PAPER – 5 : COST MANAGEMENT

QUESTIONS

Basic Cost Concepts for Decision Making

1. (a) "Costs may be classified in a variety of ways according to their nature and the information needs of the management" Explain.

   (b) Indicate the major areas of short-term decisions in which differential cost analysis is useful.

   (c) "Relevant cost analysis helps in drawing the attention of managers to those elements of cost which are relevant for the decision." Comment.

Marginal Costing

2. AB Ltd has two divisions A and B. Division A manufacture a product 'AAA' for industrial use whereas division B is manufactures the containers and stores product 'AAA' by using protective materials 'BBB'. AB ltd is exploring the possibility of closing down the division B and outsource the work to an outside company X Ltd.

   (i) The details of expenses of division B during the previous year is as given below :

	For manufacturing Container (Rs)	For storing Product AAA (Rs)
Direct Material	6,35,000	
Cost of protective material BBB		1,75,000
Direct labour	2,50,000	1,20,000
Maintenance of Machine	96,000	
Depreciation of Machine	44,000	
Rent of warehouse		1,25,000
Manufacturing overheads	1,70,000	
Administrative overheads apportioned to division B	2,40,000	60,000

   (ii) X Ltd after full assessment of requirement offered to manufacture the containers at a cost of Rs 12,00,000 per annum on a contact basis and store the product 'AAA' at a cost of Rs 5,00,000 per annum.

   (iii) The stock of protective materials costing Rs 4,25,000 with division B, if disposed off, will fetch only 60% of its value.

   (iv) In case of closure of manufacturing department of division B, the terminal benefits to be given to employees who can be transferred to division A is estimated to be Rs 2,00,000 whereas the same for store is Rs 1,00,000.

(v) In case of closure of B, 75% of the administrative overheads of B will be curtailed.

(vi) Old machine of division B, if disposed off, would fetch Rs 1,50,000.

You are required to evaluate the following proposals on the basis of 5 years term, taking cost of capital 12% per annum :

Proposal 1 : Closing division B and manufacturing & storing may be given to X Ltd.

Proposal 2 : Continue division B for manufacturing & Storing may be given to X ltd

Proposal 3 : Continue division for Storing only and manufacturing may be given to X Ltd.

Marginal Costing

3. (a) How is marginal costing different from absorption costing? What are the various limitations attributed to marginal costing?

(b) Jay Kay Limited is a single product manufacturing company. The following information relates to the months of May and June, 2009:

		May	June
		Rs.	Rs.
(i)	Budgeted Costs and Selling prices:		
	Variable manufacturing cost per unit	2.00	2.20
	Total fixed manufacturing cost (based on budgeted output of 25,000 units per month)	40,000	44,000
	Total fixed marketing cost	14,000	15,400
	Selling price per unit	5.00	5.50
(ii)	Actual production and sales:		
		Units	Units
	Production	24,000	24,000
	Sales	21,000	26,500

(iii) There was no stock of finished goods at the beginning of May, 2009. There was no wastage or loss of finished goods during May or June, 2009.

(iv) Actual costs incurred corresponded to those budgeted for each month.

You are required to calculate the relative effects on the monthly operating profits of applying: (i) Absorption costing and (ii) Marginal costing.

Decision making

4. ABC Ltd is in the business of publishing, printing and distributing a range of catalogues and other manuals. The management have now decided to discontinue printing and distribution and concentrate solely on publishing. Instead of ABC Ltd, XYZ Ltd shall now print and distribute the range of catalogues and other manuals. This shall be done on behalf of ABC Ltd . commencing either at 30 June 2009 or 30 November, 2009. XYZ Ltd

will receive Rs. 65,000 per month for a contract which will commence either at 30 June, 2009 or 30 November 2009.

The results of ABC Ltd for a typical month are as follows:

	Publishing	Printing	Distribution
	Rs. '000	Rs. '000	Rs. '000
Salaries and wages	28	18	4
Materials and supplies	5.5	31	1.1
Occupancy costs	7	8.5	1.2
Depreciation	0.8	4.2	0.7

Information related to the possible closure proposals is as follows:

(i) Two specialist staff from printing will be retained at their present salary of Rs. 1,500 each per month in order to fulfill a link function with XYZ Ltd One further staff member will be transferred to publishing to fill a staff vacancy through staff turnover, anticipated in July. This staff member will be paid at his present salary of Rs. 1,400 per month which is Rs. 100 more than that of the staff member who is expected to leave. On closure all other printing and distribution staff will be made redundant and paid an average of two months redundancy pay.

(ii) The printing department has a supply of materials (already paid for) which cost Rs. 18,000 and which will be sold to XYZ Ltd. for Rs. 10,000 if closure takes place on 30 June, 2009. Otherwise the material will be used as part of the July 2009 printing requirements. The distribution department has a contract to purchase pallets at a cost of Rs. 500 per month for July and August, 2009. A cancellation clause allows for non-delivery of the pallets for July and August for a one-off payment of Rs. 300. Non-delivery for August only will require a payment of Rs. 100. If the pallets are taken from the supplier, XYZ Ltd has agreed to purchase them at a price of Rs. 380 for each month's supply which is available. Pallet costs are included in the distribution material and supplies cost stated for a typical month.

(iii) Company expenditure on apportioned occupancy costs to printing and distribution will be reduced by 15% per month if printing and distribution departments are closed. At present, 30% of printing and 25% of distribution occupancy costs are directly attributable costs which are avoidable on closure, whilst the remainder are apportioned costs.

(iv) Closure of the printing and distribution departments will make it possible to sub–let part of the building for a monthly fee of Rs. 2,500 when space is available.

(v) Printing plant and machinery has an estimated net book value of Rs. 48,000 at 30 June, 2009. It is anticipated that it will be sold at a loss of Rs. 21,000 on 30 June, 2009. If sold on 30 November, 2009 the prospective buyer will pay Rs. 25,000.

(vi) The net book value of distribution vehicles at 30 June, 2009 is estimated as Rs. 80,000. They could be sold to the original supplier at Rs. 48,000 on 30 June, 2009. The original supplier would purchase the vehicles on 30 November, 2009 for a price of Rs. 44,000.

Required:

Using the above information, prepare a summary to show whether ABC Ltd. should close the printing and distribution departments on financial grounds on 30 June, 2009 or on 30 November, 2009. Explanatory notes and calculations should be shown. Ignore taxation.

Decision Making

5. Unique Products manufactures and sells in a year 20,000 units of a particular product to definite customers at a price of Rs.100 per unit. The concern has a capacity to produce 25,000 unit of the product per annum. To produce beyond 25,000 units per annum, the concern will have to install a new equipment at a cost of Rs.15 lakhs. The equipment will have a life span of 10 years and will have no residual value. There is an offer from a client to purchase 10,000 units of the product regularly at a price of Rs.90 per unit. The order accepted, will have to be over and above the existing level of production of 20,000 units.

   The cost structure is as under:

	Per Unit
Direct Material	30
Direct Labour	20
Variable Overhead	10
Profit	20
Fixed Overhead	Rs. 4,00,000

   During the coming year, it has been estimated that the cost of direct material, as company the current year will increase by 10%. Because of certain wage agreement direct labour will increase by 25%. Fixed overheads will increase by 10%. If the new order for 10,000 is accepted, fixed overheads will increase further by Rs.60,000 due to increased administrative charges.

   You are required to analyse whether the concern should accept the order or instead of that try to secure order for the balance unused capacity, as available now, through some sales promotion expenses which will be Rs.50,000 per annum. Ignore financial charges for the new investment.

Areas of Decision Making

6. R Ltd. has spare capacity in two of its manufacturing departments – Department 4 and Department 5. A five-day week of 40 hours is worked, but there is only enough internal work for 3 days per week so that 2 days per week (16 hours) could be available in each department. R Ltd. has sold this time to another manufacturer, but there is some concern about the profitability of this work.

The accountant has prepared a table giving the hourly operating cost in each department. The summarised figures are as follows:

	Department 4	Department 5
	Rs.	Rs.
Power costs	40	60
Labour costs	40	20
Overhead costs	40	40
	120	120

The labour is paid on a time basis and there is no charge in the weekly wage bill whether or not the plant is working at full capacity. The overhead figures are based on firm's current overhead absorption rates (fixed and variable) when the departments are operating at 90% of full capacity (assume a 50 week year). The budgeted fixed overhead attributed to Department 4 is Rs. 36,000 p.a. and that for Deptt. 5 Rs. 50,400 p.a.

As a short term measure the company has been selling processing time to another manufacturer @ Rs. 70 per hour in either departments. The customer is willing to continue this arrangement and to purchase any spare time available, but R Ltd. is considering the introduction of a new product on a minor scale to absorb the spare capacity.

Each unit of the new product would require 45 minutes in Deptt. 4 and 20 minutes in Deptt. 5. The variable cost of the required input material is Rs. 10 per unit. The market study indicated as follows:

(i) with a selling price of Rs. 100, the demand would be 1,500 units p.a.

(ii) with a selling price of Rs. 110, the demand would be 1,000 units p.a.

(iii) with a selling price of Rs. 120, the demand would be 500 units p.a.

You are required to calculate the best weekly programme for the spare time in the two manufacturing departments, to determine the best price to charge for the new product and to quantity the weekly gain that this programme and price should yield.

Standard Costing and variance Analysis

7. ABC Ltd manufactures a product '1+7 ASCS' at its plant at Faridabad, the maximum capacity of which is 200 units per month. Details of raw material which go into the making of 1 unit of '1+7 ASCS' are provided to you below;

S. No.	Raw Material description	Standard quantity per finished unit (No)	Standard purchase price per unit (Rs 00)
1	A	1	6
2	B	2	5
3	C	3	4
4	D	4	3

5	E	5	2
6	F	6	1

Standard Fixed overheads are Rs. 20,00,000 per month whereas the standard variable overhead rate has been estimated as equal to Rs. 1,400 per unit of finished good. You are required to compute the

(a) standard cost of the product

(b) compute the production volume variance in case the company produces and sells only 100 units of finished goods in the concerned month.

(c) compute the usage and material price variances considering the following actual data(actual production and sale: 100 units)

Raw material description	Actual quantity consumed (Nos)	Actual price(Rs 00)
A	102	7
B	201	6
C	310	5
D	415	4
E	540	3
F	610	2

(d) Assuming no deviations in the actual selling price (Rs 30,000) and the actual overheads from what was projected in standards , you are required to compute actual profits .

Standard Costing and Variance Analysis

8. Budgetary control and standard costing are used within an insurance company and a standard cost of Rs. 20 has been set for obtaining and issuing each new life policy.

Prior to the commencement of the annual financial period, the life business manager had forecast that 7,500 policies would be sold during the year and the Rs. 20 standard cost was based on the following budgeted costs for the department. Actual costs are also shown.

Code	Budget	Actual
301	Rs. 30,000	Rs. 33,750
302	30,000	28,500
303	15,000	13,000
431	45,000	50,000
599	30,000	33,000
	1,50,000	1,58,250

At the end of the year, it was ascertained that

1. 6,750 new life policies had been issued.
2. the sales staff and underwriting staff received as salaries pay award of 12½% which had been back-dated to the beginning of the year and this had not been included in the budget.
3. expenses on codes 302, 303 and 431 are regarded as direct costs which vary with activity, and those on code 301 are treated as a direct fixed cost whilst those on code 599 are an indirect fixed cost.

You are required to

(i) present a statement (or control report) for the life business manager showing the variances which have arisen,

(ii) comment on the likely cause or causes for each variance identifying, so far as you can from the information given, how much of each variance arises from price differences and how much can be related to efficiency or inefficiency.

Pricing Decisions

9. (a) A manufacturer has three products X, Y, and Z. Currently sales, cost and selling price details and processing time requirements are as follows:

	Product X	Product Y	Product Z
Annual sales (units)	6000	6000	750
Selling price (Rs.)	20.00	31.00	39.00
Unit cost (Rs.)	18.00	24.00	30.00
Required per unit (hours)	1	1	2

The firm is working at full capacity (13,500 processing hours per year). Fixed manufacturing overheads are absorbed into unit costs by a charge of 200% of variable cost. This procedure fully absorbs the fixed manufacturing overhead. Assuming that:

(i) processing time can be switched from one product line to another.

(ii) The demand at current selling prices is:

Product X	Product Y	Product Z
11000	8000	2000

(iii) The selling prices are not to be altered. You are required to calculate the best production programme for the next operating period and to indicate the increase in net profit that this should yield. In addition identify the shadow price of a processing hour.

(b) A review of the selling prices is in progress and it has been estimated that, for each product, an increase in the selling price would result in a fall in demand at the rate of 2000 units for an increase of Rs.1 and similarly, that a decrease of Rs.1 would increase demand by 2000 units. Specifically the following price/demand relationships would apply:

Product X		Product Y		Product Z	
Selling Price Rs.	Estimated Demand	Selling Price Rs.	Estimated Demand	Selling Price Rs.	Estimated demand
24.50	2000	34.00	2000	39.00	2000
23.50	4000	33.00	4000	38.00	4000
22.50	6000	32.00	6000	37.00	6000
21.50	8000	31.00	8000	36.00	8000
20.50	10000	30.00	10000	35.00	10000
19.50	12000	29.00	12000	34.00	12000
18.50	14000	28.00	14000	33.00	14000

From this information you are required to calculate the best selling prices, the revised best production plan and the net profit that this plan should produce.

Pricing Decisions

10. Z Electronics Co (ZEC) has made an agreement with Tuzuki of Japan for import of kits of Automatic Washing Machine in completely knocked down (CKD) condition. The terms of agreement are :

(i) Tuzuki will supply some items keeping 20% margin on cost. These imported items are of value of 40% of FOB price of Washing Machine and balance 60% will be locally manufactured.

(ii) ZEC will pay a lump sum of Rs 300 lakhs for technical know how and drawing for manufacturing of 3 lakhs washing machines.

(iii) ZEC will also pay a royalty at 10% of selling price fixed by it in the local market less landed cost of imported kits and cost of locally procured components.

The following related information is also available :

(i) FOB price for washing machine is Rs 8000.

(ii) Insurance & freight is Rs 300 per set of imported items

(iii) Effective custom duty is @ 40% on CIF price

(iv) Assembling & other overhead costs will be Rs 1,000 per set.

(v) Expected profit is 20% on selling price

You are required to calculate the selling price of Washing machine (rounded to Rs 10)

Transfer Pricing

11. The interdivisional transfer prices at ABC Ltd are fixed by using a cost plus return on investment approach. The budget details for Division A for the year 2008-2009 are as follows;

Investment in Division A	Rs.
Fixed Assets	5,00,000
Current Assets	3,00,000
Debtors	2,00,000
Annual Fixed Cost for the Division	8,00,000
Variable cost per unit of the product	10
Budgeted volume	4,00,000 units per year
Desired ROI	28%

Determine the Transfer price for Division A?

Transfer Pricing

12. ABC Ltd which is manufacturing consumer products has two divisions Assembling and Finishing. The two divisions are operating as cost centres

(i) Present activities and cost involved in Assembling division & Finishing division and in a year:

Assembly Division :

No of sets assembled : 12,000

Manufacturing of parts (including material) : Rs 6.00 lakhs

Parts purchased from market : Rs 4.00 lakhs

Other Variable cost : Welding cost : Rs 5 lakhs and Assembling cost : Rs 9.00 lakhs

Fixed cost for the unit : Rs 6 lakhs

25% of the production of Assembly division is sold in the market at a price of Rs 300 per set and 75% is transferred to Finishing Division at Rs 280

Cost incurred in Finishing Division :

Painting cost : Rs 5.00 lakhs

Polishing cost : Rs 1.00 lakhs
Other fixed cost Rs 4.00 lakhs.
Selling Price per set is Rs 450.

(ii) Division Assembly has proposed for expansion of their division for an enhancement of capacity by 20% at a cost Rs 20 lakhs. It is indicated that there will be no change in factory fixed cost in the operation of additional volume of job. Division Assembly proposes to maintain the transfer to finishing division to the existing level and selling additional sets to market at present price.

(iii) Division Finishing has proposed for a transfer of whole of the output of Assembly division at a price of Rs 280 per unit and the additional units can be sold in the market at existing price which will involve advertisement expenses to the extent of Rs 4.00 lakhs and fixed cost in the division will go up by Rs 1.00 lakhs.

(iv) Assembly division claims that transfer rate of Rs 280 is irrational in a sense of undue favour to Finishing division at their cost and Finishing Division is given the advantage of market price for their products whereas the Assembly division is deprived of that advantage. Assembly division agreed to transfer the whole of its output to Finishing Division at a price of Rs 300.

You are required to give your recommendation assuming opportunity cost of capital is 15%

Target Costing

13. (a) What is Target Costing and list the steps involved in target costing process with the help of a block diagram.

(b) You are the manager of a paper mill (XYZ Ltd) and have recently come across a particular type of paper, which is being sold at a substantially lower rate (by another company –ABC Ltd) than the price charged by your own mill. The value chain for one use of one tonne of such paper for ABC Ltd is as follows,

ABC Ltd. ⟶ Merchant ⟶ Printer ⟶ Customer

ABC Ltd sells this particular paper to the merchant at the rate of Rs 1,466 per tonne. ABC Ltd pays for the freight which amounts to Rs 30 per tonne. Average returns and allowances amount to 4% of sales and approximately equals Rs 60 per tonne.

The value chain of your company, through which the paper reaches the ultimate customer is similar to the one of ABC Ltd. However, your mill does not sell directly to the merchant, the latter receiving the paper from a huge distribution center maintained by your company at Haryana. Shipment costs from the mill to the Distribution Center amount to Rs 11 per tonne while the operating costs in the Distribution Center have been estimated to be Rs 25 per tonneThe return on investments required by the Distribution Center for the investments made amount to an estimated Rs 58 per tonne.

You are required to compute the "Mill manufacturing Target Cost" for this particular paper for your company. You may assume that the return on the investment expected by your company equals Rs 120 per tonne of such paper.

Costing of Service Sector

14. HAL is an aircraft manufacturer that has introduced a new airplane model. It expects the plane to cost Rs. 150,000,000 to manufacture to (not including development cost) but their products have historically exhibited an 85% experience curve. Assuming the same experience rate will apply to this product.

    1. Compute the cost of computing the each of the first five planes
    2. Compute the average cost per plane to produce the first 25 planes.

Activity Based Cost Management

15 ABC Ltd plans to use activity-based costing to determine it product costs. It presently, uses a single plantwide factory overhead rate for allocating factory overhead to products, based on direct labour hours. The total factory overhead cost is as follows:

Department	Factory overhead
	Rs.
Production Support	12,25,000
Production (factory overhead only)	1,75,000
Total cost	14,00,000

The Company determined that it performed four major activities in the Production Support Department. These activities, along with their budgeted costs, are as follows:

Production Support Activities	Budgeted Cost
	Rs.
Set up	4,28,750
Production control	2,45,000
Quality control	1,83,750
Materials management	3,67,500
Total	12,25,000

ABC Ltd estimated the following activity-base usage quantities and units produced for each of its three products:

Products	Number of Units	Direct Labour hours	Setups	Production Orders	Inspections	Material requisitions
Product K	10,000	25,000	80	80	35	320
Product L	2,000	10,000	40	40	40	400
Product M	50,000	1,40,000	5	5	0	30
Total cost	62,000	1,75,000	125	125	75	750

Instructions:

1. Determine the factory overhead cost per unit for Products K, L and M under the single plantwide factory overhead rate method. Use direct labor hours as the activity base.
2. Determine the factory overhead cost per unit for Products K, L and M under activity-based costing.
3. Which method provides more accurate product costing? Why?

Activity Based Cost Management

16. ALPHA Limited specializes in the distribution of pharmaceutical products. It buys from the pharmaceutical companies and resells to each of the three different markets.

(i) General Supermarket Chains

(ii) Drugstore Chains

(iii) Chemist Shops

The following data for the month of April, 2009 in respect of ALPHA Limited has been reported:

	General Supermarket Chains	Drugstore Chains	Chemist Shops
Average revenue per delivery	Rs. 84,975	Rs. 28,875	Rs. 5,445
Average cost of goods sold per delivery	Rs. 82,500	Rs. 27,500	Rs.4,950
Number of deliveries	Rs. 330	Rs. 825	Rs. 2,750

In the past, ALPHA Limited has used gross margin percentage to evaluate the relative profitability of its distribution channels.

The company plans to use activity –based costing for analysing the profitability of its distribution channels.

The Activity analysis of ALPHA Limited is as under:

Activity Area	Cost Driver
Customer purchase order processing	Purchase orders by customers
Line-item ordering	Line-items per purchase order
Store delivery	Store deliveries
Cartons dispatched to stores	Cartons dispatched to a store per delivery
Shelf-stocking at customer store	Hours of shelf-stocking

The April, 2009 operating costs (other than cost of goods sold) of ALPHA Limited are Rs. 8,27,970. These operating costs are assigned to five activity areas. The cost in each area and the quantity of the cost allocation basis used in that area for April, 2009 are as follows:

Activity Area	Total costs in April, 2009	Total Units of Cost Allocation Base used in April, 2009
Customer purchase order processing	Rs. 2,20,000	5,500 orders
Line-item ordering	Rs. 1,75,560	58,520 line items
Store delivery	Rs. 1,95,250	3,905 store deliveries
Cartons dispatched to store	Rs. 2,09,000	2,09,000 cartons
Shelf-stocking at customer store	Rs. 28,160	1,760 hours

Other data for April, 2009 include the following:

	General Supermarket Chains	Drugstore Chains	Chemist Shops
Total number of orders	385	990	4,125
Average number of line items per order	14	12	10
Total number of store deliveries	330	825	2,750
Average number of cartons shipped per store delivery	300	80	16
Average number of hours of shelf-stocking per store delivery	3	0.6	0.1

Required:

(i) Compute for April, 2009 gross-margin percentage for each of its three distribution channels and compute ALPHA Limited's operating income.

(ii) Compute the April, 2009 rate per unit of the cost-allocation base for each of the five activity areas.

(iii) Compute the operating income of each distribution channel in April, 2009 using the activity-based costing information. Comment on the results. What new insights are available with the activity-based cost information?

(iv) Describe four challenges one would face in assigning the total April,2009 operating costs of Rs. 8,27,970 to five activity areas.

Business Environment & Life Cycle Costing

17 (a) What do you understand by MRP? What are its objectives?

(b) Describe the concept of Back flushing as used in the JIT system. What problems need to be addressed before implementing such a concept? Briefly discuss.

(c) What is product life cycle costing? What are the costs that you would include in product life cycle cost?

Total Quality Management & Value Chain Analysis

18 (a) Define Total Quality Management? What are the six Cs for successful implementation of TQM?

(b) What is the concept of 'Value-chain' and what steps are involved in value chain analysis approach for assessing competitive advantages?

Budgeting Control and Performance Measurement

19. (a) Distinguish between fixed budget and flexible budget.

(b) Explain the role of bench marking in continuous improvement in an organisation.

(c) The performance of a company at two levels of operations during 2008-09 is as under:

Capacity utilisation	50%	60%
Direct materials	Rs.1,00,000	1,20,000
Direct wages	Rs.1,60,000	1,92,000
Production overheads	Rs.6,00,000	6,50,000
Adm. Overheads	Rs.1,20,000	1,20,000
Selling overheads	Rs.2,20,000	2,40,000

The company produced 12,000 units at 60% capacity utilisation. The profit margin is 20% on sales.

During the next year 2009-10, the company is poised for increasing the capacity utilisation to 75%. The company desires to have the same profit margin as in 2008-09. The following percentage changes in costs are expected to be applicable in the next year.

- Direct material prices will increase by 5%
- Direct wage rates will increase by 3%.
- Direct labour efficiency will fall by 4%.
- Variable production overheads will increase by 6%.
- Fixed production overheads will increase by 10% upto 80% capacity utilisation and by 22% thereafter.
- Variable selling expenses will increase by 10%.
- Fixed selling expense will increase by 8%.
- Administrative Overheads will increase by 15%.

The company expects to receive an export order for 3000 units while operating at 75% capacity utilisation. The anticipated export price offer is Rs.92 per unit.

Required:

(i) Prepare a flexible budget for 2009-10 and determine the cost per unit of output at the capacity utilisation levels of 75% and 90%.

(ii) Calculate the sales value and profit for 2009-10 at 75% capacity.

(iii) Advise the management as to whether or not the export order at the price of Rs.92 per unit should be accepted.

Linear Programming

20. (a) The simplex tableau for a maximisation problem of linear programming is given below:

Product mix.(x_i)	x_1	x_2	s_1	s_2	Quantity (bi)
x_2	1	1	1	0	10
s_2	1	0	–1	1	3
c_j	4	5	0	0	
z_j	5	5	5	0	50
$z_j–c_j$	1	0	5	0	

Answer the following questions, giving reasons in brief:

(i) Is the above solution optimal?

(ii) Are there more than one optimal solution?

(iii) Is this solution degenerate?

(iv) Is this solution feasible?

(v) If s_1 is slack in machine A (in hours/week) and s_2 is slack in machine B (in hours/ week), which of these machines is being used to the full capacity when producing according to this solution?

(vi) A customer would like to have one unit of product x_1 and is willing to pay in excess of the normal price in order to get it. How much should the price be increased in order to ensure no reduction of profit?

(vii) Machine A (associated with slack s_1, in hours/week) has to be shut down for repairs for 2 hours next week. What will be the effect on profits?

