Test Series: September, 2016

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – II

PAPER – 5: ADVANCED MANAGEMENT ACCOUNTING

Question No. ***1*** *is compulsory*

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

Time Allowed – 3 Hours **Maximum Marks – 100**

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

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

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

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

The company's marginal cost of capital is 17% pa and supplies of bulk gas cost the company Rs. 0.065 per metered unit. Wastage of 15% has to be allowed to determine what the maximum capital project cost can be to allow the company to provide the service required. *(5 Marks)*

(b) Z Co. has prepared the following statement for the month of April 2016.

Particulars	Budget Details	Static Budget	Actual
Units produced & Sold		4,000	3,200
		Rs.	Rs.
Direct Materials	3 kg p.u. @ Rs. 15 per kg.	1,80,000	1,55,000
Direct Labour	1 hr. p.u. @ Rs. 36 per hour	1,44,000	1,12,800
Variable Overhead	1 hr. p.u. @ Rs. 22 per hour	88,000	73,600

Fixed Overhead		90,000	84,000
Total Cost		5,02,000	4,25,400
Sales		6,00,000	4,48,000
Profit		98,000	22,600

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

Required

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

(c) Star Multinational Ltd. (SML) has two Divisions 'Dx' and 'Dz' with full profit responsibility. The Division 'Dx' produces Component 'X' which it sells to 'outside' customers only. The Division 'Dz' produces a product called the 'Z' which incorporates Component 'X' in its design. 'Dz' 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 'Dx' Division has enough capacity to meet entire requirements of Division 'Dz' and accordingly he requires internal transfer between the divisions at marginal cost from the overall company's perspective.

Manager of Division 'Dx' 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 'Dx' will not induce managers of both Divisions to make optimum decisions.

Required

You are requested to help him out of the problem. *(5 Marks)*

(d) Find the dual problem for the following:

Minimize

$$Z = 2x_1 - 3x_2 + 4x_3$$

Subject to the constraints

$$\begin{aligned} 3x_1 + 2x_2 + 4x_3 &\geq 9 \\ 2x_1 + 3x_2 + 2x_3 &\geq 5 \\ 7x_1 - 2x_2 - 4x_3 &\leq 10 \\ 6x_1 - 3x_2 + 4x_3 &\geq 4 \\ 2x_1 + 5x_2 - 3x_3 &= 3 \\ x_1, x_2, x_3 &\geq 0 \end{aligned}$$

(5 Marks)

2. (a) J-Parts Inc., Japan based firm, has just invented a new part 'J-7'. New part has a budgeted total profit of Rs.75,000 from the first 256 parts. The time taken to produce the first part was 112.50 hours. The labour rate is Rs.20 per hour. A 90% learning curve is expected to apply indefinitely.

Required

Calculate the sensitivity of the budgeted total profit from the first 256 parts to changes in the learning rate. *(8 Marks)*

(b) Sha Tin Ltd. manufactures weighing machines of standard size and sells its products to two industrial customers namely LI Ltd. and FU Ltd. and to a dealer SU Ltd. having shops in different cities. The maximum retail price per unit of weighing machine is Rs. 11,000 and per unit average cost of production is Rs. 5,500 (40% is general fixed overhead cost).

The Finance Officer has been asked to undertake a customer profitability analysis and calculate and compare the profit margin per customer (before deducting general fixed overhead) to know about the real customer profitability.

Following are the additional overhead information:

Delivery costs	Rs. 200 per kilometer
Emergency delivery cost (in addition to delivery cost)	Rs. 21,000 per delivery
Order processing cost	Rs. 6,000 per order
Specific discount and sales commission	As per negotiation
Product Advertisement cost	Actual cost

The following data are available for each customer

Particulars	**LI Ltd.**	**FU Ltd.**	**SU LTD.**
Sales (in units)	2,000	1,000	800
Total delivery kilometer travelled	1,000	800	900
No. of emergency delivery	2	1	0
No. of orders processed	4	2	8
Specific Discount (percentage of sales revenue)	25%	20%	15%
Sales Commission (percentage of sales revenue)	15%	10%	5%
Advertisement Costs (Rs.)	8,75,000	6,15,000	4,30,000

Required

Analyse the profitability for each customer, which customer is the most profitable.

(8 Marks)

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

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

Required

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

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

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

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

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

Required

Evaluate the performance of the company using Balance Scorecard approach.

(8 Marks)

4. (a) SFM Ltd. is producing a component called 'FR'. Estimated costs are:

	Fixed Cost per year (Rs. '000)	Variable Cost per 'FR' (Rs.)
Production	32,000	3,600
Distribution	2,000	200

Direct labour costs are 40% of the variable production costs. In the production department machining and assembling of 'FR', 90 men work 8 hours per day for 300 days in a year. Each worker can machine and assemble 1 'FR' per uninterrupted 180 minutes time frame. In each 8 hours working day, 20 minutes are allowed for coffee-break, 30 minutes on an average for training and 22 minutes for supervisory instructions. Besides 10% of each day is booked as idle time to cover checking in and checking out changing operations, getting materials and other miscellaneous matters.

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

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

Required

State, whether you would advise the management to allow the strike to go ahead, rather than to the union's demand. *(8 Marks)*

(b) An organization producing 4 different products, viz., WW, WX, WY, and WZ having 4 operators, viz., A,B, C and D who are capable of producing any of the four products, works effectively 7 hours a day. The time (in minutes) required for each operator for producing each of the products are given in the cells of the following matrix along with profit (Rs. per unit):

Operator	Product			
	WW	WX	WY	WZ
A	3.0	5.0	7.0	6.0
B	3.5	2.5	1.5	2.0

C	3.0	3.5	5.0	5.0
D	10.0	5.0	7.5	7.5
Profit	1.5	1.0	2.0	0.5

Required

Find out the assignment of operators to product which will maximize the profit.

(8 Marks)

5. (a) Managing Director of Superb-Tech Product Ltd (STPL) thinks that Standard Costing has little to offer in the reporting of material variances due to frequently change in price of materials.

STPL can utilize one of two equally suitable raw materials and always plan to utilize the raw material which will lead to cheapest total production costs. However STPL is frequently trapped by price changes and the material actually used often provides, after the event, to have been more expensive than the alternative which was originally rejected.

During last accounting period, to produce a unit of 'X' STPL could use either 2.50 Kg of 'XG' or 2.50 kg of 'XD'. STPL planned to use 'XG' as it appeared it would be cheaper of the two and plans were based on a cost of 'XG' of Rs. 1.50 per Kg. Due to market movements the actual prices changed and if STPL had purchased efficiently the cost would have been:

'XG' Rs. 2.25 Kg; 'XD' Rs. 2.00 Kg

Production of 'X' was 1,000 units and usage of 'XG' amounted to 2,700 Kg at a total cost of Rs. 6,480/-

Required

Analyze the material variance for 'X' by:

(i) Traditional Variance Analysis; and

(ii) An approach which distinguishes between Planning and Operational Variances. *(8 Marks)*

(b) K-2 Automobiles Ltd. is a leading manufacturer of commercial vehicles in India. It uses Standard Costing and Variance Analysis to measure its operating performance. Now management of K-2 Automobiles Ltd. wants to compete globally and changed its performance measurement system to Kaizen Costing.

Required

State why Kaizen Costing could be more useful for performance measurement than the Standard Costing and Variance Analysis. *(4 Marks)*

(c) "Cost is not the only criterion for deciding in favour of shut down" – Briefly explain.

(4 Marks)

6. (a) West Wood Appliances Ltd. (WWAL) manufactures consumer durable products in a very highly competitive market. WWAL is considering launching a new product 'W-9' into the market and gathered the following data:

Expected Market Price- Rs. 5,000 per unit

Direct Material Cost- Rs. 1,850 per unit

Direct Labour Cost- Rs. 80 per hour

Variable Overhead Cost- Rs. 1,000 per unit

Packing Machine Cost (specially to be purchased for this product)- Rs.5,00,000

WWAL expects the selling price for the new product will continue throughout the product's life and a total of 1,000 units can be sold over the entire lifetime of the product.

Direct labour costs are expected to reduce as the volume of output increases due to the effects of 80% learning curve (index is -0.3219). The expected time to be taken for the first unit is 30 hours and the learning effect is expected to end after 250 units have been produced. Units produced after first 250 units will take the same time as the 250th unit.

Required

(i) Calculate the expected total labour hours over the life time of the product 'W-9'.

(ii) Profitability of product 'W-9' that WWAL will earn over the life time of the product.

(iii) Average target labour cost per unit over the life time of the product if WWAL requires average profit of Rs. 800 per unit, to achieve its long term objectives.

Note: $250^{-0.3219} = 0.1691$, $249^{-0.3219} = 0.1693$ *(8 Marks)*

(b) A cake vendor buys pieces of cake every morning at Rs.4.50 each by placing his order one day in advance **(at the time of receiving his previous order)** and sale them at Rs. 7.00 each. Unsold cake can be sold next day at Rs.2.00 per piece and there after it should be treated as no value. The pattern for demand of cake is given below:

Fresh Cake:

Daily Sale	100	101	102	103	104	105	106	107	108	109	110
Probability	.01	.03	.04	.07	.09	.11	.15	.21	.18	.09	.02

One day old cake:

Daily Sale	0	1	2	3
Probability	.70	.20	.08	.02

Use the following set of random numbers:

Fresh Cake	37	73	14	17	24	35	29	37	33	68
One Day Old Cake	17	28	69	38	50	57	82	44	89	60

The vendor adopts the following rule.

If there is no stock of cake with him at the end of previous day, he orders for 110 pieces otherwise he orders 100 or 105 pieces whichever is nearest actual fresh cake sale on the previous day.

Required

Starting with zero stock and a pending order of 105 pieces, simulate for 10 days and calculate vendor's profit. *(8 Marks)*

7. Answer any 4 out of the following 5 questions:

(a) The product mix of a Delta Ltd. is as under:

	Products	
	M	N
Units	54,000	18,000
Selling Price	Rs. 7.5	Rs. 15
Variable Cost	Rs. 6	Rs. 4.5

Find the break-even points in units, if the company discontinues product 'M' and replace with product 'O'. The quantity of product 'O' is 9,000 units and its selling price and variable costs respectively are Rs. 18 and Rs. 9. Fixed Cost is Rs. 15,000. *(4 Marks)*

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

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

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

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

(iv) Manager (Operations) has concerns about creation of confusion among employees and workers regarding their roles and degradation in quality of production. *(4 Marks)*

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

Required

Annora has asked you to recommend industries and firms that would be good candidates for the article. What would you advice? Explain your recommendations.

(4 Marks)

(d) Write a short note on alternate solution in "transportation problem". *(4 Marks)*

(e) A project has the following time schedule:

Activity	Duration (in Weeks)
1–2	2
1–3	2
1–4	1
2–5	4
3–6	8
3–7	5
4–6	3
5–8	1
6–9	5
7–8	4
8–9	3

Required

Draw the arrow diagram.

(i) Draw the arrow diagram.

(ii) Identify critical path and find the total project duration. *(4 Marks)*

Test Series: September, 2016

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – II

PAPER – 5: ADVANCED MANAGEMENT ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) Working Notes

1. No. of Customer = 1,900

(5,000 × 40% × 95%)

2. Consumption of Gas = 11,40,000 Metered units

(1,900 × 50 mt.× 12 months)

Gas Supply = 13,41,176 Metered units

{11,40,000 × (100 ÷ 85)}

3. Cash Inflow

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

One Time Connection Charge = Rs. 4,75,000

(Rs. 250 × 1,900 customers)

Maximum Capital Project Cost Can be to Allow the Company to Provide the Service Required

By Following the Concept of Perpetuity

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

∴ Investment = Rs. 30,91,612

(b) Statement Showing "Flexible Budget for 3,200 units Activity Level"

Particulars	**Amount (Rs.)**
Sales $\left(\frac{\text{Rs. }6,00,000}{4,000\text{ units}} \times 3,200\text{ units}\right)$	4,80,000

Less: Variable Cost	
Direct Material (3,200 units × 3 kg. per unit × Rs.15 per kg.)	1,44,000
Direct Labour (3,200 units × 1 hr. per unit × Rs.36 per hr.)	1,15,200
Variable Overhead (3,200 units × 1 hr. per unit × Rs.22 per hr.)	70,400
Contribution	1,50,400
Less: Fixed Overhead	90,000
Profit	60,400

(c) 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 'Dx' should be allowed to record the transactions at *full cost per unit* plus *a profit margin*. On the other hand Division 'Dz' may be charged only *marginal cost*. Any inter divisional profits can be eliminated by accounting adjustment.

Impact:

- Division 'Dx' will earn a profit on inter Division transfers.
- Division 'Dz' can chose the output level at which the marginal cost of the product '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 'Dx' can transfer its products to Division 'Dz' at *marginal cost per unit* and *a lump-sum fixed fee*.

Impact:

- 'Two Part Transfer Pricing System' will inspire the Division 'Dz' to choose the optimal output level.
- This pricing system also enable the Division 'Dx' to obtain a profit on inter Division transfer.

(d) Primal

Minimize $Z = 2x_1 - 3x_2 + 4x_3$

Subject to the constraints

$$3x_1 + 2x_2 + 4x_3 \geq 9$$
$$2x_1 + 3x_2 + 2x_3 \geq 5$$
$$-7x_1 + 2x_2 + 4x_3 \geq -10$$
$$6x_1 - 3x_2 + 4x_3 \geq 4$$
$$2x_1 + 5x_2 - 3x_3 \geq 3$$
$$-2x_1 - 5x_2 + 3x_3 \geq -3$$
$$x_1, x_2, x_3 \geq 0$$

Dual

Maximize $Z = 9y_1 + 5y_2 - 10y_3 + 4y_4 + 3y_5 - 3y_6$

Subject to constraints

$$3y_1 + 2y_2 - 7y_3 + 6y_4 + 2y_5 - 2y_6 \leq 2$$
$$2y_1 + 3y_2 + 2y_3 - 3y_4 + 5y_5 - 5y_6 \leq -3$$
$$4y_1 + 2y_2 + 4y_3 + 4y_4 - 3y_5 + 3y_6 \leq 4$$
$$y_1, y_2, y_3, y_4, y_5, y_6 \geq 0$$

By substituting $y_5 - y_6 = y_7$ the dual can alternatively be expressed as:

Maximize $Z = 9y_1 + 5y_2 - 10y_3 + 4y_4 + 3y_7$

Subject to constraints

$$3y_1 + 2y_2 - 7y_3 + 6y_4 + 2y_7 \leq 2$$
$$-2y_1 - 3y_2 - 2y_3 + 3y_4 - 5y_7 \geq 3$$
$$4y_1 + 2y_2 + 4y_3 + 4y_4 - 3y_7 \leq 4$$
$$y_1, y_2, y_3, y_4 \geq 0, \; y_7 \text{ unrestricted in sign.}$$

2. (a) Cumulative Average Time for 256 parts = 48.43 hrs.*

[$112.50 \times (0.90^8)$]

Total Time for 256 parts = 12,398.08 hrs.

