section 143(2).

(b) A hybrid mismatch is an arrangement that exploits a difference in the tax treatment of an entity or an instrument under the laws of two or more tax jurisdictions to achieve double non-taxation.

Branch mismatches arise where the ordinary rules for allocating income and expenditure between the branch and head office result in a portion of the net income of the taxpayer escaping the charge to taxation in both the branch and residence jurisdiction. Unlike hybrid mismatches, which result from conflicts in the legal treatment of entities or instruments, branch mismatches are the result of differences in the way the branch and head office account for a payment made by or to the branch.

Hybrid mismatch arrangements arise due to -

- (i) Creation of two deductions for a single borrowing
- (ii) Generation of deductions without corresponding income inclusions
- (iii) Misuse of foreign tax credit
- (iv) Participation exemption regimes

Specific country laws that allow taxpayers to opt for the tax treatment of certain domestic and foreign entities may aid hybrid mismatches.

BEPS Action Plan 2 gives recommendations to neutralise the effects of hybrid mismatch arrangements, which include general changes to domestic law followed by a set of dedicated anti-hybrid rules. Treaty changes are also recommended. The 2017 report includes specific recommendations for improvements to domestic law intended to reduce the frequency of branch mismatches as well as targeted branch mismatch rules which adjust the tax consequences in either the residence or branch jurisdiction in order to neutralise the hybrid mismatch without disturbing any of the other tax, commercial or regulatory outcomes.

6. (a) (i) (I) Penalty under section 271C is attracted for failure to deduct tax at source. The penalty would be a sum equal to the amount of tax which such person has failed to deduct. Such penalty can be imposed only by the Joint Commissioner. Therefore, Harish & Associates shall be liable for penalty under section 271C equal to the amount of tax which they have failed to deduct under section 194C from the payments made to the contractors. The penalty would be in addition to the disallowance of 30% of expenditure/payment under section 40(a)(ia).

(II) Section 133(6) empowers the Income-tax authority to require any person to furnish information in relation to such points or matters which will be useful for or relevant to any enquiry or proceeding under the Act. Failure on the part of an assessee to furnish the information in relation to such points or matters as required makes him liable for

penalty under section 272A(2) of Rs. 100 for every day during which the failure continues.

**Note** – In a case where no proceeding is pending, the Income-tax authority can exercise this power only after obtaining the approval of the Principal Director/Director or Principal Commissioner/Commissioner as the case may be. In this case, it is presumed that the Income-tax authority has obtained the approval of the Principal Director/Director or Principal Commissioner/ Commissioner before exercising this power.

- (ii) (I) As regards setting off of losses, the provisions relating to merger and amalgamation already contain specific anti-avoidance safeguards. Therefore, GAAR need not be invoked when SAAR is applicable, though as per CBDT Circular No. 7/2017 dated 27.01.2017, GAAR and SAAR can co-exist.
  - (II) In case of merger of a profit-making company with loss making company, there is no specific anti-avoidance safeguards. However, since such merger would be under the order of High Court, GAAR would not be invoked if the High Court has explicitly and adequately considered the tax implication while sanctioning the merger scheme.
- (b) (i) Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.  
"Specified Service" means
  - (1) online advertisement;
  - (2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and
  - (3) any other service as may be notified by the Central Government.However, equalisation levy shall not be levied
  - where the non-resident providing the specified services has a permanent establishment in India and the specified service is effectively connected with such permanent establishment.
  - the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed Rs. 1 lakh.
  - where the payment for specified service is not for the purposes of carrying out business or professionIn the present case, equalisation levy @6% is chargeable on the amount of Rs. 15,00,000 received by Xylo Inc., a non-resident not having a PE in India from LMN Ltd., an Indian company. Accordingly, LMN Ltd. is required to deduct equalisation levy of Rs. 90,000 i.e., @6% of Rs. 15 lakhs, being the amount paid towards online advertisement services provided by Xylo Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.
- (ii) Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed from the date of application by Mr. Sarthak to the Authority for Advance Rulings, he cannot withdraw the application.

However, the Authority for Advance Rulings (AAR), in *M.K. Jain AAR No.644 of 2004*, has observed that though section 245Q(3) provides that an application may be withdrawn by the applicant within 30 days from the date of the application, this, however, does not preclude the AAR from permitting withdrawal of the application after the said period with its permission, if the circumstances of the case so justify.

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE GROUP II**  
**PAPER 8: INDIRECT TAX LAWS**

**Maximum Marks: 100 Marks**

**Time Allowed: 3 Hours**

Notes:

- (i) *Working Notes should form part of the answer. However, in answers to Question in Division A, working notes are not required.*
- (ii) *Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of a note.*
- (iii) *All questions should be answered on the basis of position of (i) GST law as amended up to 30<sup>th</sup> April, 2019 and (ii) customs law as amended by the Finance Act, 2018 and notifications/circulars issued till 30<sup>th</sup> April, 2019.*
- (iv) *The GST rates for goods and services mentioned in various questions are hypothetical and may not necessarily be the actual rates leviable on those goods and services. The rates of customs duty are also hypothetical and may not necessarily be the actual rates. Further, GST compensation cess should be ignored in all the questions, wherever applicable.*

**Division A: Multiple Choice Questions (30 marks)**

**(Questions nos. 1-10 are of 2 marks each and 11- 20 are of 1 marks each)**

**Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions in this division are compulsory.**

1. State which of the following statement is incorrect:
  - (i) An agent, supplying goods on behalf of principal where invoice is issued in the name of principal, is required to get compulsorily registered under GST.
  - (ii) Persons who are required to deduct tax under section 51, whether or not separately registered under this Act are compulsory required to get registered under GST without any threshold.
  - (iii) Every person supplying online information and database access or retrieval services from a place outside India to a registered person in India is compulsory required to get registered under GST without any threshold.
  - (iv) Persons who supply services, other than supplies specified under sub-section (5) of section 9, through such electronic commerce operator who is required to collect tax at source under section 52 are compulsory required to get registered under GST without any threshold.