(viii) How many units of the two-product x_1 and x_2 are being produced according to this solution and what is the total profit?

(b) (a) The management accountant of Atul Enterprises Ltd. has suggested that a linear programming model might be used for selecting the best mix of five possible products, A, B, C, D and E.

(i) The following information is available:

	Per unit of product				
	A	B	C	D	E
	Rs.	Rs.	Rs.	Rs.	Rs.
Selling price	48	42	38	31	27
Costs:					
Materials	15	14	16	15	16
Direct labour	18	16	6	4	4
Fixed overheads*	9	8	3	2	2
Total costs	42	38	25	21	22
Net profits	6	4	13	10	5

*based on 50% of direct labour cost.

(ii) Expected maximum unit demand per week for each product at the prices indicated:

A	B	C	D	E
1,500	1,200	900	600	600

(iii) Cost of materials includes a special component, which is in short supply; it costs Rs.3 a unit. Only 5,800 units will be available to the company during the week. The number of units of the special component needed for a unit of each product is:

A	B	C	D	E
1	1	3	4	5

(iv) Labour is paid at a rate of Rs.1.50 per hour and only 20,000 hours will be available in a week.

(v) The management of Atul Enterprises Ltd. has ruled that expenditure on materials must not exceed a sum of Rs.30,000.

(vi) All other resources are freely available in sufficient quantities for planned needs.

Formulate a linear programming model stating clearly the criterion you use.

The Transportation Problem

21. A ladies fashion shop wishes to purchase the following quantities of summer dresses:

Dress Size	I	II	III	IV
Quantity	100	200	450	150

Three manufacturers are willing to supply dresses. The quantities given below are the maximum they are able to supply of any given combination of orders for dresses:

Manufacturer	A	B	C
Total quantity	150	450	250

The shop expects the profit per dress to vary with the manufacturer as given below:

	Sizes			
	I	II	III	IV
Manufacturer	Rs.	Rs.	Rs.	Rs.
A	2.50	4.00	5.00	2.00
B	3.00	3.50	5.50	1.50
C	2.00	4.50	4.50	2.50

You are required to:

(a) use the transportation technique to solve the problem of how the orders should be placed on the manufacturers by the fashion shop in order to maximize profits: and

(b) explain how you know that there is no further improvement possible. Show your workings.

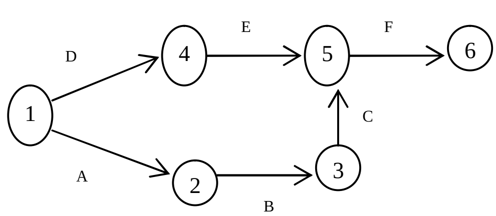
The Assignment Problem

22. Methods engineer wants to assign four new methods to work centers. The assignment of new methods will increase Production (in units) and they are given below. If only one method can be assigned to a work center, determine the optimum assignment.

Methods \ Work Center	A	B	C
1	10	7	8
2	8	9	7
3	7	12	6
4	10	10	8

Critical Path analysis and PERT

23. In the project net work shown in the figure given below, the nodes are denoted by numbers and activities by letters. The normal and crash durations of the various activities along with Costs are shown below.



Activity	Normal Duration (Days)	Normal cost (Rs.)	Crash Duration (Days)	Crash cost
A	8	1800	6	2200
B	16	1500	11	2200
C	14	1800	9	2400
D	12	2400	9	3000
E	15	800	14	2000
F	10	2000	8	4000

Determine the least cost for 36 days schedule.

Critical Path Analysis and PERT

24. The activities involved in a PERT project detailed below:

Job	Duration		
	a = optimistic	m = most likely	b = pessimistic
1-2	4	7	16
2-3	7	13	31
3-5	6	12	18
7-8	5	20	29
5-8	2	5	8
6-7	4	10	28
4-5	4	7	16
1-6	3	6	15
2-4	3	6	9

Required:

(i) Draw a net work diagram.

(ii) Find the critical path after estimating the earliest and latest event times for all nodes.

(iii) Find the probability of completing the project before 35 weeks.

(iv) What is the chance of project duration exceeding 50 weeks?

Simulation

25. An investment corporation wants to study the investment projects based on three factors: market demand in units, price per unit minus cost per unit and the investment is required These factors are felt to be independent of each other. In analyzing a new consumer product, the corporation estimates the probability distributions.

Annual Demand		(Price-Cost) Per unit		Investment Required	
Units	Probability	Rs.	Probability	Rs.	Probability
20000	0.05	3.00	0.10	1750000	0.25
25000	0.10	5.00	0.20	2000000	0.50
30000	0.20	7.00	0.40	2500000	0.25
35000	0.30	9.00	0.20		
40000	0.20	10.00	0.10		
45000	0.10				
50000	0.05				

Using simulation process, repeat the trails 10 times, compute the return on investment for each trail taking these three factors into account .Approximately, what is the most likely return?

SUGGESTED ANSWERS

Basic Cost Concepts for Decision Making

1. (a) Cost classification is the process of grouping costs according to their characteristics. Costs are classified or grouped according to their common characteristics. Costs may be classified according to elements, according to functions or operations, according to their behaviour, according to controllability or according to normality.

   The break up of the aggregate costs into relevant types, is an essential pre-requisite of decision making as well as of controlling costs. Classification of costs on different bases is thus necessary for various purposes. For the purpose of decision-making and control, costs are distinguished on the basis of their relevance to different type of decisions and control functions. The importance of distinguishing cost as direct or indirect lies in the fact that direct costs of a product or an activity can be accurately allocated while indirect costs have to be apportioned o the basis of certain assumptions. This is so because direct costs are controllable at the operational level whereas indirect costs are not amenable to such control.

   (b) Cost information is required both for short-term and long-run managerial problems. Differential costs are of particular use in short-term problems which are non-repetitive, onetime, ad-hoc problems. The following are the most common short-term problems and areas where differential costs analysis may be deployed.

   1. Accept – or – reject special order decisions.
   2. Make – or – buy decisions.
   3. Sell – or – process decisions.

4. Reduce – or – maintain price decisions.
5. Add – or – drop product decisions.
6. Operate – or shut down decisions.

(c) Relevant costs are pertinent or valid costs for a decision. These bear upon or 'influence decision' and are directly related to the decisions to be made. These are critical to the decisions, and have significance for it. These are the cots whish generally respond to managerial decision making, and have significance in arriving at correct conclusions. These costs are capable of making of difference in user-decisions and enter into a choice between alternative courses of action. In specific terms relevant costs for decisions are defined as "expected future costs that will differ under alternatives".

Relevant costs are futuristic in nature. These are the costs that are expected to occur during the time period covered by the decisions. These costs are different between alternative being considered. Only costs that differ among decisions alternatives are relevant to a decision.

Marginal Costing

2.

	Saving in case B discontinue Manufacturing	Saving in case B discontinue Storing
Direct Material / protective material	635	175
Direct Labour	250	120
Maintenance of Machine	96	
Depreciation of machine	44	
Rent of warehouse		125
Manufacturing overheads	170	
Reduction in administrative overheads	180	45
Total	1375	465

Evaluation of the proposals :

	Proposal 1	Proposal 2	Proposal 3
Saving of manufacturing expenses	1375		1375
Saving of storing expenses	465	465	
Total avoidable expenses (A)	1840	465	1375
Additional expenses to be incurred :			
Loss in sale of protective materials	170		170

Terminal benefit to employees	300	100	200
Total (B)	470	100	370
Net saving (A -B)	1370	365	1005
Sale value of Machine ©	150		150
Cash inflow in first year (D= A - B + C)	1520	365	1155
Contract value (E)	1700	500	1200
Net Cash flow in the first year(F= D - E)	-180	-135	-45
Cash flow in subsequent years (A - E)	140	-35	175
Cumulative cash flow value from 2nd year to 5th year (multiple factor 3.038 for 12%) (G)	425.32	-106.33	531.65
NPV (F + G)	245.32	-241.33	486.65

Hence, proposal 3 may be accepted i.e Division B may continue with storing and manufacturing may be given to outside firm X Ltd.

3. (a) Marginal Costing vs. Absorption Costing

1. While applying Marginal Costing only variable costs are considered for Product Costing and Inventory Valuation purposes whereas both fixed and variable costs are considered while using Absorption Costing.
2. Expenses are classified on the basis of their nature i.e, fixed or variable in Marginal Costing whereas the classification of expenses is done on the basis of functions while applying Absorption Costing.
3. Marginal Costing considers fixed costs as period costs whereas the same costs are considered to be inventoriable costs for Absorption Costing purposes.
4. Marginal Costing reports emphasise more on the Contribution quantum whereas Absorption Costing highlights Net Profits.
5. The difference in the magnitude of the opening and the closing stock does not effect the unit cost of production in case Product Costing is done using the Marginal Costing concepts. However, in case Absorption Costing is used the unit cost of production may be effected due to the impact of fixed overheads.
6. There is no related Volume Variance in case a Marginal Costing system is used. However, in case of an Absorption Costing system, Volume Variance plays a prominent role for decision making and control purposes.

Limitations of Marginal Costing

- The use of Marginal Costing necessitates the need to classify expenses as fixed and variable. Frequently most of the expenses are semi-variable and so need to be divided amongst their variable and fixed components. This is difficult in practical situations.

- ♦ Contribution by itself is not a guide towards attaining optimum profitability. It needs to be interpreted along with the key factor.
- ♦ It is not practical to exclude overheads of fixed nature for valuing work-in-progress of large contracts. The use of Marginal Costing does not provide with useful results for decision making purposes nor does it give a correct valuation of the work-in-progress in such cases.
- ♦ Marginal Costing ignores the time factor as well as the investment involved for decision making purposes. For example two products may have the same Marginal Cost , however one of them can be produced in a shorter time and hence it should be the preferable produce. However , Marginal Costing ignores this time factor. Similarly the quantum of investment involved for alternative uses available are not considered in Marginal Costing.

(b) (a) Quantity tally:

		May 2009	June 2009
Opening Stock	units	–	3,000
Production	units	24,000	24,000
Total	units	24,000	27,000
Sales	units	21,000	26,500
Closing Stock	units	3,000	500
Fixed manufacturing overheads	Rs.	40,000	44,000
Budgeted output	units	25,000	25,000
Fixed overheads absorption rate per unit	Rs.	1.60	1.76

(i) Profitability based on absorption costing:

	May 2009 Rs.	June 2009 Rs.
Sales:		
May: 21,000 units @ Rs. 5.00	1,05,000	
June: 26,500 units @ Rs. 5.50		1,45,750
Production Costs:		
Variable: May 24,000 units @ Rs. 2.00	48,000	
June 24,000 units @ Rs. 2.20		52,800
Fixed: May 24,000 units @ Rs. 1.60	38,400	
June 24,000 units @ Rs. 1.76		42,240

Total production costs	86,400	95,040
Add: Opening stock		
May Nil		
June 3,000 units @ Rs. 3.60*		10,800
Total	86,400	1,05,840
Less: Closing stock		
May 3,000 units @ Rs. 3.60*	10,800	
June 500 units @ Rs. 3.96*		1,980
Production cost of goods sold	75,600	1,03,860
Marketing fixed costs	14,000	15,400
Total cost of goods sold	89,600	1,19,260
Profit (Sales – COGS)	15,400	26,490
Budgeted output		
Actual output		
Shortfall		
Under recovery of fixed overheads		
May 1,000 units @ Rs. 1.60	1,600	
June 1,000 units @ Rs. 1.76		1,760
Net profit	13,800	24,730

*Total cost = VC + FC

May 2.00 + 1.60 = 3.60

June 2.20 + 1.76 = 3.96

(ii) Profitability based on marginal costing:

	May 2009	June 2009
	Rs.	Rs.
Sales	1,05,000	1,45,750
Production cost – variable	48,000	52,800
Add: Opening stock		
May Nil		
June		6,000
Total	48,000	58,800
Less: Closing stock		
May 3,000 units @ Rs. 2.00	6,000	
June 500 units @ Rs. 2.20		1,100

Variable cost of goods sold			42,000	57,700
Contribution			63,000	88,050
Fixed costs:	May	June		
Production	40,000	44,000		
Marketing	14,000	15,400	54,000	59,400
Net profit			9,000	28,650

Decision Making

4. The costs/benefits of closing on 30 November, 2009 instead of closing on 30 June, 2009 are:

	Rs.	Rs.
Payments to XYZ Ltd avoided (5 months @ Rs. 65,000)		3,25,000
*Salaries and wages cost		
5 months @ (Rs. 18,000 + Rs. 4,000 – Rs. 3,000 + Rs. 1,300)		(1,01,500)
**Printing materials		
(5 months @ Rs. 31,000) – Rs. 18,000 + Rs. 10,000)		(1,47,000)
***Distribution materials		(5,280)
Occupancy costs		
****Printing	17,212.50	
*****Distribution	2,175.00	
		(19,387.50)
Loss of sub-letting income (5 months @ Rs. 2,500)		(12,500)
******Additional loss on sale of plant		(2,000)
Additional loss on sale of vehicles (Rs. 48,000 – Rs. 44,000)		(4,000)
Net benefit of closing on 30 November		33,332.50

The plant should remain open until 30 November.

* The total salaries equal Rs. 22,000 (Rs. 18,000 + Rs. 4,000) but two staff will be retained so the net saving of closing on 30 June is reduced by their salaries (Rs. 3,000 per month). If closure does not occur until November, the vacancy in the publishing department will need to be filled (at Rs. 1,300 per month) until closure in November when the transfer occurs. The redundancy pay will arise whenever closure occurs and is therefore irrelevant.

** The future cash outflow on printing materials is Rs. 31,000 per month for five months less the Rs. 18,000 held in stock. However, the opportunity to sell the stock is lost, therefore, there is an additional cost of Rs. 10,000.

*** If the department is closed then the options are (from note (ii) in the question):

(i) Accept both deliveries, pay for them and sell the goods to XYZ Ltd:

(2 × Rs. 500) – (2 × Rs. 380) = Rs. 240 net cost.

(ii) Accept the July delivery, pay for it, sell it to XYZ Ltd and pay the cancellation cost for August:

(Rs. 500 – Rs. 380) + Rs. 100 = Rs. 220 net cost.

(iii) Cancel both deliveries at a net cost of Rs. 300.

The lowest cost option would be selected if closure occurred, therefore this is a benefit of continuing to November.

The distribution material costs to November are (5 months @ Rs. 1,100) – Rs. 220 = Rs. 5,280.

**** Attributable costs are [(Rs. 8,500 × 30%) + (Rs. 8,500 × 70% × 15%)] × 5 months = Rs. 17,212.50.

***** Attributable costs are [(Rs. 1,200 × 25%) + (Rs. 1,200 × 75% × 15%)] × 5 months = Rs. 2,175.

******

	Rs.	
Net book value	48,000	
June sale	21,000	loss
Therefore June proceeds	27,000	
November proceeds	25,000	
Additional loss	2,000	

Decision Making

5. Comparative profit Statement (based on Revised Cost Structure)

	Proposal 1 Sell 20,000 units only	Proposal 2 Secure orders for 5,000 additional units (unused capacity) and sell 25,000 units	Proposal 3 Accept the new order for 10,000 additional units and sell 30,000 units
	Rs.	Rs.	Rs.
Total sales revenue (A)	20,00,000 (Rs.20,000 units × Rs.100)	25,00,000 25,000 units × Rs.100)	29,00,000 (20,000 units × 100 + 10000 units × 90)
Direct Material	6,60,000 (20000 units × Rs. 33)	8,25,000 (25,000 units × Rs. 33)	9,90,000 (30,000 units × Rs. 33)
Director Labour	5,00,000	6,25,000	7,50,000

	(20,000 units × Rs.25)	(Rs.25,000 units × Rs. 25)	(30,000 units × Rs.25)
Variable overhead	2,00,000	2,50,000	3,00,000
	(20,000 units × Rs.10)	(25,000 units × Rs.10)	(30,000 units × Rs.10)
Fixed overheads	4,40,000	4,40,000	4,40,000
	(Rs.4,00,000+ Rs.40,000)		
Add: Administrative charges	-	-	60,000
Add: Sales promotion expenses	-	50,000	-
Depreciation (New equipment)			1,50,000
Total cots (B)	18,00,000	21,90,000	26,90,000
Profit (C) = [(A) – (B)]	2,00,000	3,10,000	2,10,000

Analysis

An analysis of the profit figures of M/s Unique products under three proposals clearly shows that it is maximum under proposal 2. Therefore, it is advisable for the concern to produce and sell 25,000 units @ Rs.100/- per unit and utilise its full production capacity.

Areas of Decision Making

6. The relevant cost of producing the new product is the variable cost plus the lost contribution from selling the processing time to another manufacturer. It is given that, the main product will absorb 3 days per week.

Calculation of variable overhead rates

	Dept. 4	Dept. 5
Normal Hrs.per annum (0.9×40 hr×50 wks)	1,800 hrs	1,800hrs
Fixed O.H. rate/hr. (Rs.)	20 (36,000/1,800)	28(50,400/1800)
Total O.H. rate/hr (given) (Rs.)	40	40
Thus variable OH rate/hr (Rs.)	20	12

The variable costs per hour are:

Department 4 : Power Cost Rs 40 + Variable Cost Rs 20 = Rs 60

Department 5 : Power Cost Rs 60 + Variable Cost Rs 12 = Rs 72

Note: labour costs are fixed (given).

If the new product is not developed, dept. 4 shall sell unused processing time at Rs. 70 per hour. It is not profitable for Dept. 5 to sell processing time at Rs. 70 per hour since the variable costs is more at Rs. 72. Therefore the relevant cost per processing hour are

Dept. 4 Rs. 70 (Rs. 60 variable cost + Rs. 10 lost contribution for selling processing time)

Dept. 5 Rs. 72

Relevant cost for producing the new product

	Rs
Direct Material (Given)	10.00
Dept. 4, variable operating cost (0.75 hr $\times$Rs. 70)	52.50
Dept. 5 variable operating cost (0.33 hr. $\times$ Rs. 72)	24.00
Relevant cost	86.50

Additional contribution for various selling prices/demand levels

	Rs.	Rs.	Rs.
Selling price per unit	100	110	120
Restricted demand (Units)	* 1067	1000	500
Relevant cost (Rs)	86.50	86.50	86.50
Contribution (Rs)	13.50	23.50	33.50
Total Contribution (Rs)	14,404.50	23,500	16,750

* Dept 4 (800 Hrs $\times \frac{4}{3}$) = 1,067 units

* Dept. 5 (800 Hrs $\times$ 3) = 2400 units

Hence selling 1000 units @ Rs. 110 per unit will achieve optimum contribution.

Computation of spare time for production of 1,000 units pa

	Department 4	Department 5
Time required per unit (Hours)	$\frac{3}{4}$	$\frac{1}{3}$
Total time for producing 1,000 units (Hours)	750	334
Time available (Hours)	800	800
Spare time (Hours)	50	466
Spare time per week (Hours)	1	9.32

Therefore Dept 4 can sell 1 hr. per week at Rs. 70 per hour.

It is not profitable to sell spare capacity of 9.32 hrs. / week at the existing rate of Rs. 70 per hour.

Weekly gain from this programme

	Rs.
Selling price	110
Variable cost	
Direct materials	10
Dept. 4 variable operating cost 0.75×60	45
Dept. 5 variable operating cost 0.33×72	24
	79
Contribution / unit	31
Weekly sale	20 units
Additional contribution / week	620
Plus contribution of selling 1 hr (selling price – variable cost = 70-60)	10
Total contribution	630
Without the new product the weekly contribution 16 hours $\times$ Rs. 10 per hr	160
Additional gain for introducing the new product	470

Standard Costing and Variance Analysis

7. (a) Standard Cost Sheet

Description	Cost per unit of Finished Good
Standard Raw Material Cost	Rs 5,600
Variable Overheads	Rs 1,400
Standard Fixed Overheads	Rs 10,000
Standard Cost per Unit of Finished Good	Rs 17,000

(b) Production Volume Variance

Unutilised capacity × Standard Fixed Cost per Finished Good

100 × Rs 10,000 = Rs 10,00,000 Adverse

(c) Usage and Material Price Variance (Actual Production : 100 Units)

Raw Mat.	Std Qty/FG	Std Qty on actual prod	Actual Qty on actual prod	Act Price per Ut of RM(Rs)	Std Price per Ut of RM (Rs)	Usage Variance (Rs)	Price Variance (Rs)
A	1	100	102	700	600	(1,200)	(10,200)
B	2	200	201	600	500	(500)	(20,100)

C	3	300	310	500	400	(4,000)	(31,000)
D	4	400	415	400	300	(4,500)	(41,500)
E	5	500	540	300	200	(8,000)	(54,000)
F	6	600	610	200	100	(1,000)	(61,000)
						(19,200)	(2,17,800)

(d)

Standard Profit (Rs 13,000 × 100)	Rs 13,00,000
Usage Variance	(19,200)
Price Variance	(2,17,800)
Production Volume Variance	(10,00,000)
Actual Profit	63,000

Standard Costing and Variance Analysis

8. (i) Control Report

Code		Fixed budget	Flexed Budget	Actual	Variances
		7,500 units	6,750 units	6750	
301	Sales salaries	Rs. 30,000	Rs. 30,000	33,750	Rs. 3750 (A)
302	Staff Commission	30,000	27,000	28,500	1,500 (A)
303	Staff expenses	15,000	13,500	13,000	500 (F)
431	Underwriting Staff	45,000	40,500	50,000	9,500 (A)
599	Other Admin Costs	30,000	30,000	33,000	3,000 (A)
		1,50,000	1,41,000	158,250	17,250 (A)

(ii) Sales Salaries. Rs. 3,750 (A) Rate Variance is due to unanticipated pay award.

Sales Commission – Rs. 3000 (F) is due to drop in activity and Rs. 1500 (A) may be due to increasing sales commission on selected policies or due to inefficiency.

Sales Expenses – Rs. 1500 reduction due to drop in activity and Rs. 500 (F) for improved control.

Underwriting Salaries – Rs. 4,500 (F) due to drop in activity, Rs. 5062 (A) due to unbudgeted salaries increases and Rs. 4,438 (A) due to inefficiency.

Other Administration – Rs. 3,000 (A) seem to have been caused by changes due to high cost suppliers or hiring temporary office staff

Product Pricing

9. (a) The question states that fixed manufacturing costs are absorbed into the unit costs

by a charge of 200% of variable cost. Therefore unit variable cost is one third of total unit cost.

Contribution per processing hour

	Product X	Product Y	Product Z
Selling price	20	31	39
Variable cost	6	8	10
Production contribution	14	23	29
Contribution per processing hour	14	23	14.50
Ranking	3	1	2

Optimal programme

	Output	Hours used	Contribution(Rs.)
Product Y	8000	8000	184000
Z	2000	4000	58.00
X	1500	1500	21.00
			263.00

Existing programme

	Output	Hours used	Contribution(Rs.)
Product X	6000	6000	84,000
Y	6000	6000	1,38,000
Z	750	1500	21,750
			2,43,750

Contribution and profits will increase by Rs.19250 if the optimal production programme is implemented. An additional hour of processing would be used to increase product X by one unit, thus increasing contribution by Rs.14. Therefore the shadow price (or opportunity cost) of one scarce processing hour Rs.14.

Capacity is limited to 13500 hours. It is therefore necessary to allocate output on the basis of marginal contribution per hour. Products X and Y each require processing hour, whereas product Z requires 2 processing hours. To simplify the calculations, hours are allocated in 2000 blocks. Consequently, the allocation of the fiALPHA 2000 hours will yield a marginal contribution of Rs.37000 from X, RS.52000 from Y and 29500 from Z Note that an output of 2000 units of Z will require 4000 processing hours, and will yield a contribution of Rs.59,000 In other words, the marginal contributions for X and Y in the above schedule are expressed in terms of blocks of 2000 hours, whereas the marginal contribution for Z is expressed in terms of blocks of 4000 hours. To express the marginal contribution of

Z in terms of blocks of 2000 hours, if is necessary to divide the final column of the above schedule by 2.

Processing hours are allocated as follows.

	Hours		Marginal contribution(Rs.)
Product Y	FiALPHA 2000		52000
Y	Next 2000		48000
Y	2000		44000
Y	2000		40000
X	2000		37000
Y	2000		36000
X	1500	(balance)	24250
	13500		281250

Note

*3500×(Rs.23.50- Rs.6)-RS.37000=Rs.24250

The optimum output is Rs.10,000 units of product B at a selling price of Rs.30 and 3500 units of Y at a selling price of Rs.23.50, and contribution will be maximized at Rs.2,81,250 . It is assumed that it is company policy to change selling prices only in steps of Rs.1

(b)

	Product X			Product Y			Product Z		
Demand	Price (Rs.)	Total contribut-ion (Rs,000)	Marginal contribut-ion (Rs,000)	Price (Rs.)	Total contribut-ion (Rs,000)	Marginal contribut-ion (Rs,000)	Price (Rs.)	Total contribut-ion (Rs,000)	Marginal contribut-ion (Rs,000)
2000	24.50	37	37	34	52	52	39.50	59	59
4000	23.50	70	33	33	100	48	39.00	116	57
6000	22.50	99	29	32	144	44	38.50	171	55
8000	21.50	124	25	31	184	40	38.00	224	53
10000	20.50	145	21	30	220	36	37.50	275	51
12000	19.50	162	17	29	252	32	37.00	324	49
14000	18.50	175	13	28	280	28	36.50	371	47

Pricing Decisions

10.