[48.43 hrs.× 256 parts]

Total Labour Cost of 256 parts = Rs.2,47,961.60

[12,398.08 hrs.× Rs. 20]

Revised Labour Cost for *zero profit* = Rs.3,22,961.60

[Rs. 2,47,961.60 + Rs. 75,000]

Total Time for 256 parts (Revised)	=	16,148.08 hrs.
		[Rs. 3,22,961.60/Rs. 20]
Cumulative Average Time for 256 parts (Rev.)		
	=	63.08 hrs.
		[16,148.08/256]

The usual learning curve model is

$$y = ax^b$$

Where

y	=	Cumulative Average Time per part for x parts
a	=	Time required for first part
x	=	Cumulative number of parts
b	=	Learning coefficient (log r/log 2)

Accordingly

$$\Rightarrow \quad 63.08 = 112.50 \times (256)^b$$

$$\Rightarrow \quad 0.5607 = 2^{8b}$$

$$\Rightarrow \quad \log 0.5607 = \log 2^{8b}$$

$$\Rightarrow \quad \log 0.5607 = 8 \times b \times \log 2$$

$$\Rightarrow \quad \log 0.5607 = 8 \times \frac{\log r}{\log 2} \times \log 2$$

$$\Rightarrow \quad \log 0.5607 = 8 \log r$$

$$\Rightarrow \quad \log 0.5607 = \log r^8$$

$$\Rightarrow \quad 0.5607 = r^8$$

$$\Rightarrow \quad r = \sqrt[8]{0.5607}$$

$$\Rightarrow \quad r = 0.9302$$

Learning Rate (r) = 93.02%.

Therefore

Sensitivity = 3.02/90

= 3.36%

☞ Students may also take 48.38 hrs. (112.50 × 0.43)

(b) Customer Profitability Statement

Particulars	LI Ltd.	FU Ltd.	SU Ltd.
Sales (units)	**2,000**	**1,000**	**800**
	(Rs.)	(Rs.)	(Rs.)
Sales Revenue (A)	2,20,00,000	1,10,00,000	88,00,000
Less: Average Variable Cost (B) (Rs. 5,500 × 60% = 3,300 p.u.)	66,00,000	33,00,000	26,40,000
Contribution [70%of Sales] (A)-(B)	1,54,00,000	77,00,000	61,60,000
Less: Additional Overheads			
Delivery Cost (No. of K.M. × Rs. 200)	2,00,000	1,60,000	1,80,000
Emergency Delivery Cost (No. of Emerg. Delivery × Rs. 21,000)	42,000	21,000	-
Order Processing Cost (No. of Orders × Rs. 6,000)	24,000	12,000	48,000
Specific Discount	55,00,000	22,00,000	13,20,000
Sales Commission	33,00,000	11,00,000	4,40,000
Advertisement Cost	8,75,000	6,15,000	4,30,000
Profit *per customer**	54,59,000	35,92,000	37,42,000
Profit Margin *per customer** (%)	24.81%	32.65%	42.52%
Rank	III	II	I

** Before deducting general fixed overhead cost*

The contribution margin is 70% for each customer but when the other overheads costs per customer is included in the above profitability statement the profitability of the three customers become different. SU Ltd. is the most profitable customer.

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

Particulars	Cost per annum (Rs.)
Fixed Expenses:	
Insurance	50,000.00
Garage Charges	30,000.00
Depreciation	7,00,000.00
Running Expenses:	

Repair and Maintenance	50,000.00
Cost of Lubricants and Sundries	1,25,925.00
Fuel Cost	5,03,700.00
Salary of Driver and Two Attendants	3,00,000.00
Route Permit Charges	15,000.00
Total Cost *per annum*	17,74,625
Add: Markup @ 20% of Total Cost or 16.67% of Total Revenue	3,54,925
Total Revenue	21,29,550

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

Workings

Total Passenger Kms	=	2,51,85,000
Total Buses	=	15
Passenger Kms *per bus*	=	16,79,000 (2,51,85,000 Kms / 15)
Total Passenger Capacity *per bus*	=	42 – 2 = 40
Annual Distance Covered *by a bus*	=	41,975 Kms (16,79,000Kms / 40)

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

Profitability Statement for *Each Bus*

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

Profit*	…[B] – [A]	1,55,405.00	63,853.00
Profit* to Total Revenue		7.71%	3.17%

** Gross Margin*

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

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

(b) The balanced scorecard is a method which displays organisation's performance into four dimensions namely financial, customer, internal and innovation. The four dimensions acknowledge the interest of shareholders, customers and employees taking into account of both long-term and short-term goals. The detailed analysis of performance of the company using Balance Scorecard approach as follows:

(i) Financial Perspective

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

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

(ii) Customer Perspective

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

(iii) Internal Business Perspective

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

(iv) Learning and Growth Perspective

Employee training programmes are covered under this perspective.

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

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

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

Annual Cost of Settlement

= 54,000 units × Rs.216

= Rs.1,16,64,000

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

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

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

Working Note

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

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

(2) Calculation of Labour Cost:

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

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

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

(3) Statement Showing Budgeted Production:

Total Time in a Day: (8hrs. × 60 minutes)	=	480 minutes
Less: Idle Time	=	48 minutes
Coffee Break	=	20 minutes
Instructions	=	22 minutes
Training	=	30 minutes
Productive Time *per day*	=	360 minutes

Therefore, 'FR' to be produced per man per day: (360/180 × 1)

= 2 units

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

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

(b) Given that the unit (factory) works effectively for 7 hours and the processing time (in minutes) for each of the four products by different operators, we obtain the production and profit matrices as follows:

Production Matrix

Operator	Product			
	WW	WX	WY	WZ
A	140	84	60	70
B	120	168	280	210
C	140	120	84	84
D	42	84	56	56

Profit Matrix:

Operator	Product			
	WW	WX	WY	WZ
A	210	84	120	35
B	180	168	560	105
C	210	120	168	42
D	63	84	112	28

Subtract all the elements from the highest value and obtain the following matrix:

Operator	Product			
	WW	WX	WY	WZ
A	350	476	440	525
B	380	392	0	455
C	350	440	392	518
D	497	476	448	532

Subtracting row minimum, we obtain:

Operator	Product			
	WW	WX	WY	WZ
A	0	126	90	175
B	380	392	0	455
C	0	90	42	168
D	49	28	0	84

Subtracting column minimum and after assignment, we get:

Operator	Product			
	WW	WX	WY	WZ
A	$\boxed{0}$	98	90	91
B	380	364	$\boxed{0}$	371
C	0	62	42	84
D	49	$\boxed{0}$	0	0

Since required number of assignments could not be made, proceed further:

Operator	Product			
	WW	WX	WY	WZ
A	$\boxed{0}$	36	90	29
B	380	302	$\boxed{0}$	309
C	0	$\boxed{0}$	42	22
D	111	0	62	$\boxed{0}$

The optimum solution is:

Operator	Product	Profit (Rs.)
A	WW	210
B	WY	560
C	WX	120
D	WZ	28
Total Profit		918

5. (a) Traditional Variance (Actual Vs Original Budget)

Usage Variance = (Standard Quantity – Actual Quantity) x Standard Price
= (2,500 Kg – 2,700 Kg) x Rs. 1.50
= Rs. 300 (A)

Price Variance = (Standard Price – Actual Price) x Actual Quantity
= (Rs. 1.50 – Rs. 2.40) x 2,700 Kg
= Rs. 2,430 (A)

Total Variance = Rs. 300 (A) + Rs. 2,430 (A)

	=	Rs. 2,730 (A)
Operational Variance (Actual Vs Revised)		
Usage Variance	=	(2,500 Kg – 2,700 Kg) x Rs. 2.25
	=	Rs. 450 (A)
Price Variance	=	(Rs. 2.25 – Rs. 2.40) x 2,700 Kg
	=	Rs. 405 (A)
Total Variance	=	Rs. 450 (A) + Rs. 405 (A)
	=	Rs. 855 (A)
Planning Variance (Revised Vs Original Budget)		
Controllable Variance	=	(Rs. 2.00 – Rs. 2.25) x 2,500 Kg
	=	625 (A)
Uncontrollable Variance	=	(Rs. 1.50 – Rs. 2.00) x 2,500 Kg
	=	1,250 (A)
Total Variance	=	Rs. 625 (A) + Rs. 1,250 (A)
	=	Rs. 1,875 (A)
Traditional Variance	**=**	**Operational Variance + Planning Variance**
	=	855 (A) + 1,875 (A)
	=	2,730 (A)

(b) Both Standard Costing and Kaizen Costing are helpful and used for *measurement of performance of a company* but there are differences in approach between the two systems.

Under Standard Costing system standards of all important variables like cost and quantity of materials, labours and overheads are set at the beginning of the year or activity. These set standards are compared with the actual performance to analyse the variances. As a step further all variances are classified as planning and operational variances to distinguish variances that are within the manager's control and beyond their effort. In brief Standard Costing and Variance Analysis helps in determine the variances and *take post event measures to stop recurrences*.

On the other hand Kaizen Costing *emphasises on continual improvement*. Targets once set at the beginning of the year or activities are updated continuously to reflect the improvement that has already been achieved and that are yet to be achieved.

As a continuous improvement measure Kaizen Costing set new challenges before the workers and managers and helps to improve and control the situation to achieve desired target results. Therefore, if Kaizen costing is used in place of Standard

Costing and Variance analysis to measure performance then definitely it will keep K-2 Automobile Ltd. competent enough to head on with the global automobile players.

(c) Cost is not only criterion for deciding in the favour of shut down. Non-cost factors worthy of consideration in this regard are as follows:

(i) Interest of workers, if the workers are discharged, it may become difficult to get skilled workers later, on reopening of the factory. Also shut-down may create problems.

(ii) In the face of competition it may difficult to re-establish the market for the product.

(iii) Plant may become obsolete or depreciate at a faster rate or get rusted. Thus, heavy capital expenditure may have to be incurred on re-opening.

6. (a) Calculation of Total Labour Hours Over the Life Time of The Product 'W-9'

The average time per unit for 250 units

$$Y_x = ax^b$$

Or, $Y_{250} = 30 \times 250^{-0.3219}$

Or, $Y_{250} = 30 \times 0.1691$

Or, $Y_{250} = 5.073$ hours

Total time for 250 units = 5.073 × 250 units

= 1,268.25 hours

The average time per unit for 249 units

$Y_{249} = 30 \times 249^{-0.3219}$

Or, $Y_{249} = 30 \times 0.1693$

Or, $Y_{249} = 5.079$ hours

Total time for 249 units = 5.079 × 249 units

= 1,264.67 hours

Time for 250th unit

= 1,268.25 hours – 1,264.67 hours

= 3.58 hours

Total Time for 1,000 units

= (750 × 3.58 hours) + 1,268.25 hours

= 3,953.25 hours

Profitability of the Product 'W-9'

Sales 1,000 Units

Particulars	Amount (Rs.)
Sales	50,00,000
Less: Direct Material	18,50,000
Direct Labour (3,953.25 hours × Rs. 80)	3,16,260
Variable Overheads (1,000 units× Rs. 1,000)	10,00,000
Contribution	18,33,740
Less: Packing Machine Cost	5,00,000
Profit	13,33,740

Average Target Labour Cost *per unit*

Particulars	Amount (Rs.)
Expected Sales Value	50,00,000
Less: Desired Profit (1,000 units × Rs. 800)	8,00,000
Target Cost	42,00,000
Less: Direct Material (1,000 units × Rs. 1,850)	18,50,000
Variable Cost (1,000 units × Rs. 1,000)	10,00,000
Packing Machine Cost	5,00,000
Target Labour Cost	8,50,000
Average Target Labour Cost *per unit* (Rs. 8,50,000 ÷ 1,000 units)	850

(b) Random No- Coding for Fresh Cake

No. of Cakes	Probability	Cumulative Probability	Random Numbers
100	0.01	0.01	00 – 00
101	0.03	0.04	01 – 03
102	0.04	0.08	04 – 07
103	0.07	0.15	08 – 14
104	0.09	0.24	15 – 23
105	0.11	0.35	24 – 34
106	0.15	0.50	35 – 49
107	0.21	0.71	50 – 70
108	0.18	0.89	71 – 88
109	0.09	0.98	89 – 97
110	0.02	1.00	98 – 99

Random No. Coding for One Day Old Cake

No. of Cakes	Probability	Cumulative Probability	Random Numbers
0	0.70	0.70	00 – 69
1	0.20	0.90	70 – 89
2	0.08	0.98	90 – 97
3	0.02	1.00	98 – 99

Let us simulate the sale of fresh and one day old cakes for the next ten days using the given random numbers / information.

Simulation Sheet

Day	R. No. of Fresh Cake	Fresh Stock	Demand	Sales Pcs.	Cl. Stock	Order Initiated	One Day Old Stock	R.N. of Old Cake	Sale of Old Cake Pcs.	Loss Pcs.
1	37	105	106	105	0	110	0	17	0	0
2	73	110	108	108	2	110	0	28	0	0
3	14	110	103	103	7	105	2	69	0	2
4	17	105	104	104	1	105	7	38	0	7
5	24	105	105	105	0	105	1	50	0	1
6	35	105	106	105	0	110	0	57	0	0
7	29	110	105	105	5	110	0	82	0*	0
8	37	110	106	106	4	105	5	44	0	5
9	33	105	105	105	0	105	4	89	1	3
10	68	105	107	105	0	110	0	60	0	0
				1051					1	18

Calculation of Vendor's Profit

	Amount (Rs.)
Sales of Fresh Cakes (1,051 Pcs. × Rs.7)	7,357.00
Sale of One Day Old Cake (1 Pcs. × Rs.2)	2.00
Total Sales Revenue	7,359.00
Less: Cost of Cakes Sold [Rs.4.50 × (1,051 + 1) Pcs.]	4,734.00
Less: Cost of Spoilt Cakes [Rs.4.50 × 18 Pcs.]	81.00
Profit	2,544.00

7. (a)

N	=	18,000 units
O	=	9,000 units
Ratio (N : O)	=	2:1
Let		
t	=	No. of units of 'O' for BEP
N	=	2t No. of units for BEP
Contribution of 'N'	=	Rs. 10.5 per unit
Contribution of 'O'	=	Rs. 9 per unit
At Break Even Point:		
$\Rightarrow$ 10.5 x (2t) + 9 x t -15,000	=	0
$\Rightarrow$ 30t	=	15,000
$\Rightarrow$ t	=	500 units
BEP of 'N'	=	2t
	=	1,000 units
BEP of 'O'	=	t
	=	500 units

(b) (i) Invalid

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

(ii) Valid

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

(iii) Invalid

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

(iv) Invalid

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

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

Life Cycle Costing technique is particularly important when:

(i) High percentage of total life-cycle costs are incurred before production begins and revenue are earned over several years and

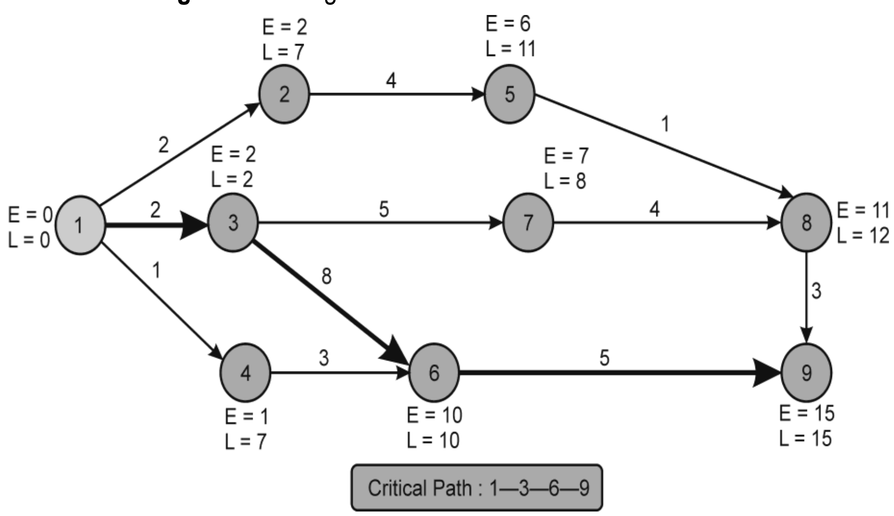
(ii) High fraction of the life cycle costs are locked in at the R & D and design stages.