(a) (i), (ii)  
(b) (iii), (iv)  
(c) (i), (iii), (iv)  
(d) None of the above
2. M/s. Jolly Electronics (P) Ltd., is an authorized dealer of M/s. GG Micro Ltd., located and registered in Lucknow, Uttar Pradesh. It has sold following items to Mr. Alla Rakha (a consumer):

Product	Amount (Rs.)
Refrigerator (500 litres) taxable @ 18%	40,000/-
Stabilizer for refrigerator taxable @ 12%	5,000/-

LED television (42 inches) taxable @ 12%	30,000/-
Split air conditioner (2 Tons) taxable @ 28%	35,000/-
Stabilizer for air conditioner taxable @12%.	5,000/-
Total value	1,15,000/-

M/s. Jolly Electronics (P) Ltd. has given a single invoice, indicating price of each item separately to Mr. Alla Rakha. Mr. Alla Rakha, has given a single cheque of Rs. 1,00,000/- for all the items as a composite discounted price. State the type of supply and the tax rate applicable on the same.

(a) Composite supply; Highest tax rate applicable to split air conditioner, i.e. 28%

(b) Mixed supply; Highest tax rate applicable to split air conditioner, i.e. 28%

(c) Supply other than composite and mixed supply; Highest tax rate applicable to split air conditioner i.e. 28%

(d) Supply other than composite and mixed supply; respective tax rate applicable to each item

3. Which of the following statements is correct while issuing a tax invoice?

(i) Place of supply in case of inter-State supply is not required to be mentioned

(ii) The power of attorney holder can sign the tax invoice in case the taxpayer or his authorised representative has been travelling abroad

(iii) Quantity is not required to be mentioned in case of goods when goods are sold on “as is where is basis”

(iv) Description of goods is not required to be given in case of mixed supply of goods

(a) (ii), (iii)

(b) (i), (ii), (iii)

(c) None of the above

(d) All of the above

4. Which of the following activity is taxable under GST?

(i) Supply of food by a hospital to patients (not admitted) or their attendants or visitors.

(ii) Transportation of passengers by non-air-conditioned railways

(iii) Services by a brand ambassador by way of folk dance performance where consideration charged is Rs. 1,40,000.

(iv) Transportation of agriculture produce by air from one place to another place in India

(v) Services by way of loading, unloading, packing, storage or warehousing of rice

(vi) Service provided by GTA where consideration charged for transportation of goods for a single carriage is Rs. 900

(a) (i), (v), (vi)

(b) (iii), (iv), (v)

(c) (i), (iii), (iv)

(d) (iv), (v)

5. In which of the following supplies of goods and services made exclusively to Government departments, agencies etc. and persons notified under section 51 of the CGST Act, 2017, TDS is required to be deducted?

- (i) Health Department executed a contract with a local supplier to supply “medical grade oxygen” of Rs.2.6 lakh (including GST) and is making full payment.
- (ii) Government school is making a payment of Rs.3.5 Lakh to a supplier for supply of cooked food as mid-day meal under a scheme sponsored by Central/State Government
- (iii) Municipal Corporation of Kolkata purchases a heavy generator from a supplier in Delhi. Now, it is making payment of Rs.5 lakh and IGST @18% on Rs.5 lakh for such purchase.
- (iv) Finance Department is making a payment of Rs.3 lakh (including GST) to a supplier of ‘printing & stationery’.

Assume all other conditions for deduction of TDS are fulfilled.

- (a) (i), (ii) and (iii)
- (b) (ii), (iii) and (iv)
- (c) Only (i) and (ii)
- (d) Only (iii) and (iv)

6. Rupam wishes to file an appeal to Appellate Tribunal. In which of the following cases, the Appellate Tribunal cannot refuse to admit his appeal?

- i. Amount of tax/ ITC or difference in tax/ difference in ITC involved exceeds Rs. 50,000
- ii. Amount of fine, fee or penalty determined by the order exceeds Rs. 50,000
- iii. Amount of tax/ ITC or difference in tax/ difference in ITC involved is Rs. 50,000
- iv. Amount of fine, fee or penalty determined by the order is Rs. 50,000
- v. Amount of tax/ ITC or difference in tax/ difference in ITC involved is less than Rs. 50,000
- vi. Amount of fine, fee or penalty determined by the order is less than Rs. 50,000

- (a) i. and ii.
- (b) i. and iii.
- (c) ii. and iv.
- (d) v. and vi.

7. State which of the following statement is correct:

- (i) Services by any artist by way of performance in folk or classical art forms of music, dance, or theatre as a brand ambassador if the consideration charged for such performance is not more than Rs. 150,000/- is exempt.
- (ii) Services of life insurance business under Life micro-insurance product as approved by the Insurance Regulatory and Development Authority, having minimum amount of cover of Rs. 2,00,000/- is exempt
- (iii) Service by an acquiring bank, to any person in relation to settlement of an amount upto Rs. 2,500/- in a single transaction transacted through credit card, debit card, charge card or other payment card service is exempt.
- (iv) Services provided by a goods transport agency by way of transport in a goods carriage of, goods, where gross amount charged for the transportation of goods on a consignment transported in a single carriage is Rs. 2250/-, is exempt.

Your options are-

- (a) (i)

- (b) (ii), (iii)
- (c) (ii), (iii), (iv)
- (d) None of the above

8. M/s. Shahrukh Beedi Company (P) Ltd., is a manufacturer of cigarettes. It has been registered under GST in the State of West Bengal.

The turnover of the company from the period April, 2018 to March, 2019 is Rs. 90,00,000/-. The Excise duty paid on the cigarettes removed is Rs. 10,00,000/-. CGST and SGST paid on the cigarettes is Rs. 18,00,000/-.

The company also recovered actual freight of Rs. 5,00,000/- on the supply of cigarettes so made during the financial year 2018-19, and also charged CGST/ SGST thereon. The company paid RCM @ 5% while availing the services of GTA of Rs. 5,00,000/-.

Compute the aggregate turnover of M/s. Shahrukh Beedi Company (P) Ltd.,

- (a) Rs. 90,00,000/-
- (b) Rs. 1,00,00,000/-
- (c) Rs. 1,18,00,000/-
- (d) Rs. 1,05,00,000/-

9. Mr. Prabhu Deva, registered under GST in Mumbai, is in the business of trading of marble handicraft items domestically as also exporting the same. His annual turnover and input tax details are as follows:

	Turnover	Tax paid on	input tax
Taxable goods	1,25,00,000/-	12,50,000/-	
Exported goods	75,00,000/-	5,50,000/-	
Exempt goods	50,00,000/-	5,00,000/-	

Mr. Prabhu Deva exported the goods under LUT without payment of IGST.