	(Rs)
FOB price of complete Washing Machine	8000
Value of imported items (40% of FOB price)	3200

Value of locally manufactured items (60% of FOB Price)		4800
A.	Cost of imported Items :	
	(i) FOB price of imported parts	3200
	(ii) Freight & Insurance	300
	(iii) CIF value	3500
	(iv) Custom duty 40% on CIF value	1400
	Landed cost of imported kits (iii) +(iv)	4900
B.	Cost of material - both imported + local (4800 +4900)	9700
C.	Assembling cost	1000
D.	Technical know how cost per machine	100
E.	Total cost excluding royalty (B+ C + D)	10800
F.	Royalty	434
G.	Total Cost	11234
H.	Profit (25% of Cost)	2806
Selling Price of Washing Machine (G + H)		14040

Working note for calculation of royalty :

Let Royalty	= X
Cost	= (10800 + X)
Selling price	= (10800 + X) x 1.25
	= (13500 +1.25 X)
Royalty	= (Selling Price – landed cost of imported kits – landed cost of local items) x 0.10
Or X	= (13500 + 1.25 X – 9700) x 0.10
Or X	= 380 + 0.125 X
Or 0.875 X	= 380
Or X	= 434

Transfer Pricing

11. Assumptions

Investments include fixed assets and net working capital.

Current liabilities and creditors may be taken as nil as they have been not been provided for in the question.

Investments	Rs	Rs
Fixed Assets		5,00,000
Net working capital		

Current Assets	3,00,000	
Debtors	2,00,000	5,00,000
Total investments		10,00,000

The desired rate of return is 28%

Therefore the profit margin = 28% of Rs 10,00,000

= Rs 2,80,000

Budgeted volume = 4,00,000 units

Profit margin per unit	= Re 0.70
Fixed cost per unit	= Rs 2.00
(Rs 8,00,000 ÷4,00,000 units)	
Variable cost per unit	=Rs 10.00
Transfer price per unit	= Rs 12.70

Transfer Pricing

12.

(i) Existing profitability of divisions & company

Assembly Division	Rs lakhs
Total Sales value (3000 x 300 + 9000 x 280)	34.20
Total Variable cost for Division	24.00
Contribution	10.20
Fixed cost	6.00
profit for division Assembly	4.20
Finishing Division	
Total sales value 9000 set @ Rs 450	40.50
Variable cost (9000 x 280) + 6 lakhs	31.20
Contribution	9.30
Fixed Cost	4.00
Profit for division Finishing	5.30
Total Profit of the company	9.50

(ii) Evaluation of the proposal : Expansion of assembly division & transfer to Finishing division at existing level

Total Sales value (5400 x 300 + 9000 x 280)	41.40
Total Variable cost for Division (24 x 1.2)	28.80
Contribution	12.60

	Fixed cost + opportunity cost of capital invested (6.00 +20 x 0.15)	9.00
	Profit for division Assembly	3.60
	Finishing Division	
	Total sales value 9000 set @ Rs 450	40.50
	Variable cost (9000 x 280) + 6 lakhs	31.20
	Contribution	9.30
	Fixed Cost	4.00
	Profit for division Finishing	5.30
	Total Profit of the company	8.90
(iii)	Evaluation of the proposal : Expansion of assembly division & transfer of whole assembly output to Finishing division at a price of Rs 280	
	Assembly Division	
	Total Sales value (14400 x 280)	40.32
	Total Variable cost for Division (24 x 1.2)	28.80
	Contribution	11.52
	Fixed cost + opportunity cost of capital invested (6.00 +20 x 0.15)	9.00
	Profit for division Assembly	2.52
	Finishing Division	
	Total sales value 14400 set @ Rs 450	64.80
	Variable cost (14400 x 280) + 6 lakhs	46.32
	Contribution	18.48
	Fixed Cost + Advertisement cost	9.00
	Profit for division Finishing	9.48
	Total Profit of the company	12.00
(iv)	Evaluation of the proposal : Expansion of assembly division & transfer of whole assembly output to Finishing division	
	Total Sales value (14400 x 300)	43.20
	Total Variable cost for Division (24 x 1.2)	28.80
	Contribution	14.40
	Fixed cost + opportunity cost of capital invested (6.00 +20 x 0.15)	9.00
	Profit for division Assembly	5.40
	Finishing Division	
	Total sales value 14400 set @ Rs 450	64.80
	Variable cost (14400 x 300) + 6 lakhs	49.20

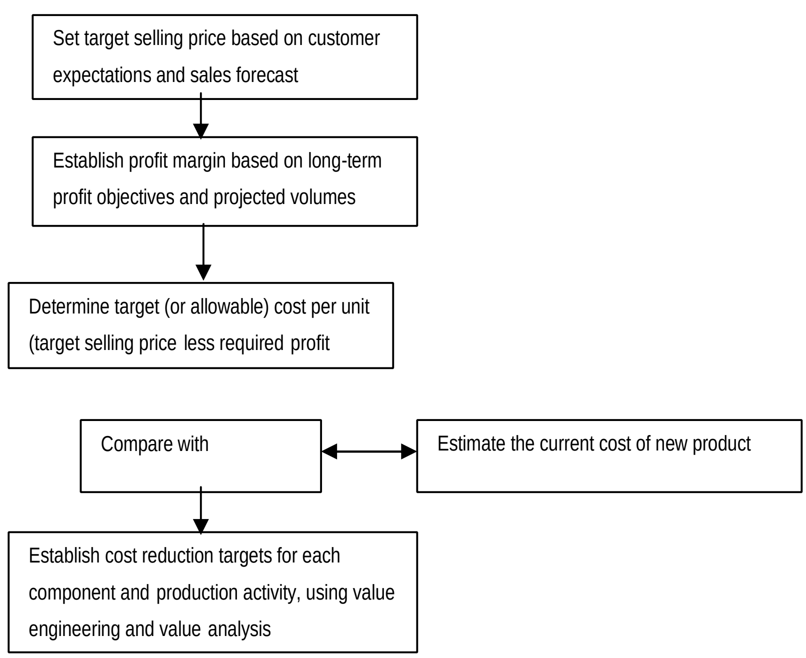
Contribution	15.60
Fixed Cost + Advertisement cost	9.00
Profit for division Finishing	6.60
Total Profit of the company	12.00

The proposal (iv) i.e transfer of all units from Assembly to Finishing Division at a transfer price of Rs 300 is recommended. With adoption of this price, profitability of the company as a whole will go up and each division will get its due share of profitability.

Target Costing

13. (a) Target Costing: It is a management tool used for reducing a product cost over its entire life cycle. It is driven by external Market factors. Marketing management prior to designing and introducing a new product determines a target market price. This target price is set at a level that will permit the company to achieve a desired market share and sales volume. A desired profit margin is then deducted to determine the target maximum allowable product cost. Target costing also develops methods for achieving those targets and means to test the cost effectiveness of different cost-cutting scenarios.

Target Costing Process



(b) Computation of Target Cost

	Per tonne (in Rs)
ABC Ltd selling price to the merchant	1,466
Less freight paid by ABC Ltd	(30)
Less normal sales returns and allowances	(60)
XYZ Ltds Capital charge	(120)
Target cost for XYZ Ltd	1,256
Ship to Distribution Centre	(11)
Distribution Centre operating cost	(25)
Subtotal	1,220
Distribution centre capital charge	(58)
Mill target manufacturing cost	1,162

Costing of Service Sector

14. Using the 85% experience curve the cost of first five planes should be approximately

$T_1 =$ Rs. 150,000,000 × 1.0000 = Rs. 150,000,000

$T_2 =$ Rs. 150,000,000 × 0.8500 = Rs. 127,500,000

$T_3 =$ Rs. 150,000,000 × 0.7730 = Rs. 115,950,000

$T_4 =$ Rs. 150,000,000 × 0.7230 = Rs. 108,450,000

$T_5 =$ Rs. 150,000,000 × 0.6860 = Rs. 102,900,000

From the 85% column in table the total time factor for 25 units is 14.801, so the total cost for the 25 planes will be Rs. 150,000,000×14.801 = Rs. 2,220,150,000. Dividing this by 25 gives the average cost of Rs. 88,806,000.

Activity Based Cost Management

15. 1. Single plantwide factory overhead rate $= \dfrac{\text{Rs.}14,00,000}{1,75,000 \text{ direct labour hours}}$

= Rs. 8 per direct labour hour

Factory overhead cost per unit:

	Product K	Product L	Product M
Number of direct labour hours	25,000	10,000	1,40,000
Single plant wide factory overhead rate	× Rs.8/dlh	× Rs.8/dlh	× Rs.8/dlh
Total factory overhead	Rs.2,00,000	Rs.80,000	Rs.11,20,000
Number of units	÷ 10,000	÷ 2,000	÷ 50,000
Cost per unit	Rs. 20.00	Rs. 40.00	Rs. 22.40

2. Under activity-based costing, an activity rate must be determined for each activity pool:

Activity	Activity Cost Pool Budget	÷	Estimated Activity Base	=	Activity Rate
Set up	Rs. 4,28,750	÷	125 set ups	=	Rs. 3,430 per setup
Production control	Rs. 2,45,000	÷	125 production orders	=	Rs. 1,960 per production order

Activity	Activity Cost Pool Budget	÷	Estimated Activity Base	=	Activity Rate
Quality control	Rs. 1,83,750	÷	75 inspections	=	Rs. 2,450 per inspection
Materials management	Rs. 3,67,500	÷	750 requisitions	=	Rs. 490 per requisition
Production	Rs. 1,75,000	÷	1,75,000 direct labour hours	=	Rs. 1 per direct labour hour

These activity rates can be used to determine the activity-based factory overhead cost per unit as follows:

Product K

Activity	Activity –Base Usage	×	Activity Rate	=	Activity Cost
Set up	80 setups	×	Rs. 3,430	=	Rs. 2,74,400
Production control	80 production orders	×	1,960	=	1,56,800
Quality control	35 inspections	×	2,450	=	85,750
Materials management	320 requisitions	×	490	=	1,56,800
Production	25,000 direct labour hours	×	1	=	25,000
Total factory overhead					Rs.6,98,750
Unit volume					÷ 10,000
Factory overhead cost per unit					Rs. 69.88

Product L

Activity	Activity –Base Usage	×	Activity Rate	=	Activity Cost
Set up	40 setups	×	Rs. 3,430	=	Rs. 1,37,200
Production control	40 production orders	×	1,960	=	78,400
Quality control	40 inspections	×	2,450	=	98,000
Materials management	400 requisitions	×	490	=	1,96,000

Production	10,000 direct labour hours	×	1	=	10,000
Total factory overhead					Rs.5,19,600
Unit volume					÷ 2,000
Factory overhead cost per unit					Rs. 259.80

Product M

Activity	Activity –Base Usage	×	Activity Rate	=	Activity Cost
Set up	5 setups	×	Rs. 3,430	=	Rs. 17,150
Production control	5 production orders	×	1,960	=	9,800
Quality control	0 inspections	×	2,450	=	0
Materials management	30 requisitions	×	490	=	14,700
Production	1,40,000 direct labour hours	×	1	=	1,40,000
Total factory overhead					Rs.1,81,650
Unit volume					÷ 50,000
Factory overhead cost per unit					Rs. 3.63

3. Activity-based costing is more accurate, compared to the single plant wide factory overhead rate method. Activity-based costing properly shows that Product M is actually less expensive to make, while the other two products are more expensive to make. The reason is that the single plant wide factory overhead rate method fails to account for activity costs correctly. The setup, production control, quality control, and materials management activities are all performed on products in rates that are different from their volumes. For example, Product L requires many of these activities relative to its actual unit volume. Product L requires 40 setups over a volume of 2,000 units (average production run size = 50 units), while Product M has only 5 setups over 50,000 units (average production run size = 10,000 units). Thus, Product L requires greater support costs relative to Product M.

   Product M requires minimum activity support because it is scheduled in large batches and requires no inspections (has high quality) and few requisitions. The other two products exhibit the opposite characteristics

Activity Based Cost Management

16. (i) ALPHA Limited's

Statement of operating income and gross margin percentage for each of its three distribution channel

	General Super Market Chains	Drugstore Chains	Chemist Shops	Total
Revenues: (Rs.)	2,80,41,750 (330 x Rs. 84,975)	2,38,21,875 (825 x Rs. 28,875)	1,49,73,750 (2,750 x Rs. 5,445)	6,68,37,375
Less: Cost of goods sold: (Rs.)	2,72,25,000 (330 x Rs 82,500)	2,26,87,500 (825 x Rs 27,500)	1,36,12,500 (2,750 x Rs 4,950)	635,25,000
Gross Margin: (Rs.)	8,16,750	11,34,375	13,61,250	33,12,375
Less: Other operating costs: (Rs)				8,27,970
Operating income: (Rs.)				24,84,405
Gross Margin	2.91%	4.76 %	9.09%	4.96%
Operating income %				3.72

(ii) Computation of rate per unit of the cost allocation base for each of the five activity areas for April 2009

	Rs.
Customer purchase order processing (Rs. 2,20,000/ 5,500 orders)	40/ order
Line item ordering (Rs. 1,75,560/ 58,520 line items)	3/ line item order
Store delivery (Rs. 1,95,250/ 3,905 store deliveries)	50/ delivery
Cartons dispatched (Rs. 2,09,000/ 2,09,000 dispatches)	1/ dispatch
Shelf-stocking at customer store (Rs.) (Rs. 28,160/ 1,760 hours)	16/ hour

(iii) Operating Income Statement of each distribution channel in April-2009 (Using the Activity based Costing information)

	General Super market Chains	Drugstore Chains	Chemist Shops
Gross margin (Rs.) : (A) (Refer to (i) part of the answer)	8,16,750	11,34,375	13,61,260

Operating cost (Rs.) : (B) (Refer to working note)	1,62,910	1,90,410	4,74,650
Operating income (Rs.) : (A–B)	6,53,840	9,43,965	8,86,600
Operating income (in %) (Operating income/ Revenue) x 100	2.33	3.96	5.96

Comments and new insights: The activity-based cost information highlights, how the 'Chemist Shops' uses a larger amount of ALPHA Ltd's resources per revenue than do the other two distribution channels. Ratio of operating costs to revenues, across these markets is:

General supermarket chains (Rs. 1,62,910/ Rs. 2,80,00,750) x 100	0.58%
Drug store chains (Rs. 1,90,410/ Rs. 2,38,21,875) x 100	0.80%
Chemist shops (Rs. 4,74,650/ Rs. 1,49,73,750) x 100	3.17%

Working note:

Computation of operating cost of each distribution channel:

	General Super market Chains Rs.	Drugstore Chains Rs.	Chemist Shops Rs.
Customer purchase order processing	15,400 (Rs. 40 x 385 orders)	39,600 (Rs. 40 x 990 orders)	1,65,000 (Rs. 40 x 4125 orders)
Line item ordering	16,170 (Rs. 3 x 14 x 385)	35,640 (Rs. 3 x 12 x 990)	1,23,750 (Rs. 3 x 10 x 4125)
Store delivery	16,500 (Rs. 50 x 330 deliveries)	41,250 (Rs. 50 x 825 deliveries)	1,37,500 (Rs. 50 x 2750 deliveries)
Cartons dispatched	99,000 (Re. 1 x 300 cartons x 300 deliveries)	66,000 (Re. 1 x 80 cartons x 825 deliveries)	44,000 (Re. 1 x 16 cartons x 2,750 deliveries)
Shelf stocking	15,840 (Rs. 16 x 330 deliveries x 3 Av. hrs.)	7,920 (Rs. 16 x 825 deliveries x 0.6 Av. hrs)	4,400 (Rs. 16 x 2,750 deliveries x 0.1 Av. hrs)
Operating cost	1,62,910	1,90,410	4,74,650

(iv) Challenges faced in assigning total operating cost of Rs. 8,27,970 :

- Choosing an appropriate cost driver for activity area.
- Developing a reliable data base for the chosen cost driver.
- Deciding, how to handle costs that may be common across several activities.
- Choice of the time period to compute cost rates per cost driver.
- Behavioural factors.

Business Environment & Life Cycle Costing

17. (a) Material Requirements Planning (MRP) is a software based production planning and inventory control system used to manage manufacturing processes. Although it is not common nowadays, it is possible to conduct MRP by hand as well.

MRP is designed to answer three questions: what is needed, how much is needed, and when is it needed. The primary inputs of MRP are a bill of materials, which tells what goes into a finished product; a master schedule, which tells how much finished product is desired and when; and an inventory-records file, which tells how much inventory is on hand or on order. This information is processed, using various computer programs to determine the net requirements for each period of the planning horizon. Outputs from the process include planned-order schedules, order releases, changes, performance-control reports, planning reports, and exception reports.

An MRP system is intended to simultaneously meet the following 3 objectives:

1. Ensure materials and products are available for production and delivery to customers.
2. Maintain the lowest possible level of inventory.
3. Plan manufacturing activities, delivery schedules and purchasing activities.

For further details please refer to chapter 10 of the Institute's Cost Management book.

(b) Traditional accounting systems record the flow of inventory through elaborate accounting procedures. Such systems are required in those manufacturing environment where inventory/WIP values are large. However, since JIT systems operate in modern manufacturing environment characterized by low inventory and WIP values, usually also associated with low cost variances, the requirements of such elaborate accounting procedures does not exist.

Back flushing requires no data entry of any kind until a finished product is completed. At that time the total amount finished is entered into the computer system which is multiplied by all components as per the Bill of materials (BOM) for each item produced. This yields a lengthy list of components that should have been used in the production process and this is subtracted from the opening stock to arrive at the closing stock to arrive at the closing stock/inventory.

The problems with back flushing that must be corrected before it works properly are:

(i) The total production quantity entered into the system must be absolutely correct, if not, then wrong components and quantities will be subtracted from the stock.

(ii) All abnormal scrap must be diligently tracked and recorded. Otherwise materials will fall outside the black flushing system and will not be charged to inventory.

(iii) Lot tracing is impossible under the back flushing system. This is required when a manufacturer needs to keep records of which production lots were used to create a product in case all the items in a lot need be recalled.

(iv) The inventory balance may be too high at all times because the back flushing transactions that relieves inventory usually does so only once a day, during which time other inventory is sent to the production process. This makes it difficult to maintain an accurate set of inventory records in the warehouse.

(c) Product life cycle costing traces costs and revenues of each product over several calendar periods throughout their entire life cycle.

The costs are included in different stages of the product life cycle.

Development phase – R & D cost / Design cost.

Introduction phase – Promotional cost / Capacity costs.

Growth phase/Maturity–Manufacturing cost/Distribution costs/Product support cost.

Decline/Replacement phase - Plants reused/sold/scrapped/related costs.

Total Quality Management & Value Chain Analysis

18. (a) The total quality management is a set of concepts and tools for getting all employees focused on continuous improvement in the eyes of the customer. Quality is an important aspect of world-class manufacturing. The success of Japanese companies is grass rooted in their long-term commitment to improvement of quality. A world class manufacturing approach demands that the quality must be designed into product and the production process, rather than an attempt to remove poor quality by inspection. This means that the objectives of quality assurance in a world-class-manufacturing environment, is not just reject defective product, but to systematically investigate the cause of defects so that they can be gradually eliminated. Though the goal is zero defect, the methodology is one of continuous improvement.

Six Cs of TQM

(i) Commitment - If a TQM culture is to be developed, so that quality improvement becomes normal part of everyone’s job, a clear commitment, from the top must be provided. Without this all else fails.

(ii) Culture - Training lies at the centre of effecting a change -in culture and attitudes. Negative perceptions must be changed to encourage individual contributions.

(iii) Continuous improvement - TQM is a process, not a program, necessitating that we are committed in the long term to the never ending search for ways to do the job better.

(iv) Co-operation: The on-the-job experience of all employees must be fully utilized and their involvement and co-operation sought in the development of improvement strategies and associated performance measures.

(v) Customer focus: Perfect service with zero defects in all that is acceptable at either internal or external levels.

(vi) Control: Documentation, procedures and awareness of current best practice are essential if TQM implementations are to function appropriately The need for control mechanisms is frequently overlooked, in practice.

(b) Value chain is the linked set of value creating activities from the basic raw materials and components sources to the ultimate end use of the product or service delivered to the customer.

The six business functions contained in the value chain are (i) Research and Development, (ii) Design (iii) Production (iv) Marketing (v) Distribution and (vi) Customer service.

Most corporations define their mission as one of creating products and services. In contrast, the other companies are acutely aware of the strategic importance of individual activities within their value chain, They are concentrating on those activities that allow them to capture maximum value for their customers and themselves.

These firms use the value chain analysis approach to better understand which segments, distribution channels, price points. product differentiation. selling prepositions and value chain configuration will yield them the greatest competitive advantage.

The way the value chain approach helps these organizations to assess competitive advantage includes the use of following steps of analysis.

(i) Internal cost analysis - to determine the sources of profitability and the relative cost positions of internal value creating processes;

(ii) Internal differentiation analysis - to understand the sources of differentiation with internal value-creating process; and

(iii) Vertical linkage analysis - to understand the relationships and associated costs among external suppliers and customers in order to maximize the value delivered to customers and to minimize the cost.

The value chain approach used for assessing competitive advantages is an integral part of the strategic planning process. Like strategic planning, value chain analysis is a continuous process of gathering, evaluating and communicating information for business decision-making.

Budgeting Control and Performance Measurement

19. (a) Distinction between fixed budget and flexible budget:

- Fixed budget does not change with the change in the volume of activity attained whereas the flexible budget changes in accordance with the activity attained.
- Fixed budget operates at one level of activity and under one set of conditions flexible budget consists of a series of budgets at different levels of activity.
- In fixed budget both fixed and variable costs are related to only one level of activity and hence the variance analysis does not serve any useful purpose. In flexible budgeting since budgets are flexed to the level of activity attained, control is facilitated.
- In fixed budgeting, if the actual activity attained differs significantly cost ascertainment and price fixation are rendered difficult. Flexible budgeting facilitates correct ascertainment of costs and facilitates price quotations.
- Comparison of actual performance with the budgeted targets is meaningless in fixed budgets whereas such comparisons in flexible budgets provide a meaningful basis of performance measurement.

(b) Bench marking is a technique which is being adopted as a mechanism for achieving continuous improvement. It is a continuous process of measuring a company's products, services or activities against the other best performing organizations either internal or external to the company. The objective is to ascertain how the processes and activities can be improved. The latest developments, best practices and model examples can be incorporated within various operations of the business of the company. It represents an ideal way of achieving high competitive standards.

(c) Year 2008-2009

At 60% production 12,000 units

At 50% production 10,000 units

Production overheads:

	Rs.		
12,000 units	6,50,000	Total cost of 12,000 units	6,50,000
10,000 units	6,00,000	Variable cost @ Rs. 25/- per unit	3,00,000
2,000 units	50,000	Fixed costs	3,50,000

Selling overheads:

Units	Rs.		
12,000	2,40,000	Total cost of 12,000 units	2,40,000
10,000	2,20,000	Variable cost @ Rs.10/- per unit	1,20,000
2,000	20,000	Fixed costs	1,20,000

Flexible budget for 2009-10:

Account	Cost @ 60%	Increase	Revised @ 60%	75%	90%
Units				15,000	18,000
Materials	1,20,000	5%	1,26,000	1,57,500	1,89,000
Labour	1,92,000	3%	1,97,760	1,97,760	
	Efficiency fall	4%	2,06,000	2,57,500	3,09,000
Production Overheads V	3,00,000	6%	3,18,000	3,97,000	4,77,000
F	3,50,000	10%	3,85,000	3,85,000	4,27,000
Admn.Overheads F	1,20,000	15%	1,38,000	1,38,000	1,38,000
Selling overheads V	1,20,000	10%	1,32,000	1,65,000	198,000
F	1,20,000	8%	1,29,600	1,29,600	1,29,600
Total				16,30,100	18,67,600
				108.67	103.67

Cost per unit

At 75% capacity : Profit 20%

$\therefore$ Sales = $\dfrac{16{,}30{,}100 \times 100}{80} = 20{,}37{,}625$

Profit = 20,37,625 – 16,30,100 = Rs.4,07,525

Incremental cost of 3,000 units = (16,30,100 – 18,67,600) = Rs.2,37,500

Incremental cost per unit = 79.17 S.P offered is Rs.92

Hence the export order is acceptable

Linear Programming

20. (a) (i) The solution is optimal, since all the elements in the last row are non–negative.

(ii) No, because the elements in the last row under non-basic variables x_1 and s_1 are strictly positive.

(iii) No, because none of the basic variables x_2 or s_2 is zero.

(iv) Yes, because the values of basic variable x_2 and s_2 are non-negative.

(v) Machine A is being used to the full capacity because the value of slack variable s_1 is zero in the optimum simplex table. This indicates that the entire time (in hours/week) is consumed by the activities of the model.

(vi) From the given table, the element in the last row under x_1 is 1; therefore, an increase of x_1 from its current zero level to a positive level will mean the reduction in the total profit at the rate of unity per week. Hence in order to ensure that there should not be any reduction, price of x_1 should be increased by Re. one.

(vii) There will be no effect on the profits as s_1 is not in the final basis.

(viii) $x_1=0$ and $x_2 = 10$ with total profit of Rs.50.