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

(d) The Δ_{ij} matrix or $C_{ij} – (u_i + v_j)$ matrix, where C_{ij} is the cost matrix and $(u_i + v_j)$ is the cell evaluation matrix for unallocated cell. The Δ_{ij} matrix has one or more 'Zero' elements, indicating that, if that cell is brought into the solution, the optimum cost will not change though the allocation changes.

Thus, a 'Zero' element in the Δ_{ij} matrix reveals the possibility of an alternative solution.

(e) **(i)** The **Arrow Diagram** for the given data is drawn below:



(ii) The **Critical Path** is 1–3–6–9.

Total Project Duration is 15 weeks.

Test Series: September, 2016

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – II

PAPER – 6: INFORMATION SYSTEMS CONTROL & AUDIT

*Question No. **1** is compulsory.*

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

Time Allowed – 3 Hours **Maximum Marks – 100**

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

   The company intends to utilize the services of a professional analyst to conduct a preliminary investigation and present a report on smooth implementation of the ideas of the new subsidiary. Based on the report submitted by the analyst, the company decides to proceed further with three specific objectives - reduce operational risk, increase business efficiency and ensure that information security is being rationally applied. The company has been advised to adopt ISO 27001 for achieving the same.

   (i) What are the two primary methods through which the analyst would have collected the data ? *(8 Marks)*

   (ii) To retain their e-documents for specified period, what are the conditions laid down in Section 7, Chapter III of Information Technology Act, 2000? *(4 Marks)*

   (b) What do you understand by Financial Controls? Explain major financial control techniques in brief. *(8 Marks)*

2. (a) What do mean by Expert Systems? What are the need and benefits of Expert Systems? (*6 Marks)*

   (b) Discuss major tasks performed by Operating System? *(6 Marks)*

   (c) Discuss various dimensions under which the phase 'Feasibility Study' of SDLC is evaluated. *(4 Marks)*

3. (a) What are the objectives and goals of Business Continuity Planning(BCP)? *(6 Marks)*

   (b) Differentiate between Black Box Testing and White Box Testing. *(6 Marks)*

   (c) Discuss the advantages of Cloud Computing. *(4 Marks)*

4. (a) Discuss computer crime exposures, in brief. *(6 Marks)*

   (b) Discuss in brief, various steps involved in Information Systems Audit. *(4 Marks)*

   (c) What are Detective Controls? *(4 Marks)*

5. (a) Discuss the seven enablers of COBIT 5. *(6 Marks)*

   (b) Discuss characteristics of Decision Support System (DSS). *(6 Marks)*

   (c) What do you understand by the term “Corporate Governance”? *(6 Marks)*

6. (a) Discuss objectives and goals of Business Continuity Planning? *(6 Marks)*

   (b) Discuss the impact of Information Systems audit on organizations. *(6 Marks)*

   (c) Discuss Office Automation System. *(4 Marks)*

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

   (a) Key governance practices for evaluating risk management.

   (b) Impact of technology on Internal Controls.

   (c) SA 402.

   (d) Platform as a Service in Cloud Computing.

   (e) Strength of Agile model. *(4 × 4 = 16 Marks)*

Test Series: September, 2016

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – II

PAPER – 6: INFORMATION SYSTEMS CONTROL & AUDIT

SUGGESTED ANSWERS/HINTS

1. (a) (i) Two primary methods through which the analyst would have collected the data are given as follows:

- **Reviewing Internal Documents:** The analyst first tries to learn about the organization involved in or affected by the project. For example, the subsidiary's activities based on its business and operation plans. S/he will also examine proposed organization charts and functions of positions mentioned in it.
- **Conducting Interviews:** Written documents tell the analyst 'how the system should operate' but they may not include enough details to allow a decision to be made about the merits of a system proposal nor do they present users' views about current operations. To learn these details, analysts use interviews. Preliminary investigation interviews involve only management and supervisory personnel. The analyst may conduct interviews with persons who are scheduled to occupy various positions in the subsidiary.

(ii) Section 7, Chapter III of Information Technology Act, 2000 provides that the documents, records or information which is to be retained for any specified period shall be deemed to have been retained if the same is retained in the electronic form provided the following conditions are satisfied:

(1) Where any law provides that documents, records or information shall be retained for any specific period, then, that requirement shall be deemed to have been satisfied if such documents, records or information are retained in the electronic form, –

(a) the information contained therein remains accessible so as to be usable for a subsequent reference;

(b) the electronic record is retained in the format in which it was originally generated, sent or received or in a format, which can be demonstrated to represent accurately the information originally generated, sent or received;

(c) The details, which will facilitate the identification of the origin, destination, date and time of dispatch or receipt of such electronic record are available in the electronic record.

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

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

Major financial control techniques are given as follows:

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

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

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

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

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

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

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

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

(b) Operating system performs the following major tasks:

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

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

- **Technical:** Is the technology needed available?
- **Financial:** Is the solution viable financially?
- **Economic:** Return on Investment?
- **Schedule/Time:** Can the system be delivered on time?

- **Resources:** Are human resources reluctant for the solution?
- **Operational:** How will the solution work?
- **Behavioral:** Is the solution going to bring any adverse effect on quality of work life?
- **Legal:** Is the solution valid in legal terms?

3. **(a)** The primary objective of a Business Continuity Plan (BCP) is to minimize loss by minimizing the cost associated with disruptions and enable an organization to survive a disaster and to reestablish normal business operations. The key objectives of the contingency plan should be to:

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

Therefore, the goals of the business continuity plan should be to:

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

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

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

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

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

entire system can be fully functional in a matter of a few minutes. Of course, the amount of time taken here will depend on the exact kind of technology that we need for your business.

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

(i) Financial Loss: Financial losses may be direct like loss of electronic funds or indirect like expenditure towards repair of damaged electronic components.

(ii) Legal Repercussions: An organization has to adhere to many laws while developing security policies and procedures. These laws protect both the perpetrator and organization from trial. The organizations will be exposed to lawsuits from investors and insurers if there have no proper security measures. The IS auditor should take legal counsel while reviewing the issues associated with computer security.

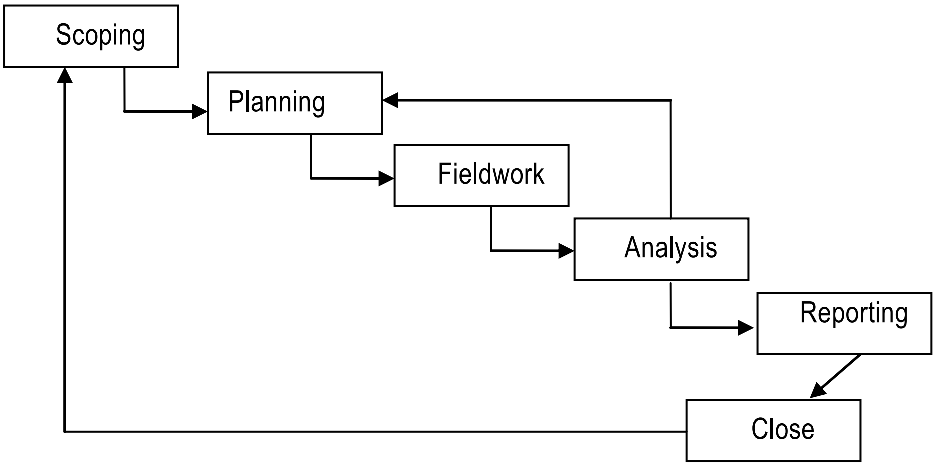
(iii) Loss of Credibility or Competitive Edge: In order to maintain competitive edge, many companies, especially service firms such as banks and investment firms, needs credibility and public trust. This credibility will be shattered resulting in loss of business and prestige if security violation occurs.

(iv) Blackmail/Industrial Espionage: By knowing the confidential information, the perpetrator can obtain money from the organization by threatening and exploiting the security violation.

(v) Disclosure of Confidential, Sensitive or Embarrassing Information: These events can spoil the reputation of the organization. Legal or regulatory actions against the company may be also a result of disclosure.

(vi) Sabotage: People, who may not be interested in financial gain but who want to spoil the credibility of the company or to will involve in such activities. They do it because of their dislike towards the organization or for their intemperance.

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



Steps in IS Audit process

(i) **Scoping and pre-audit survey:** Auditors determine the main area/s of focus and any areas that are explicitly out-of-scope, based on the scope-definitions agreed with management. Information sources at this stage include background reading and web browsing, previous audit reports, pre audit interview, observations and, sometimes, subjective impressions that simply deserve further investigation.

(ii) **Planning and preparation:** During which the scope is broken down into greater levels of detail, usually involving the generation of an audit work plan or risk-control-matrix.

(iii) **Fieldwork:** Gathering evidence by interviewing staff and managers, reviewing documents, and observing processes etc.

(iv) **Analysis:** This step involves desperately sorting out, reviewing and trying to make sense of all that evidence gathered earlier. SWOT (Strengths, Weaknesses, Opportunities, Threats) or PEST (Political, Economic, Social, Technological) techniques can be used for analysis.

(v) **Reporting:** Reporting to the management is done after analysis of evidence gathered and analyzed

(vi) **Closure:** Closure involves preparing notes for future audits and follow up with management to complete the actions they promised after previous audits.

(c) **Detective Controls:** These controls are designed to detect errors, omissions or malicious acts that occur and report the occurrence. An example of a detective control would be a use of automatic expenditure profiling where management gets regular reports of spend to date against profiled spend. The main characteristics of such controls are given as follows:

- Clear understanding of lawful activities so that anything which deviates from these is reported as unlawful, malicious, etc;
- An established mechanism to refer the reported unlawful activities to the appropriate person or group;
- Interaction with the preventive control to prevent such acts from occurring; and
- Surprise checks by supervisor.

Examples of detective controls include Hash totals; Check points in production jobs; bank reconciliation, and Monitoring expenditures against budgeted amount.

5. (a) Enablers are factors that, individually and collectively, influence whether something will work; in this case, governance and management over enterprise IT. Enablers are driven by the goals cascade, i.e., higher-level IT related goals defining 'what the different enablers should achieve'. The COBIT 5 framework describes seven categories of enablers, which are discussed as follows:

- **Principles, Policies and Frameworks** are the vehicle to translate the desired behaviour into practical guidance for day-to-day management.
- **Processes** describe an organized set of practices and activities to achieve certain objectives and produce a set of outputs in support of achieving overall IT-related goals.
- **Organizational structures** are the key decision-making entities in an enterprise.
- **Culture, Ethics and Behaviour** of individuals and of the enterprise are very often underestimated as a success factor in governance and management activities.
- **Information** is pervasive throughout any organization and includes all information produced and used by the enterprise. Information is required for keeping the organization running and well governed, but at the operational level, information is very often the key product of the enterprise itself.
- **Services, Infrastructure and Applications** include the infrastructure, technology and applications that provide the enterprise with information technology processing and services.
- **People, Skills and Competencies** are linked to people and are required for successful completion of all activities and for making correct decisions and taking corrective actions.

(b) Characteristics of DSS – The key characteristics of DSS are given as follows:

- This supports decision making and occurs at all levels of management.
- Instead of helping individuals working on independent tasks, it should be able to help group making decisions.
- It should be flexible and adaptable. i.e. it should be able to fit itself in the style of a particular manager and ready to change according to changes in the environment.
- DSS focuses on decision rather than data and information.
- It should be easy to use. A user should not have knowledge of computer programming to generate reports that helps in decision making.
- DSS can be used for structured problems.
- DSS should be user-friendly.
- DSS should be extensible and evolve overtime.
- DSSs are used mainly for decision making rather than communicating decisions and training purposes.
- The impact of DSS should be on decision where the manager's judgment is essential and there is sufficient structure for computers.

(c) Corporate Governance: Corporate governance is defined as the system by which a company or enterprise is directed and controlled to achieve the objective of increasing shareholder value by enhancing economic performance. Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, Board of Directors, the controlling shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital. It is about doing good business to protect shareholders' interest.

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

- Provide the safety and well-being of people on the premises at the time of disaster;
- Continue critical business operations;
- Minimize the duration of a serious disruption to operations and resources (both information processing and other resources);

- Minimize immediate damage and losses;
- Establish management succession and emergency powers;
- Facilitate effective co-ordination of recovery tasks;
- Reduce the complexity of the recovery effort; and
- Identify critical lines of business and supporting functions.

Therefore, the goals of the business continuity plan should be to:

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

(b) Impact of Information Systems audit on organizations is as follows:

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

- **Information Systems Auditing:** It is the process of attesting objectives (those of the external auditor) that focus on asset safeguarding and data integrity and management objectives (those of the internal auditor) that include effectiveness and efficiency both.
- **Asset Safeguarding Objectives:** The information system assets (hardware, software, data information etc.) must be protected by a system of internal controls from unauthorised access.
- **Data Integrity Objectives:** It is a fundamental attribute of IS Auditing. The importance to maintain integrity of data of an organisation requires all the time. It is also important from the business perspective of the decision maker, competition and the market environment.
- **System Effectiveness Objectives:** Effectiveness of a system is evaluated by auditing the characteristics and objective of the system to meet business and user requirements.
- **System Efficiency Objectives:** To optimize the use of various information system resources (machine time, peripherals, system software and labour) along with the impact on its computing environment.

(c) **Office Automation Systems (OAS) –** It is most rapidly expanding computer based information systems. Different office activities can be broadly grouped into the following types of operations:

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

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

7. **(a)** The key governance practices for evaluating risk management are given as follows:

- **Evaluate Risk Management:** Continually examine and make judgment on the effect of risk on the current and future use of IT in the enterprise. Consider whether the enterprise's risk appetite is appropriate and that risks to enterprise value related to the use of IT are identified and managed;
- **Direct Risk Management:** Direct the establishment of risk management practices to provide reasonable assurance that IT risk management practices are appropriate to ensure that the actual IT risk does not exceed the board's risk appetite; and
- **Monitor Risk Management:** Monitor the key goals and metrics of the risk management processes and establish how deviations or problems will be identified, tracked and reported on for remediation.

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

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

(c) SA402: Audit Considerations Relating to an Entity using Service Organization, SA 402 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 24, "Audit Considerations Relating to Entities Using Service Organizations" issued by the ICAI in 2002. The revised Standard deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organizations. SA 402 also deals with the aspects like obtaining an understanding of the services provided by a service organization, including internal control, responding to the assessed risks of material misstatement, Type 1 and Type 2 reports, fraud, non-compliance with laws and regulations and uncorrected misstatements in relation to activities at the service organization and reporting by the user auditor. This SA is effective for audits of financial statements w.e.f. April 1, 2010.