Now, Mr. Prabhu Deva seeks your help in calculating the amount of refund of ITC, which he is eligible to claim.

- (a) 18,00,000/-
- (b) 6,75,000/-
- (c) 5,40,000/-
- (d) 6,90,000/-

10. State whether the following statements are true or false:

1. Zero rated supply means supply of any goods or services or both which attracts nil rate of tax.
2. Exempt supply means export of goods or services or both, or supply of goods or services or both to a Special Economic Zone developer or a Special Economic Zone unit.
3. Non-taxable supply means supply of goods or services or both which is not leviable to tax under CGST Act, 2017 but leviable to tax under the Integrated Goods and Services Tax Act, 2017.
4. ITC may be availed for making zero rated supply of exempt goods.

- (a) False, False, False, True
- (b) True, False, False, False

(c) True, True, False, False  
(d) False, False, False, False

11. M/s. Raman Plastics is a manufacturer of plastic toys. It is registered person under GST in Shimla, Himachal Pradesh. It procures its raw materials from Punjab. During the month of April-2019, it purchased material of Rs. 35.00 Lakh and paid IGST thereon amounting to Rs. 6.30 Lakh. It supplied 30% of its production in the State of Jammu and Kashmir, whereas the 70% of its production was supplied taxable @ 0.1% to a merchant exporter during the month of Apr-2019. The returns for the month of April, 2019 were duly filed in time. The last date upto which the taxpayer can claim refund of input tax credit on account of inverted duty structure is

(a) 20-Apr-2021  
(b) 20-May-2021  
(c) 31-Mar-2022  
(d) 20-Apr-2020

12. Banke Bihari (Pedewala), is a famous sweets manufacturer, located and registered in Mathura, Uttar Pradesh. He received an order for 200 Kg. of sweets on 2nd May, 2019 from M/s. Ghoomghoom Travels (P) Ltd., located and registered in same locality of Mathura for a total consideration of Rs. 1,00,000/. All 200 Kg. sweets were delivered to M/s. Ghoomghoom Travels (P) Ltd. on 5th May, 2019, but without invoice, as accountant of Mr. Banke Bihari was on leave on that day. However, the invoice was raised for the same on 6th May, 2019, when the accountant joined the office after leave. Payment in full was made on 7th May, 2019.

Determine the time of supply of goods in this case.

(a) 2<sup>nd</sup> May, 2019  
(b) 5<sup>th</sup> May, 2019  
(c) 6th May, 2019  
(d) 7th May, 2019

13. Aflatoon Spares (P) Ltd., located and registered in Haryana, supplied spare parts (FOB basis) to Mr. Laxmi Khurana, an unregistered person, located in Rajasthan. Mr. Laxmi Khurana booked the courier himself with Black Dart Courier (P) Ltd., registered in Delhi for delivery in Rajasthan. Black Dart Courier (P) Ltd. picked up the goods from Haryana and delivered the courier in Rajasthan while passing through the State of Uttar Pradesh.

Determine the place of supply of service provided by Black Dart Courier (P) Ltd. to Mr. Laxmi Khurana:

(a) Haryana  
(b) Delhi  
(c) Rajasthan  
(d) Uttar Pradesh

14. Sukanya, a registered supplier, failed to pay the GST amounting to Rs. 5,000 for the month of January, 20XX. The proper officer imposed a penalty on Sukanya for failure to pay tax. Sukanya believes that it is a minor breach and in accordance with the provisions of section 126 of the CGST Act, 2017, no penalty is imposable for minor breaches of tax regulations. In this regard, which of the following statements is true?

(a) Penalty is leviable on Sukanya since the breach is considered as a 'minor breach' only if amount of tax involved is less than Rs. 5,000

(b) Penalty is not leviable on Sukanya since the breach is considered as a 'minor breach' if amount of tax involved is upto Rs. 5,000

(c) Penalty is leviable on Sukanya since the breach is considered as a 'minor breach' only if amount of tax involved is Nil.

(d) None of the above.

15. Mr. A, a sole proprietor, has to appear before the Appellate Authority. He decides to appear by an authorized representative. Which of the following persons can be appointed as 'authorized representative' of Mr. A under GST law?

(a) Sohan, his son, who has been dismissed from a Government service lately.

(b) Rohan, a Company Secretary, who has been adjudged insolvent.

(c) Mukul, a practicing High Court advocate.

(d) All of the above.

16. Which of the following statement(s) is/are correct?

(i) Special exemption under section 25 of the Customs Act is granted by issuing a notification;

(ii) General exemption under section 25 of the Customs Act is granted by issuing an order;

(iii) Special exemption is required to be published in official gazette;

(iv) General exemption is not required to be published in official gazette.

(a) All of above

(b) None of above

(c) Both (i) and (ii)

(d) (ii) and (iv)

17. Countervailing duty under section 9 of the Customs Tariff Act shall not be levied unless it is determined that:

(i) Subsidy relates to export performance;

(ii) Subsidy relates to use of domestic goods over imported goods in export article;

(iii) Subsidy is conferred on all persons engaged in the manufacture of export article.

(a) All of above

(b) Only (iii)

(c) (ii) and (iii)

(d) (i) and (ii)

18. Anti-Dumping duty is calculated as

(a) Higher of margin of dumping or injury margin;

(b) Lower of margin of dumping or injury margin;

(c) Higher of export price or normal value;

(d) Lower of export price or normal value

19. Read the following and choose the correct option:

- Indian customs waters extend up to 12 nautical miles;
- Indian customs waters extend up to 24 nautical miles;
- Indian customs waters extend up to exclusive economic zone of India;
- Indian customs waters include territorial waters and extend up to 200 nautical miles.