(b) To formulate a linear programming model based on the given data, an objective function in contribution terms is required. (The "net profit" figures per unit of product include an arbitrary absorption of fixed overheads. This will lead to a distortion of the appropriate product mix.)

Let the decision variable x_1, x_2, x_3, x_4 and x_5 represent the units of products A, B, C, D and E to be produced.

Then, the objective function is to maximise the contribution i.e.

Maximise $C = 15x_1 + 12x_2 + 16x_3 + 12x_4 + 7x_5$

subject to the following constraints:

$$\left.\begin{array}{ll} x_1 & \leq 1{,}500 \\ x_2 & \leq 1{,}200 \\ x_3 & \leq 900 \\ x_4 & \leq 600 \end{array}\right] \quad \text{(expected maximum demand constraints)}$$

$$x_5 \leq 600$$

$$x_1 + x_2 + 3x_3 + 4x_4 + 5x_5 \leq 5{,}800 \qquad \text{(special component constraint)}$$

$$12x_1 + 10\frac{2}{3}x_2 + 4x_3 + 2\frac{2}{3}x_4 + 2\frac{2}{3}x_5 \leq 20{,}000 \qquad \text{(labour hours constraint)}$$

$$15x_1+14x_2+16x_3+15x_4+16x_5 \leq 30{,}000 \qquad \text{(material expenditure constraint)}$$

$$x_1, x_2, x_3, x_4, x_5 \geq 0 \qquad \text{(non–negativity conditions)}$$

The Transportation Problem

21. (a) .The total requirements of shops are = 100 + 200 + 450 + 150 = 900 dresses. But, the availability is only 150 + 450 + 250 = 850 dresses. Accordingly a dummy manufacturer capable of providing 50 dresses must be included so that the table balances. The dummy will be given zero profit per dress. The initial allocations as made in the loss matrix to give maximum profit are as follows:

Table 1

Manufacturer	Size				Quantity Available
	I	II	III	IV	
A	100 3.00	1.50	0.50	50 3.50	150
B	2.50	2.00	450 0.00	4.00	450
C	3.50	200 1.00	1.00	50 3.00	250
Dummy	5.50	5.50	5.50	50 5.50	50
Quantity Required by shops	100	200	450	150	900 900

The number of allocations is six. Whereas m + n – 1 = 7. It means a degenerate situation exists. Accordingly a small allocation 'ε' must be made, so that the shadow profits can be calculated. Cell A/III will be deemed to occupy the said allocation. We introduce u_i , v_j, i = (1, 2, 3, 4) j = (1, 2, 3, 4) such that $(u_i + v_j) = C_{ij}$ for allocated cells. We assume $u_1 = 0$, and remaining u_i's and v_j's are calculated as below and are shown in the Table 2.

Table 2

Manufacturer	Size				Quantity Available	u_i's
	I	II	III	IV		
A	100 3.00	1.50	ε 0.50	50 3.50	150	$u_1 = 0$
B	2.50	2.00	450 0.00	4.00	450	$u_2 = (-0.5)$
C	3.50	200 1.00	1.00	50 3.00	250	$u_3 = (-0.5)$
Dummy	5.50	5.50	5.50	50 5.50	50	$u_4 = 2$
Quantity Required by shops	100	200	450	150	900 900	
v_j's	v_1= 3.00	v_2= 1.50	v_3= 0.50	v_4= 3.50		

Compute $C_{ij} – (u_i + v_j)$ for all of the non-allocated cells. Since it is positive for all of the non-allocated cells, hence the initial solution is an optimal one. The maximum profit of the concern in this case is computed as below:

The following table shows the allocations, which will yield the optimal profit.

Manufacturer	Size	Quantity	Profit / Unit Rs.	Total Profit Rs.
A	I	100	2.50	250
	IV	50	2.00	100
B	III	450	5.50	2,475
C	II	200	4.50	900
	IV	50	2.50	125
			Total Profit	3,850

(b) No improvement to this profit is possible because of actual/shadow profit comparison given in Table 2. Where there is zero difference, it means alternative solution is possible. For example, some dresses could be ordered from manufacturer A in Sizes II, III and from manufacturer B in size I.

Working Notes:

Values relating to Table 2

Occupied Cells, $C_{ij} = u_i + v_j$	Unoccupied cells: Compute $\Delta_{ij} = C_{ij} - (u_i + v_j)$
Cell A, I $\Rightarrow u_1 + v_1 = 3.00$ Since $u_1 = 0$, therefore $v_1 = 3.00$	Cell A, II $\Rightarrow 1.50 - (0 + 1.50) = 0$
Cell A, III $\Rightarrow u_1 + v_3 = 0.50$ Since $u_1 = 0$, therefore $v_3 = 0.50$	Cell B, I $\Rightarrow 2.50 - (-0.5 + 3.00) = 0$
Cell A, IV $\Rightarrow u_1 + v_4 = 3.50$ Since $u_1 = 0$, therefore $v_4 = 3.50$	Cell B, II $\Rightarrow 2.00 - (-0.5 + 1.50) = 1$
Cell B, III $\Rightarrow u_2 + v_3 = 0$ Since $v_3 = 0.50$, therefore $u_2 = (-0.50)$	Cell B, IV $\Rightarrow 4.00 - (-0.5 + 3.50) = 1$
Cell C, IV $\Rightarrow u_3 + v_4 = 3$ Since $v_4 = 3.5$ therefore $u_3 = (-0.5)$	Cell C, I $\Rightarrow 3.50 - (-0.5 + 3.00) = 1$
Cell C, II $\Rightarrow u_3 + v_2 = 1$ Since $u_3 = (-0.5)$; therefore $v_2 = 1.50$	Cell C III $\Rightarrow 1 - (-0.5 + 0.5) = 0$
Consider Dummy, IV $\Rightarrow u_4 + v_4 = 5.50$ Since $v_4 = 3.50$ therefore $u_4 = 2.00$	Cell Dummy, I $\Rightarrow 5.50 - (2 + 3) = 0.50$
	Cell Dummy, II $\Rightarrow 5.50 - (2 + 1.5) = 2$
	Cell Dummy, III $\Rightarrow 5.50 - (2 + 0.5) = 3$

22. (a) This problem is of maximization and is also unbalanced Introducing one more column for a fictious work center (say D) in order to get balanced assignment problem.

Work Center → / ↓ Methods	A	B	C	D
1	10	7	8	0
2	8	9	7	0
3	7	12	6	0
4	10	10	8	0

For converting it into the minimization problem subtract every element from the maximum element i.e. 12.

Work Center → / ↓ Methods	A	B	C	D
1	2	5	4	2
2	4	3	5	2
3	5	0	6	2
4	2	2	4	2

Apply Hangarian rule for obtaining the solution.

Work Center → / ↓ Methods	A	B	C	D
1	0	3	0	1
2	1	0	0	0
3	5	0	4	3
4	0	0	0	1

Since the minimum number of lines drawn are equal to four. Hence we arrive at the solution as follows.

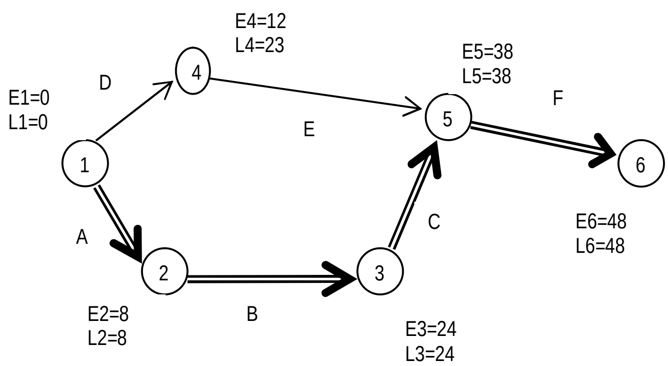
Work Center → / ↓ Methods	A	B	C	D
1	0	3	0	1
2	1	0	0	0
3	5	0	4	3
4	0	0	0	1

Hence the optimal solution is:

Methods		Work centres		Units
1		C		8
2		D		0
3		B		12
4		A		10
				30

Critical Path Analysis

23.



First assume that all activities occur at normal times. Then the following net work shows the critical path computations under normal conditions. The critical path is A → B → C → F. The schedule of project is 48 days and its associated normal cost becomes = Rs.(1800+1500+1800+2400+800+2000) = Rs.10,300.

The different minimum cost schedule that can occur between normal and crash times, which are mainly depend on the cost time slopes for different activities. The cost times slopes can be computed by the formula:

$$\text{Cost-time slope}=\frac{\text{Crash cost} - \text{Normal cost}}{\text{Normal time} - \text{Crash time}}$$

These slopes for the activities of the above net work are obtained as follows:

Activity :	A	B	C	D	E	F
Slope :	200	140	120	200	1200	1000

Now proceed step-by step as follows:

Step 1: Since the present schedule consumers more time, the schedule can be reduced by crashing some of the activities. Since the project duration controlled by the activities lying on the critical path, the duration of some activities on the critical path is reduced.

First reduce the duration of that activity which involves minimum cost. Activity C with minimum slopes given in the minimum cost. So the duration of activity C is compressed from 14 days to 9 days with an additional cost Rs.5 × 120 = Rs.600. Therefore, new schedule corresponds to 43 days with accost of Rs.(10,300+600) = Rs.10,900

Step 2: Now it can be observed that the present schedule still consumers more time and also not all the activities on the critical path are at their crash durations. Hence the project duration can be reduced by crashing some other activity .Out of the remaining activities on the critical path, the activity B has the least slpoe.So reduce the duration of activity from B from 16 days to 11 days at a cost of Rs.5 ×140=Rs.700.Thus the new project duration becomes 38 days with a cost of Rs(10900+700)=Rs.11600.

Step 3: This project duration is still more than required duration of 36 days. So select some other activity lying on the critical path for crashing .Obviously only the activities A and F on the critical path can be considered for crashing .Since activity A has smaller slope, the duration of A can by only one day although it can be compressed by 2 days (from 8 to 6 days). Because, the path $1 \rightarrow 4 \rightarrow 5 \rightarrow 6$ becomes a parallel critical path as soon as A is compressed by one day. Thus new schedule corresponds to 37 days with accost of Rs.(11600+200) = Rs.11800.

Step 4: Since only 36 days schedule is required, compress some activity by one day. To do so compress one day in each of the two parallel critical paths. So there are three choices:

(i) Activity F can be compressed by one day at accost of Rs.1000.

(ii) Activities A and D can be compressed by one day each (Since B and C are already at their crash points) .This gives the total cost of Rs. (200+200)=Rs.400.

(iii) Activities A and E can be compressed by one day each at total cost of Rs(200+1200)=Rs.1400

But, the second choice gives the least cost schedule and it should be selected .This involves a 36 days schedule with a cost of Rs. (11800+400) =Rs.12200.

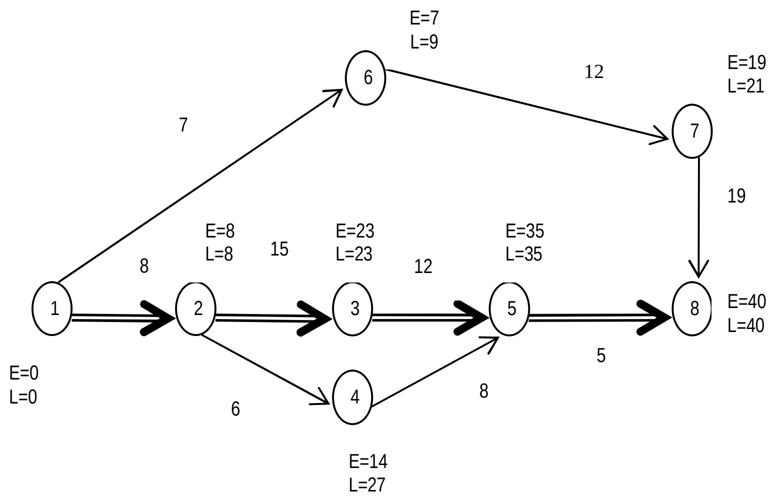
After effective crashing for a schedule of 36 days, the duration of activities and the cost involved are :

Activity	Duration (days)	Cost (Rs)
A	6	2200
B	11	2200
C	9	2400

D	11	2600
E	15	800
F	10	2000

Critical Path Analysis and PERT

24. (i) The required net work is given below



Various path	Duration paths
1-2-3-5-8	8+15+12+5= 40
1-2-4-5-8	8+6+8+5 = 27
1-6-7-8	7+12+19 = 38

Hence the critical path is 1-2-3-5-8 with duration of 40 weeks

(ii) Expected duration of various activities is calculated in the following table;

Job	Duration			Expected duration = $\left(\frac{a+4m+b}{6}\right)$	Variance $=\left(\frac{b-a}{6}\right)^2$
	(a)	(m)	(b)		
1-2	4	7	16	8	4
2-3	7	13	31	15	16
3-5	6	12	18	12	4
7-8	5	20	29	19	16
5-8	2	5	8	5	1
6-7	4	10	28	12	16
4-5	4	7	16	8	4

1-6 2-4	3 3	6 6	15 9	7 6	4 1

The earliest and latest event times for all the nodes are shown in the above diagram.

From this time estimates, it is evident that the critical path for project is 1-2-3-5-8 and the project duration is 40 weeks.

(iii) Variance for various activities which constitute the critical path is calculated and shown in the last column of the table.

Variance overall project duration= σ^2 = (4+16+4+1) =25 weeks

Standard deviation of all critical paths σ = 5 weeks

Now, we want to find probability of completing the project before 35 weeks.

Then we have to find the value from normal variate:

$$Z = \frac{X - \overline{X}}{\sigma} \text{ here } \overline{X} = 35 \text{ weeks}$$

$$\text{So, } Z = \frac{35-40}{5} = -1$$

Area under normal curve corresponds to Z=-1 is 0.3413

Therefore the probability of completing the project before 36 weeks is 0.5 - 0.3413 =0.16 or 16% approximately.

(iv) To calculate the chance of project duration exceeds 50 weeks, then first find

$$Z = \frac{50-40}{5} = 2.0$$

Area under normal curve corresponds Z=2.0 is 0.4772

Hence the probability of project duration before 50 weeks is given by 0.5 + 0.4772 = 0.9772 or 97.72%.

Probability of project duration exceeding 50 weeks =100%-97.72%=2.28%

25. The yearly return can be determined by the formula:

$$\text{Return (R)} = \frac{(\text{price } - \text{cost})}{\text{Investment}} \times \text{ number of units demanded}$$

To determine accumulative probability distribution corresponding to each of three factors, we assign appropriate set of random numbers corresponding each of three factors as shown in table 1, 2 and 3.

Table: 1

Annual Demand	Probability	Cumulative probability	Random Number
20000	0.05	0.05	00-04
25000	0.10	0.15	05-14
30000	0.20	0.65	15-34
35000	0.30	0.65	35-64
40000	0.20	0.85	65-84
45000	0.10	0.95	85-94
50000	0.05	1.00	95-99

Table: 2

(Price - Cost) per unit	Probability	Cumulative probability	Random Number
3.00	0.10	0.10	00-09
5.00	0.20	0.30	10-29
7.00	0.40	0.70	30-69
9.00	0.20	0.90	70-89
10.00	0.10	1.00	90-99

Table: 3

Investment Required	Probability	Cumulative probability	Random Number
17,50,000	0.25	0.25	00-24
20,00,000	0.50	0.75	25-74
25,00,000	0.25	1.00	75-99

We prepare the simulation work-sheet for 10 trials. The simulated return (R) is also calculated by using formula R, the results are shown table-4

Table-4

Trials	Random Numbers of Demand	Simulated Demand ('000)	Random number for profit (price-cost) per unit	Simulated profit	Random Numbers for investment	Simulated Investment ('000's)	Simulated return(%) $= \frac{\text{Demand} \times \text{Profit per unit}}{\text{Investment}}$
1	28	30	19	5.00	18	1750	8.57
2	57	35	07	3.00	67	2000	5.25
3	60	35	90	10.00	16	1750	20.00
4	17	30	02	3.00	71	2000	4.5
5	64	35	57	7.00	43	2000	12.25
6	20	30	28	5.00	68	2000	7.50
7	27	30	29	5.00	47	2000	7.50
8	58	35	83	9.00	24	1750	18.00
9	61	35	58	7.00	19	1750	14.00
10	30	30	41	7.00	97	2500	8.40

Result: Table: 4 shows, the highest likely return is 20% which is corresponding to the annual demand of Rs.35,000 units resulting a (profit of Rs.10 per unit and the required investment will be Rs.17, 50,000.

PAPER – 6 : MANAGEMENT INFORMATION AND CONTROL SYSTEMS

QUESTIONS

Basic Concepts of Systems

1. (a) Write a note on deterministic and probabilistic systems

   (b) Define "Information". What are the characteristics of good or useful information?

Transaction Processing Systems

2. (a) Explain the coding in Accounting Information System (AIS) of Transaction Processing System (TPS).

   (b) Discuss in brief the transaction cycles which exist in all businesses?

Basic Concepts of MIS

3. (a) What is Management Information System? With the help of a figure explain the functions of MIS of an organisation.

   (b) What are the major constraints in operating a Management Information System?

Systems Approach and Decision Making

4. (a) Explain the role played by Financial Information System in making financial decisions.

   (b) Draw a schematic chart representing the flow of information for making financial decisions.

Decision Support and Executive Information Systems

5. (a) Describe Decision Support Systems (DSSs). What are their major components?

   (b) List out the software tools of Decision Support System.

Enabling Technologies

6. (a) Explain the characteristics of Client-Server technology.

   (b) Describe the various components of Client-Server architecture.

System Development Process

7. (a) Draw a context diagram for payroll processing.

   (b) Why should users be involved in the software development process?

Systems Design

8. (a) Distinguish between logical design and physical design.

   (b) Discuss briefly the guidelines based on which the printed and visual display outputs are designed.

System's Acquisition, Software Development and Testing

9. (a) Discuss some of the program design tools available for software development.

   (b) What basic features should be ascertained by the system analyst before purchasing packaged software?

Systems Implementation and Maintenance

10. (a) Discuss in brief operation evaluation of the new system.

    (b) Why is personnel training important for the success of systems implementation? What type of training should be imparted to system operators and users?

Design of Computerised Commercial Applications

11. (a) Write an overview of an Accounting Information System.

    (b) Draw a flow chart explaining the processes involved in a payroll application.

Enterprise Resource Planning: Redesigning Business

12. List out various steps involved in the implementation of a typical ERP package

13. List out various functions of Treasury Cash Management

Controls in EDP Set-up: General Controls

14. Explain the following:

    (a) Access token

    (b) Access control list

    (c) Threats to operating system integrity.

15. What controls and procedures can be adopted to reduce threats from misuse of passwords?

Controls in EDP Set-up: Application Controls

16. What is a source document fraud? What controls can be used to prevent this type of frauds?

17. Explain the following input controls.

    (a) Data coding controls

    (b) Validation controls

    (c) Input error correction

18. Briefly describe the various checks that could be performed during the validation run.

Detection of Computer Frauds

19. (a) "During computer processing the system might fail to detect erroneous input, improperly correct input errors, process erroneous input, or improperly distribute or

disclose output". Discuss the control procedure to detect and prevent these errors and the system review and the test of control procedures employed by the auditor.

(b) What measures can be taken by the organization to prevent computer fraud?

Cyber Laws and Information Technology Act, 2000

20. Define some of the following terms as mentioned in Information Technology Act, 2000:
    (a) Computer System
    (b) Computer Network
    (c) Digital Signature
    (d) Secure System

21. Discuss various sections relating to suspension and revocation of digital signature certificate.

Audit of Information Systems

22. (a) Explain the purpose of using reprocessing technique and parallel simulation to the auditor.
    (b) Describe the major techniques of concurrent audit of information systems.

Information Security

23. (a) Briefly describe the role of awareness, training and education in implementing Information security.
    (b) Give examples of the information security controls.

Use of Simple Case Tools, Analysis of Financial Statements using Digital Technology

24. (a) What are CASE Tools? Explain the benefits of Computer Aided Software Engineering.
    (b) Write a short note on evolution of CASE tools.

25. What is a programming CASE work-bench? Give some tools, which are part of a programming work-bench.

SUGGESTED ANSWERS/HINTS

1. (a) Deterministic and probabilistic system: A deterministic system operates in a predictable manner. The interaction among the parts is known with certainty. If one has a description of the state of the system at a given point in time plus a description of its operation, the next state of the system may be given exactly, without error. An example is a correct computer program, which performs exactly according to a set of instructions.

The probabilistic system can be described in terms of probable behaviour, but a certain degree of error is always attached to the prediction of what the system will do. An inventory system is an example of a probabilistic system. The average demand, average time for replenishment, etc, may be defined, but the exact value at any given time is not known.

(b) Information is data that has been put into a meaningful and useful context. It is defined as "Information is data that has been processed into a form that is meaningful to the recipient and is of real or perceived value in current or progressive decision."

The term "data" and "information" are often used interchangeably. However, the relation of data to information is that of raw material to finished product. Business decisions are generally based on the information. The management plays the part of converting the information into action through the process of decision-making.

Information flows are as important to the survival of a business as the flow of blood is to the life and survival of an individual. Information flow is important for good business decisions and it has been often said that a receipt of a good business is "90% information and 10% inspiration."

Important characteristics of good or useful information are as follows:

(a) Timeliness	(b) Purpose	(c) Mode and Format
(d) Redundancy	(e) Rate	(f) Frequency
(g) Completeness	(h) Reliability	(i) Cost-benefit analysis
(j) Validity	(k) Quality	

For details to above points, please refer to study material, Chapter-1, Section 1.5.1.

2. (a) For a transaction processing system to gather and process data efficiently, accounting data are often coded. AISs can use codes to identify accounting information uniquely, to compress data, to classify transactions in accounts, and to convey special meanings.

Four types of codes are generally used:

(i) Mnemonic codes,

(ii) Sequence codes,

(iii) Block codes, and

(iv) Group codes.

The choices among these codes and the way these codes are constructed are determined by:

- The code's use,
- The need for consistency,

- Considerations of design efficiency,
- An allowance for growth, and
- The desire to use standard codes throughout a company.

(b) A transaction processing cycle organises transactions by an organisation's business processes. The nature and types of transaction processing cycles vary, depending on the information needs of a specific organisation. Nevertheless, most business organisations have in common, transactions that may be grouped according to four common cycles of business activity. These cycles exist in all types of business – both profit –seeking and not – for- profit.

(a) Revenue cycle: Firms sell their finished goods to customers through this cycle. It involves processing cash sales, credit sales, and receipt of cash following a credit sale.

(b) Expenditure cycle: Events related to acquisition of goods and services from other entities in exchange for cash.

(c) Production cycle: Events related to the transformation of resources into goods and services. It involves the planning, scheduling, and control of the physical product through the manufacturing process.

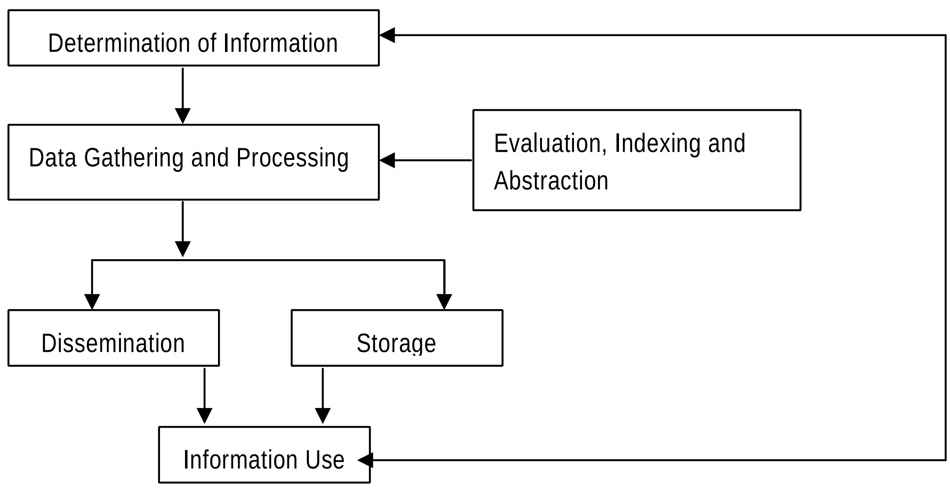
(d) Finance cycle: Events related to the acquisition and management of capital funds, including cash. It might also include application systems concerned with cash management and control, debt management, and administration of employee benefit plans.

The transaction cycle model of an organisation includes a fifth cycle – the financial reporting cycle. It is not an operating cycle. It obtains accounting and operating data from other cycles and processes these data in such a manner that financial reports may be prepared.

3. (a) Management Information System: Information is critical to the success of any business organisation. Management Information System (MIS) is a computer based system which deals with the use, storage and retrieval of information in an organisation.

MIS is a "system of people, equipment, procedures, documents and communication that collects, validates, and operates on transformers, stores, retrieves and present data for use in various management activities such as planning, budgeting, accounting, controlling and various other processes.