(d) Platform as a Service (PaaS): in Cloud Computing Cloud providers deliver a computing platform including operating system, programming language execution environment, database, and web server. Application developers can develop and run their software solutions on a cloud platform without the cost and complexity of acquiring and managing the underlying hardware /software layers. In PaaS, one can make applications and software's on other's database. Thus, it gives us the platform to create, edit, run and manage the application programs we want. All the development tools are provided. Some of examples of PaaS include AWS Elastic Beanstalk, Cloud Foundry, Heroku, Force.com, EngineYard etc.

(e) Strength of Agile Model: Some of the strengths identified by the experts and practitioners include the following:

- Agile methodology has the concept of an adaptive team, which enables to respond to the changing requirements.
- The team does not have to invest time and efforts and finally find that by the time they delivered the product, the requirement of the customer has changed.
- Face to face communication and continuous inputs from customer representative leaves a little space for guesswork.
- The documentation is crisp and to the point to save time.
- The end result is generally the high quality software in least possible time duration and satisfied customer.

Test Series: September, 2016

MOCK TEST PAPER – 2

FINAL: GROUP – II

PAPER – 7: DIRECT TAX LAWS

*Question **1** is compulsory*

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

Time Allowed – 3 Hours **Maximum Marks – 100**

1. (a) "Ghanshyam" after purchase put to use on 15-12-2013 a machine worth Rs. 3,00,000 which is eligible for depreciation @ 15% under the Act. He sold this machine to "Rahim" on 1-1- 2015 for Rs. 3,20,000 (FMV on that date was Rs. 2,50,000), who after having used the machine for his business purposes again sold it back to "Ghanshyam" on 15-11-2015 for Rs. 3,10,000.

   Compute the amount of allowable depreciation and of chargeable capital gain, if any, for assessment years 2014-15 to 2016-17 assuming that this was the only machine in the block of asset held by both "Ghanshyam" and "Rahim". *(10 Marks)*

   (b) Mr. Yogesh, aged 66 years, running business as a proprietor furnishes the particulars of his income for the year ended 31.03.2016 as under:

   (a) Net Profit of Rs. 3,65,500 from the wholesale business of textiles and fabrics arrived at after charge of following expenses in the Profit & Loss Account:

   (i) Personal travelling expenses of Rs. 12,750.

   (ii) Purchase of furniture items for shop on 13.6.2015 of Rs. 25,000 but charged in shop expenses.

   (b) He owns a house with two floors constructed with the financial assistance of HDFC, out of which ground floor is used by him for self use and first floor was let out on rent for Rs. 8,500 p.m. from April, 2015. The municipal tax paid for the whole house was of Rs. 2,500 and interest paid on housing loan for the construction was Rs. 52,000. Both the floors of the house are identical.

   (c) He deposited insurance premium on the life of self of Rs. 12,500, wife Rs. 13,500, son and daughter of Rs. 28,000, repaid housing loan of Rs. 50,000 and paid Rs. 25,000 by credit card for health insurance of himself and his family.

   Compute taxable income and the amount of tax payable by Mr. Yogesh on such income for the Assessment Year 2016-17. *(10 Marks)*

2. Sunshine Ltd. engaged in manufacturing activity furnishes the following details:

   Net profit as per Profit and Loss Account Rs. 50,00,000.

(i) Depreciation charged to Profit and Loss Account is Rs. 16,00,000. Depreciation as per Income-tax Act, 1961 amounts to Rs. 28,00,000, which includes the following:

Depreciation rate meant for computers has been adopted for (i) accessories like printers and scanners; and (ii) EPABX. The written down value of these as on 1-4-2015 is given below:

(a) Printers and Scanners	Rs. 50,000
(b) EPABX	Rs. 2,00,000

Assume that there were no additions during the year.

(ii) It incurred Rs. 2,50,000 as expenditure for public issue of shares. The public issue could not materialize on account of non-clearance by SEBI. This amount is charged to Profit & Loss Account.

(iii) It incurred expenditure of Rs. 2,00,000 towards issue of debentures. This amount has been capitalized in the books.

(iv) The company paid Rs. 1,00,000 as compounding fee for violations in the pollution control regulations. This has been charged as revenue expenditure.

(v) The company lost cash of Rs. 25,00,000 due to theft when it was withdrawn from bank and taken to administrative office. It is not insured and hence, fully charged as revenue expenditure.

(vi) Rs. 5,00,000 was spent during the year towards permitted CSR activities as per section 135 of the Companies Act, 2013. This is charged to Profit and Loss Account.

(vii) It paid Rs. 1,00,000 to commodity broker for commodity transactions at MCX. The amount was debited to profit and loss account and no tax was deducted at source on this payment.

(viii) The company during the year employed 115 new workers in factory which was 20% of the existing work force and 18 employees in the registered office which was equal to 10% of the existing employee strength. It paid Rs. 20,00,000 and Rs. 8,00,000, respectively, as additional wages and salary.

(ix) It paid Rs. 50,000 to an electoral trust by cash and Rs. 1,00,000 by cheque to a registered political party. Both these are debited to Profit and Loss Account.

Compute the total income of the company for the assessment year 2016-17 Give reasons in brief for treatment of each of the above items. Ignore MAT provisions. *(16 Marks)*

3. (a) An institution having yoga as its main object is registered under section 12AA. Its total receipts for the P.Y.2015-16 is Rs. 40 lakhs, out of which receipts from business activity is Rs. 10 lakhs. Discuss whether the institution would continue to retain its "charitable status" and be eligible for exemption under section 11 for A.Y.2016-17, if its registration has not been cancelled.

Would your answer be different if the above institution has "advancement of any other object of general public utility" as its main object and applies its receipts from business activity towards its main object? *(4 Marks)*

(b) Mrs. Arpita, a resident individual, sold her house property on 16.01.2016. On the said transaction, she earned a long-term capital gain of Rs. 1,91,50,000. She invested a sum of Rs. 35,00,000 in bonds of NHAI on 05.03.2016. She further invested a sum of Rs. 45,00,000 in bonds of RECL on 05.05.2016. She purchased a house property for Rs. 60 lakhs in Dubai on 15.3.2016. She purchased two flats situated adjacent to each other in Lucknow on 25.7.2016 through two different sale deeds from two different buyers for Rs. 25 lakhs each and constructed a door to link both the flats so that she can use the same as a single house property. Her other income representing interest on fixed deposits for the financial year 2015-16 was Rs. 32,000. Compute the tax payable by her for the A.Y.2016-17. *(6 Marks)*

(c) M, N and O are investment funds incorporated in India in the form of a limited liability partnership (LLP). For P.Y.2015-16, the following are the particulars relating to the income earned by these funds –

Particulars	**M**	**N**	**O**
	Rs.		
Business Income		3,00,000	(1,50,000)
Capital Gains	12,00,000	18,00,000	(4,50,000)
Income from Other Sources [Interest on deposits]	6,00,000	7,20,000	9,00,000

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

(1) each investment fund has 30 unit holders each having one unit; and

(2) income from investment in the investment fund is the only income of the unit-holder.

(ii) Determine the amount of loss to be carried forward by Investment Fund O and/or its unit holders to A.Y.2017-18.

(iii) Is distribution tax payable by the Investment Funds on income distributed to unit holders?

(iv) In case the Investment Funds do not distribute the entire income earned during the P.Y.2015-16 to the unit holders by 31.3.2016, would the income chargeable to tax in the hands of unit holders, as computed in (i) above, undergo a change? *(6 Marks)*

4. (a) Mr. Sharma held 15% equity shares in Moon Ltd., a private limited company. He gifted all the shares held by him in Moon Ltd., to his wife Mrs. Sharma on 25/5/2015. The transfer was made without adequate consideration. On 20/6/2015, Mrs. Sharma obtained a loan of Rs. 80,000 from Moon Ltd., when the company's accumulated profit was Rs. 50,000. What are the tax implications of the above transactions? *(4 Marks)*

(b) Vinod had placed a deposit of Rs. 10 lacs in a bank on which he received interest of Rs. 80,000. He had also borrowed Rs. 5 lacs from the same bank on the security of the deposit and was liable to pay Rs. 50,000 by way of interest to the bank. He, therefore, offered the difference between two amounts of Rs. 30,000 as income from other sources. Is this correct? *(4 Marks)*

(c) Raghuram purchased equity shares in Push Ltd., a constituent of BSE-500 index on Mumbai Stock Exchange on 1st March, 2011. He sold the shares on 4th March, 2016 at a loss of Rs. 10,000. He wants to set off the loss against other long-term capital gain during the year. Examine whether such set off is permissible. Both purchase and sale transactions were entered into on a recognized stock exchange.

(4 Marks)

(d) Mohit, an individual, was carrying on a business as sole proprietor. On his death, his legal heirs decide to continue the same business by forming a firm. At the time of death, Mohit had a determined business loss of Rs. 2 Lacs, under the provisions of the Income-tax Act, 1961 to be carried forward.

Does the firm, consisting of all the legal heirs of Mohit, get a right to have this loss adjusted against its current income? Discuss. *(4 Marks)*

5. (a) The following are the details pertaining to M/s. Xerox, a partnership firm, for the year ended 31-3-2016:

(i) Gross total income of Rs. 420 lakhs, which includes a profit of Rs. 380 lakhs from an undertaking engaged in the business of developing a highway project having a turnover of Rs. 15 crores.

(ii) The profits of the undertaking are eligible for deduction under section 80-IA. This is the fourth year and the deduction available is Rs. 340 lakhs.

(iii) The firm has not undertaken any international transaction or specified domestic transaction during the said year.

Since M/s. Xerox has encountered some issues relating to tax implications of certain transactions in respect of which it wants to seek opinion of tax consultants, it is planning to file the return of income only in the month of December, 2016.

You are required to work out the total income and tax liability of the firm in both the scenarios - namely, where the return is filed on 30-09-2016 and when the same is filed in December, 2016; and advise the firm the right course of action to minimize tax liability. *(10 Marks)*

(b) Assessment of Chirag Ltd. was completed under section 143(3) with an addition of Rs. 15 lakhs to the returned income. The assessee-company preferred appeal before the Commissioner (Appeals) which is pending now.

In this backdrop, answer the following:

(i) Based on fresh information that there was escapement of income for the same assessment year, can the Assessing Officer initiate reassessment proceedings when the appeal is pending before Commissioner (Appeals)?

(ii) Can the Assessing Officer pass an order under section 154 for rectification of mistake in respect of issues not being subject matter of appeal?

(iii) Can the assessee-company seek revision under section 264 in respect of matters other than those preferred in appeal? *(6 Marks)*

6. (a) The Assessing Officer completed the assessment under section 143(3) on the basis of the returned income filed by Cue Ltd. for a certain assessment year. However, the Assessing Officer initiated reassessment proceeding under section 147 as he had reason to believe that income had escaped assessment on account of certain deductions allowed under section 37 which are not incurred wholly and exclusively for the purpose of business and accordingly, he issued notice under section 148. However, after sufficient enquiries made by him, he came to the conclusion that no additions were required on account of these expenses, since such expenses were ultimately found to be incurred wholly and exclusively for the purpose of the business of Cue Ltd. However, the Assessing Officer made additions on account of disallowances under section 40A(2) in respect of other expenses which were not the original "reason to believe" and passed his reassessment order under section 147. The Assessing Officer is of the view that Explanation 3 to section 147 permits him to assess the income which has escaped assessment and which comes to his notice subsequently in the course of proceeding under section 147, even though the said issues were not part of the reasons recorded in the notice under section 148. Is the action of the Assessing Officer valid, considering the facts of this case? *(6 Marks)*

(b) What are the circumstances when an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, enabling the Commissioner to exercise revisionary jurisdiction under section 263(1)? *(4 Marks)*

(c) Flower Ltd. has commenced the operations of manufacture of goods in a factory on 1.5.2011. It had employed new regular workmen in its factory, the details of whom are as follows –

Previous year	Number of new regular workmen employed during the year	Number of regular workmen leaving employment	Total number of regular workmen as at the end of the Previous year
2011-12	300	-	300
2012-13	300	50	550
2013-14	-	20	530
2014-15	-	30	500

In the P.Y.2015-16, due to capacity addition, it employs the following workmen, including casual workmen and workmen through contract labour, the particulars of whom are given below –

	Nature of workmen	Number employed	Date of employment	Monthly wages paid per workmen (Rs.)
(i)	Casual workmen	35	20.5.2015	2,000
(ii)	Workmen employed through contract labour	20	20.5.2015	2,500
(iii)	Regular workmen	55	1.5.2015	4,000
		15	31.7.2015	4,000
		10	21.8.2015	4,000

Compute the deduction, if any, under section 80JJAA available to Flower Ltd. for A.Y.2016-17, if the profits and gains derived from manufacture of goods in the factory for the A.Y.2016-17 is Rs. 8.17 lakhs. *(6 Marks)*

7. (a) Explain in the context of provisions contained in Chapter XVII of the Act and also work out the amount of tax to be deducted by the payer of income in the following cases:

(i) Payment of Rs. 5 lacs made by Trial & Co. to Ria Events Co. Ltd. for organizing a debate competition on the subject "Preservation of Rural Heritage of Madhya Pradesh".

(ii) "Profit Commission" of Rs. 1 lac paid by a re-insurance company to the insurer company after the expiry of the term of insurance where there was no claim during the treaty.

(iii) Kamal, a part time director of PQR Pvt. Ltd. was paid an amount of Rs. 2,25,000 as fees which was actually in the nature of commission on sales for the period 01-04-2015 to 30-06-2015. *(6 Marks)*

(b) An order for A.Y. 2015-16 was passed by the Assessing Officer as per section 143(3), but the typist wrongly typed in the order, the assessment year as A.Y. 2014-15 and the relevant previous year as ending on 31.3.2014. The assessee claimed in appeal that the same is an invalid order which was not accepted by the CIT (Appeals) on the ground of the error being of clerical nature. Discuss the correctness of the order of the CIT (Appeals). *(4 Marks)*

(c) Trust Lime Co. of US entered into contracts with three Indian companies namely Right Ltd., Tight Co. Ltd. and Frank Ltd. for supplying know-how. Trust Lime Co. made an application to the Authority for Advance Rulings (AAR) on the rate of withholding tax on receipts applicable to it.

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

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

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

(6 Marks)

Test Series: September, 2016

MOCK TEST PAPER – 2

FINAL: GROUP – II

PAPER – 7 : DIRECT TAX LAWS

SUGGESTED ANSWERS/HINTS

1. (a) Computation of allowable depreciation/ chargeable capital gains

In case of Ghanshyam

	Rs.
Assessment year 2014-15 (P.Y. 2013-14)	
WDV as on 01-04-2013	Nil
Addition during the year on 15-12- 2013	3,00,000
	3,00,000
Less: Depreciation @ 7.5% (since the machinery is put to use for less than 180 days)	22,500
WDV as on 01-04-2014	2,77,500
Assessment year 2015-16 (P.Y.2014-15)	
Actual Sale consideration – 01.01.2015	3,20,000
Less: WDV as on 01-04-2014	2,77,500
Short-term capital gains chargeable to tax under section 50	42,500
Assessment year 2016-17 (P.Y.2015-16)	
WDV as on 01-04-2015	Nil
Addition during the year on 15-11-2015 *[See Note 1]*	2,77,500
	2,77,500
Less: Depreciation @ 7.5% (since the machinery is put to use for less than 180 days)	20,813
WDV as on 01-04-2016	2,56,687

In case of Rahim

	Rs.
Assessment year 2015-16 (P.Y.2014-15)	
WDV as on 01-04-2014	Nil
Addition during the year on 01-01-2015 [See Note 2]	2,50,000
	2,50,000

Less: Depreciation @ 7.5% (since the machinery is put to use for less than 180 days)	18,750
WDV as on 01-04-2015	2,31,250
Assessment year 2016-17(P.Y.2015-16)	
Actual Sale consideration – 15.11.2015	3,10,000
Less: WDV as on 01-04-2015	2,31,250
Short-term capital gains chargeable under section 50	78,750

Notes:

1. As per *Explanation 4* to section 43(1), where an asset which had once belonged to the assessee and had been used by him for the purpose of his business and thereafter, ceased to be his property by reason of transfer or otherwise, is re-acquired by him, the actual cost to the assessee shall be lower of the following:

   (a) Actual cost when he first acquired the asset *minus* the depreciation actually allowable to him till the date of transfer (i.e., Rs. 2,77,500, in this case); or

   (b) Actual price for which it is re-acquired (i.e., Rs. 3,10,000).