- Only (ii)
- (iii) and (iv)
- (ii) and (iv)
- Only (iv)

20. The taxable event under the Customs Act, 1962 is:

- Import of goods into India/ export of goods from India;
- Supply of goods into India/ Supply of goods from India to outside India;
- Sale of goods into India/ Sale of goods outside India;
- Manufacture of goods into India for supply outside India.

#### **Division B: Descriptive Questions (70 Marks)**

**Question no. 1 is compulsory. Attempt any four questions out of the remaining five questions.**

1. Power Engineering Pvt. Ltd., a registered supplier, is engaged in providing expert maintenance and repair services for large power plants that are in the nature of immovable property, situated all over India. The company has its Head Office at Bangalore, Karnataka and branch offices in other States. The work is done in the following manner.

- The company has self-contained mobile workshops, which are container trucks fitted out for carrying out the repairs. The trucks are equipped with items like repair equipments, consumables, tools, parts etc. to handle a wide variety of repair work.
- The truck is sent to the client location for carrying out the repair work. Depending upon the repairs to be done, the equipment, consumables, tools, parts etc. are used from the stock of such items carried in the truck.
- In some cases, a stand-alone machine is also sent to the client's premises in such truck for carrying out the repair work.
- The customer is billed after the completion of the repair work depending upon the nature of the work and the actual quantity of consumables, parts etc. used in the repair work.
- Sometimes the truck is sent to the company's own location in other State(s) from where it is further sent to client locations for repairs.

Work out the GST liability [CGST & SGST or IGST, as the case may be] of Power Engineering Pvt. Ltd., Bangalore on the basis of the facts as described, read with the following data for the month of November 20XX.

<b>S. No.</b>	<b>Particulars</b>	<b>Rs.</b>
A.	Truck sent to own location in Tamil Nadu <ol style="list-style-type: none"> <li>Value of items contained in the truck - Rs. 3,00,000</li> <li>Value of truck - Rs. 25,00,000</li> </ol>	

B.	Truck sent to a client location in Tamil Nadu for carrying out repairs. Stand-alone machine is also sent in the truck to client location for repairs (i) Value of items contained in the truck – Rs. 2,85,000 (ii) Value of stand-alone machine - Rs. 4,00,000 (iii) Value of truck - Rs. 20,00,000 (Billing for repairs to be done afterwards depending upon the actual items used)	
C.	Truck sent to a client location in Karnataka for carrying out repairs (i) Value of items contained in the truck - Rs. 1,06,000 (ii) Value of truck - Rs. 20,00,000 (Billing for repairs to be done afterwards depending upon the actual items used)	
D.	Invoices raised for repair work carried out in Tamil Nadu [including the invoice for repair work done in 'B'] -	70,00,000
E.	Invoices raised for repair work carried out in Karnataka [including the invoice for repair work done in 'C']	12,00,000

Also, specify the document(s), if any, which need to be issued by Power Engineering Pvt. Ltd., Bangalore for the above transactions.

All the given amounts are exclusive of GST, wherever applicable. Assume the rates of taxes to be as under:

Items used for repairs		
CGST – 6%	SGST – 6%	IGST – 12%
Container truck, Stand-alone machines		
CGST – 2.5%	SGST – 2.5%	IGST – 5%
Works contract for repairs and maintenance of immovable property		
CGST – 9%	SGST – 9%	IGST – 18%

You are required to make suitable assumptions, wherever necessary.

**(14 Marks)**

2. (a) Determine whether GST is payable in case of each of the following independent services provided by the registered persons:

- (1) Fees charged from office staff for in-house personality development course conducted by Markanday College - Rs. 80,000. Markanday College provides education as a part of a curriculum for obtaining an engineering degree recognised by law.
- (2) Bus fees collected from students by Starward College - Rs. 3,500 per month. Starward College provides education as a part of a curriculum for obtaining an engineering degree recognised by law.
- (3) Housekeeping service provided in the Smart Kids school, a play school by M/s. Spick & Span - Rs. 25,000 per month.
- (4) Global link supplied "Tracing Alphabets", an online educational journal, to Kidzee School - Rs. 4,000. The Kidzee School used the same for its students of UKG class. **(5 Marks)**

(b) Mr. X, a money changer, has exchanged US \$ 10,000 to Indian rupees @ Rs. 64 per US \$. Mr. X wants to value the supply in accordance with rule 32(2)(b) of CGST Rules.

Determine the value of supply made by Mr. X.

**(4 Marks)**

(c) From the following particulars, calculate total customs duty and integrated tax payable:

(i) Date of presentation of bill of entry: 20.6.20XX [Rate of BCD 20%; Inter-bank exchange rate: Rs. 61.60 and rate notified by CBIC Rs. 70].

(ii) Date of arrival of aircraft in India: 30.6.20XX [Rate of BCD 10%; Inter-bank exchange rate: Rs. 61.80 and rate notified by CBIC Rs. 73.00].

(iii) Rate of Integrated tax leviable under section 3(7) of the Customs Tariff Act: 12%. Ignore GST Compensation Cess.

(iv) CIF value 2,000 US Dollars; Air freight 500 US Dollars, Insurance cost 100 US Dollars [Landing charges not ascertainable].

(v) Social Welfare Surcharge 10%. (5 Marks)

3. (a) I buy a set of modular furniture from a retail store. Invoice is issued to me and I make the payment. The furniture is to be delivered to me later in the week when a technician is available to assemble and install it. The next day the rate of tax applicable to modular furniture is revised upward, and the store sends me a supplementary invoice with the delivery note accompanying the furniture to collect the differential amount of tax.

Is this correct on store's part? (4 Marks)

(b) The place of supply in relation to immovable property is the location of immovable property. Suppose a road is constructed from Delhi to Mumbai covering multiple states.

What will be the place of supply of construction services? (5 Marks)

(c) An importer imported certain inputs for manufacture of final product. A small portion of the imported inputs were damaged in transit and could not be used in the manufacture of the final product. An exemption notification was in force providing exemption in respect of specified raw materials imported into India for use in manufacture of specified goods, which was applicable to the imports made by the importer in the present case.

Briefly examine whether the importer could claim the benefit of the aforesaid notification in respect of the entire lot of the inputs imported including those that were damaged in transit.