Management Information Systems (MIS) are information systems typically computer-based, that are used within an organisation. An information system can be defined as "a system that collects and processes data (information) and provides it to managers at all levels who use it for decision making, planning, program implementation, and control." An information system is comprised of all the components that collect, manipulate, and disseminate data or information. It usually includes hardware, software, communications systems such as telephone lines, and the data itself. The activities involved include inputting data, processing of data into information, storage of data and information, and the production of outputs such as management reports. The functions of MIS can be shown with the help of the following diagram:



(b) The major constraints which come in the way of operating a management information system are as follows:

(i) Non-availability of experts, who can diagnose the objectives of the organisation and provide a desired direction for installing and operating system. This problem may be overcome by grooming internal staff. The grooming of staff should be preceded by proper selection and training.

(ii) Non-availability of standard MIS product. Experts usually face the problem of selecting the sub-system of MIS to be installed and operated upon.

(iii) Non-availability of cooperation from staff. Educating the staff may solve this problem. This task should be carried out by organising lectures, showing films and also explaining to them the utility of the system. Besides this, some persons should also be involved in the development and implementation of the system.

(iv) High turnover of experts in MIS. Turnover in fact arises due to several factors like pay packet; promotion chances; future prospects, behaviour of top ranking managers etc. Turnover of experts can be reduced by creating better working conditions and paying at least at par with other similar concerns.

(v) Difficulty in quantifying the benefits of MIS, so that it can be easily comparable with cost. This raises questions by departmental managers about the utility of MIS.

4. (a) Financial information system plays an important role in making following financial decisions:

(i) Estimation of requirements of funds: This is the very important and starting point of making financial decisions. A very careful estimation of funds and the time at which these funds are required is made in this stage. This can be done by forecasting all physical activities of the firm and translating them into monetary units.

(ii) Capital structure decisions: Decisions are to be taken to select an optimum mix of different sources of capital structure. There are many options available for procuring funds. Decision maker has to decide the ratio between debt and equity, long-term and short-term funds etc. He has to ensure that overall capital structure is such that the company is able to procure funds at optimum cost.

(iii) Capital budgeting decisions: Funds procured from various sources are required to be invested in different assets. With the help of capital budgeting, decision maker can determine feasibility of investment in long-term assets. This will help in attainment of financial objectives.

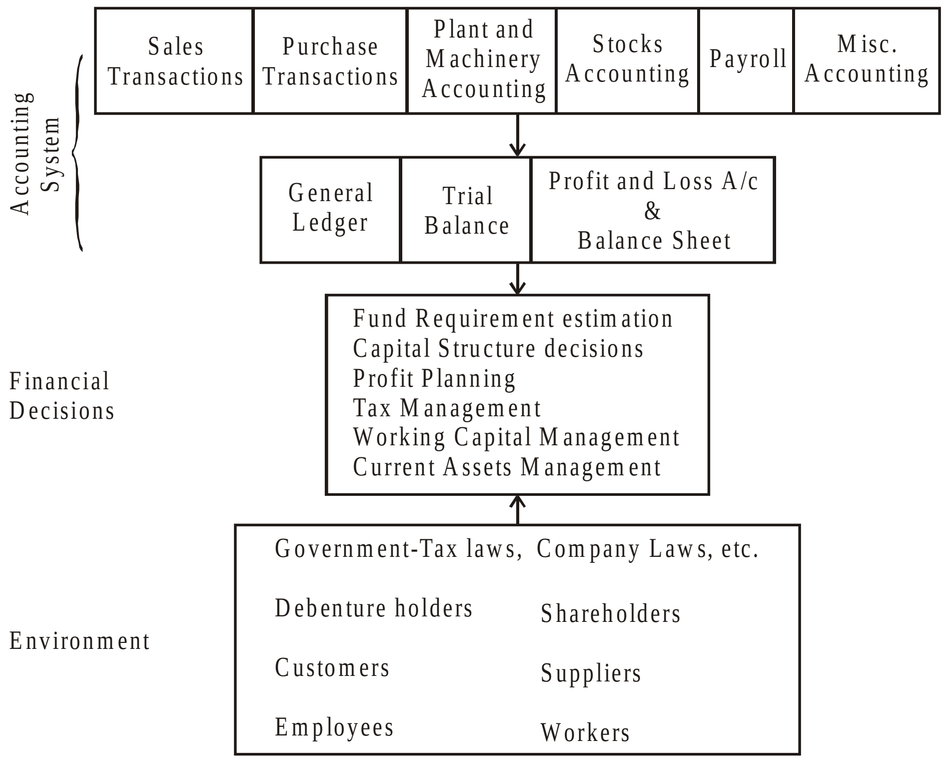
(iv) Profit planning: This part of profit planning is essential for the growth of the organisation. The decision maker has to make decision regarding profits and dividends.

(v) Tax management: Tax planning is aimed at reducing of outflow of cash resources by way of taxes so that the same may be effectively utilized for the benefit of business. The purpose of tax planning is to take full advantage of exemptions, deductions, concessions, rebates, allowances and other relief.

(vi) Working capital management: Working capital management is concerned with the investment of long term funds into current assets. Decisions are to be taken for effective financing of current assets required for day-to-day running of the organisation.

(vii) Current assets management: Policy decisions are taken regarding various items of current assets. Credit policy determines the amount of sundry debtors at any point of time. Inventory policy is to be determined jointly between finance and production department.

(b) The schematic chart representing flow of information for making financial decisions is given below:



5. (a) A Decision Support System (DSS) can be defined as 'a system that provides tools to managers to assist them in solving, semi-structured and unstructured problems.' It provides managers with a set of capabilities that enables them to generate the information required by them in making decisions. Thus, a DSS supports the human decision-making process, rather than providing a means to replace it.

A decision support system has four basic components:

(i) The users (iii) Planning languages

(ii) Databases (iv) Model base.

For details to above points, please refer to study material, Chapter 5, Section 5.3.

(b) The tools of decision support include a variety of software supporting database query, modelling, data analysis and display. A comprehensive toolkit for DSS would include software supporting these application areas. Examples of software tools falling into these four categories are given in table below:

Data based software	Model based software	Statistical software	Display based software
Dbase Plus Foxpro Sysbase R:base 7.6 / 5000 SQL MySQL	IFPS Lotus 1-2-3 Multiplan Omnicalc Calc Foresight	SAS SPSS Minitab	SASGRAPH TELLAGRAF ChartMaster

6. (a) The key characteristics of a client / server technology are:

- Client/server architecture consists of a client process and a server process that can be distinguished from each other.
- The client portion and the server portions can operate on separate computer platforms.
- Either the client platform or the server platform can be upgraded without having to upgrade the other platform.
- The server is able to service multiple clients concurrently; in some client/server systems, clients can access multiple servers.
- The client/server system includes some sort of networking capability.
- A significant portion of the application logic resides at the client end.
- Action is usually initiated at the client end, not the server end.
- A user-friendly Graphical User Interface (GUI) generally resides at the client end.
- A Structured Query Language (SQL) capability is characteristic of the majority of client/ server systems.

(b) Various components of client–server architecture are briefly described below:

(i) Clients: Clients, which are typically PCs, are the "users" of the services offered by the servers. There are three types of clients: (a) Non-Graphical User Interface (NGUI) clients, (b) GUI-clients, (c) Object –Oriented User Interface (OOUI) clients.

(a) Non-GUI clients include ATMs, Cell phones, fax machines and robots that require minimum amount of human interaction.

(b) GUI-clients are human interaction models usually involving objects / action models like the pull-down menus as in windows operating system.

(c) OOUI clients take GUI clients even further with expanded visual formats, multiple work places, and object interaction rather than application interaction. Windows 95 is a common OOUI-client.

(ii) Servers: Servers await requests from the client and regulate access to shared resources. There are four types of servers:

(a) File server: It shares files across a network by maintaining a shared library of documents, data and images.

(b) Database server: This has processing power to execute Structured Query Language (SQL) requests from clients.

(c) Transaction server: It executes a series of SQL commands, an Online Transaction Processing program (OLTP) as opposed to database servers, which respond to a single client command.

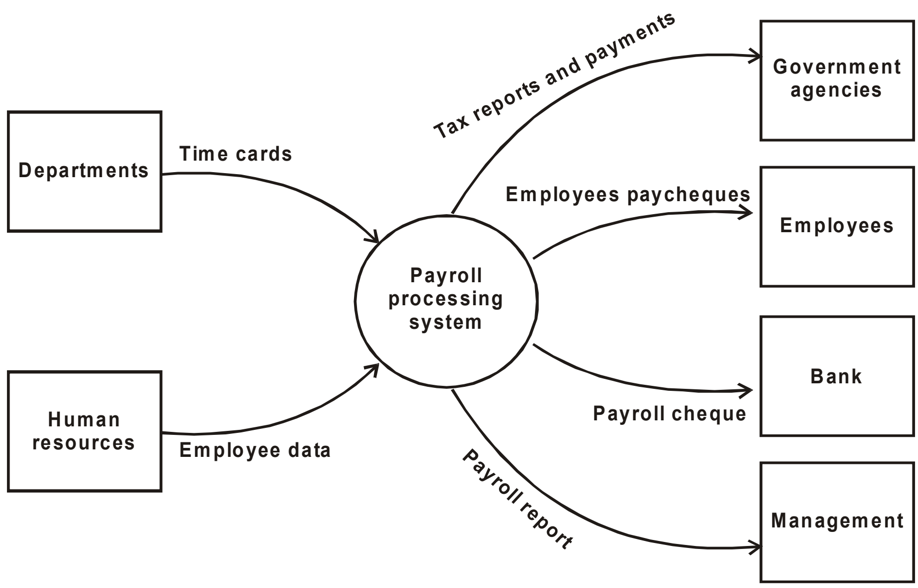
(d) Web server: This allows clients and servers to communicate with a universal language called HTTP.

(iii) Middleware: The network system implemented within the client/server technology is commonly called by the computer industry as middleware. It is the distributed software that is needed to allow clients and servers to interact. The middleware is typically composed of four layers which are service, back-end processing, network operating system and transport stacks. The service layer carries coded instructions and data from software applications to the back-end processing layer for encapsulating network-routing instructions. Next, the network operating system adds additional instructions to ensure that the transport layer transfers data packets to its designated receiver efficiently and correctly.

(iv) Fat-client or Fat-server: Fat client or fat-servers are popular terms which serve as vivid description of the type of client/server system in place. In a fat-client system, more of the processing takes place on the client, like with a file server or database server. Fat-servers place more emphasis on the server and try to minimise the processing done by clients. Examples of fat –server are groupware and web server. Visually fat-clients are referred to as 2-tier system and fat-servers referred to as 3-tier systems.

(v) Network: The network hardware is the cabling, the communication cords and the devices that link the server and the clients. The communication and data flow over the network is managed and maintained by network software.

7. (a) The context diagram for payroll processing is given below:



(b) Involving users in the development process provides valuable feedback and ensures that the users themselves understand the system's limitations and capabilities. Specifically, it enables users to share in the responsibility for the success or failure of the system developed for them. In addition, involving users secures their aid in detecting missing, unnecessary, or awkward system features and in pointing out errors in procedures, input and output specifications, data stores and other design features. Most importantly, user involvement often leads to productive changes in the specifications, thus preventing problems later in the development process.

8. (a) The differences between the logical design and physical design are:

- The logical design of an information system is like an engineering blueprint; it shows major features of the system and how they are related to one another. The reports and outputs of the system are like the engineer's design components. Data and procedures are linked together to produce a working system.
- The physical design activity follows the logical design; the activity involves producing program software, files and a working system. Design specifications; instruct programmers about what the system should do. The programmers, in

turn, write the programs that accept input from users, process data, produce the reports, and store data in the files.

(b) Following are the guidelines, which should be followed while preparing the printed and visual display outputs. It will not only make the analyst's job easier, but will also ensure that users will receive an understandable output.

Printed Outputs:

1. Reports and documents should be designed to read from left to right and top to bottom.
2. Most important items should be easiest to find.
3. Each printed reports should include the heading or title of the report, page number, date of preparation and column headings. The heading or title of the report orients the user to what it is they are reading. The title should be descriptive, yet concise. Each page should be numbered so that the user has an easy point of reference when discussing output with others or relocating important figures. The date of report preparation should be included on each print out. Sometimes this helps users to estimate the value of the output. Column headings serve to further orient the user as to the report contents.
4. Each data item must have a heading, which should be short and descriptive. Data items that are related to one another should be grouped together on the report.
5. Control breaks should be used in the report to help readability. There should be control breaks, summaries and other important information by boxing them off with special characters such as asterisks or extra space. This makes it easier to find critical information.
6. Sufficient margin should be made available on the right and left as well as top and bottom of an output report. This enables the user to focus his attention on the material centered on the page and makes reading easier.
7. The detail line for variable data should be defined by indicating whether each space is to be used for an alphabetic, special or numeric character.
8. The mock up reports should be reviewed by users and programmers for feasibility, usefulness, readability, understand ability and an aesthetic appeal.

Visual display outputs: Many of the principles of good design discussed for printed output also apply to output that is shown on work-stations or video display terminals. However, it should be noted that a visual display terminal offers less space to work with compared to most printed outputs. Moreover, the system analyst is also required to give instructions to the user on how to use the display unit.

Layout of display screen: Each display page is commonly called a screen or panel. It's lay out will ease or impede its use. Designing a layout begins with verifying the characteristics of the display screen. These include:

(i) Physical dimensions of the screen;

(ii) Number of rows and columns of data that can be displayed;

(iii) Degree of resolution (high, medium, low);

(iv) Number of colours available (for example, monochrome, three colours, eight colours etc.);

(v) Methods of highlighting (underline, bold, blinking, alternate intensities);

(vi) Methods of intensity control (high / low; normal / inverse).

Visual display screens typically have 80 columns with 24 or 25 lines. Point-of-sale display and some portable computers have smaller dimensions. Screen design begins with the recognition that the screen is composed of different areas. Layout tools assist the analyst in specifying the contents of a single or multiple design formats.

It is helpful to divide the display screens into sections that are consistently used in the same way to present information, identifications and messages to the user. In designing output screens, we need areas for (i) headings and titles, (ii) content of the display, (iii) messages and instructions and (iv) sometimes explanations for the information in the report. The headings and titles are positioned as the top portion of the screen, messages and instructions at the bottom, and explanations if needed, on the right-hand side. If only a very small amount of information is to be presented, it can be placed in the centre of the screen or in the upper left quadrant. However, it is mainly a matter of preference of the concerned system analysts.

9. (a) Some of the several program design tools are discussed below:

(i) Program flow chart: Program flow chart is among the most common program design tools that managers and users encounter when reviewing the design work of the system development project. These flow charts depict the logical steps through which a computer program must proceed when solving a problem. At one time, program flow charts were considered the premier program design tool. Although they are still widely used, sometimes it is difficult for programmers to translate a program flow chart directly into a structured code.

(ii) Pseudo code: When reviewing the work done by a program designer, users may also need to review narrative descriptions of program logic. Pseudo code, like program flow charts, also represents program logic. However, instead of using graphical symbols and flow lines, pseudo code presents program logic in English - like statements. Pseudo code is generally preferred by programmers over flowcharts because it represents program code more closely.

(iii) Structure chart: Another type of program design tool that a user may review is the program structure chart. Structure charts, which look similar to corporate organisation charts, are useful for organising problems.

(iv) 4GL Tools: The various tools described above were developed as manually applied methods for designing programs or systems. The main drawback of manually applied tools is that they take a lot of time to prepare. Also, when a program flow chart is prepared or a structure chart is drawn, the programmer is not sure if it is internally consistent. Fourth-generation languages provide a way out to remove these obstacles by automating many of these manual tasks by using 4GL tools. These tools ensure that the work done with them is consistent with the other work performed by the system team. The automation of manual task and internal consistency checks are two reasons due to which productivity gains result from using 4GL tools.

(v) Object oriented programming and design tools: These tools provide a means of enhancing programmer productivity and of reducing the application backlogs common in many organisations. Object oriented software design results in a model that describes object, classes and their relationships to one another. The object-oriented design is often taken from a data flow diagram (DFD). In fact, every input and output screen, every process and data store found in a fully decomposed DFD may be a candidate for an object in an object-oriented design. There is a wide variety of object oriented development tool kits available in the market. For example, Microsoft's Application provides an integrated object oriented program development system that includes (1) tools for creating and manipulating objects, (2) a visual programming environment for constructing object and application interfaces, and (3) a shell that supports either object oriented programming or traditional structured program.

For details to above points, please refer to study material, Chapter 9, Section 9.6.

(b) The following features of package software may be ascertained before purchasing the same:

(i) What is the package designed to do?

(ii) How developed is the software package?

(iii) How is the package organised?

(iv) Is the package operable?

(v) Can the package operate on our hardware configuration?

(vi) Can the program provide the needed reports?

(vii) Does the program have adequate capacity in terms of the number of transactions it can process, the number and length of fields per record it can process, the total file size permitted and so on?

(viii) How many processing runs on the computer are required to complete each data processing job? Some programs will perform several tasks each time they are executed. Others may perform only one task per run and hence a programme may, have to be executed several times, requiring more operator time and computer processing to complete the job.

(ix) How long does the program take to process? The efficiency of program processing varies considerably among the programs that perform the same task. Some may require much more time compared to other programs.

(x) Will the package require modifications?

(xi) Can the package be modified if necessary?

(xii) What are the overall costs?

(xiii) Is comprehensive documentation available?

(xiv) Who will maintain the package?

(xv) What are the package constraints?

(xvi) Where is the package currently used?

(xvii) What is the primary language? How many languages the package support?

(xviii) What input/output techniques are utilised?

(xix) What are the required input/output formats?

(xx) How must input be organised?

(xxi) What kind of user training is provided or required?

10. (a) The evaluation of the information system's operation pertains to whether the hardware, software and personnel are capable to perform their duties and they do actually perform them so. Operation evaluation answers such questions as:

- Are all transactions processed on time?
- Are all values computed accurately?
- Is the system easy to work with and understand?
- Is terminal response time within acceptable limits?
- Are reports processed on time?
- Is there adequate storage capacity for data?

Operation evaluation is relatively straightforward if evaluation criteria are established in advance. For example, if the systems analyst lays down the criterion that a system which is capable of supporting one hundred terminals should give response time of less than two seconds, evaluation of this aspect of system operation can be done easily after the system becomes operational.

(b) Importance of training personnel: A system can succeed or fail depending on the way it is operated and used. Therefore, the quality of training received by the personnel involved with the system in various capacities helps or hinders the successful implementation of information system. Thus, training is becoming a major component of systems implementation. When a new system is acquired which often involves new hardware and software, both users and computer professionals generally need some type of training. Often this is imparted through classes, which are organised by the vendor, and through hands-on learning techniques.

Training systems operators: Many systems depend on the computer-centre personnel who are responsible for keeping the equipment running as well as for providing the necessary support services. Their training must ensure that they are able to handle all possible operations, both routine and extra-ordinary. Operator training must also involve the data entry personnel. If the system calls for the installation of new equipment, such as a new computer systems, special terminals or data-entry equipments, the operators training should include such fundamentals as how to turn the equipment on and use it, and knowledge of what constitute normal operation and use. The operators should also be instructed in what common malfunctioning may occur, how to recognise them, and what steps to take when they arise. As part of their training, operators should be given both a trouble shooting list that identifies possible problems and remedies for them, as well as the names and telephone numbers of individuals to contact when unexpected or unusual problem arise. Training also involves familiarization with run procedures, which involve working through the sequence of activities needed to use a new system on an on-going basis.

User training: User training may involve equipment use, particularly in the case where a micro-computer is in use and the individual involved is both operator and user. In these cases, users must be instructed how to operate the equipment. User training must also instruct the individuals involved in trouble shooting of the system, determining whether the problem is caused by the equipment or software or by something they have done in using the system. Most user training deals with the operation of the system itself. Training in data coding emphasises the methods to be followed in capturing data from transactions or preparing data for decision support activities. Users should be trained on data handling activities such as editing data, formulating inquiries (finding specific records or getting responses to questions) and deleting records of data. From time to time, users will have to prepare disks, load paper into printers, or change ribbons on printers. Some training time should be devoted to such system maintenance activities. If a micro computer or data entry system uses disks, users should be instructed in formatting and testing disks.

Training is often seen as a necessary evil by managers. While recognising its importance, many mangers have to release employees from their regular job activities so that they can be trained. When managers are actively involved in determining training needs, they are usually more supportive of training efforts. It is generally wise to have managers directly involved in evaluating the effectiveness of training activities because training deficiencies can translate into reduced user productivity level.

11. (a) A typical Accounting Information System can be divided into four separate areas:

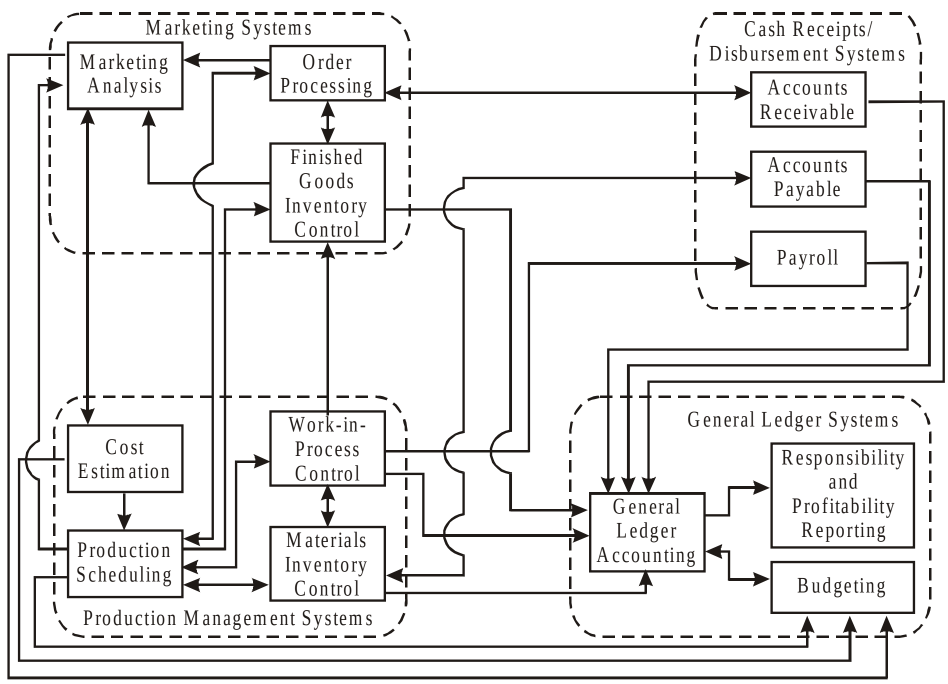
(i) The general ledger systems, which include the general ledger, budgeting, and responsibility/profitability reporting.

(ii) The cash receipts/disbursements systems, which include the accounts payable, payroll and accounts receivable systems.

(iii) The production management systems, which include the materials inventory control, work-in-process control, cost estimation, and production scheduling systems.

(iv) The marketing systems, which include finished goods inventory control, order processing, and marketing analysis systems.

The flow lines between the various systems in the figure below illustrate interfaces between these systems. The arrows on the flow lines indicate the direction of the information flow from one system to another.



(b) The flow chart drawn on the next page shows the processing of payroll. Inputs to the system consists of keyed data for time cards, batch control information and the employee master file, updated by the preliminary master payroll file update. Outputs from the system include a completed employee master file, updated by time cards information, reports and documents as discussed below:

In run # 1, the payroll edit program is executed. The first function of this program is to detect errors in the input data. If an error is detected, it is immediately printed to permit correction. If accumulated totals computed by the computer program from individual records do not balance control totals contained in the lead record, the difference is also printed. Processing is discontinued at this point so that errors can be corrected. Once this is done, the edit program is rerun to produce an error free input file. The input file produced by the payroll edit program is recorded on magnetic disk or tape.

In run # 2, the payroll transaction file is sorted by the employee number within department number.

In run # 3, the sorted transaction file is used to update the master file on magnetic disk. The type of cost code stored in master file indicates the nature of the account to which employee's gross pay is charged such as direct labour, indirect labour etc.

Gross and net pay are calculated in this run; year-to-date and current period data are accumulated and written on the payroll master file. The data necessary for printing pay slips and pay cheques for the current period are put on a magnetic disk constituting another output of this run. Payroll register is also printed during this run. Payroll register is a printed record of details in the computed employee master file.

In run #4, the current period payroll master disk is used to produce pay cheques and pay slips.

In run #5, the current period payroll disk is sorted by job number.