   Therefore, in this case, the actual cost of machinery reacquired by Ghanshyam would be Rs. 2,77,500, being the lower of the two amounts given above.

2. As per *Explanation 3* to section 43(1), where the assets were at any time, before the date of acquisition by the assessee, used by any other person for the purposes of business or profession and the Assessing Officer is satisfied that the main purpose of the transfer of such asset was the reduction of his liability (by claiming excess depreciation with reference to enhanced cost), the actual cost to the assessee shall be such an amount as determined by the Assessing Officer, with the previous approval of the Joint Commissioner.

   Consequently, the cost of machinery in the hands of Rahim would be Rs. 2,50,000, assuming that the fair market value given in the question is the amount determined by the Assessing Officer, with the previous approval of the Joint Commissioner.

(b) Computation of total income and tax liability of Mr. Yogesh for the A.Y.2016-17

Particulars	Rs.	Rs.
Income from house property		
Self-occupied portion (50%)		
Annual Value under section 23(2)	Nil	

Less: Deduction under section 24(b)		
Interest on housing loan [Rs. 52,000 × 50%]	26,000	(26,000)
Let-out portion (50%)		
Income of let out portion being rent of Rs. 8,500 p.m. received for 12 months **(Rent received has been taken as the GAV in the absence of other information)**.		
Gross Annual Value under section 23(1) (Rs. 8,500 × 12)	1,02,000	
Less: 50% of municipal taxes paid allowable in respect of rented out portion (i.e., 50% of Rs. 2,500)	1,250	
Net Annual Value (NAV)	1,00,750	
Less: **Deduction under section 24**		
30% of NAV under section 24(a)	30,225	
Interest on housing loan under section 24(b)	26,000	44,525
		18,525
Profits and gains of business or profession		
Net profit as per profit and loss account of wholesale business of textiles and fabrics	3,65,500	
Add: Expenses charged in profit and loss account either not allowable or to be considered separately -		
Personal travelling expenses of proprietor	12,750	
Purchase of furniture wrongly debited to shop expenses	25,000	
	4,03,250	
Less: Depreciation on furniture @ 10% on Rs. 25,000	2,500	4,00,750
Gross Total Income		**4,19,275**
Less: **Deduction under Chapter VI-A**		
Under section 80C		
- Life insurance premium		
Self	12,500	
Wife	13,500	
Son and daughter	28,000	
- Housing loan repaid	50,000	
	1,04,000	
Maximum allowable upto Rs. 1.50 lakh (section 80CCE)	1,04,000	

Under section 80D [Medical insurance premium]		
Mediclaim insurance premium of Rs. 25,000 [maximum deductible is Rs. 30,000 where it covers a resident senior citizen]	25,000	1,29,000
Total Income		**2,90,275**
Total Income (rounded off)		2,90,280
Tax on total income of Rs. 2,90,280		Nil
(The basic exemption limit for senior citizen is Rs. 3,00,000 for A.Y.2016-17)		

2. Computation of Total Income of Sunshine Ltd. for the A.Y.2016-17

Particulars	Amount (Rs.)	
Profits and Gains from Business and Profession		
Net profit as per profit and loss account		50,00,000
Add: Items debited but to be considered separately or to be disallowed		
Depreciation as per books of account (Note 1)	16,00,000	
Expenditure on public issue of shares which could not materialize due to non-clearance by SEBI (Note 2)	2,50,000	
Compounding fee paid for violating pollution control regulations (Note 3)	1,00,000	
Loss of cash in transit from bank to administrative office on account of theft (Note 4)	-	
Expenditure towards permitted CSR activities as per section 135 of the Companies Act, 2013 (Note 5)	5,00,000	
Payment to commodity broker without deducting tax at source (Note 6)	30,000	
Donations to electoral trust and registered political party (Note 7)	1,50,000	
		26,30,000
		76,30,000
Less: Items credited but to be considered separately / Expenditure to be allowed		
Depreciation allowable under the Income-tax Act, 1961 (Note 1)	27,10,000	

Expenditure on issue of debentures (Note 8)	2,00,000	
		29,10,000
Gross Total Income		**47,20,000**
Less: Deduction under Chapter VI-A		
Under section 80GGB [Donation to registered political party] (Note 7)	1,00,000	
Under section 80JJAA (Note 9)	6,00,000	7,00,000
Total Income		**40,20,000**

Notes:

(1) Depreciation as per books of account charged to profit and loss account (i.e., Rs. 16 lakhs) has to be added back and depreciation calculated as per Income-tax Rules, 1962 (i.e. Rs. 27.10 lakhs) is allowable as deduction under section 32.

Computer accessories and peripherals like printer and scanner form an integral part of the computer system and they cannot be used without the computer; hence, they are eligible for depreciation@60% *[CIT v. BSES Yamuna Powers Ltd. (2013) 358 ITR 47 (Del.)].*

However, EPABX is not a computer and is, hence, not entitled to higher depreciation@60% *[Federal Bank Ltd. v. ACIT (2011) 332 ITR 319 (Kerala)]*.

Therefore, depreciation as per Income-tax Act, 1961 would be Rs. 27.10 lakhs, which is computed as follows –

Particulars	Rs.
Depreciation computed as per Income-tax Act, 1961	28,00,000
Less: Depreciation@60% wrongly provided in respect of EPABX = 60% of Rs. 2,00,000	1,20,000
	26,80,000
Add: Depreciation@15% on EPABX = 15% of Rs. 2,00,000	30,000
Correct Depreciation as per Income-tax Act, 1961	**27,10,000**

(2) Share issue expenses incurred by the company constitutes a capital expenditure, even though it could not go in for the public issue on account of non-clearance by SEBI. Though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts [*Mascon Technical Services Ltd. v. CIT (2013) 358 ITR 545 (Mad.)].*

Since the expenditure has been charged to profit and loss account, the same has to be added back.

(3) The amount paid for compounding an offence is inevitably a penalty and the mere fact that it has been described as compounding fee cannot, in any way, alter the character of the payment which is in the nature of penalty. Hence, the same is not allowable as revenue expenditure [*Millenia Developers P Ltd. v. Deputy CIT (2010) 322 ITR 401 (Kar.)]*.

Since the compounding fee has been charged to profit and loss account, the same has to be added back.

(4) In order to determine whether any loss from theft, dacoity, embezzlement, etc., is deductible or not, what is material is whether the loss incurred by theft, dacoity, etc., is incidental to the carrying on of the business. It does not make much difference whether such act is committed by the employees of the assessee or by strangers [*G.G. Dandekar Machine Works Ltd. v. CIT (1993) 202 ITR 161 (Bom.)]*.

In this case the loss due to theft took place when cash was withdrawn from bank and taken to administrative office. Hence, it is incidental to business and thus, allowable as revenue expenditure. Since the same has already been charged as revenue expenditure, no further adjustment is required.

(5) Any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall not be allowed as deduction under section 37. Since the expenditure has been charged to profit and loss account, the same has to be added back for computing business income.

It is assumed that the CSR expenditure is not of the nature described in sections 30 to 36 of the Income-tax Act, 1961, and hence, does not qualify for deductions under those sections.

(6) The payment to commodity broker is in the nature of commission on which tax is deductible under section 194H.

Hence, payment of Rs. 1 lakh to a commodity broker for commodity transactions at MCX would attract disallowance@30% under section 40(a)(ia), due to non-deduction of tax at source under section 194H.

(7) Donation to an electoral trust and a registered political party is not an allowable expenditure under section 37 since it is not laid out wholly or exclusively for the purposes of business or profession. Hence, the same has to be added back while computing business income.

However, donation made by a company to an electoral trust or registered political party is allowable deduction under section 80GGB from gross total income, subject to the condition that payment is made otherwise than by way of cash. Since the donation to electoral trust is made in cash, the same does not qualify for deduction under section 80GGB. However, donation of Rs. 1 lakh by cheque to a registered political party would be eligible for deduction under section 80GGB.

(8) The expenditure on issue of debentures is not in the nature of capital expenditure and is laid out or expended wholly and exclusively for the purpose of the assessee's business and is therefore, allowable as a deduction. The act of borrowing money is incidental to the carrying on of business, the loan obtained is not an asset or an advantage of enduring nature, the expenditure is made for securing the use of money for a certain period, and it is irrelevant to consider the object with which the loan was obtained *[India Cements Ltd. v. CIT (1966) 60 ITR 52 (SC)].*

Since the said expenditure has been capitalized in the books of account, the same has to be deducted to compute business income.

(9) Deduction of 30% of additional wages paid to the new regular workmen employed by the assessee in a factory is allowable under section 80JJAA, where the gross total income of an Indian company includes profits and gains derived from the manufacture of goods in a factory.

"Additional wages" means the wages paid to the new regular workmen in excess of 50 workmen employed during the previous year. In case of an existing factory, the number of regular workmen employed during the year should be 10% or more of the existing number of workmen employed on the last day of the previous year.

In this case, 115 new workmen are employed in the factory during the P.Y.2015-16 and the new workmen employed in the factory constitute 20% of the existing workforce, the company is eligible for deduction under section 80JJAA, assuming that these workmen are regular workmen. The deduction under section 80JJAA would be available in respect of wages paid to these 115 workers who are over the existing workers of 575 in factory.

Therefore, deduction under section 80JJAA would be Rs.6,00,000, being 30% × Rs. 20,00,000.

No deduction is allowable under section 80JJAA in respect of additional salaries paid to new employees working in a place other than a factory (registered office, in this case).

Note *- It is logical to assume that the additional wages of Rs. 20 lakh and salaries of Rs. 8 lakh have been debited to profit and loss account. Hence, no further adjustment is required to be made regarding such wages and salaries while computing business income.*

3. (a) Section 2(15) defines "charitable purpose" to include relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, the "advancement of any other object of general public utility" shall not be a charitable purpose, if the institution is carrying on any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income derived from such activity.

Since ***yoga*** has been specifically included in the definition of "charitable purpose" by the Finance Act, 2015 with effect from A.Y.2016-17, it would no longer fall under the residual clause "advancement of any other object of general public utility". Therefore, an institution having yoga as its main object would not be subject to the restrictions which are applicable to the "advancement of any other object of general public utility". Such institution would continue to retain its "charitable" status, even if it derives income from an activity in the nature of trade.

However, if an institution having its main object as "advancement of any other object of general public utility" derives income from an activity in the nature of trade during a financial year, it would lose its "charitable" status for that year, even if it applies such income for its main objects.

It may be noted that if the receipts from such activity does not exceed 20% of the total receipts in that year, then, the institution would not lose its "charitable" status, even its main object is "advancement of any other object of general public utility", provided such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

In this case, the receipts from such activity are 25% of total receipts. Hence, the institution will lose its charitable status and will not get the benefit of tax exemption under section 11 or 12 in the P.Y.2015-16, even if it applies such receipts for its main object and irrespective of whether the registration issued is cancelled or not.

(b) Computation of total income of Mrs. Arpita for the A.Y.2016-17

	Particulars	**Rs.**
A	Long term capital gains	1,91,50,000
	Less: Deduction under section 54 **[See Note 1 below]**	50,00,000
		1,41,50,000
	Less: Deduction under section 54EC **[See Notes 2 & 3 below]**	50,00,000
	Long term capital gain	91,50,000
B	Income from Other Sources [Interest on fixed deposit]	32,000
	Total Income	**91,82,000**

As per section 112, in case of an individual, being a resident where her total income includes long-term capital gain and other income, the tax payable on the total income is the aggregate of the amount of income tax on long-term capital gains @ 20% and the amount of income tax on the total income as reduced by the amount of long term capital gain, had the total income so reduced been her total income.

However, the unexhausted basic exemption limit can be exhausted against long-term capital gains, and tax would be leviable on the balance long-term capital gains @ 20%. Therefore, the basic exemption limit of Rs. 2,50,000 should be first adjusted against other income of Rs. 32,000 and the unexhausted basic exemption limit of Rs. 2,18,000 should be adjusted against the long-term capital gains of Rs. 91,50,000. The balance long-term capital gains of Rs. 89,32,000 would be taxable@20% plus education cess@2% and secondary and higher education cess@1%. Therefore, the tax payable by the assessee would be Rs. 18,39,992.

Notes:

(1) Section 54 provides that exemption thereunder can be availed in respect of investment made in **one residential house situated in India**. Therefore, Mrs. Arpita cannot avail exemption under section 54 in respect of investment in house property situated outside India at Dubai.

The next issue is whether Mrs. Arpita can claim exemption under section 54 in respect of Rs. 50 lakhs invested in two flats situated next to each other in Lucknow, where necessary modification has been effected to use the same as a single house. On this issue, the Karnataka High Court in *CIT v. D. Ananda Basappa (2009) 309 ITR 329* observed that where the assessee had shown that the flats were situated side by side and the builder had also certified that he had effected modification of the flats to make them as a single house by constructing a door between the apartments, it was immaterial that the flats were purchased through different sale deeds from two different buyers. The Court observed that these were not the grounds to hold that the assessee did not have the intention to purchase the two flats to be used as one house. The Court held that the assessee was entitled to exemption under section 54 in respect of purchase of both the flats to form one residential house.

Therefore, in this case, Mrs. Arpita can avail exemption in respect of investment of Rs. 50 lakhs in purchase of two flats situated next to each other in Lucknow, since necessary modification has been effected to use the two flats as a single house property. Also, she has made the investment in purchase of two flats within the stipulated period of two years after the date of transfer.

(2) In order to claim exemption under section 54EC, the assessee has to invest in specified bonds of RECL or NHAI within a period of 6 months from the date of transfer of the asset.

(3) However, investments in such bonds by an assessee during any financial year cannot exceed Rs. 50 lakhs.

Further, second proviso to section 54EC(1) also provides that the investment made by an assessee in bonds of NHAI/RECL, out of capital gains arising from transfer of one or more original assets, during the financial year in which the original asset or assets are transferred and in the subsequent financial year should not exceed Rs. 50 lakhs.

In this case, Mrs. Arpita has invested Rs. 35 lakhs in bonds of NHAI in the F.Y.2015-16 and Rs. 45 lakhs in bonds of RECL in the F.Y.2016-17, both within six months from the date of transfer. However, since the amount of investment made during the financial year in which asset transferred and in the subsequent financial year cannot exceed Rs. 50 lakhs, she is eligible to claim exemption of only Rs. 50 lakhs under section 54EC.