(5 Marks)

4. (a) A taxable person has mistakenly paid CGST and SGST for an inter-State supply. Subsequently, when he discovers the same, can he adjust the IGST liability against the wrongly paid CGST and SGST? (3 Marks)

(b) The aggregate turnover of Sangri Services Ltd., Delhi exceeded Rs. 20 lakh on 12<sup>th</sup> August. He applied for registration on 3rd September and was granted the registration certificate on 6<sup>th</sup> September. You are required to advise Sangri Services Ltd. as to what is the effective date of registration in its case. It has also sought your advice regarding period for issuance of Revised Tax Invoices. (6 Marks)

(c) Determine the customs duty payable under the Customs Tariff Act, 1975 including the safeguard duty of 30% under section 8B of the said Act with the following details available on hand:

Assessable value of Sodium Nitrite imported from a developing country from 26th February, 2017 to 25th February, 2018 (both days inclusive)	Rs. 30,00,000
Share of imports of Sodium Nitrite from the developing country against total imports of Sodium Nitrite to India	4%
Basic custom duty	10%
Integrated tax under section 3(7) of the Customs Tariff Act, 1975.	12%
Social welfare surcharge	10%

Note: Ignore GST compensation cess.

(5 Marks)

5. (a) Mr. X, an unregistered person under GST purchases the goods supplied by Mr. Y who is a registered person without receiving a tax invoice from Mr. Y and thus helps in tax evasion by Mr. Y. What disciplinary action may be taken by tax authorities to curb such type of cases and on whom?

Suppose, in the above case, a disciplinary action is taken against Mr. X and an adhoc penalty of Rs. 20,000/- is imposed by issue of SCN without describing contravention for which penalty is going to be imposed and without mentioning the provisions under which penalty is going to be imposed. Should Mr. X proceed to pay for penalty or challenge SCN issued by department?

**(5 Marks)**

(b) On 05.07.20XX, a show cause notice for Rs. 5,00,000 was issued to Mr. Janak Singhal demanding short payment of GST of Rs. 4,50,000 for the month of January, 20XX and also interest of Rs. 50,000.

Mr. Janak Singhal raised objections and after personal hearing on 30.08.20XX, adjudicating authority passed the final order for Rs. 3,50,000 for GST, without any reference with regard to payment of interest.

Mr. Janak Singhal deposited the tax of Rs. 3,50,000 on 02.09.20XX and informed the department on the same day. Subsequently, on 15.09.20XX, department demanded payment of interest of Rs. 60,000 on GST of Rs. 3,50,000.

Mr. Janak Singhal is not ready to pay any interest. His contention is that he is not liable for interest because he deposited all the amount specified in the final adjudication order.

Examine with a brief note the validity of the action taken by the Department with reference to provisions of the CGST Act, 2017. **(4 Marks)**

(c) Mr. Sujoy, an Indian entrepreneur, went to London to explore new business opportunities on 01.04.2018. His wife also joined him in London after three months. The following details are submitted by them with the Customs authorities on their return to India on 15.04.2019:

- (a) used personal effects worth Rs. 80,000,
- (b) 2 music systems each worth Rs. 50,000,
- (c) the jewellery brought by Mr. Sujoy worth Rs. 48,000 [20 grams] and the jewellery brought by his wife worth Rs. 96,000 [40 grams].

With reference to Baggage Rules, 2016, determine whether Mr. and Mrs. Sujoy will be required to pay any customs duty? **(5 Marks)**

6. (a) Briefly discuss the modes of recovery of tax available to the proper officer. **(4 Marks)**

(b) In what cases, assessment order passed by proper officer may be withdrawn? **(5 Marks)**

(c) With reference to drawback on re-export of duty paid imported goods under section 74 of the Customs Act, 1962, answer in brief the following questions:

- (i) What is the time limit for re-exportation of goods as such?
- (ii) What is the rate of duty drawback if the goods are exported without use?
- (iii) Is duty drawback allowed on re-export of wearing apparel without use? **(5 Marks)**

**MOCK TEST PAPER 1**  
**FINAL (NEW) COURSE: GROUP – I**  
**PAPER 8: INDIRECT TAX LAWS**  
**SUGGESTED ANSWERS**

**Division A**

1. (c)
2. (d)
3. (c)
4. (c)
5. (d)
6. (a)
7. (d)
8. (d)
9. (b)
10. (a)
11. (b)
12. (b)
13. (a)
14. (a)
15. (c)
16. (b)
17. (d)
18. (b)
19. (b)
20. (a)

**Division B**

1. **Computation of GST Liability of Power Engineering Pvt. Ltd., Bangalore for the month of November 20XX**

<b>S.No.</b>	<b>Particulars</b>	<b>Rs.</b>
A.	Items sent in container truck to own location in Tamil Nadu - IGST @ 12% [Note 1]	36,000
B.	Container truck sent to own location in Tamil Nadu [Note 2]	-
	Stand-alone machine sent in container truck to client location in Tamil Nadu, for carrying out repairs [Note 3]	-
	Container truck sent to client location in Tamil Nadu [Note 3]	-
	Items sent in container truck to client location in Tamil Nadu, for carrying out repairs [Note 4]	-

C.	Container truck sent to client location in Karnataka [Note 3] Items sent in container truck to client location in Karnataka, for carrying out repairs [Note 4]	-
D.	Invoices raised for repair work carried out in Tamil Nadu: IGST @ 18% [Note 5 and Note 6]	12,60,000
E.	Invoices raised for repair work carried out in Karnataka: CGST 9% + SGST 9% [Note 5 and Note 7]	2,16,000
<b>Total GST liability</b>		<b>15,12,000</b>

**Notes:**

(1) Movement of goods without any consideration to a 'distinct person' as specified in section 25(4) of the CGST Act, 2017 is deemed to be a supply in terms of Schedule I of the said Act. The purchase value is taken as taxable value, being the open market value in terms of rule 28(a) of the CGST Rules 2017. (However, if the regional office is eligible to take full input tax credit, any value may be declared in the tax invoice and that will be taken to be the open market value in terms of the second proviso to the same rule.)

In the given case-

- the location of the supplier is in Bangalore (Karnataka); and
- the place of supply of items contained in the truck is the location of such goods at the time at which the movement of goods terminates for delivery to the recipient i.e., Tamil Nadu in terms of section 10(1)(a) of the IGST Act, 2017.