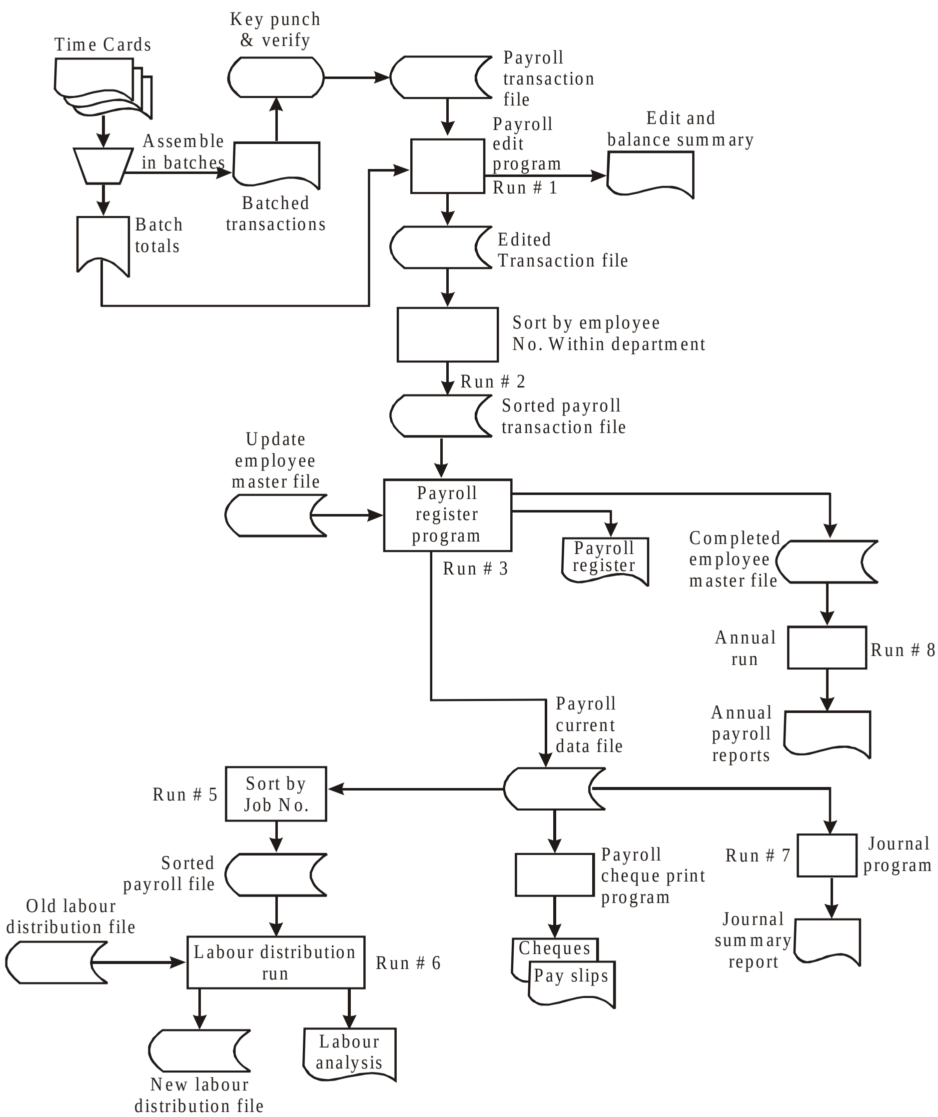
In run # 6, the output file of run # 5 is used to update the old labour distribution file.

The cumulative values of various trades as at the end of last month are updated to as at the end of this month by means of the payroll file.

The labour analysis is printed for each job as another output of this run.

In run # 7, a journal report is printed. This report is used to supply current and year–to–date entries to the general ledger, which is the final consolidated accounting document. Journal reports record total funds expended by source and by disposition. For example, total money amount for overtime and total amount for special advances etc are summarized by separate account on the general ledger. Similarly, total insurance premium deductions, provident fund deductions, staff welfare fund, income tax deduction etc. make up other accounts.

In run #8, the completed master payroll file is used to print quarterly/ annual reports. Government regulations require quarterly/ annual reports on payroll activities. Such reports include provident fund deduction statement, income-tax deductions, insurance premium deductions etc. Many other reports for internal accounting purposes may also be printed on quarterly/ yearly basis.



12. Several steps are involved in the implementation of a typical ERP package. These are:

    (i) Identifying the needs for implementing an ERP package.

    (ii) Evaluating the 'As Is' situation of the business i.e., to understand the strength and weakness prevailing under the existing circumstances.

    (iii) Deciding the 'Would be' situation for the business i.e., the changes expected after the implementation of ERP.

    (iv) Reengineering the business process to achieve the desired results in the existing processes.

    (v) Evaluating the various available ERP packages to assess suitability.

    (vi) Finalising of the most suitable ERP package for implementation.

    (vii) Installing the required hardware and networks for the selected ERP package.

    (viii) Finalising the Implementation consultants who will assist in implementation.

    (ix) Implementing the ERP package.

13. In a Treasury cash management, the company's payment transactions are grouped into cash holdings, cash inflows and cash outflows. Cash Management provides following information:

    (i) Information on the sources and uses of funds to secure liquidity to meet payment obligations when they become due.

    (ii) Monitors and Controls incoming and outgoing payment flows.

    (iii) Supplies data required for managing short-term money market investment and borrowing.

    (iv) Enables to know current cash position, short term cash management and medium and long term financial budgeting.

    (v) Enables analysis of liquidity.

    (vi) Helps in cash management decisions.

    (vii) In bank accounting, helps in electronic banking and control functions for managing and monitoring of bank accounts.

    (viii) The liquidity forecast function integrates anticipated payment flows from financial accounting, purchasing and sales to create a liquidity outlook from medium to long term.

    (ix) Covers foreign currency holdings and foreign currency items.

14. (a) Access token: If the log-on attempt is successful, the operating system creates an access token that contains key information about the users, including user ID, password, user group, and privileges granted to the user. The information in the access token is used to approve all actions attempted by the user during the session.

(b) Access control list: Access to system resources such as directories, files, programs, and printers are controlled by an access control list assigned to each resource. These lists contain information that defines the access privileges for all valid users of the resource. When a user attempts to access a resource, the system compares his or her ID and privileges contained in the access token with those contained in the access control list. If there is a match, the user is granted access.

(c) Threats to operating system integrity: Operating system control objectives are sometimes not achieved because of flaws in the operating system that are exploited either accidentally or intentionally.

Accidental threats include hardware failures that cause the operating system to crash. Operating system failures are also caused by errors in user application program that the operating system cannot interpret. Accidental system failures may cause whole segments of memory to be "dumped" to disks and printers, resulting in the unintentional disclosure of confidential information.

Intentional threats to the operating system are most commonly attempts to illegally access data or violate user privacy for financial gain. However, a growing form of threat is from destructive programs from which there is no apparent gain. These exposures come from three sources:

(i) Privileged personnel who abuse their authority. Systems administrators and systems programmers require unlimited access to the operating system to perform maintenance and to recover from system failures. Such individuals may use this authority to access users' programs and data files.

(ii) Individuals both internal and external to the organisation who browse the operating system to identify and exploit security flaws.

(iii) An individual who intentionally (or accidentally) inserts a computer virus or other form of destructive program into the operating system.

15. The controls and procedures that can be adopted to reduce threats from misuse of passwords are:

- The most common method of password control is the reusable password. The user defines the password to the system once and then reuses it to gain future access. Most operating systems set only basic standards for password acceptability.

- The user must be encouraged to use "Strong" passwords. Software's are available that automatically scans password files and notifies the security administrator when weak passwords are detected, thus assuring that only "smart" passwords are used on the system.

- The user should be educated about the use of strong passwords and the benefits of changing the passwords periodically.

- The user should be informed about possible traps that they may fall into if they reveal their login and passwords.
- The authentication system must not allow re-entry of password more than 2-3 times in case the authentication fails.

16. Systems using physical source documents to initiate transactions are vulnerable to source document fraud. Source document fraud can be used to remove assets from the organisation. For example, an individual with access to purchase orders and receiving reports could fabricate a purchase transaction to a non-existent supplier. If these documents were entered into the data processing stream, along with a fabricated vendor's invoice, the system could process these documents as if a legitimate transaction had taken place. In the absence of other compensating controls to detect this type of fraud, the system would create an account payable and subsequently write a cheque for payment. To control against this type of exposure, the organisation must implement control procedures over source documents to account for each document, as described below:

    (i) Use Prenumbered Source Documents: Source documents should come pre-numbered from the printer with a unique sequential number on each document. Source document numbers permit accurate accounting of document usage and provide an audit trail for tracing transactions through accounting records.

    (ii) Use Source Documents in Sequence: Source documents should be distributed to the users and used in sequence. This requires that adequate physical security be maintained over the source document inventory at the user site. When not in use, documents should be locked away. At all times, access to source documents should be limited to authorised persons.

    (iii) Periodically Audit Source Documents: Missing source documents should be identified by reconciling document sequence numbers. Periodically, the auditor should compare the numbers of documents used to date with those remaining in inventory plus those voided due to errors. Documents not accounted for should be reported to management.

17. (a) Data coding controls: Coding controls are checks on the integrity of data codes used in processing. A customer's account number, an inventory item number, and a chart of accounts number are all examples of data codes. Three types of errors can corrupt a data code and cause processing errors: transcription, single transposition and multiple transposition. Check digit can be used to ensure integrity of the code in subsequent processing.

    (b) Validation controls: Input validation controls are intended to detect errors in transaction data before the data are processed. Validation procedures are most effective when they are performed as close to the source of the transaction as possible. However, depending on the type of CBIS in use, input validation may occur at various points in the system. There are three levels of validation controls: field interrogation, transaction interrogation and file interrogation.

(c) Input error correction: When errors are detected in a batch they must be corrected and the records resubmitted for reprocessing. This must be a controlled process to ensure that errors are dealt with completely and correctly. There are three common error handling techniques: immediate correction; create an error file, and reject the entire batch.

For details to above points, please refer to study material, Chapter 14, Section 14.1.

18. The checks which could be performed during a validation run can be categorised as field checks and transaction checks. Various field checks have been described below:

(i) Limit check: This is a basic test for data processing accuracy and may be applied to both the input and output data. The field is checked by the program against predefined limits to ensure that no input/output error has occurred or at least no input error exceeding certain pre–established limits has occurred.

(ii) Picture check: Under this check, only certain characters are allowed in a data field. The computer can test the field to determine that no invalid characters are used.

(iii) Valid code check: If there are a limited number of valid codes, the code being read may be checked against pre–determined transaction codes, or table to ensure that it is one of the valid codes.

(iv) Check digit: It is an extra digit that is computed from the code itself and placed alongside it for subsequent checking. There are a number of check digit schemes. Module 11 check digit scheme has been empirically established as the best to detect transposition errors.

(v) Arithmetic check: Arithmetic check is performed in different ways to validate the results of other computations or the value of selected data field.

(vi) Valid combinations of fields: In addition to each of the individual fields being tested, combination of fields may be tested for validity.

(vii) Cross check: It may be employed to verify fields appearing in different files to see that the results tally.

(viii) Valid field size, sign and composition: If the code number should be specified number of digits in length, the computer may be programmed to test that the field size is as specified. If the sign of the field must always be positive or always negative, a test may be made to determine that the field does indeed contain a proper composition of characters.

Various transaction checks are given below:

(i) Sequence checks are exercised to detect any missing transactions, off–serially numbered vouchers.

(ii) Format completeness checks are used to check the presence and position of all the fields in a transaction.

(iii) Redundant data checks are employed to check the validity of codes with reference to the description.

(iv) Checks may be incorporated to ensure that transactions pertain to the correct period.

(v) Combination checks may be exercised on various fields of a file.

(vi) Passwords may be issued to check entry of data by unauthorised persons in on–line systems.

(vii) Probability checks are used to avoid unnecessary rejection of data as data can, on occasions, exceed normal values in a range due to purely random causes.

In addition to above checks, hash totals and batch totals can also be applied to ensure that all the transactions have been transcribed correctly.

19. (a) During computer processing the system might fail to detect erroneous input, improperly correct input errors, process erroneous input, or improperly distribute or disclose output. The control procedures to detect and prevent these errors and the system review and tests of control procedures which the auditor employs are given below. The purpose of these audit procedures is to gain an understanding of the controls, evaluate their adequacy, and observe operations for evidence that the controls are actually being followed:

Types of Errors and Fraud

- Failure to detect incorrect, incomplete, or unauthorised input data.
- Failure to properly correct errors flagged by data editing procedures.
- Introduction of errors into files or data bases during updating.
- Improper distribution or disclosure of computer output.
- Intentional or unintentional report inaccuracies.

Control Procedures

- Computer data editing routines.
- Proper use of internal and external file labels.
- Reconciliation of batch totals.
- Effective error correction procedures.
- Understandable operating documentation and run manuals.
- Competent supervision of computer operations.
- Effective handling of data input and output by data control personnel.

- File change listings and summaries prepared for user department review.
- Maintenance of proper environmental conditions in computer facility.

Audit Procedures: System Review

- Review administrative documentation for processing control standards.
- Review systems documentation for data editing and other processing controls.
- Review operating documentation for completeness and clarity.
- Review copies of error listings, batch total reports, and file change lists.
- Observe computer operations and data control functions.
- Discuss processing and output controls with operators and IS supervisory personnel.

Audit Procedures: Tests of Controls

- Evaluate adequacy of processing control standards and procedures.
- Evaluate adequacy and completeness of data editing controls.
- Verify adherence to processing control procedures by observing computer operations and the data control function.
- Verify that selected application system output is properly distributed.
- Reconcile a sample of batch totals, and follow up on discrepancies.
- Trace disposition of a sample of errors flagged by data edit routines to ensure proper handling.
- Verify processing accuracy for a sample of sensitive transactions.
- Verify processing accuracy for selected computer-generated transactions.
- Search for erroneous or unauthorised code via analysis of program logic.
- Check accuracy and completeness of processing controls using test data.
- Monitor on-line processing systems for using concurrent audit techniques.
- Re-create selected reports to test for accuracy and completeness.

Compensating Controls

- Strong user controls.
- Effective source data controls.

(b) Organisations must take every precaution to protect their information systems. A number of measures can significantly decrease the potential for fraud and any resulting losses.

(i) Make Fraud Less Likely to Occur: Some computer consultants claim that the most effective method of obtaining adequate system security is to rely on the integrity of company employees. At the same time, research shows that most frauds are committed by current and former employees. Thus employees are both the greatest control strength and weakness. Organisations can take steps to increase employee integrity and reduce the likelihood of employees committing a fraud.

(ii) Use Proper Hiring and Firing Practices: A manager's most important responsibilities are to hire and retain honest people. Similarly, a company should be very careful when firing employees. Dismissed employees should be removed from sensitive jobs immediately and denied access to the computer system to prevent sabotage or copying confidential data before they leave.

(iii) Manage Disgruntled Employees: Many employees who commit fraud are seeking revenge or "justice" for some wrong they perceive has been done to them. Hence companies should have procedures for identifying these individuals and either helping them resolve their feelings or removing them from jobs with system access.

(iv) Train Employees in Security and Fraud Prevention Measures: Many top executives believe that employee training and education is the most important element of any security program. Fraud is much less likely to occur in an environment where employees believe security is everyone's business.

20. (a) Some of the important terms as defined in the Information Technology Act, 2000 "computer system" means a device or collection of devices, including input and output support devices and excluding calculators which are not programmable and capable of being used in conjunction with external files, which contain computer programmes, electronic instructions, input data and output data, that performs logic, arithmetic, data storage and retrieval, communication control and other functions;

(b) "computer network" means the interconnection of one or more computers through-

(i) the use of satellite, microwave, terrestrial line or other communication media; and

(ii) terminals or a complex consisting of two or more interconnected computers whether or not the interconnection is continuously maintained;

(c) "digital signature" means authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with the provisions of section 3;

(d) “secure system” means computer hardware, software, and procedure that-

   (a) are reasonably secure from unauthorised access and misuse;

   (b) provide a reasonable level of reliability and correct operation;

   (c) are reasonably suited to performing the intended functions; and

   (d) adhere to generally accepted security procedures;

21. Suspension of digital signature certificate: Chapter VIII of the Act containing sections 35 to 39 lay down procedures relating to digital signature certification. The Certifying Authority may suspend such certificate if it is of the opinion that such a step needs to be taken in public interest.

    Such certificate shall not be suspended for a period exceeding 15 days unless the subscriber has been given an opportunity of being heard.

    Section 38 provides for the revocation of Digital Signature Certificate under certain circumstances. Such revocation shall not be done unless the subscriber has been given an opportunity of being heard in the matter. Upon revocation or suspension, the Certifying Authority shall publish the notice of suspension or revocation of a Digital Signature Certificate.

22. (a) The pre-processing technique and parallel simulation can be used by auditors to detect unauthorised program changes. The reprocessing technique uses a verified copy of the source code. On a surprise basis, the auditor uses the program to reprocess data and compare that output with the company’s data. Discrepancies in the two sets of output are investigated to ascertain their cause. Parallel simulation is similar to reprocessing except that the auditor writes a program instead of saving a verified copy of the source code. The auditor’s results are compared with the company’s, and any differences are investigated. Parallel simulation can be used to test a program during the implementation process.

    (b) Major techniques of concurrent audit of information systems are discussed below:

       (1) Integrated test facility technique: places a small set of fictitious records in the master file. Processing test transactions to update these dummy records will not affect the actual records. Because fictitious and actual records are processed together, employees remain unaware that this testing is taking place. The auditor compares processing and expected results in order to verify that the system and its controls are operating correctly.

       (2) Snapshot technique: examines the way transactions are processed; selected transactions are marked with a special code that triggers the snapshot process. Audit modules in the program record these transactions and their master file records before and after processing. Snapshot data are recorded in a special file and reviewed by the auditor.

(3) SCARF (System Control Audit File Review): uses embedded audit modules to continuously monitor transaction activity and collect data on transactions with special audit significance. The data are recorded in a SCARF file or audit log. Transactions that might be recorded in a SCARF file include those exceeding a specified rupee limit. Periodically the auditor examines the information to identify any questionable transactions.

(4) Audit hooks: These are audit routines that flag suspicious transactions, for example, an Insurance Company determined that their policy holder systems was vulnerable to fraud each time a policy holder changed his name or address and subsequently withdrew money. Internal auditors of the company devised a system of audit hooks to tag records with a name or address change whenever a policy holder changed his name or address and then subsequently withdraw funds from the policy. When audit hooks are employed, auditors can be informed of questionable transactions as soon as they occur.

(5) Continuous and intermittent simulation (CIS): This embeds an audit module in a data base management system. The CIS module examines all transactions that update the DBMS using criteria similar to those of SCARF. If a transaction has special audit significance, the module independently processes the data, records the results and compares them with DBMS results. In case of discrepancies, the details are written into an audit log for subsequent investigation.

23 (a) People are often the weakest link in securing information. Awareness of the need to protect information, training in the skills needed to operate them securely, and education in security measures and practices are of critical importance for the success of an organisation's security program.

The overriding benefits of awareness, training, and education, are in improving employee behaviour and attitudes towards information security and in increasing the ability to hold employees accountable for their actions. Raising the collective awareness level of the organisation regarding security matters can be achieved through a variety of training methods-videos, newsletters, posters, briefings, etc. To be effective, the campaign must be creative and frequently changed.

Training and communication are usually focused on security-related job skills and stimulate practices such as protecting the physical area and equipment (caring for media such as diskettes), protecting passwords, and reporting security violations. Advanced training may be needed for managers and specialised training necessary for system administrators and information systems auditors.

Education is more in-depth and typically targeted for information systems security professionals to gain expertise. It is normally achieved through external programs and should be regarded as part of career development.

(b) Information security controls are generally grouped into three types of control: Physical, Logical and Administrative. The examples of each type of control are as follows:

1. Physical: Doors, Locks, Guards, Floppy disk and magnetic disk access locks, Cables locking system to desks/walls, CCTV, Paper shredders and Fire Suppression Systems.
2. Logical (Technical): Passwords, File permissions, Access control lists, Account Privileges and Power protection Systems.
3. Administrative: Security Awareness, User Account Revocation Policy etc.

For details to above points, please refer to study material, Chapter-18, Section 18.4.

24. (a) CASE stands for 'Computer Aided Software Engineering'. CASE tools are automated software tools. CASE is the use of a computer-assisted method to organize and control the development of software, especially on large, complex projects involving many software components and people. Using CASE allows designers, code writers, testers, planners, and managers to share a common view of where a project stands at each stage of development. CASE helps ensure a disciplined, check-pointed process. A CASE tool may portray progress (or lack of it) graphically. It may also serve as a repository for or be linked to document and program libraries containing the project's business plans, design requirements, design specifications, detailed code specifications, the code units, test cases and results, and marketing and service plans.

Some of the benefits of CASE and similar approaches are that, by making the customer part of the process (through market analysis and focus groups, for example), a product is more likely to meet real-world requirements. Because the development process emphasises testing and redesign, the cost of servicing a product over its lifetime can be reduced considerably. An organised approach to development encourages code and design reuse, reducing costs and improving quality. Finally, quality products tend to improve an organisations image, providing a competitive advantage in the market.

(b) CASE originated in the 1970s when computer companies were beginning to borrow ideas from the hardware manufacturing process and applied them to software development. Some CASE tools supported the concepts of structured programming and similar organised development methods. More recently, CASE tools have had to encompass or accommodate visual programming tools and object-oriented programming. A CASE tool may be part of a spectrum of processes designed to ensure quality in what is developed. Many companies have their processes audited and certified as being in conformance with the ISO 9000 standard. Some typical CASE tools are:

- Configuration management tools
- Data modelling tools

- Model transformation tools
- Program transformation tools
- Refactoring tools
- Source code generation tools, and
- Unified Modelling Language.

25. Programming workbench is made up of a set of tools to support the process of program development tools:

    (i) Language compiler: Translates host programs to object code. As part of a translation process, an abstract syntax tree and a symbol table is created.

    (ii) Structured editor: Incorporates embedded programming language knowledge and edits the syntax representation of the program in the Abstract Syntax Tree (AST) rather than its source code text.

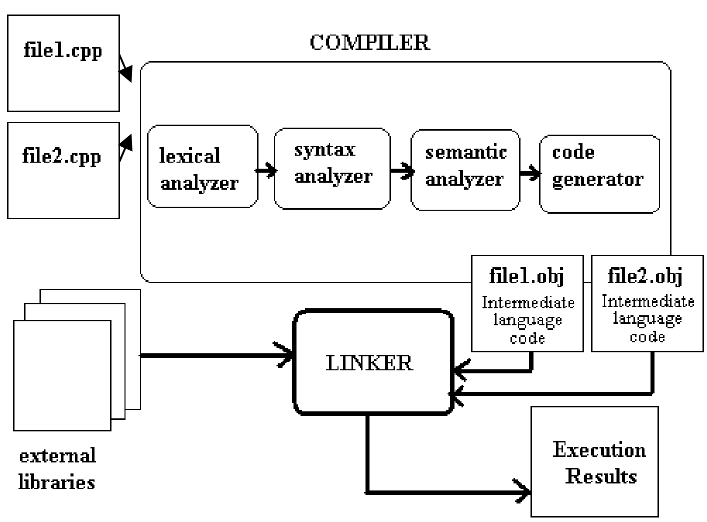
    (iii) Linker: Links the object code program with components which have already been compiled.

    (iv) Loader: Loads the executable program into the computer memory prior to execution.

    (v) Cross referencer: Produces a cross-reference listing showing where all program names are declared and used.

    (vi) Pretty printer: Scans the AST and prints the source program according to embedded formatting rules.

    (vii) Static analyzer: Analyses the source code to discover anomalies such as un-initialised variables, unreachable code etc.



The flowchart demonstrates the process of compiling two source files (file1.cpp and file2.cpp) into object files (file1.obj and file2.obj) and further execution.

(viii) Dynamic analyzer: Produces a source code listing annotated with the number of times each statement was executed when the program was run & generates information on program benches and loops and statistics of processor usage.

(ix) Interaction debugger: Allows the user to control the execution sequence and view the program state as execution processes.

PAPER – 7 : DIRECT TAXES

QUESTIONS

1. Basic Concepts

   "The illegality tainted with the income has no bearing on its taxability" – Elucidate this statement with the help of a recent case law.

2. Residential Status and Scope of total income

   "Territorial nexus is essential for taxing income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fees for technical services" – Discuss the correctness or otherwise of this statement.

3. Incomes which do not form part of total income

   Mr. Ramesh, aged 55 years, died on account of a bomb blast in a Mumbai local train. His son, Mr.Gopal, received a compensation of Rs.4 lakh from the State Government. Explain the tax treatment of the compensation received by Mr.Gopal from the State Government.

4. Charitable or religious trusts and institutions

   An institution operating for promotion of education claiming exemption under section 11 since 1993 furnishes the following data for the assessment year 2009-10.

Sl. No.	Particulars	Rs. in crores
(i)	Fees collected from students	4.5
(ii)	Expenses incurred to run the institution	2.0
(iii)	Land acquired to be used as a cricket field for the students	1.2
(iv)	Amount earmarked and set apart for construction of an arts block within the next 4 years.	1.0

   Compute the total income of the institution for the A.Y.2009-10.

5. Salaries

   Find out the taxable value of perquisite from the following particulars in case of an employee to whom the following assets held by the company were sold on 1.8.2008:

	Amount in Rs.		
	Ford Car	Computer	Furniture
Cost of Purchase (July, 2006)	9,13,000	2,05,000	42,000
Sale Price	5,20,000	46,000	21,000

The assets were put to use by the company from the day they were purchased.

6. Income from house property

Rajesh owns a house in Hyderabad. During the previous year 2008-09, 3/4th portion of the house was self-occupied and 1/4th portion was let out for residential purposes at a rent of Rs.12,000 p.m. The tenant vacated the property on February 28th, 2009. The property was vacant during March, 2009. Rent for the months of January 2009 and February 2009 could not be realised in spite of the owner's efforts. All the conditions prescribed under Rule 4 are satisfied. Municipal value of the property is Rs.4,00,000 p.a., fair rent is Rs.4,40,000 p.a. and standard rent is Rs.4,80,000. He paid municipal taxes @10% of municipal value during the year. A loan of Rs.30,00,000 was taken by him during the year 2005 for acquiring the property. Interest on loan paid during the previous year 2008-09 was Rs.1,48,000. Compute Rajesh's income from house property for the A.Y. 2009-10.