(c) (i) Computation of total income of the investment funds for A.Y.2016-17

Particulars	M	N	O
	Rs.		
Business Income	Nil	3,00,000	Nil
Capital Gains [Exempt under section 10(23FBA)]	-	-	-
Income from other sources [Exempt under section 10(23FBA)]	-	-	-
Total Income	**Nil**	**3,00,000**[1]	**Nil**

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

Particulars	M	N	O
	Rs.		
Business Income [Exempt under section 10(23FBB)]	-	-	-
Capital Gains [Rs.12,00,000/30, Rs.18,00,000/30, Nil]	40,000	60,000	-
Income from other sources [Rs. 6,00,000/30, Rs.7,20,000/30, (Rs. 9,00,000 - Rs. 1,50,000)/30]	20,000	24,000	25,000
Total Income	**60,000**	**84,000**	**25,000**

[1] The total income of Investment Fund M would be chargeable to tax@30% since the fund is a LLP.

Notes:

1. As per section 10(23FBA), income other than profits and gains of business or profession is exempt in the hands of the Investment fund. Such income is taxable in the hands of the unit holders as if he had directly made the investment. Section 115UB(3) provides the nature of such income from Investment Fund in the hands of unit holders[2].

2. Income under the head "Profits and gains of business or profession" is taxable in the hands of the Investment Fund. Hence, such income is exempt in the hands of the unit holders as per section 10(23FBB).

(ii) Where in any previous year, the net result of computation of total income of the investment fund [without providing for exemption under section 10(23FBA)] is a loss under any head of income and such loss cannot be or is not wholly set-off against income under any other head of income of the said previous year, then, the same has to be carried forward for set-off as per Chapter VI at the Fund level. Consequently, the loss incurred by the Investment Fund under any head of income cannot be passed on to the investors.

Accordingly, in case of Investment Fund O, the business loss of Rs. 1,50,000 has to be set-off against income from other sources of Rs. 9,00,000. The balance income of Rs. 7,50,000 is taxable in the hands of the unit holders. Loss of Rs. 4,50,000 under the head "Capital gains" cannot be set-off against income from other sources. The same has to be carried forward by Investment Fund O for set-off against income under the head "Capital gains" in the A.Y.2017-18.

(iii) Dividend distribution tax leviable under Chapter XII-D and tax on distributed income leviable under Chapter XII-E would not apply to income paid by an Investment Fund to its unit holders. Therefore, no distribution tax is payable by the Investment Funds on income distributed to its unit holders.

(iv) Section 115UB(6) provides that if the income accruing or arising to, or received by, an Investment Fund, during a previous year is not paid or credited to the unit-holders, it shall be deemed to have been credited to the account of the unit-holder on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year.

Therefore, income chargeable to tax in the hands of unit holders would not undergo a change, even if the Investment Funds do not distribute the entire

[2] As per section 115UB(3), the income paid or credited by the Investment Fund shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder as if it had been received by, or had accrued or arisen to, the Investment Fund.

income earned by them during the P.Y.2015-16 to the unit holders by 31.3.2016.

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

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

Accordingly, in this case, Rs. 50,000 (i.e., loan to the extent of accumulated profits of Moon Ltd.) would be deemed as dividend in the hands of Mrs. Sharma, who holds 15% equity shares in Moon Ltd., under section 2(22)(e).

Thereafter, the clubbing provisions under section 64(1)(iv) would be attracted, as per which, income as arises, directly or indirectly, from asset transferred to spouse, otherwise than for adequate consideration, would be included in the hands of the transferor.

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

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

(b) The interest income from deposit in the bank is assessable under the head "Income from Other Sources". The deduction admissible against this income is any expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income. However, the interest paid on the borrowing of Rs. 5 Lacs does not fall in this category. This has been held by the Supreme Court in *CIT v. Dr. V. Gopinathan (2001) 248 ITR 449.* In that case, the Supreme Court observed that the interest received by the assessee from the bank on a fixed deposit is income in his hands and there could be no deduction there from unless there is a law permitting such deduction. The interest on a loan taken by the assessee on the security of the fixed deposit would not go to reduce the income by way of interest on the fixed deposit as there is no provision for deduction of such interest on the loan.

Therefore, in this case, the full sum of Rs. 80,000 will be liable to tax under the head "Income from Other Sources".

Note: In case the assessee had deposited business funds and availed loan against such deposit for business use of such loan, the interest on loan against deposit is eligible for deduction.

(c) Section 10(38) exempts long term capital gain arising from transfer of equity shares in a company or a unit of an equity oriented fund, if such transfer has been subjected to securities transaction tax. Hence, the capital gain / capital loss will have no tax implication.

In this case, the assessee has suffered a loss of Rs. 10,000 by selling eligible equity shares. It is settled principle that the loss arising from an exempt source is not eligible for set off against income arising from a taxable source. In the case of *CIT v. Thiagarajan. S.S (1981) 129 ITR 115 (Mad),* the Madras High Court held that loss incurred by an assessee from an exempted source, cannot go to set off income from a taxable source. In view of the same, the set off in the instant case is not permissible.

(d) Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that the only exception is when the business passes on to another by inheritance.

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

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

5. (a) As per section 80AC, while computing the total income of an assessee of a previous year ***(P.Y. 2015-16, in this case)*** relevant to any assessment year ***(A.Y. 2016-17, in this case),*** any deduction is admissible, *inter alia,* under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the due date specified in section 139(1).

Since the turnover of the partnership firm M/s. Xerox has exceeded Rs. 100 lakhs in the previous year 2015-16, it would be subject to audit under section 44AB, in which case the due date of filing its return of income for A.Y.2016-17 would be 30th September, 2016 as per section 139(1).

Computation of total income and tax liability of M/s. Xerox for A.Y.2016-17

I. Where the firm files its return of income on 30th September 2016:

Particulars	Rs. in lakhs
Gross Total Income	420.00
Less: Deduction under section 80-IA	340.00
Total Income	**80.00**
Tax liability@30%	24.00
Add: Education cess@2% and secondary and higher education cess@1%	0.72
Regular income-tax payable	**24.72**
Computation of Alternate Minimum Tax payable [Section 115JC]	
Total Income	80.00
Add: Deduction under section 80-IA	340.00
Adjusted Total Income	**420.00**
Alternate Minimum Tax (AMT) @ 18.5% on Rs. 420 lakhs	**77.70**
Add: Surcharge@12% (Since adjusted total income > Rs. 1 crore)	9.32
	87.02
Add: Education cess@2% and SHEC@1%	2.61
Total tax payable (AMT)	**89.63**

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2015-16 and it shall be liable to pay income-tax on such total income@18.5% **[Section 115JC(1)]**. Therefore, the tax payable for the A.Y.2016-17 would be Rs. 89.63 lakhs.

Tax credit for Alternate Minimum Tax [Section 115JD]	**Rs. in lakhs**
Total tax payable for A.Y.2016-17 (Alternate Minimum Tax)	89.63
Less: Regular income-tax payable	24.72
To be carried forward for set-off against regular income-tax payable (upto a maximum of ten assessment years).	64.91

II. Where the firm files its return of income in December 2016:

Where the firm files its return in December, 2016, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IA would not be available. In such circumstances, the gross total income of Rs. 420 lakhs would be the total income of the firm.

Particulars	Rs. in lakhs
Income-tax@30% of Rs. 420 lakhs	126.00
Add: Surcharge@12% (since total income exceeds Rs. 100 lakhs)	15.12
Income-tax (plus surcharge)	141.12
Add: Education cess@2% and SHEC@1%	4.23
Total tax liability	**145.35**

Right course of action to minimize tax liability

The right course of action to minimize tax liability would be to file the return of income under section 139(1) on or before the due date 30.9.2016 and claim deduction under section 80-IA. In such a case, the firm can claim deduction of Rs. 340 lakhs under section 80-IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) within 31.3.2018 (i.e., within one year from the end of A.Y.2016-17) which would replace the original return filed under section 139(1). A return filed under section 139(1) [i.e., on or before the due date of filing return of income] can only be revised under section 139(5). A belated return filed under section 139(4) cannot be revised.

If the firm files the return of income under section 139(1) on or before 30.9.2016, its tax liability would stand reduced to Rs. 89.63 lakhs, as against Rs. 145.35 lakhs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of Rs. 64.91 lakhs. Therefore, the firm is advised to file its return of income on or before 30.9.2016.

(b) **(i)** As per the third proviso to section 147, the Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment. The doctrine of partial merger would apply in this case.

Therefore, even when an appeal is pending before Commissioner (Appeals), the Assessing Officer can initiate reassessment proceedings in respect of income chargeable to tax which has escaped assessment, provided such income is not the subject matter of the appeal before the Commissioner (Appeals) i.e., such income which has escaped assessment does not form part of the additions of Rs.15 lakhs to the returned income, which is the subject matter of appeal.

(ii) As per section 154(1A), the Assessing Officer can pass an order under 154(1) to rectify a mistake apparent from the record, provided the rectification is in relation to a matter, other than the matter which has been considered and decided in the appeal before Commissioner (Appeals). The doctrine of partial merger holds good for section 154 also.

Since the issue under consideration in this case relates to rectification of a mistake in respect of a matter which is not the subject matter of appeal, the Assessing Officer can pass an order under section 154 for rectification of the same provided the same is a mistake apparent from the record.

(iii) As per section 264(4), the Commissioner shall not revise any order under section 264, where such order has been made the subject of an appeal to the Commissioner (Appeals). Thus, the concept of total merger would apply in the case of section 264.

Therefore, under section 264, the Commissioner cannot revise an order which is pending before the Commissioner (Appeals), even if the revision pertains to a matter, other than the matter(s) covered in the appeal.

6. (a) As per section 147, the Assessing Officer may assess or reassess such income **and also** any other income chargeable to tax which has escaped assessment and which comes to his notice in the course of proceedings under that section.

The issue under consideration is whether the Assessing Officer can make an assessment on the basis of an issue which came to his notice during the course of assessment, when the issues, which originally formed the basis of issue of notice under section 148, were dropped in its entirety.

There are two different views in this regard. One view is based on the Delhi High Court ruling in *Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136.* Another view is based on the Punjab & Haryana High Court ruling in *CIT v. Mehak Finvest P Ltd (2014) 367 ITR 769.*

The Delhi High Court, in *Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136*, observed that the words “and also” used in section 147 are of wide amplitude. The language of the section is indicative of the position that the assessment or reassessment must be of the income, in respect of which the Assessing Officer has formed a ‘reason to believe’ for the issue of notice under section 148 **and also** in respect of any other income which comes to his notice subsequently during the course of the proceedings as having escaped assessment. The correct interpretation, therefore, would be to regard the words **'and also'** as being “conjunctive and cumulative with” and not “in alternative to” the first part of the sentence, namely, “the Assessing Officer may assess and reassess such income”.

If the income, the escapement of which was the basis of the formation of the "reason to believe", is not assessed or reassessed, it would not be open to the Assessing Officer to independently assess only that income which comes to his notice subsequently in the course of the proceedings under the section as having escaped assessment. If he intends to do so, a fresh notice under section 148 would be necessary.

Considering the rationale of the Delhi High Court ruling, the action of the Assessing Officer in passing a reassessment order under section 147 by making additions on account of disallowances under section 40A(2) in respect of other expenses, when the original "reasons to believe" ceased to exist, is not valid.

However, the Punjab & Haryana High Court, in *Mehak Finvest P Ltd.'s* case, expressed a different view on this issue, based on *Explanation 3* to section 147, which clarifies that the Assessing Officer may, for the purpose of assessment or reassessment under this section, assess or reassess the income in respect of any issue, which has escaped assessment, and such issue comes to his notice subsequently in the course of the proceedings under this section, notwithstanding that the reasons for such issue have not been included in the reasons recorded under section 148(2). The High Court noted that *Explanation 3 to section 147* nowhere postulates or contemplates that the Assessing Officer cannot make any additions on any other ground unless some addition is made on the basis of the original ground for which reassessment proceeding was initiated. It cited the dismissal of special leave petition (SLP) against the High Court ruling in *Majinder Singh Kang's* case by the Supreme Court on 19.08.2011 as the binding precedent.

The Punjab & Haryana High Court, accordingly, held that even though no addition is made on the original grounds which formed the basis of initiation of reassessment proceedings, the Assessing Officer is empowered to make additions on another ground for which reassessment notice might not have been issued but which came to his notice subsequently during the course of proceedings for reassessment

If the rationale of the Punjab & Haryana High Court ruling is applied to the case on hand, the action of the Assessing Officer in passing a reassessment order under section 147 by making additions on account of disallowance under section 40A(2) in respect of other expenses, when the original "reasons to believe" ceased to exist, is valid.

***Note** – The question can be answered on the basis of the rationale of the Delhi High Court ruling in Ranbaxy Laboratories' case or the Punjab and Haryana High Court ruling in Mehak Finvest P Ltd.' s case.*

(b) Under section 263(1), if the Principal Commissioner or Commissioner considers that any order passed by the Assessing Officer **is erroneous in so far as it is prejudicial to the interests of the Revenue**, he may, after giving the assessee an opportunity of being heard and after making an enquiry, pass an order enhancing or modifying the assessment made by the Assessing Officer or cancelling the assessment and directing fresh assessment.

Explanation 2 has been inserted by the Finance Act, 2015 with effect from 1st June, 2015 to provide that an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the Revenue, if, in the opinion of the Principal Commissioner or Commissioner,—

(1) the order is passed without making inquiries or verification which should have been made;

(2) the order is passed allowing any relief without inquiring into the claim;

(3) the order has not been made in accordance with any order, direction or instruction issued by the CBDT under section 119;

(4) the order has not been passed in accordance with any decision which is prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person.

(c) (i) Deduction under section 80JJAA is available where the gross total income of an assessee includes any profits and gains derived from manufacture of goods in a factory and the assessee has employed new regular workmen in such factory in the previous year. The deduction shall be 30% of additional wages (i.e., wages paid to new regular workmen in excess of 50 workmen employed by the assessee in such factory during the previous year). However, in case of an existing factory, no deduction shall be allowed if the increase in the number of regular workmen employed during the year is less than 10% of the existing number of workmen employed in such factory as on the last day of the preceding year.

It may be noted that the deduction under section 80JJAA would be allowable for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

In this case, Flower Ltd. is eligible for deduction under section 80JJAA for A.Y.2016-17 since its gross total income includes profits and gains derived from the manufacture of goods in a factory and it has employed new regular workmen in its factory in the P.Y.2015-16 in excess of 10% of existing number of workmen as on 31.3.2015.

New regular workmen employed during the P.Y.2015-16 = 55 **[See Working Note below]**

Existing workmen as on 31.3.2015 = 500

New regular workmen is in excess of 10% of existing workmen as on 31.3.2015.

The deduction under section 80JJAA would be 30% of additional wages paid to the new regular workmen employed by it in such factory during the previous year.

Additional wages = Rs. 4,000 per month ×11 months × 55 workmen = Rs. 24,20,000

Deduction under section 80JJAA = 30% of Rs. 24,20,000 = Rs. 7,26,000.