Therefore, the given supply of items is an inter-State supply as the location of the supplier and the place of supply are in two different States [Section 7(1)(a) of IGST Act, 2017]. Thus, the supply is leviable to IGST in terms of section 5(1) of the IGST Act, 2017.

Since the activity is a supply, a tax invoice is to be issued by Power Engineering Pvt. Ltd. in terms of section 31(1)(a) of the CGST Act, 2017 for sending the items to its own location in Tamil Nadu.

(2) As per section 25(4) of the CGST Act, 2017, a person who has obtained more than one registration, whether in one State or Union territory or more than one State or Union territory shall, in respect of each such registration, be treated as 'distinct persons'.

Schedule I to the CGST Act, 2017 specifies situations where activities are to be treated as supply even if made without consideration. Supply of goods and/or services between 'distinct persons' as specified in section 25 of the CGST Act, 2017, when made in the course or furtherance of business is one such activity included in Schedule I under para 2.

However, in view of the GST Council's recommendation, it has been clarified that the inter-State movement of various modes of conveyance between 'distinct persons' as specified in section 25(4), not involving further supply of such conveyance, including trucks carrying goods or passengers or both; or for repairs and maintenance, may be treated 'neither as a supply of goods nor supply of service' and therefore, will not be leviable to IGST. Applicable CGST/SGST/IGST, however, shall be leviable on repairs and maintenance done for such conveyance [Circular No. 1/1/2017 IGST dated 07.07.2017].

Since the activity is not a supply, tax invoice is not required to be issued by Power Engineering Pvt. Ltd. However, a delivery challan is to be issued by the company in terms of rule 55(1)(c) of CGST Rules, 2017 for sending the truck to its own location in Tamil Nadu.

(3) Supply of goods without consideration is deemed to be a supply *inter alia* when the goods are supplied to a 'distinct person'. However, in this case, stand-alone machine and container truck

are moved to client location and not between 'distinct persons'. Hence, the same will fall outside the scope of definition of supply and will not be leviable to GST.

Here again, a delivery challan is to be issued in terms of rule 55(1)(c) of CGST Rules, 2017 for sending the stand-alone machines and container truck to client location.

(4) As per section 2(119) of the CGST Act, 2017, 'works contract' means a contract for, *inter alia*, repair, maintenance of any immovable property wherein transfer of property in goods (whether as goods or in some other form) is involved in the execution of such contract.

In this case, the supplier provides maintenance and repair services for power plants that are in the nature of immovable property and uses consumables and parts, wherever necessary, for the repairs. Hence, the contract is that of a works contract.

Further, as per section 2(30) of the CGST Act, 2017, a works contract is a 'composite supply' as it consists of taxable supplies of both goods and services which are naturally bundled and supplied in conjunction with each other. The composite supply of works contract is treated as supply of service in terms of para 6(a) of Schedule II to the CGST Act, 2017.

The items used in relation to the repair and maintenance work could be consumables or could be identifiable items/parts. In either case, the transfer of property in goods is incidental to a composite supply of works contract service. Thus, the value of the items actually used in the repairs will be included in the invoice raised for the service and will be charged to tax at that point of time.

Here again, a delivery challan is to be issued in terms of rule 55(1)(c) of CGST Rules, 2017 for sending the items for carrying out the repairs.

(5) The activity is a composite supply of works contract, which is treated as supply of service. As per section 8(a) of the CGST Act, 2017, a composite supply is treated as a supply of the principal supply involved therein and charged to tax accordingly.

Since the activity is a supply of service, a tax invoice is to be issued by Power Engineering Pvt. Ltd. in terms of section 31(2) of the CGST Act, 2017.

(6) In the given case-

- the location of the supplier is in Bangalore (Karnataka); and
- the place of supply of works contract services relating to the power plant (immovable property) is the location at which the immovable property is located i.e., Tamil Nadu in terms of section 12(3)(a) of the IGST Act, 2017.

Therefore, the given supply is an inter-State supply as the location of the supplier and the place of supply are in two different States [Section 7(1)(a) of IGST Act, 2017]. Thus, the supply will be leviable to IGST in terms of section 5(1) of the IGST Act, 2017.

(7) In the given case, the location of the supplier and the place of supply of works contract services are within the same State. Therefore, the given supply is an intra-State supply in terms of section 8(1) of IGST Act, 2017 and thus, chargeable to CGST and SGST.

2. (a) (1) As per *Notification No. 12/2017 CT (R)* dated 28.06.2017, services provided by an educational institution to its students, faculty and staff are exempt from GST. Educational Institution has been defined to mean, *inter alia*, an institution providing services by way of education as a part of a curriculum for obtaining a qualification recognised by any law for the time being in force.

Since Markanday College provides education as a part of a curriculum for obtaining an engineering degree recognised by law, the services provided by it to its staff by way of conducting personality development course would be exempt from GST.

(2) As Starward College is an educational institution, the transport services provided by it to its students would be exempt from GST.

(3) As per *Notification No. 12/2017 CT (R)* dated 28.06.2017, services provided to an educational institution, by way of, *inter alia*, house-keeping services performed in such educational institution are exempt from GST. However, such an exemption is available only when the said services are provided to a pre-school education and a higher secondary school or equivalent.

Therefore, house-keeping services provided to Smart Kids Play School would be exempt from GST.

(4) As per *Notification No. 12/2017 CT (R)* dated 28.06.2017, services provided to an educational institution by way of supply of online educational journals or periodicals is exempt from GST. However, such an exemption is available only when the said services are provided to an educational institution providing education as a part of a curriculum for obtaining a qualification recognised by any law for the time being in force.

Therefore, GST is payable in case of supply of online journal to students of UKG class of Kidzee School.

(b) As per rule 32(2)(b) of CGST Rules, the value in relation to the supply of foreign currency, including money changing, is deemed to be-

- (i) 1% of the gross amount of currency exchanged for an amount up to Rs. 1,00,000, subject to a minimum amount of Rs. 250;
- (ii) Rs. 1,000 and 0.5% of the gross amount of currency exchanged for an amount exceeding Rs. 1,00,000 and up to Rs. 10,00,000.