7. Profits and gains of business or profession

(a) A Ltd. paid IDBI a lump sum prepayment premium of Rs.1.2 lakh on 7.4.2008 for restructuring its debts and reducing its rate of interest. It claimed the entire sum as business expenditure for the P.Y.2008-09. The Assessing Officer, however, held that the prepayment premium should be amortised over a period of 10 years (being the tenure of the restructured loan), and thus, allowed only 10% of the pre-payment premium in the P.Y.2008-09. Discuss, with reasons, whether the contention of A Ltd. is correct or that of the Assessing Officer.

(b) Explain the tax treatment for depreciation on emergency spares (of plant and machinery) acquired during the year which, even though kept ready for use, have not actually been used during the relevant previous year.

8. Profits and gains of business or profession

The written down value of plant and machinery on 1.4.2008 of ABC Ltd. engaged in manufacturing of PVG granules is Rs.800 lakh. The company purchased additional plant and machinery for Rs.500 lakh on 1.5.2008 inclusive of one second hand machinery of Rs.350 lakh imported from Japan to increase its installed capacity of production from 2000 TPA to 3000 TPA. The new machinery was put to use from 1.11.2008. Compute the depreciation allowable in the hands of ABC Ltd. for the A.Y.2009-10.

9. Capital Gains

Mr. Ganesh sold his residential house in Mumbai and purchased two residential flats adjacent to each other on the same day vide two separate registered sale deeds from two different persons. The builder had certified that he had effected necessary modification to make it one residential apartment. Mr. Ganesh sought exemption under section 54 in respect of the investment made in purchase of the two residential flats. The Assessing Officer, however, gave exemption under section 54 to the extent of purchase of one residential flat only contending that sub-section (1) of section 54 clearly restricts the benefit of exemption to purchase of one residential house only and the two flats cannot be treated as one residential unit since –

(i) the flats were purchased through different sale deeds; and

(ii) it was found by the Inspector that, before the sale, the residential flats were in occupation of two different tenants.

Discuss the correctness of the contention of the Assessing Officer.

10. Capital Gains

Rewari Ltd. owns two industrial undertakings – one engaged in production of television sets and the other engaged in production of air-conditioners. As a restructuring drive, the company has decided to sell its undertaking producing air-conditioners as a going concern by way of slump sale for Rs.525 lakh to a new company called Adya Ltd., in which it holds 80% equity shares. The balance sheet of Rewari Ltd. as on 31st March, 2009 reads as follows:

Rs. in lakh

Particulars	Television Unit	Air-conditioner Unit
	Rs.	Rs.
Fixed Assets (Depreciable assets)	200	250
Debtors	180	150
Inventories	100	50
Liabilities	90	100
Paid up share capital	500	
General Reserve	200	
Share Premium	40	

The company set up the air-conditioner unit on 1st January, 2005. The written down value of the block of assets for tax purpose as on 31st March, 2009 is Rs.300 lakh of which Rs.120 lakh is attributable to the air-conditioner unit. Determine the tax liability which would arise to Rewari Ltd. as a consequence of the slump sale.

11. Income from other sources

Mrs. Harini Rao, who draws a salary of Rs.12,000 p.m. received the following gifts during the previous year 2008-09 -

(i) Gift of Rs.1,50,000 on 15-5-2008 from her close friend.

(ii) Gift of jewellery worth Rs.3,00,000 on 1-8-2008 from her fiancée.

(iii) Gifts of Rs.51,000 each received from her two friends on the occasion of her marriage on 30-10-2008.

(iv) Gift of Rs.51,000 on 1-11-2008 from her father's sister.

(v) Gift of Rs.21,000 from her husband's friend on 1-1-2009.

(vi) Gift of Rs.25,000 on 12-1-2009 from her family friend.

(vii) Gift of Rs.11,000 on 12-2-2009 from her brother's mother-in-law.

(viii) Gift of Rs.75,000 from her sister-in-law.

Compute her gross total income for the assessment year 2009-10.

12. Deductions from Gross Total Income

(a) Mr.Harsh, aged 42 years, furnishes the following information relating to premium on mediclaim policy paid by cheque for the year ending 31.03.2009 :

(i) for self – Rs.8,000;

(ii) for spouse, aged 35 years – Rs.8,000;

(iii) for non-dependent father, aged 70 years - Rs.21,000;

(iv) for dependent mother-in-law, aged 65 years - Rs.11,000.

Compute his eligible deduction under section 80D for A.Y.2009-10. Would your answer be different, in case the premium was paid in cash?

(b) Mr.Ravi, a Cost Accountant, derives Rs.2,12,000 as taxable professional income. Income of Mr.Ravi from other sources is Rs.21,000. He pays medical insurance premium of Rs.28,000 for insuring the health of his non-dependant parents; Rs.17,000 for self and spouse and Rs.4,000 for his sister. He incurs expenditure of Rs.25,000 on medical treatment of his dependant mentally retarded (severe disability) brother in an approved hospital duly certified. He pays rent of Rs.4,000 per month. Calculate his total income for the assessment year 2009-10.

13. Relief under section 89

In the case of Mr. Hari, you are informed that the salary for the previous year 2008-09 is Rs.6,20,000 and arrears of salary received is Rs.80,000. Further, you are given the following details relating to the earlier years to which the arrears of salary received is attributable to:

Previous year	Taxable Salary	Arrears now received (Rs.)
2000 - 2001	75,000	15,000
2001 - 2002	80,000	25,000
2002 - 2003	90,000	40,000

Compute the relief available under section 89 of the Income-tax Act and the tax payable for the A.Y. 2009-10.

Note 1: Rates of Taxes:

(a) For A.Y. 2001-02; 2002-03 & 2003-04

Upto 50,000 – Nil; 50,001 to 60,000 – 10% ;

60,001 to 1,50,000 – 20% ; above 1,50,000 –30%

(b) Surcharge

A.Y. 2001-02	-12% (if total income exceeds Rs.60,000)
	-17% (if total income exceeds Rs.1,50,000)
A.Y. 2002-03	- 2% (if total income exceeds Rs.60,000)
A.Y. 2003-04	- 5% (if total income exceeds Rs.60,000)

14. Assessment of Firms – Computation of total income of a firm

M/s. Harilal Industries, a partnership firm, submits the following profit and loss account for computation of its business income for the assessment year 2009-10.

Profit and loss account for the year ending 31.03.2009

Expenses	Rs.	Income	Rs.
To Salaries	4,23,000	By gross profit	7,35,000
" Rent	32,000	" Dividend from UTI	8,000
" Printing & Stationery	5,600		
" Telephone	3,700		
" Conveyance	21,000		
" Travelling	14,000		
" Interest	72,000		
" Depreciation	27,000		
" Legal fees	15,000		
" Auditor's fees	18,000		
" PF contribution	24,000		
" Net profit	87,700		
Total	7,43,000	Total	7,43,000

Additional information:

(i) Salaries include Rs.1,50,000 paid to working partner A and Rs.1,00,000 to working partner B.

(ii) Interest paid includes Rs.54,000, being interest paid on loan given by partner B at the rate of 18% simple interest.

(iii) Out of provident fund contribution debited to profit and loss account, Rs.10,000 is outstanding beyond the due date of filing of return.

(iv) The firm purchased goods by issuing account payee drafts except in the case of one bill for Rs.80,000 for which payment has been made by cash. This has been debited to trading account as part of purchases.

15. Fringe Benefit Tax

Discuss whether fringe benefit tax liability is attracted in respect of the following expenses -

(i) Expenditure on gifts to employee on the occasion of his marriage;

(ii) Payment of club membership fee;

(iii) Expenditure on use of telephones installed in office;

(iv) Expenditure on Group Medical Insurance;

(v) Subsidy provided to a school not meant exclusively for employees' children.

16. Assessment of Companies – Computation of Minimum Alternate Tax

ABC Ltd., engaged in diversified activities, earned a net profit of Rs.4,25,000 after debit/credit of the following items to its profit and loss account for the year ended on 31.3.2009:

(a)	Items debited to Profit and Loss Account	Rs.
	Provision for income-tax	80,000
	Interest on income-tax	4,000
	Education cess on income-tax	1,600
	Secondary and higher education cess on income-tax	800
	Dividend distribution tax	10,000
	Provision for deferred tax	7,000
	Wealth-tax	19,000
	Securities Transaction Tax	13,500
	Fringe Benefit Tax	16,000
	Transfer to General Reserve	15,000
	Provision for gratuity based on actuarial valuation	12,000
	Provision for losses of subsidiary company	14,000
	Proposed dividend	16,000
	Preference dividend	13,000
	Expenditure to earn agricultural income	5,000
	Expenditure to earn LTCG exempt under section 10(38)	4,000
	Expenditure to earn dividend income	2,000
	Depreciation (including depreciation of Rs.15,000 on revaluation)	35,000
(b)	Items credited to Profit and Loss Account	
	Amount credited to P& L A/c from Special Reserve	10,000
	Amount credited to P& L A/c from Revaluation Reserve	18,000

Agricultural income	25,000
LTCG exempt under section 10(38)	16,000
Dividend income	12,000

The company provides the following additional information:

Brought forward Business Loss/Unabsorbed Depreciation:

Assessment Year	Amount as per books	
	Loss	Depreciation
2006-07	50,000	40,000
2007-08	30,000	Nil
2008-09	10,000	25,000

You are required to examine the applicability of section 115JB of the Income-tax Act, and compute book profit and the tax credit to be carried forward, assuming that the total income computed as per the provisions of the Income-tax Act is Rs.1,20,000.

17. Assessment Procedure

(a) Explain the scheme for submission of returns through tax return preparers.

(b) In respect of a case which is pending before the Appellate Tribunal, does the Assessing Officer have the power to assess or reassess an income which is chargeable to tax and has escaped assessment? Discuss.

18. Appeals and Revision

"The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal and such period of stay can exceed one year from the date of such order, if the delay is not attributable to the assessee" – Discuss the correctness or otherwise of this statement.

19. Collection and Recovery of tax

"The scope of coverage of TDS provisions under section 194C has been widened by the Finance Act, 2008" – Discuss the correctness of this statement.

20. Penalties and Prosecution

(a) "The presence of "mens rea" is essential for imposition of penalty under section 271(1)(c)" – Discuss the correctness or otherwise of this statement with the aid of a recent Apex Court ruling.

(b) Does the Commissioner of Income-tax have power to grant immunity from penalty and prosecution in respect of a person whose case has been abated under section 245HA? If so, can such immunity granted be withdrawn? Discuss.

21. Assessment Procedure / Transfer Pricing

What is the time limit for completion of assessment/re-assessment where a reference is made to the Transfer Pricing Officer under section 92CA(1) in the following cases –

(i) for completion of assessment under section 144 for the A.Y.2009-10.

(ii) for completion of re-assessment under section 147, if notice is served under section 148 on 1.5.2008.

(iii) for completion of assessment in cases where the last of the authorizations for search under section 132 was executed during the financial year 2008-09.

22. Double Taxation Relief

Gautam, a resident both in India and Malaysia in the previous year 2008-09, owns a land, a rubber estate and a residential house at Malaysia. He has earned income of Rs.35 lakh from his rubber estate in Malaysia during the financial year 2008-09. He also sold his land in Malaysia resulting in short-term capital gain of Rs.17 lakh during the year. Gautam has no permanent establishment of business in India. However, he has derived rental income of Rs.4 lakh from property let out in Pune. He has a house in Mumbai where he stays during his visit to India. The Article 4 of the Double Taxation Avoidance Agreement between India and Malaysia provides that where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has a permanent home available to him. If he has a permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests).

You are required to state with reasons whether the business income of Gautam arising in Malaysia and the capital gains in respect of sale of land situated in Malaysia can be taxed in India.

23. Wealth-tax

Enlist the persons who are not liable to wealth-tax under the Wealth-tax Act, 1957.

24. Wealth-tax

Gamma Limited is engaged in the construction of residential flats. For the valuation date 31.3.2009, it furnishes the following data and requests you to compute the taxable wealth:

(i) Land in urban area (Construction is not permitted as per municipal laws in force) Rs.42 lakh

(ii) Motor-cars (used for running on hire by the company) Rs.12 lakh.

(iii) Jewellery (investment) Rs.25 lakh. Loan taken for purchase of the same Rs.14 lakh.

(iv) Cash balance (as per books) Rs.3 lakh.

(v) Bank balance Rs.8 lakh.

(vi) Guest House (situated in a place which is 45 kms away from the local limits of the municipality) Rs.15 lakh.

(vii) Residential flat occupied by the Managing Director Rs.12 lakh. The managing director is on whole time appointment and is drawing remuneration of Rs.1.50 lakh per month.

(viii) Residential house let out on hire for 150 days Rs.6 lakh.

The computation should be supported with proper reasoning for inclusion or exclusion.

25. Wealth-tax

State, with reasons, whether the following constitute assets chargeable to wealth tax on the valuation date 31.3.2009:

(i) Agricultural farm house situated 50 kms outside the municipal limits of Jaipur, but within 18 kms of Niwai Municipal Corporation.

(ii) Factory building and godowns leased out on rent.

(iii) Silver and gold in the jewellers shop

(iv) Cash balance of Rs.4 lakh.

SUGGESTED ANSWERS/HINTS

1. The statement is correct.

This issue came up before the Madras High Court in CIT v. K. Thangamani (2009) 309 ITR 0015. The Court observed that the income-tax authorities are not concerned about the manner or means of acquiring income, and allowing tainted income to escape the tax net would be nothing but a premium or reward to the person for doing illegal trade. The Income-tax Act treats the income earned legally as well as illegal income alike. In the event of taxing the income of only those who acquire the same through legal manner, the tendency of those who acquire income by illegal means would increase.

In this case, the assessee had collected refund from the Income-tax Department on the basis of bogus TDS certificates filed by it. The Court held that such income received by the assessee by getting refund from the Income-tax Department by fabricating TDS certificates is taxable. Therefore, even if the assessee has been prosecuted by the law enforcing authorities for commission of offence, the income earned by him would be an income liable for assessment. It would not be a defence in such cases that the State is also becoming a party to the illegal act by sharing the ill-gotten wealth.

Therefore, illegality tainted with the earning has no bearing on its taxability.

2. This statement is not correct.

The Supreme Court, in Ishikawajima-Harima Heavy Industries Ltd. v. Director of Income-tax (2007) 288 ITR 408, observed that in order to tax the income of a non-resident assessee under section 9(1)(vii), relating to fee for technical services, the income sought to be taxed must have sufficient territorial nexus with India i.e. the fees paid for technical services provided by a non-resident cannot be taxed in India unless the services were utilized in India and rendered in India. This observation is not in consonance with the source rule spelt out in the law and the stand taken by India in the bilateral treaties with different countries.

The Finance Act, 2007 has now clarified that such income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India. An Explanation has been inserted in section 9 to clarify that income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fee for technical services is to be taxed irrespective of territorial nexus.

3. Section 10(10BC) exempts any amount received or receivable as compensation by an individual or his legal heir on account of any disaster. Such compensation should be granted by the Central Government or a State Government or a local authority. However, exemption would not be available in respect of compensation for alleviating any damage or loss, which has already been allowed as deduction under the Act.

"Disaster" means a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or man made causes, or by accident or negligence. It should have the effect of causing -

(1) substantial loss of life or human suffering; or

(2) damage to, and destruction of, property; or

(3) damage to, or degradation of, environment.

It should be of such a nature or magnitude as to be beyond the coping capacity of the community of the affected area.

Therefore, the compensation received by Mr. Gopal on the death of his father in the Mumbai bomb blast, is exempt under section 10(10BC) since it is received -

(1) on account of a disaster;

(2) from the State Government; and

(3) by the legal heir.

4. Computation of total income of the institution for the A.Y. 2009-10

Particulars	Rs. in crores
Fees received	4.500
Less : Expenses incurred to earn the income	2.000
	2.500
Less : 15% (exempt even if not spent for the objects of the institution)	0.375
	2.125
Less : Accumulated for specified purpose (See Note 2)	1.000
Balance to be spent	1.125
Actual amount spent on purchase of land for cricket field (See Note 1) Rs.1.2 crores - restricted to	1.125
Total income	Nil

Notes –

1. The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Therefore, land acquired to be used as a cricket field for students amounts to capital expenditure incurred for promoting the objects of the institution.

2. Section 11(2) provides that a trust/institution can accumulate or set apart its income for a specified purpose by informing the concerned Assessing Officer. However, the period for which the funds can be accumulated cannot exceed 5 years. The amount so accumulated should be invested in the specified forms and modes. In this case, it is assumed that the institution has informed the concerned Assessing Officer and invested Rs.1 crore in the specified forms and modes.

5. Computation of taxable value of perquisite

Sl. No.	Description of asset	Value of perquisite Rs.
1.	Ford Car	64,320
2.	Computer	5,250
3.	Furniture	12,600
	Total	82,170

	Nature of Asset		
	Ford Car – 20% (WDV)	Computer – 50% (WDV)	Furniture - 10% (SLM)
Sale Price (B)	5,20,000	46,000	21,000
Cost of purchase (July, 2006)	9,13,000	2,05,000	42,000
Less : Normal wear & tear	1,82,600	1,02,500	4,200
Reduced actual cost (July 2007)	7,30,400	1,02,500	37,800
Less : Normal wear & tear	1,46,080	51,250	4,200
Reduced actual cost (July 2008) (A)	5,84,320	51,250	33,600
Taxable perquisite (A) – (B)	64,320	5,250	12,600

Note: According to Rule 3(7), the value of perquisite in respect of transfer of a movable asset shall be the difference between sale price and the actual cost as reduced by the specified rate for normal wear and tear for each completed year of usage.

6. There are two units of the house. Unit I with 3/4th area is used by Rajesh for self-occupation throughout the year and no benefit is derived from that unit, hence it will be treated as self-occupied and its annual value will be nil. Unit 2 with 1/4th area is let-out during the previous year and its annual value has to be determined as per section 23(1).

Computation of Income from house property of Mr. Rajesh for the A.Y. 2009-10

Particulars		Amount in rupees
Unit I (3/4th area – self-occupied)		
Annual Value		Nil
Less: Deduction u/s 24(b)		
3/4th of Rs.1,48,000		1,11,000
Income from Unit I (self-occupied)		-1,11,000
Unit II (1/4th area – let out)		
Computation of GAV		
Step 1 – Computation of Annual Letting Value (ALV)		
ALV = Higher of municipal valuation (MV) and fair rent (FR), but restricted to standard rent (SR). However, in this case, standard rent of Rs.1,20,000 (1/4th of Rs.4,80,000) is more than the higher of MV of Rs.1,00,000 (1/4th of Rs.4,00,000) and FR of Rs.1,10,000 (1/4th of Rs.4,40,000). Hence the higher of MV and FR is the ALV. In this case, it is the fair rent.	1,10,000	

Step 2 – Computation of actual rent received/ receivable		
12,000×9 = 1,08,000	1,08,000	
[The property was let-out for 11 months. However, rent for 2 months i.e. January and February, 2009 could not be realized. As per Explanation to section 23(1), actual rent should not include any amount of rent which is not capable of being realized. Therefore, actual rent has been computed for 9 months]		
Step 3 – GAV is the higher of ALV and actual rent received/receivable. However, as per section 23(1)(c), where the let-out property is vacant for part of the year and owing to vacancy, the actual rent is lower than the ALV, then the actual rent received would be the GAV of the property. In this case, the actual rent is lower than the ALV owing to vacancy, since had the property not been vacant in March 2009, the actual rent would have been 1,20,000 (i.e., 1,08,000 + 12,000), which is higher than the ALV of Rs.1,10,000. Therefore, in this case, section 23(1)(c) would apply and the actual rent of Rs.1,08,000 would be the GAV, since it is lower than the ALV owing to vacancy.	1,08,000	
Gross Annual Value(GAV)		1,08,000
Less: Municipal taxes paid by the owner during the previous year relating to let-out portion		
1/4th of (10% of Rs.4,00,000) = 40000/4 = 10,000		10,000
Net Annual Value(NAV) = (1,08,000-10,000)		98,000
Less: Deductions under section 24		
(a) 30% of NAV = 30% of Rs.98,000	29,400	
(b) Interest paid on borrowed capital (relating to let out portion) [1/4th of Rs.1,48,000]	37,000	66,400
Income from Unit II (let-out)		31,600
Loss under the head "Income from house property" = -1,11,000 + 31,600		-79,400

7. (a) This issue came up before the Delhi High Court in CIT v. Gujarat Guardian Ltd (2009) 177 Taxman 434. The Court observed that the assessee company's claim for deduction has to be allowed in one lump sum keeping in view the provisions of section 43B(d), which provide that any sum payable by the assessee as interest on any loan or borrowing from any financial institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the periods, in which the liability to pay such sum is incurred by the assessee according to the method of

accounting regularly followed by the assessee. The High Court concurred with the Tribunal's view supporting the assessee that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable. Since there was no dispute that prepayment premium paid was nothing but interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, in terms of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the payment has actually been made.

Therefore, applying the ratio of the above case, the contention of A Ltd. is correct and not that of the Assessing Officer.

Note – Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Section 2(28A) defines interest to include, inter alia, any other charge in respect of the moneys borrowed or debt incurred. Section 43B provides for certain deductions to be allowed only on actual payment. From a combined reading of these three sections, it can be inferred that –

(i) pre-payment premium represents interest as per section 2(28A);

(ii) such interest is deductible as business expenditure as per section 36(1)(iii);

(iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).

(b) This issue was dealt with by the Delhi High Court in CIT v. Insilco Ltd (2009) 179 Taxman 55. The Court observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

Note – One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is "kept ready for use". For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term "use" embraces both active use and passive use for business purposes.

8. Computation of allowable depreciation in the hands of ABC Ltd. for the A.Y. 2009-10

Particulars	Rs. in lakh
WDV as at 1.4.2008	800
Add : Addition during the year (put to use for less than 180 days)	500
WDV as at 31.3.2009	1300
Normal depreciation	
- On opening WDV of Rs.800 lakh @15%	120.00
- On addition of Rs.500 lakh @ 7.5% (i.e. 50% of 15%) [See Note 1]	37.50
Enhanced deprecation	
- On addition of Rs.150 lakh @ 10% (i.e. 50% of 20%) [See Note 2]	15.00
Total depreciation allowable	172.50

Notes –

(1) Normal depreciation would be restricted to 50% of the specified rate if the new asset is put to use for less than 180 days during the year.

(2) In addition to normal depreciation, enhanced depreciation @ 20% of the actual cost of new machinery or plant installed is allowable in the year in which the new machinery is first put to use. Such enhanced depreciation shall also be restricted to 10% (i.e.,50% of 20%), if the new machinery is put to use for a period of less than 180 days in the year. Further, such enhanced depreciation is not available in respect of second-hand machinery. Hence, imported second hand machinery of Rs.350 lakh is not eligible for such enhanced depreciation.

9. This issue came up recently before the Karnataka High Court in CIT v. D.Ananda Basappa (2009)309 ITR 0329. The Court observed that 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 one unit by opening the door between the apartments. Therefore, it was immaterial that the flats were occupied by two different tenants prior to sale or that it was purchased through different sale deeds. The Court observed that these were not the grounds to hold that the assessee did not have the intention to purchase the two flats as one unit. The Court held that the assessee was entitled to exemption under section 54 in respect of purchase of both the flats to form one unit.

Applying the ratio of the above decision to the case on hand, Mr. Ganesh is entitled to exemption under section 54 in respect of purchase of two flats to form one apartment. Therefore, the contention of the Assessing Officer is not correct.

10. Computation of tax liability of Rewari Ltd. consequent to slump sale

Particulars	Rs. in lakh
Sale consideration	525
Less : Net worth (as per Working Note below)	220
Long term capital gain (See Notes 1 & 2 below)	305
Income tax thereon @ 20%	61.000
Add : Surcharge @ 10%	6.100
	67.100
Add : Education cess @ 2% and secondary and higher education cess @ 1%	2.013
Tax liability as a consequence of slump sale	69.113

Working Note – Computation of net worth of the air-conditioner unit

Particulars		Rs. in lakh
Written down value of depreciable assets as per the Income-tax Act (relating to air-conditioner unit)		120
Book value of non-depreciable assets		
Debtors	150	
Inventories	50	200
Total assets		320
Less : Liabilities (value as appearing in the books of account)		100
Net worth		220

Notes -

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

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. In this case, since the undertaking was held for a period of more than 36 months, it is a long term capital asset and the capital gain on transfer of such asset would be regarded as long term capital gain.

(2) In the case of slump sale, indexation benefit is not allowed.