Working Note:

Number of new regular workmen

Particulars	No. of workmen	
Total number of workmen employed during the year		135
Less: Casual workmen employed during the year	35	
Workmen employed through contract labour	20	
Workmen employed for a period of less than 300 days during the P.Y.2015-16 (workmen employed on 31.7.2015 and 21.8.2015)	25	80
Total number of new regular workmen employed during the P.Y.2015-16		**55**

"Regular workman" does not include a casual workman or a workman employed through contract labour or any other workman employed for a period of less than 300 days during the previous year.

Note – In respect of new regular workmen employed in the P.Y. 2011-12, deduction under section 80JJAA would have been allowed for three assessment years i.e., A.Y.2012-13 to A.Y.2014-15. Likewise, in respect of new regular workmen employed in the P.Y.2012-13, deduction under section 80JJAA would have been allowed for three assessment years i.e., A.Y.2013-14 to A.Y.2015-16.

7. (a) (i) The services of Event Managers in relation to sports activities alone have been notified by the CBDT as "professional services" for the purpose of section 194J. In this case, payment of Rs. 5 lacs was made to an event management company for organization of a debate competition. Hence, the provisions of section 194J are not attracted.

However, TDS provisions under section 194C relating to contract payments would be attracted and consequently, tax has to be deducted @ 2% under section 194C. The tax deductible under section 194C would be Rs. 10,000, being 2% of Rs. 5 lacs.

(ii) Section 194D requires deduction of tax at source @10% from insurance commission.

Reinsurance is different from insurance since there is no direct contractual relationship between the person insured and the re-insurer.

In order to attract section 194D, the commission or any other payment covered under the section should be a remuneration or reward for soliciting or procuring the insurance business. The insurance companies do not procure business for the reinsurance company nor does the reinsurer pay commission or other payment for soliciting the business from the insurance companies. Therefore, section 194D has no application.

Hence, when profit commission is paid by a reinsurance company to an insurance company, after the expiry of the term of insurance, in respect of cases where there is no claim during the operation of the reinsurance treaty, tax deduction under section 194D is not attracted.

(iii) Section 194J provides for deduction of tax at source @10% on any remuneration or fees or commission, by whatever name called, paid to a director, which is not in the nature of salary in respect of which tax is deductible at source under section 192.

Hence, tax is to be deducted at source under section 194J @10% by PQR Pvt. Ltd. on the commission of Rs. 2,25,000 paid to Kamal, a part-time director. The tax deductible under section 194J would be Rs. 22,500, being 10% of Rs. 2,25,000.

(b) Section 292B provides that no return of income, assessment, notice or summons furnished or made or issued or taken in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment or notice etc., if such return of income, assessment, notice, summons etc. is in substance and effect in conformity with or according to the intent and purpose of the Act. Therefore, a clerical mistake cannot invalidate an otherwise valid assessment. Thus, the typographical error in the assessment order as to assessment year and previous year does not make the same invalid unless established otherwise. Accordingly, the action of the CIT(Appeals) in not accepting the claim of the assessee is valid.

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

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

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

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

Test Series: September, 2016

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – II

PAPER – 8: INDIRECT TAX LAWS

Question No. 1 is compulsory.

Attempt any five questions from the remaining six Questions.

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

Time Allowed – 3 Hours **Maximum Marks – 100**

1. (a) Dev & Company is a manufacturing company. In the preceding financial year, the details of its clearances of excisable goods are as follows:-

	Particulars	Rs. (Lakhs)
(i)	Total exports (including for export to Bhutan Rs. 50 lakhs)	600
(ii)	Clearances of excisable goods without payment of duty to a 100% EOU	10
(iii)	Job work under *Notification No. 84/94-CE dated 11.4.94*	50
(iv)	Job work under *Notification No. 214/86-CE dated 25.3.86*	50
(v)	Clearances of goods bearing brand name of National Small Industries Corporation	100
(vi)	Clearances of corrugated boxes bearing the brand name of Sugar & Spice Confectioners. Sugar & Spice Confectioners use these corrugated boxes for packing the bakery products produced by them.	200

On the basis of above information, you are required to ascertain the eligibility of Dev and Company for exemption based on value of clearances in terms of *Notification No. 8/2003-CE dated 1.3.2003* for the current financial year. *(5 Marks)*

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

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

Particulars	(Rs.)
Gross amount (excluding all taxes) charged by the Shiv Pvt. Ltd. for the contract	6,00,000
Fair market value of the material supplied by Nanak Ltd. (determined in accordance with the generally accepted accounting principles)	1,00,000
Amount charged by Nanak Ltd. for the material (inclusive of VAT)	60,000
Excise duty paid on inputs	12,750
Service tax paid on input services	6,000
Excise duty paid on capital goods, purchased during the year, used in the contract	4,000

Note: Rate of service tax is 14.5% (including Swachh Bharat Cess). *(10 Marks)*

(c) A consignment of 800 metric tonnes of edible oil of Malaysian origin was imported by a charitable organization in India for free distribution to below poverty line citizens in a backward area under the scheme designed by the Food and Agricultural Organization. This being a special transaction, a nominal price of US$ 10 per metric tonne was charged for the consignment to cover the freight and insurance charges. The Customs House found out that at or about the time of importation of this gift consignment there were following imports of edible oil of Malaysian origin:

S. No.	Quantity imported in metric tonnes	Unit price in US $ (CIF)
1.	20	260
2.	100	220
3.	500	200
4.	900	175
5.	400	180
6.	780	160

The rate of exchange on the relevant date was 1 US $ = Rs. 60.00 and the rate of basic customs duty was 10% ad valorem. There is no countervailing duty or special additional duty. Calculate the amount of duty leviable on the consignment under the Customs Act, 1962 with appropriate assumptions and explanations, where required.

(5 Marks)

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

(b) The CESTAT passed an order in case of Mr. Shyam holding that the activity carried out by Mr. Shyam is liable to service tax. Aggrieved by the said order, Mr. Shyam wishes to file an appeal against the said order. You are required to advise him as to whether he can file an appeal to High Court on the question of levy of service tax on a particular activity. *(8 Marks)*

(c) State the difference between transit and transhipment of goods under the provisions of the Customs Act. *(4 Marks)*

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

The Central Excise Department has issued a show cause notice to M/s X & Co. Ltd. that the process of preparing tarpaulin made ups by means of cutting, stitching and fixing eyelets amounts to manufacture under the Central Excise Act, 1944.

Write a brief note with reference to decided case law, if any, whether the Department's view in the matter is legally sustainable. *(4 Marks)*

(b) Narayan (P) Ltd., a service provider, has availed and utilized credit of excise duty without actual receipt of excisable goods. A personal penalty of Rs. 1,90,000 has been imposed on Mr. Gopal, Manager of Narayan (P) Ltd. and Rs. 72,000 on Miss Shanu, an officer of Narayan (P) Ltd. who were in charge of, and were responsible to, Narayan (P) Ltd. for the conduct of its business at the time of such availment and utilization of the credit.

Discuss whether such penalty can be imposed on Mr. Gopal and Miss Shanu under section 78A of Finance Act, 1994. Can penalty be imposed on manager or officer of a company in any other case? Explain. *(8 Marks)*

(c) Tirupati & Co. had smuggled rough diamonds into the country clandestinely without payment of duty. The Department issued a notice to Tirupati & Co. proposing confiscation of the diamonds under clause (d) of section 111 of the Customs Act, 1962 and imposing penalties on various persons concerned.

However, the said goods were unconditionally exempted from payment of import duty vide an exemption notification. So, Tirupati & Co. claimed the benefit of the said exemption notification. The Department, however, refused to grant the benefit of exemption meant for imported goods to smuggled goods.

Do you think that Department's action is valid in law? *(4 Marks)*

4. (a) How are the 'incomplete or unfinished goods having the essential characteristics of finished goods' classified under the Central Excise Tariff Act, 1985? *(4 Marks)*

(b) (i) The assessee received some taxable services from Ram. A formal contract was entered into between them. As per the terms of the contract, Ram had to bear all the taxes, duties and other liabilities in connection with discharge of his obligations.

Subsequently, liability to pay service tax in case of such taxable services was shifted from service provider to service receiver retrospectively, owing to an amendment in law. Therefore, the assessee deducted service tax in the bills raised by Ram. Ram refused to accept the said deduction saying that the contractual clause could not alter the liability placed on the service recipient (i.e. the assessee) by law.

Discuss whether the contention of Ram stands to reason with the help of a decided case law, if any. *(4 Marks)*

(ii) M/s. Royal-One Restaurant has an air-conditioned and a non air-conditioned restaurant in a single complex. The air-conditioned and non air-conditioned restaurants of M/s Royal -One Restaurant are clearly demarcated and separately named. However, the food is sourced from the common kitchen. Discuss, whether the service tax will be leviable in respect of service provided in relation of serving of food in the non air-conditioned restaurant. Explain briefly with reasons. *(4 Marks)*

(c) Write a brief note on "remission of duty in case of volatile goods" under section 70 of the Customs Act, 1962. *(4 Marks)*

5. (a) What is the remedy available with the Department when the Central Excise Officer does not find the self assessment by the assessee in order? *(4 Marks)*

(b) What is the place of provision of service in the following independent cases?

(i) AB Trade Links of Hyderabad are appointed as commission agent by a foreign company for sale of its goods to Indian customers. In lieu of their services, AB Trade Links receive a fixed percentage of commission from the concerned foreign company.

(ii) YZ Fabricators of Mysore has temporarily imported certain goods from its customer located in Egypt for repairs. The said goods have been re-exported to Egypt after carrying out the necessary repairs without being put to any use in Mysore. *(8 Marks)*

(c) Explain the doctrine of unjust enrichment with respect to refund of duty. *(4 Marks)*

6. (a) What are the various methods of making verification of sureties? *(4 Marks)*

Or

How can a decision, order, summon or notice be served on the intended person under section 37C(1)(a) of the Central Excise Act, 1944? *(4 Marks)*

(b) Determine whether the following services amount to continuous supply of service in the following independent cases:-

(i) MNO & Co., a firm of interior decorators, enters in to a contract with Mr. Kanha on 01.02.2016 for doing up the interiors of his newly constructed home for a total consideration of Rs. 60 lakh. As per the terms of the contract, MNO & Co. will complete the work by 31.07.2016 and consideration will be paid in six equal instalments on the first day of each month covered during the period of contract.

(ii) Mr. Keshav has taken a mobile connection from Cell Free, a telecom service provider, on 10.01.2016. However, on account of poor service, he discontinued the services of Cell Free on 15.03.2016. *(8 Marks)*

(c) List some supplies which are 'deemed exports' for purpose of benefits under Foreign Trade Policy 2015-2020. *(4 Marks)*

7. (a) Enlist the amounts that are credited to the Consumer Welfare Fund set up under section 12C of the Central Excise Act, 1944. *(4 Marks)*

(b) With reference to the Finance Act, 1994 and the rules made thereunder relating to service tax, state whether registration is required in case of the following persons or class of persons and if it is so required, what is the last date of applying for the registration:

(i) An input service distributor who commenced business with effect from 01.09.2015.

(ii) Mr. Vaibhav started providing non-taxable services under an unregistered brand name of another person on 01.01.2015. With effect from 01.04.2015, service tax was levied on the services provided by him owing to an amendment in law. His aggregate value of taxable services exceeded Rs. 9,00,000 on 31st March, 2016. *(8 Marks)*

(c) Briefly explain as to how FTP is linked with excise and customs laws. *(4 Marks)*

Test Series: September, 2016

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – II

PAPER – 8: INDIRECT TAX LAWS

SUGGESTED ANSWERS / HINTS

1. (a) **Calculation of value of clearances of Dev and Company during preceding financial year**

Particulars	Rs. (in lakhs)
Export to Bhutan (Note-1)	50
Clearances of excisable goods bearing brand name of National Small Industries Corporation (Note-4)	100
Clearances of corrugated boxes bearing the brand name of Sugar and Spice Confectioners used for packing the bakery products by them (Note-4)	200
Value of clearances during the preceding financial year	350

Notes: In order to claim the benefit of exemption under *Notification No. 8/2003 – C.E.* in a financial year, the total turnover of a unit should not exceed Rs. 400 lakh in the preceding year. As per *Notification No. 8/2003 CE dated 01.03.2003*, for the purpose of computing the turnover of Rs. 400 lakh:-

1. export turnover has to be excluded. However, export to Bhutan cannot be excluded as the same are treated as "clearances for home consumption".
2. clearances under specified job work notifications are excluded and *Notification No. 214/86 CE* and *84/94-CE* are the specified notifications.
3. clearances of excisable goods without payment of duty to a 100% EOU are excluded.
4. clearances bearing the brand name or trade name of another person are excluded. However, following clearances of excisable goods bearing brand name are included:-
   (a) Goods bearing brand name/trade name of National Small Industries Corporation.
   (b) Goods in the nature of packing materials and meant for use as packing material by or on behalf of the person whose brand name they bear.

Since, the value of clearances in the previous financial year does not exceed Rs. 400 lakh, Dev & Company is eligible to claim the benefit of *Notification No. 8/2003 dated 1st March, 2003* in the current financial year.

(b) The contract entered into by Shiv Pvt. Ltd. requires the provision of both services and material and is for the purpose of carrying out completion of an immovable property. Therefore, it falls within the scope of term 'works contract' as defined under section 65B(54) of the Finance Act, 1994. As per section 66E(h) of Finance Act, 1994, service portion in the execution of a works contract is a declared service and thus, service provided by Shiv Pvt. Ltd. would be liable to service tax.

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

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

(i) the amount charged for such goods or services, if any; and

(ii) the value added tax or sales tax, if any, levied thereon.

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

Particulars	**(Rs.)**
Gross amount (excluding all taxes) charged by Shiv Pvt. Ltd. for the contract	6,00,000
Add: Fair market value of the material supplied by Nanak Ltd.	1,00,000
Less: Amount charged by Nanak Ltd. for the material (including VAT)	60,000
Total amount charged	6,40,000
Value of service portion in the execution of works contract (70% of 6,40,000)	4,48,000
Service tax on Rs. 4,48,000 @14%	62,720
Less: CENVAT credit on inputs (Note-1)	-
CENVAT credit on input services	6,000

CENVAT credit on capital goods (50%) (Note-2)	2,000
Service tax payable	54,720
Add: Swachh Bharat Cess (Rs. 4,48,000 @ 0.5%)(Note-3)	2,240
Total Service tax payable	**56,960**

Notes:

1. CENVAT credit of duties or cess paid on any inputs, used in or in relation to a works contract, is not available [Explanation 2 to rule 2A of the Valuation Rules].
2. Only 50% of the duty paid on the capital goods is available as CENVAT credit, in the current year [Rule 4(2)(a) of the CENVAT Credit Rules, 2004].
3. Swachh Bharat Cess cannot be paid by utilizing credit of any other duty or tax.