Therefore, the value of supply, made by Mr. X, under rule 32(2)(b) of CGST Rules is computed as under:

Particulars	Rs.	Rs.
Value of currency exchanged in Indian rupees [Rs. 64 x US \$ 10,000]	6,40,000	
Upto Rs. 1,00,000	1,000	
For Rs. 5,40,000 [0.50% x Rs. 5,40,000]	<u>2,700</u>	
<b>Value of supply</b>		<b>3,700</b>

(c) Computation of total customs duty and integrated tax payable

Particulars	Amount
CIF value	2000 US Dollars
Less: Freight	500
Insurance	<u>100</u> 600 US Dollars
FOB Value	1400 US Dollars
Add: Air Freight [Note 1]	280
Insurance (actual amount)	<u>100</u> 380 US Dollars
	1780 US Dollars
	Rs.
Value @ Rs. 70.00 [Note 2]	1,24,600.00
Assessable Value	1,24,600.00
Basic Custom Duty @ 10% (a) [Note 3]	12,460.00
Add: Social Welfare Surcharge @10% on 1,24,600 (b)	<u>1,246.00</u>

Sub-total		1,38,306.00
Integrated tax under section 3(7) (12% on Rs. 1,38,306) (c) [Note 4]		<u>16,596.72</u>
<b>Total duty and integrated tax (a +b + c) (rounded off)</b>		<b>30,303</b>

**Notes:**

- (1) If the goods are imported by air, the freight cannot exceed 20% of FOB price [Fifth proviso to Rule 10(2) of the Customs (Determination of Value of Imported Goods) Rules, 2007].
- (2) Rate of exchange notified by CBIC on the date of presentation of bill of entry would be the applicable rate. [Proviso to Section 14(1) of the Customs Act, 1962].
- (3) Rate of duty would be the rate as prevalent on the date of filing of bill of entry or arrival of aircraft, whichever is later [proviso to section 15 of the Customs Act, 1962].
- (4) Integrated tax leviable under section 3(7) of the Customs Tariff Act, 1975 is levied on the sum total of the assessable value of the imported goods, customs duties and applicable social welfare surcharge.

3. (a) No, the store is not correct in issuing supplementary invoice with revised rate of tax. The revised rate of tax is not applicable to the transaction, as the issuance of invoice as well as receipt of payment occurred before the supply. Therefore, in terms of section 14(b)(ii), the time of supply is earlier of the two events namely, issuance of invoice or receipt of payment, both of which are before the change in rate of tax, and thus, the old rate of tax remains applicable.

(b) Where the immovable property is located in more than one State, the supply of service is treated as made in each of the States in proportion to the value for services separately collected or determined, in terms of the contract or agreement entered into in this regard or, in the absence of such contract or agreement, on such other reasonable basis as may be prescribed in this behalf [Explanation to section 12(3) for domestic supplies].

In the absence of a contract or agreement between the supplier and recipient of services in this regard, the proportionate value of services supplied in different States/Union territories (where the immovable property is located) is computed on the basis of the area of the immovable property lying in each State/ Union territories [Rule 4 of the IGST Rules].

(c) The facts of the case are similar to the case of *BPL Display Devices Ltd. v. CCEx., Ghaziabad (2004) 174 ELT 5 (SC)* wherein the Supreme Court has held that the benefit of the notifications cannot be denied in respect of goods which are intended for use for manufacture of the final product but cannot be so used due to shortage or leakage.

The Apex Court has held that no material distinction can be drawn between loss on account of leakage and loss on account of damage. The benefit of said exemption cannot be denied as inputs were intended for use in the manufacture of final product but could not be so used due to shortage/leakage/damage. It has been clarified by the Supreme Court that words "for use" have to be construed to mean "intended for use".

Therefore, the importer can claim the benefit of the notification in respect of the entire lot of the inputs imported including those that were damaged in transit.

4. (a) Section 77, *inter alia*, stipulates that a registered person who has paid the Central tax and State tax or, as the case may be, the central tax and the Union territory tax on a transaction considered by him to be an intra-State supply, but which is subsequently held to be an inter-State supply, shall be refunded the amount of taxes so paid in such manner and subject to such conditions as may be prescribed.

The IGST liability cannot be adjusted against the CGST and SGST wrongly paid.

(b) As per section 25 read with CGST Rules, 2017, where an applicant submits application for registration within 30 days from the date he becomes liable to registration, effective date of registration is the date on which he becomes liable to registration. Since, Sangri Services Ltd.'s turnover exceeded Rs. 20 lakh on 12th August, it became liable to registration on same day. Further, it applied for registration within 30 days of so becoming liable to registration, the effective date of registration is the date on which he becomes liable to registration, i.e. 12th August.

As per section 31 read with CGST Rules, 2017, every registered person who has been granted registration with effect from a date earlier than the date of issuance of certificate of registration to him, may issue Revised Tax Invoices. Revised Tax Invoices shall be issued within 1 month from the date of issuance of certificate of registration. Revised Tax Invoices shall be issued within 1 month from the date of issuance of registration in respect of taxable supplies effected during the period starting from the effective date of registration till the date of issuance of certificate of registration.

Therefore, in the given case, Sangri Services Ltd. has to issue the Revised Tax Invoices in respect of taxable supplies effected during the period starting from the effective date of registration (12<sup>th</sup> August) till the date of issuance of certificate of registration (6<sup>th</sup> September) within 1 month from the date of issuance of certificate of registration, i.e. on or before 6<sup>th</sup> October.

**(c) Computation of customs duty and integrated tax payable thereon**

Particular	Amount(Rs.)
Assessable value of sodium nitrite imported	30,00,000
Add: Basic custom duty @ 10% (Rs. 30,00,000 × 10%)	3,00,000
Safeguard duty @ 30% on Rs. 30,00,000 [Safeguard duty is imposable in the given case since share of imports of sodium nitrite from the developing country is more than 3% of the total imports of sodium nitrite into India (Proviso to section 8B(1) of the Customs Tariff Act, 1975)]	9,00,000
Social welfare surcharge @ 10% x Rs. 3,00,000	30,000
Total	42,30,000
Integrated tax leviable under section 3(7) of Customs Tariff Act (Rs. 42,30,000 × 12%) [Note]	5,07,600
Total customs dutypayable (Rs. 3,00,000 + Rs. 9,00,000+ Rs. 30,000+Rs. 5,07,600)	17,37,600

Note: It has been clarified by DGFT vide Guidance note that value for calculation of integrated tax shall also include safeguard duty amount.