(c) Determination of transaction value of the subject goods:-

In the instant case, while determining the transaction value of the goods, following factors need consideration:-

1. In the given case, US $10 per metric tonne has been paid only towards freight and insurance charges and no amount has been paid or payable towards the cost of goods. Thus, there is no transaction value for the subject goods. Consequently, we have to look for transaction value of identical goods under rule 4 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Customs Valuation (DVIG) Rules, 2007].
2. Rule 4(1)(a) of the aforementioned rules provides that subject to the provisions of rule 3, the value of imported goods shall be the transaction value of identical goods sold for export to India and imported at or about the same time as the goods being valued. In the six imports given during the relevant time, the goods are identical in description and of the same country of origin.
3. Further, clause (b) of rule 4(1) of the said rules requires that the comparable import should be at the same commercial level and in substantially same quantity as the goods being valued. Since, nothing is known about the level of the transactions of the comparable consignments, it is assumed to be at the same commercial level.
4. As far as the quantities are concerned, the consignments of 20 and 100 metric tonnes cannot be considered to be of substantially the same quantity. Hence, remaining 4 consignments are left for our consideration.
5. However, the unit prices in these 4 consignments are different. Rule 4(3) of Customs Valuation (DVIG) Rules, 2007 stipulates that in applying rule 4 of the said rules, if more than one transaction value of identical goods is found, the

lowest of such value shall be used to determine the value of imported goods. Accordingly, the unit price of the consignment under valuation would be US $ 160 per metric tonne.

Computation of amount of duty payable

CIF value of 800 metric tonnes:

= 800 x 160 = US $ 1,28,000

At the exchange rate of $ 1 = Rs. 60

CIF Value (in Rupees)		=Rs. 76,80,000
Add: Landing Charges at 1%		
[As per rule 10(2) of customs valuation (DVIG) Rules, 2007= Landing charges @ 1% are to be compulsorily added to CIF value to arrive at the assessable value]		Rs. 76,800
Assessable Value	=	Rs. 77,56,800
10% of Ad Valorem duty on Rs. 77,56,800	=	Rs. 7,75,680
Add: Education cess @ 2% (rounded off)	=	Rs. 15,514
Add: Secondary and higher education cess @ 1% (rounded off)	=	Rs. 7,757
Total custom duty payable	**=**	**Rs. 7,98,951**

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

(i) if the manufacturer has manufactured and removed identical goods, within a period of one month, before or after removal of such goods, by declaring the RSP, then, the said declared RSP will be taken as the RSP of such goods;

(ii) if the RSP cannot be ascertained in the above manner, the RSP of such goods will be ascertained by conducting the enquiries in the retail market on sample basis where such goods have normally been sold at or about the same time of the removal of such goods.

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

(b) No, Mr. Shyam cannot file an appeal to High Court on the question of levy of service tax on a particular activity. Section 83 of the Finance Act, 1994 makes the provisions of section 35G and section 35L of the Central Excise Act, 1944 applicable to service tax.

Section 35G(1) of the Central Excise Act, 1944 provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal (not being an order relating, among other things, to the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment), if the High Court is satisfied that the case involves a substantial question of law.

Section 35L(1) of the Act, *inter alia*, provides that an appeal shall lie to the Supreme Court from any order passed by the Appellate Tribunal relating, among other things, to the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment. Thus, on combined reading of section 35G(1) and section 35L(1), it can be inferred that an appeal against *"an order of Tribunal relating to the determination of any question having a relation to the rate of duty of excise/service tax or to the value of goods/services for purposes of assessment*" shall not lie to High Court. Appeal against such orders will lie to Supreme Court.

Further, section 35L(2) provides that the *'determination of any question having a relation to the rate of service tax'* shall include the determination of taxability for the purpose of assessment. Thus, in the given case, the appeal lies to the Apex Court under section 35L of the Central Excise Act, 1944, which alone has exclusive jurisdiction to decide the said question.

Note: Delhi High Court, in case of Commissioner of Service Tax v. Ernst & Young Pvt. Ltd. 2014 (34) S.T.R. 3 (Del.), had also taken the aforesaid view.

(c)

Transit	Transhipment
(i) Section 53 of the Customs Act, 1962 provides for transit of goods.	(i) Section 54 of the Customs Act, 1962 provides for transhipment of goods.
(ii) In case of transit of goods, goods are allowed to remain on the same conveyance.	(ii) In case of transhipment of goods, the conveyance changes i.e., the goods are unloaded from one conveyance and loaded in another conveyance.
(iii) In case of transit of goods, there is continuity of records.	(iii) In transhipment of goods, continuity in the records is not maintained as the goods are transferred to another conveyance.

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

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

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

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

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

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

(a) evasion of service tax; or

(b) issuance of invoice, bill or, as the case may be, a challan without provision of taxable service in violation of the rules made under the provisions of Chapter V; or

(c) failure to pay any amount collected as service tax to the credit of the Central Government beyond a period of six months from the date on which such payment becomes due.

(c) Yes, the Department's action is valid in law. The facts of the given case are similar to the case of *CCus. (Prev.), Mumbai v. M. Ambalal & Co. 2010 (260) ELT 487*

(SC), wherein the Apex Court held that the smuggled goods could not be considered as 'imported goods' for the purpose of benefit of the exemption notification. It opined that if the smuggled goods and imported goods were to be treated as the same, then there would have been no need for two different definitions under the Customs Act, 1962.

The Court observed that one of the principal functions of the Customs Act was to curb the ills of smuggling on the economy. Hence, it held that it would be contrary to the purpose of exemption notifications to give the benefit meant for imported goods to smuggled goods.

4. (a) According to rule 2(a) of Central Excise Tariff Act, 1985 if any particular heading refers to a finished or complete articled, the incomplete or unfinished form of that article shall also be classified under the same heading provided the incomplete or unfinished goods have the essential characteristics of the finished goods. For example, railway coaches removed without seats would still be railway coaches. Likewise a car without seat would still be classified as car.

It was held in *Sony India Ltd. v CCE 2002 (143) ELT 411* that rule 2(a) applies only when components are not subject to further working operation for completion into the finished state.

(b) (i) The facts of the given case are similar to the case of *Rashtriya Ispat Nigam Ltd. v. Dewan Chand Ram Saran 2012 (26) S.T.R. 289 (S.C.)*. On the issue of shifting of service tax liability, the Supreme Court, in the instant case, held that service tax is an indirect tax which may be passed on. Thus, assessee can contract to shift its liability.

The Finance Act, 1994 is relevant only between assessee and the tax authorities and is irrelevant in determining rights and liabilities between service provider and service recipient as agreed in a contract between them. There is nothing in law to prevent them from entering into agreement regarding burden of tax arising under the contract between them.

Therefore, in view of the above-mentioned ruling of the Supreme Court, the contention of Ram does not stand to reason.

(ii) As per mega exemption *Notification No. 25/2012 ST dated 20.06.2012,* services provided in relation to serving of food or beverages by a restaurant, eating joint or a mess, other than those having the facility of air-conditioning or central air-heating in any part of the establishment, at any time during the year are exempt from service tax.

CBEC *Circular No.173/8/2013 ST dated 07.10.2013* clarifies that in a complex, if air-conditioned as well as non-air-conditioned restaurants are operational and these restaurants are clearly demarcated and separately named, but food is sourced from a common kitchen, services provided in relation to serving of food/beverages in the air-conditioned restaurant are liable to service tax, but such services provided in a non air-conditioned restaurant are exempt from service tax.

Therefore, services provided in relation of serving of food in the non air-conditioned restaurant are exempt from service tax.

(c) Section 70 of the Customs Act provides for the remission of duty in case of shortage of the volatile goods, which are warehoused. The Assistant/Deputy Commissioner of Customs is empowered to remit the duty leviable on such deficiency, if following conditions are satisfied:

(i) The goods should be found deficient in quantity at the time of delivery from the warehouse;

(ii) The deficiency should be on account of natural loss, i.e. evaporation etc.

Thus, duty can be remitted under section 70 only if there is natural loss. Remission on account of loss due to pilferage or thefts is not permitted.

Further, these provisions are applicable only to such warehoused goods as the Central Government, having regard to the volatility of the goods and the manner of their storage, may, by notification in the Official Gazette, specify. Following goods have been specified for this purpose:

(a) petroleum products like aviation fuel, motor spirit, kerosene, diesel oil

(b) Ethylene dichloride kept in tanks

(c) Liquid helium gas kept in containers

(d) wine, spirit and beer kept in casks.

5. (a) Where the central excise officers during scrutiny or otherwise find that self-assessment is not in order, they may ask the assessee to provide all necessary documents, records or other information for issue of duty demand for differential duty, if any, after conducting inquiry.

If the assessee fails to provide such records or information and the Department is unable to issue demand, 'Best Judgement' method, may be used to raise the demand based on collateral evidences. In such a case, the burden will be on the assessee to provide information for appropriate re-determination of duty.

(b) (i) As per rule 9(c) of Place of Provision of Services Rules, 2012 (PoPS Rules), place of provision of intermediary services is the location of service provider.

The definition of term "intermediary" as provided under rule 2(f) of PoPS Rules includes the intermediary of goods in its scope. The definition provides that "intermediary" means a broker, an agent or any other person, by whatever name called, who arranges or facilitates a provision of a service (hereinafter called the main 'service) or **a supply of goods,** between two or more persons, but does not include a person who provides the main service or supplies the goods on his account.

Accordingly, commission agent of goods are covered under rule 9(c) of PoPS Rules. Thus, the place of provision of services provided or agreed to be provided by AB Trade Links (as commission agent of goods) to foreign company will be the location of service provider i.e., Hyderabad.

(ii) Rule 4(a) of PoPS Rules provides that the place of provision of services provided in respect of goods that are required to be made physically available by the recipient of service to the provider of service in order to provide the service, is the location where the services are actually performed.

However, second proviso to rule 4(a) lays down that clause (a) of rule 4 will not apply in the case of a service provided in respect of goods that are temporarily imported into India for repairs and are exported after the repairs without being put to any use in the taxable territory, other than that which is required for such repair. Consequently, such a case will be covered under rule 3 of PoPS Rules (general rule) and the place of provision of service will be the location of service receiver.

In the given case, goods have been temporarily imported by YZ Fabricators and have been re-exported after the repairs without being put to any use in Mysore (taxable territory). Therefore, place of provision of repair services carried out by YZ Fabricators will be determined by rule 3 of PoPS Rules. Consequently, the place of provision of service will be the location of service receiver i.e. Egypt.

(c) When an importer imports goods, he has to pay the customs duty on such goods. This duty is recovered from the purchaser when these goods are sold by the importer. In other words, the burden of duty is passed on to the purchaser. Subsequently, if the importer makes a claim for refund of duty and on acceptance of such claim if he retains the amount of refund with himself without passing it to the purchaser, then this would be called as unjust enrichment. This is so as the importer gets a double benefit in this case – he recovers the duty from customer and again gets the said amount from Government as refund.

Therefore, wherever there is an over assessment or excess collection of duty, the refund is given only to the person who, at the material time of grant of refund, bears the burden of duty and interest, if any. When the person who bears the burden of duty is not identifiable or has not come forward to claim the refund, the refund is paid into a fund called Consumer Welfare Fund. The importer or the clearing agent has to prove that he has not passed the burden of duty, in order to claim refund of duty.

Section 28D of the Customs Act, 1962 provides that every person who has paid duty under the Customs Act, unless the contrary is proved by him, shall be deemed to have passed the full incidence of such duty to the buyer.

6. (a) In respect of surety bonds, periodical verification [preferably on annual basis] is required to be made by the jurisdictional Central Excise Officer with a view to ensure that the relevant sureties are financially sound, solvent and alive. The enquiry to verify the financial stability of the sureties will be made by any of the following methods:

(i) By reference to the surety's bankers.

(ii) By making personal enquiries and ascertaining whether the surety possesses a house or other immovable property, industrial equipment, shop etc. which would cover the bond amount. Alternatively, the sureties may themselves be asked to furnish a list of their property, which may be objectively verified.

(iii) By reference to Revenue Officer not below the rank of Tahsildar or a Mamalakdar.

Or

As per section 37C(1)(a) of the Central Excise Act, 1944, a decision, order, summon or notice can be served to the intended person:-

- by tendering or sending by registered post with acknowledgment due or
- by speed post with proof of delivery or
- by courier approved by the Central Board of Excise and Customs.

(b) (i) As per rule 2(c) of Point of Taxation Rules, 2011 (PoTR), continuous supply of service, *inter alia,* means any service which is provided, or agreed to be provided continuously or on recurrent basis, under a contract, for a period exceeding three months with the obligation for payment periodically or from time to time. Since in the given case, service is provided for a period of six months with the obligation of periodic payment, the same will amount to continuous supply of service.

(ii) As per rule 2(c) of PoTR, continuous supply of service, *inter alia,* includes any service where the Central Government, by a notification in the Official Gazette, prescribes provision of a particular service to be a continuous supply of service, whether or not subject to any condition.

In this regard, Central Government has notified that provision of, *inter alia,* telecommunication services shall be treated as continuous supply of service.

Since in the given case, service provided is telecommunication service, the provision thereof would amount to continuous supply of service irrespective of the period for which the service has been rendered.

(c) As per FTP 2015-2020, following are treated as deemed exports:

- Supplies against Advance Authorisation/DFIA
- Supplies to EOU/STP/EHTP/BTP
- Supplies against EPCG authorization
- Supply of marine freight containers by 100% EOU
- Supplies to projects against International Competitive Bidding
- Supplies to projects where imports permitted at zero customs duty
- Supply to mega power projects
- Supplies to UN or International Organizations for their official use.
- Supplies to nuclear projects

7. (a) The following amounts are credited to the Consumer Welfare Fund set up under section 12C of the Central Excise Act, 1944:-

(i) the amount of duty of excise as per section 11B(2) or section 11C(2) or section 11D(2) of the Central Excise Act, 1944;

(ii) the amount of duty of customs as per section 27(2) or section 28A(2), or section 28B(2) of the Customs Act, 1962;

(iii) any income from investment of the amount credited to the Fund and any other monies received by the Central Government for the purposes of this Fund;

(iv) the surplus amount referred to in section 73A(6) of the Finance Act, 1994.

(b) (i) Yes, as per rule 3(1) of the Service Tax (Registration of Special Category of Persons) Rules, 2005, an input service distributor is liable to apply for registration within a period of 30 days of the commencement of business. Thus, in the given case, the input service distributor should apply for registration on or before 01.10.2015.

(ii) According to *Notification No. 33/2012 dated 20.06.2012,* the threshold exemption limit of Rs.10 lakh is not available to taxable services provided by a person under a brand name or trade name, whether registered or not, of another person. Therefore, Mr. Vaibhav cannot postpone service tax registration till his turnover of services reaches Rs. 9 lakh.

Thus, as per rule 4(1) of Service Tax Rules, 1994, Mr. Vaibhav is liable to apply for registration:-

(a) within 30 days from the date on which service tax is levied (i.e. 01.04.2015)

or

(b) within 30 days from the date of commencement of business (i.e.

01.01.2015).

whichever is later.

Thus, Mr. A should apply for registration on or before 01.05.2015.

(c) The Foreign Trade Policy is closely knit with the Customs and Excise laws of India. However, the policy provisions *per-se* do not override tax laws. The exemptions extended by FTP are given effect to by issue of notifications under respective tax laws (e.g., Customs Tariff Act, 1975, Central Excise Act, 1944, Customs Act, 1962 etc.). Thus, actual benefit of the exemption depends on the language of exemption notifications issued by the CBEC.

In most of the cases the exemption notifications refer to policy provisions for detailed conditions. Ministry of Finance/ Tax Authorities cannot question the decision of authorities under the Ministry of Commerce (so far as the issue of authorization etc. is concerned).

Decision of Director General of Foreign Trade (DGFT) is final and binding in respect of (a) Interpretation of any provision of foreign trade policy or provision in Handbook of Procedures, Appendices, Aayat Niryat Forms (b) Classification of any item for import / export in ITC(HS).