5. (a) Both Mr. X and Mr. Y will be offender and will be liable to penalty as under:

Mr. X – Penalty under section 122(3) which may extend to Rs. 25,000/-;

Mr. Y – Penalty under section 122(1), which will be higher of following, namely (i) Rs. 10,000/- or (ii) 100% of tax evaded.

The levy of penalty is subject to a certain disciplinary regime which is based on jurisprudence, principles of natural justice and principles governing international trade and agreements. Such general discipline is enshrined in section 126 of the Act. Accordingly—

- (i) no penalty is to be imposed without issuance of a show cause notice and proper hearing in the matter, affording an opportunity to the person proceeded against to rebut the allegations levelled against him,
- (ii) the penalty is to depend on the totality of the facts and circumstances of the case, the penalty imposed is to be commensurate with the degree and severity of breach of the provisions of the law or the rules alleged,
- (iii) the nature of the breach is to be specified clearly in the order imposing the penalty,
- (iv) the provisions of the law under which the penalty has been imposed is to be specified.

Since SCN issued to Mr. X suffers from lack of clarity about nature of breach which has taken place and about provision of law under which penalty has been imposed, SCN issued by department may be challenged.

- (b) As per section 75 of the CGST Act, 2017, the interest on the tax short paid has to be paid whether or not the same is specified in the order determining the tax liability.

Thus, in view of the same, Mr. Janak Singhal will have to pay the interest even though the same is not specified in the final adjudication order. His contention that he is not liable for interest because he deposited all the amount specified in the final adjudication order is not valid in law.

However, the amount of interest demanded in the order cannot be in excess of the amount specified in the notice.

Therefore, in the given case, Department cannot demand the interest in excess of the amount specified in the notice, which will be Rs. 50,000.

- (c) As per rule 3 of the Baggage Rules, 2016, an Indian resident arriving from any country other than Nepal, Bhutan or Myanmar, shall be allowed clearance free of duty articles in his bona fide baggage, that is to say, used personal effects and travel souvenirs; and articles [other than certain specified articles], upto the value of Rs. 50,000 if these are carried on the person or in the accompanied baggage of the passenger.

Thus, there is no customs duty on used personal effects and travel souvenirs and general duty free baggage allowance is Rs. 50,000 per passenger. Thus, duty liability of Mr. Sujoy and his wife is nil for the used personal effects worth Rs. 80,000 and 2 music systems each worth Rs. 50,000.

As per rule 5 of the Baggage Rules, 2016, the jewellery allowance is as follows:

Jewellery brought by	Duty free allowance
Gentleman Passenger	Jewellery upto a weight of 20 grams with a value cap of Rs. 50,000
Lady Passenger	Jewellery upto a weight of 40 grams with a value cap of Rs. 1,00,000

However, the jewellery allowance is applicable only to a passenger residing abroad for more than 1 year.

Consequently, there is no duty liability on the jewellery brought by Mr. Sujoy as he had stayed abroad for period exceeding 1 year and weight of the jewellery brought by him is 20 grams with a value less than Rs. 50,000.

However, his wife is not eligible for this additional jewellery allowance as she had stayed abroad for a period of less than a year. Thus, she has to pay customs duty on the entire amount of

jewellery brought by her as she has already exhausted the general duty free baggage allowance of Rs. 50,000 allowed under rule 3.

6. (a) The proper officer may recover the dues in following manner:
  - (a) Deduction of dues from the amount owned by the tax authorities payable to such person.
  - (b) Recovery by way of detaining and selling any goods belonging to such person;
  - (c) Recovery from other person, from whom money is due or may become due to such person or who holds or may subsequently hold money for or on account of such person, to pay to the credit of the Central or a State Government;
  - (d) Distain any movable or immovable property belonging to such person, until the amount payable is paid. If the dues not paid within 30 days, the said property is to be sold and with the proceeds of such sale the amount payable and cost of sale shall be recovered.
  - (e) Through the Collector of the district in which such person owns any property or resides or carries on his business, as if it was an arrear of land revenue.
  - (f) By way of an application to the appropriate Magistrate who in turn shall proceed to recover the amount as if it were a fine imposed by him.
  - (g) By enforcing the bond/instrument executed under this Act or any rules or regulations made thereunder.
  - (h) CGST arrears can be recovered as an arrear of SGST and vice versa [Section 79].
- (b) Assessment Order passed by proper officer may be withdrawn in the following cases:-
  - (i) **Assessment of Non-filers of return** – The best judgment order passed by the Proper Officer under section 62 of CGST Act shall automatically stand withdrawn if the taxable person furnishes a valid return for the default period (i.e. files the return and pays the tax as assessed by him), within thirty days of the receipt of the best judgment assessment order
  - (ii) **Summary Assessment** – A taxable person against whom a summary assessment order has been passed can apply for its withdrawal to the jurisdictional Additional/Joint Commissioner within thirty days of the date of receipt of the order. If the said officer finds the order erroneous, he can withdraw it and direct the proper officer to carry out determination of tax liability in terms of section 73 or 74 of CGST Act. The Additional/Joint Commissioner can follow a similar course of action on his own motion if he finds the summary assessment order to be erroneous.
- (c) (i) As per section 74 of the Customs Act, 1962, the duty paid imported goods are required to be entered for export within two years from the date of payment of duty on the importation. This period can be extended by CBIC if the importer shows sufficient reason for not exporting the goods within two years.  
(ii) If duty paid imported goods are exported without use, then 98% of such duty is re-paid as drawback.  
(iii) Yes, duty drawback is allowed when wearing apparels are re-exported without being used. However, *Notification No. 19/65 Cus dated 06.02.1965* as amended provides that if wearing apparels have been used after their importation into India, drawback of import duty paid thereon shall not be allowed when they are exported out of India.