11. Computation of gross total income of Mrs. Harini Rao for the A.Y.2009-10

	Particulars	Rs.	Rs.
Salary			
Salary 12,000 x 12			1,44,000
Income from other sources			
(i)	Gift from close friend is taxable	1,50,000	
(ii)	Gift of jewellery is exempt as it is in kind	-	
(iii)	Gifts received from her two friends are exempt as they have been received on the occasion of her marriage	-	
(iv)	Gift from her father's sister is exempt as the donor is covered in the definition of relative	-	
(vi)	Gift from her husband's friend is taxable	21,000	
(vii)	Gift from her family friend is taxable	25,000	
(viii)	Gift from her brother's mother-in-law is taxable as the donor is not covered in the definition of relative	11,000	
(ix)	Gift from her sister-in-law (husband's sister) is exempt as the donor is covered in the definition of relative	-	
			2,07,000
Gross Total Income			3,51,000

12. (a) In the given case, Mr.Harsh has paid Rs.16,000 in aggregate towards self and spouse's mediclaim premium, deduction in respect of which shall be restricted to Rs.15,000. Mediclaim premium of Rs.21,000 paid for insuring the health of his father, who is a senior citizen, is eligible for additional deduction of up to Rs.20,000 even though his father is not dependent on him. Therefore, total deduction of Rs.35,000 [i.e., Rs.15,000 + Rs.20,000] shall be allowed to Mr. Harsh under section 80D. It may be noted that, Rs.11,000 paid for dependent mother-in-law is not allowable, since the definition of the term 'family' does not include mother-in-law. Section 80D requires payment of premium on health insurance by any mode other than cash. In case the payment is made by cash, the amount paid cannot be availed as deduction.

(b) Computation of total income of Mr. Ravi for the A.Y. 2009-10

Particulars	Rs.	Rs.
Professional income		2,12,000
Income from other sources		21,000
Gross Total Income		2,33,000
Less: Deductions under Chapter VI A		
1. Medical insurance premium paid under section 80D – (15,000 + 20,000) [See Note 1]	35,000	

2.	Expenditure for dependant mentally retarded - section 80DD [See Note 2]	75,000	
3.	Rent paid under 80GG [See Note 3]– least of the following is eligible for deduction -		
	(i) Excess of rent paid over 10% of total income (48,000 - 12,300) = 35,700		
	(ii) 25% of total income = 30,750		
	(iii) Ceiling limit Rs.2,000 p.m. = 24,000	24,000	1,34,000
	Total income		99,000

Notes -

(1) Medical insurance premium paid for self and spouse would qualify for deduction under section 80D subject to a maximum of Rs.15,000.

Mediclaim insurance premium paid for parents shall qualify for additional deduction under section 80D, subject to a maximum of Rs.20,000 (since they are senior citizens), irrespective of whether they are dependent or non-dependent on Mr. Ravi.

Medical insurance premium paid for insuring the health of sister does not qualify for deduction under section 80D, since sister does not fall within the definition of "family".

(2) Deduction under section 80DD is a flat amount of Rs.75,000, irrespective of the actual expenditure incurred in respect of a dependent, who is a person with severe disability. It is assumed that Mr.Ravi has furnished a copy of the certificate issued by the medical authority, in the prescribed form and manner, along with the return of income under section 139 in respect of A.Y.2009-10.

(3) Total income for the purpose of section 80GG would be -

Gross Total Income	2,33,000
Less : Deduction under sections 80D & 80DD	1,10,000
Total income	1,23,000

It is presumed that all the conditions for claim of deduction under section 80GG have been fulfilled by Mr. Ravi.

13. Computation of tax payable by Mr. Hari for the A.Y 2009-10

Particulars	Incl. arrears of salary	Excl. arrears of salary
Current year salary	6,20,000	6,20,000
Add: Arrears of salary	80,000	
Taxable Salary	7,00,000	6,20,000

Income-tax thereon	1,15,000	91,000
Add : Education cess @ 2% plus secondary and higher education cess @1%	3,450	2,730
Total payable	1,18,450	93,730

Computation of tax payable on arrears of salary if charged to tax in the respective assessment years

Particulars	A.Y. 2001-02		A.Y. 2002-03		A.Y. 2003-04	
	Incl. arrears	Excl. arrears	Incl. arrears	Excl. arrears	Incl. arrears	Excl. arrears
Taxable salary	75,000	75,000	80,000	80,000	90,000	90,000
Add: Arrears of salary	15,000	---	25,000	---	40,000	---
Taxable salary	90,000	75,000	1,05,000	80,000	1,30,000	90,000
Tax on the above	7,000	4,000	10,000	5,000	15,000	7,000
Add: Surcharge	840	480	200	100	750	350
Tax payable	7,840	4,480	10,200	5,100	15,750	7,350

Computation of relief under section 89

	Particulars	Rs.	Rs.
i)	Tax payable in A.Y. 2009-10 on arrears :		
	Tax on income including arrears	1,18,450	
	Less : Tax on income excluding arrears	93,730	24,720
ii)	Tax payable in respective years on arrears :		
	Tax on income including arrears (Rs.7,840+Rs.10,200+Rs.15,750)	33,790	
	Less : Tax on income excluding arrears (Rs.4,480+Rs.5,100+Rs.7,350)	16,930	16,860
	Relief under section 89 - difference between tax on arrears in A.Y 2009-10 and tax on arrears in the respective years		7,860

Tax payable for A.Y 2009-10 after relief under section 89

Particulars	Rs.
Income-tax payable on total income including arrears of salary	1,18,450
Less : Relief under section 89 as computed above	7,860
Tax payable after claiming relief	1,10,590

14. Computation of business income of M/s. Harilal Industries for the A.Y 2009-10

Particulars	Rs.	Rs.
Net Profit as per Profit & Loss Account		87,700
Add : Remuneration to partners (considered separately)		2,50,000
		3,37,700
Add: Inadmissible expenses :		
Interest [54,000 – 36,000 (calculated@12%)]	18,000	
Provident fund payment outstanding as on due date of filing of return - disallowed under section 43B	10,000	
Cash purchases [disallowed under section 40A(3)]	80,000	1,08,000
		4,45,700
Less : Amount credited but exempt		
Dividend from UTI [exempt under section 10(35)]		8,000
Book Profit		4,37,700
Less : Remuneration to partners deductible (see note below)		2,27,580
Taxable business income		2,10,120

Note - Computation of remuneration allowable as deduction as per 40(b)(v)

Particulars	Percentage allowable	Rs.
On first 75,000 of book profit	90%	67,500
On next 75,000 of book profit	60%	45,000
On the balance book profit of Rs.2,87,700	40%	1,15,080
Remuneration allowable as per 40(b)(v)		2,27,580

Since the actual remuneration of Rs.2,50,000 is more than the allowable limit of Rs.2,27,580, only Rs.2,27,580 is deductible. It is presumed that the remuneration paid is as per the terms of the partnership deed.

15. (i) Expenditure on gifts to employee on the occasion of his marriage – Yes, such expenditure is liable to FBT, whether the gift is on the occasion of marriage or otherwise.

(ii) Payment of club membership fee – Yes, since it is a fixed levy for use of some basic club facilities (like the lounge facilities).

(iii) Expenditure on use of telephones installed in office – Yes, expenditure on use of telephones installed in the office is liable to FBT, irrespective of whether the telephone is in the name of the company or not, or whether the payment for its use is made directly or indirectly by the company.

(iv) Expenditure on Group Medical Insurance – Yes, since it is for the purposes of employee welfare. However, if there is a statutory obligation, such expenditure would not be liable to FBT.

(v) Subsidy provided to a school not meant exclusively for employees' children – Yes, since the proximate purpose is promotion of employee welfare.

16. Computation of Book Profit under section 115JB

Particulars		Rs.	Rs.
Net Profit as per Profit & Loss Account			4,25,000
Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB			
Income-tax paid or payable or provision therefor			
Provision for income-tax	80,000		
Interest on income-tax	4,000		
Education cess on income-tax	1,600		
Secondary and higher education cess on income-tax	800		
Dividend distribution tax	10,000	96,400	
Provision for deferred tax		7,000	
Transfer to General Reserve		15,000	
Provision for losses of subsidiary company		14,000	
Dividend paid or proposed			
Proposed dividend	16,000		
Preference dividend	13,000	29,000	
Expenditure to earn income exempt u/s 10 [except section 10(38)]			
Expenditure to earn agricultural income [exempt u/s 10(1)]	5,000		
Expenditure to earn dividend income [exempt u/s 10(34)]	2,000	7,000	
Depreciation		35,000	2,03,400
			6,28,400
Less: Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB			
Amount credited to P& L A/c from Special Reserve		10,000	
Depreciation (excluding depreciation on account of revaluation of fixed assets) (i.e. Rs.35,000 – Rs.15,000)		20,000	
Amount credited to P& L A/c from Revaluation Reserve (to the extent of depreciation on revaluation)		15,000	
Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less taken on cumulative basis		65,000	

Income exempt u/s 10 [except section 10(38)]		
Agricultural Income [since it is exempt under section 10(1)]	25,000	
Dividend income [since it is an income exempt under section 10(34)]	12,000	1,47,000
Book Profit		4,81,400
10% of book profit		48,140
Add: Education cess @ 2%	963	
Secondary and higher education cess @ 1%	481	1,444
Tax liability under section 115JB		49,584
Total income computed as per the provisions of the Income-tax Act	1,20,000	
Tax payable @ 30%		36,000
Add: Education cess @ 2%	720	
Secondary and higher education cess @ 1%	360	1,080
Tax Payable as per the Income-tax Act		37,080

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 10% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 10% thereof plus education cess @2% and secondary and higher education cess @ 1%. Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 10% of book profit, the book profit of Rs.4,81,400 is deemed to be the total income and income-tax is payable @ 10% thereof plus education cess @2% and secondary and higher education cess @1%. The tax liability, therefore, works out to Rs.49,584.

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

Particulars	Rs.
Tax on book profit under section 115JB	49,584
Less: Tax on total income computed as per the other provisions of the Act	37,080
Tax credit to be carried forward	12,504

Notes:

1. Wealth-tax, securities transaction tax and fringe benefit tax do not form part of income-tax and hence, should not be added back to net profit for computing book profit.
2. Provision for gratuity based on actuarial valuation is a provision for meeting an ascertained liability. Therefore, it should not be added back for computing book profit.
3. Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which is credited to profit and loss account, would be deducted in arriving at the book profit. However, deduction of such long-term capital gains is not allowed for computing book profit. Consequently, expenditure to earn such income should not be added back to arrive at the book profit. Section 10(38) also provides that such long term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under section 115JB.

17. (a) Scheme for submission of returns through tax return preparers

(1) Section 139B provides that, for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income, the CBDT may notify a Scheme to provide that such persons may furnish their returns of income through a Tax Return Preparer authorised to act as such under the Scheme.

(2) The Tax Return Preparer shall assist the persons furnishing the return in a manner that will be specified in the Scheme, and shall also affix his signature on such return.

(3) A Tax Return Preparer can be an individual, other than

(i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings.

(ii) any legal practitioner who is entitled to practice in any civil court in India.

(iii) a chartered accountant.

(iv) an employee of the 'specified class or classes of persons'.

(4) The "specified class or classes of persons" for this purpose means any person other than a company or a person whose accounts are required to be audited under section 44AB (tax audit) or under any other existing law, who is required to furnish a return of income under the Act.

(5) The Scheme notified under the said section may provide for the following -

   (i) the manner in which and the period for which the Tax Return Preparers shall be authorised,

   (ii) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer,

   (iii) the code of conduct for the Tax Return Preparers,

   (iv) the duties and obligations of the Tax Return Preparers,

   (v) the circumstances under which the authorisation given to a Tax Return Preparer may be withdrawn, and

   (vi) any other relevant matter as may be specified by the Scheme.

(6) Every Scheme framed by the CBDT under this section shall be laid before each House of Parliament while it is in session to make the same effective.

(7) If both the houses decide in making any modification of Scheme, then the Scheme will have effect only in such modified form.

(8) Similarly, if both the Houses decide that any Scheme should not be framed, then such Scheme will thereafter be of no effect.

(9) However, such modification or annulment should be without prejudice to the validity of anything previously done under that scheme.

(b) The Assessing Officer can reopen a case under section 148 if he has reason to believe that any income has escaped assessment. In order to ensure that such power is used rationally and objectively by the Assessing Officers, sufficient measures have been provided in the Act. However, there have been contentions between the department and the assessees on the issue of valid reopening of assessment.

In Metro Auto Corporation v. ITO (2006) 286 ITR 618, the Bombay High Court held that reassessment was not permissible when an assessment was pending in appeal before the Tribunal. In view of such interpretation, it may not be possible to issue notice under section 148 in any case which is pending before the Appellate Tribunals or Courts. Further, by the time the Tribunal or the Court judgment is received, reopening of the case may be barred by limitation. Such a situation is not in accordance with the legislative intent.

The true legislative intent was correctly reflected in the Bombay High Court judgment in CIT v. Sakseria Cotton Mills Ltd. (1980) 124 ITR 570, where it was held that in a case where an assessment is made the subject of an appeal, only that part of the Assessing Officer's order merges with the appellate authority's order in respect of which the appellate authority has exercised the appellate jurisdiction. Hence, notice under section 148 can be issued for assessment/reassessment of income which has escaped assessment and which has not been made the subject matter of an appeal, reference or revision.

Hence, in order to clarify the true legislative intent, a second proviso has been inserted in section 147 with effect from 1.4.2008 to provide that the Assessing Officer may assess or reassess an income which is chargeable to tax and has escaped assessment other than the income involving matters which are the subject matter of any appeal, reference or revision.

18. This statement is not correct.

Section 254(2A) provides that the Appellate Tribunal, where it is possible, may hear and decide an appeal within a period of four years from the end of the financial year in which such appeal is filed. The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose of the appeal within this period of stay.

Where the appeal has not been disposed of within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed on an application made by the assessee in this behalf. However, the aggregate of period originally allowed and the period so extended should not exceed 365 days. The Appellate Tribunal is required to dispose of the appeal within this extended period.

The objective of these provisions is unambiguous that the Appellate Tribunal cannot grant stay either under the original order or under any subsequent order, beyond the period of 365 days in aggregate. However, the Bombay High Court in Narang Overseas (P.) Ltd. v. ITAT (2007) 295 ITR 22 observed that this limit would not apply where there is a delay beyond this period and the same is not attributable to the assessee. However, this decision does not reflect the true legal intention.

Therefore, section 254(2A) has been amended to clarify the correct intention. It has now been provided that the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed 365 days, even if the delay in disposing of the appeal is not attributable to the assessee. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Accordingly, even if an appeal is not heard by the bench, say, due to the bench not functioning or due to the department seeking adjournment, the stay granted by the Appellate Tribunal shall stand vacated after the period of 365 days, inspite of the assessee having taken all steps to ensure speedy disposal of the appeal and having a good prima facie case.

19. This statement is correct.

Section 194C provides for deduction of tax at source from payments to contractors and sub-contractors. Sub-section (1) of this section lists the persons who are liable to deduct tax at source from payments to a resident contractor. So far, Association of Persons and Body of Individuals were not included in this list and were therefore, not liable to deduct tax at source under section 194C(1).

The Finance Act, 2008 has now included within the scope of section 194C(1), Association of Persons and Body of Individuals, whether incorporated or not, whose total sales/gross receipts/turnover from the business or profession exceed the monetary limits specified in section 44AB during the financial year immediately preceding the financial year in which such sum is credited or paid to the account of the contractor.

Thus, such Association of Persons and Body of Individuals subject to tax audit in the immediately preceding financial year are now liable to deduct tax at source from payments to resident contractors.

20. (a) This statement is not correct.

The Apex Court, in its ruling in Dilip N. Shroff v. Joint CIT (2007) 291 ITR 519, required the presence of 'mens rea' for imposition of penalty under section 271(1)(c). "Mens rea" means a guilty mind. However, the Larger Bench of the Supreme Court, in the case of Union of India v. Dharmendra Textile Processors (2007) 295 ITR 244, observed that the conceptual and contextual difference between section 271(1)(c) and section 276C was lost sight of in Dilip B. Shroff's case. The object behind the enactment of section 271(1)(c) read with the Explanations is to provide a remedy for loss of revenue. The penalty under that provision is a civil liability. The Larger Bench held that in cases related to imposition of penalty under section 271(1)(c), willful concealment is not an essential ingredient for attracting civil liability as is the case in the matter of prosecution under section 276C. The Larger Bench, therefore, overruled the decision in Dilip N. Shroff v. Joint CIT requiring the presence of 'mens rea' in cases of penalty imposed under section 271(1)(c). Therefore, while considering an appeal against an order made under section 271(1)(c), what is required to be examined is the record which the officer imposing penalty had before him and if that record can sustain the finding that there has been concealment, that would be sufficient to sustain the penalty. Hence, there is no need for the revenue to prove that concealment was done by the assessee 'wilfully' in order to impose penalty under section 271(1)(c).

(b) Yes, the Commissioner of Income-tax has the power to grant immunity from penalty and prosecution in respect of a person whose case has been abated under section 245HA. The power to grant immunity from penalty is conferred by section 273AA and the power to grant immunity from prosecution is conferred by section 278AB.

Section 273AA empowers the Commissioner to grant immunity from penalty.

(1) The application for the immunity has to be made by the assessee (person whose case has been abated under section 245HA) to the Commissioner of Income-tax.

(2) The Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –

(i) co-operated in the proceedings after abatement; and

(ii) made a full and true disclosure of his income and the manner in which such income has been derived.

(3) The immunity granted shall stand withdrawn, if such assessee fails to comply with any condition subject to which the immunity was granted.

(4) The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, -

(i) concealed any particulars material to the assessment from the income-tax authority; or

(ii) given false evidence.

Consequently, such person would become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Section 278AB empowers the Commissioner to grant immunity from prosecution.

(1) The application for the immunity must be made by the assessee (person whose case has been abated under section 245HA) to the Commissioner of Income-tax before institution of the prosecution proceedings after abatement.

(2) The Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –

(i) co-operated in the proceedings after abatement; and

(ii) made a full and true disclosure of his income and the manner in which such income has been derived.

(3) Where the application for settlement under section 245C had been made before 1st June, 2007, the Commissioner can also grant immunity from prosecution for any offence under this Act or under the Indian Penal Code or under any other Central Act.

(4) If the assessee fails to comply with any condition subject to which the immunity was granted, the same would be withdrawn.

(5) The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, -

(i) concealed any particulars material to the assessment from the income-tax authority; or

(ii) given false evidence.

Consequently, the person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the proceedings.

21. (i) 33 months from the end of the assessment year in which the income was first assessable i.e. by 31.12.2012.

    (ii) 21 months from the end of the financial year in which notice under section 148 is served i.e. by 31.12.2010.

    (iii) 33 months from the end of the financial year in which the last of the authorizations for search under section 132 was executed i.e. by 31.12.2011.

22. According to section 5(1), a resident is chargeable to tax is respect of his global income. In this case, Gautam is a resident both in India and Malaysia.

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

    Gautam has a residential house both in Malaysia and India. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with Malaysia provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he is deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations. Gautam owns a rubber estate in Malaysia from which he derives business income. However, Gautam has no permanent establishment of his business in India. Therefore his personal and economic relations with Malaysia are closer, since Malaysia is the place where –

    (a) the property is located and

    (b) the permanent establishment (PE) has been set-up

    Therefore, he shall be deemed to be resident of Malaysia for A.Y. 2009-10.

    The facts of the case and issues arising therefrom are similar to that of CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 137 Taxman 460, where the Supreme Court held that –

    (1) If an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

(2) The treaty has application as well to capital gains derived from immovable property situated at Malaysia.

Therefore, in this case, Gautam is not liable to income-tax in India for assessment year 2009-10 in respect of business income and capital gains arising in Malaysia.

23. As per section 3 of the Wealth-tax Act, 1957, wealth-tax is leviable only on individuals, HUFs and companies. Therefore, wealth-tax is not leviable on a firm, association of persons, local authority, artificial juridical person, public charitable or religious trust other than those covered under section 21A.

Further, section 45 specifically provides that no tax shall be levied under the Wealth-tax Act in respect of the net wealth of –

(i) any company registered under section 25 of the Companies Act;

(ii) any co-operative society;

(iii) any social club;

(iv) any political party as per section 13A of the Income-tax Act;

(v) a mutual fund specified under section 10(23D) of the Income-tax Act.

24. Computation of net wealth of Gamma Ltd. as on valuation date 31.3.2009

	Particulars	Notes	Rs. in lakh
(i)	Land in urban area	1	Nil
(ii)	Motor-cars	2	Nil
(iii)	Jewellery	3	25
(iv)	Cash balance	4	Nil
(v)	Bank Balance	5	Nil
(vi)	Guest House	6	15
(vii)	Residential flat occupied by Managing Director	7	12
(viii)	Residential house let out for 150 days	8	6
			58
	Less : Debts - Loan obtained for purchase of jewellery	9	14
	Taxable wealth as on 31.03.2009		44

Notes:

(1) Land in urban area on which the construction is not permitted as per municipal laws in force does not fall within the meaning of 'asset' defined under section 2(ea) and is therefore, not taxable.

(2) Motor cars used for running on hire is not an asset as per section 2(ea) and is, therefore, not taxable.

(3) Jewellery is always taxable unless the same is held as stock-in-trade.

(4) In the case of assessees, other than individuals and HUFs, cash in hand is not taxable to the extent reflected in the books of account. In this case, since the entire cash balance of Rs.3 lakh is reflected in the books of account, it is not taxable.

(5) Bank balance is not as asset with in the meaning of 'asset' defined under section 2(ea)

(6) Guest House situated in rural area is an asset and is, therefore, taxable. Only in the case of farm house, if it is situated beyond 25 kms from the local limits of any municipality, taxability does not arise.

(7) Residential flat which is allotted by a company to an employee or an officer or a director who is in whole-time employment, having gross annual salary of less than Rs.5 lakh is not an asset within the meaning of asset defined under section 2(ea). In the given case, the residential flat is a taxable asset since it is occupied by the Managing Director whose gross annual remuneration exceeds Rs.5 lakh.

(8) Any residential property which is let out for a minimum period of 300 days in the previous year is not an asset. In the given case, the residential house is taxable since it has been let out for less than 300 days during the previous year.

(9) Debts incurred in relation to assets chargeable to tax shall be allowed as deduction in the computation of net wealth. Accordingly, loan obtained for purchase of jewellery shall be allowed as deduction since jewellery is assessable to wealth tax.

25. (i) Farm house situated within 25 kilometers from the local limits of municipality

Section 2(ea) of the Wealth-tax Act defines the term "asset". According to the said definition, buildings including farm house situated within 25 kilometers from the local limits of a municipality shall be considered as an asset. Therefore, the farmhouse situated within 18 kilometers from Niwai Municipal Corporation shall be an asset chargeable to wealth-tax.

(ii) Factory building and godowns leased out on rent

Section 2(ea) provides for exceptions to the chargeability of building or land appurtenant thereto to wealth-tax. One such exception is the property in the nature of commercial establishments or complexes. Therefore, factory buildings and godowns are not assets within the meaning of section 2(ea) of the Wealth-tax Act and are accordingly not chargeable to wealth-tax.

(iii) Silver and gold used in the jewellers' shop

Jewellery is considered as an asset within the meaning of section 2(ea) of the Wealth-tax Act. However, if jewellery is used as stock in trade, the same shall be excluded from the assets chargeable to wealth-tax. Therefore, silver and gold used in the jewellers' shop represent his stock-in-trade and would, therefore, not be chargeable to wealth-tax.

(iv) Cash balance of Rs.4 lakh

Cash in hand in excess of Rs.50,000 is considered as an "asset" under section 2(ea) for individuals and HUF. In case of other persons, any amount not recorded in the books of account shall be considered as an asset. In the given case, if the assessee is an individual or HUF, the cash balance in excess of Rs.50,000 (i.e. Rs.3.50 lakh) shall be chargeable to wealth-tax. In any other case, if the entire cash balance is accounted for in the books of account, it would not be chargeable to wealth-tax. If the cash balance is not accounted for in the books of account, the same would be chargeable to wealth-tax.

IMPORTANT CIRCULARS / NOTIFICATIONS ISSUED BETWEEN 1.5.08 and 30.4.09

I. CIRCULARS

1. Circular No. 5/2008 dated 14.7.2008

The CBDT has, vide notification S.O. No. 493(E), dated 13.3.2008, notified the categories of taxpayers who are mandatorily required to electronically pay taxes on or after 1st April, 2008. The taxpayers who are required to pay taxes by the prescribed mode are - (i) a company; and (ii) a person (other than a company), to whom the provisions of section 44AB of the Income-tax Act, 1961 are applicable. Further, payment of tax electronically has been defined to mean payment of tax by way of - (i) internet banking facility of the authorised bank or (ii) credit or debit cards.

Consequent to issue of the notification, foreign assessees have been facing difficulties in complying with the provisions with regard to mandatory e-payment of taxes. Since they do not have a presence in India, they are not able to meet the 'know your customer norms' of the banks. This has resulted in their inability to open bank accounts and make payment of taxes through the electronic mode. Also, the resident taxpayers have been facing difficulties in availing internet banking facilities of the authorized banks. A clarification has also been sought as to whether payment of tax deducted at source by a deductor will fall within the meaning of 'tax' for the purpose of the impugned notification.

Therefore, with a view to facilitating electronic payment of taxes by different categories of taxpayers, CBDT has issued Circular No.5/2008 dated 14.7.2008 to clarify that an assessee can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. It is not necessary for the assessee to make payment of taxes from his own account in an authorized bank. Further, it is also clarified that payment of any amount by a deductor by way of Tax Deducted at Source (TDS) or Tax Collected at Source (TCS) shall fall within the meaning of 'tax' for the purpose of Rule 125 of the Income-tax Rules, 1962.

2. Circular No.7/2008 dated 1.8.2008

Order under section 119(1) of the Income-tax Act, 1961 regarding exemption from the TDS provisions under section 197 read in conjunction with section 10(26BBB) of the Income-tax Act, 1961

The CBDT has, in exercise of the powers conferred under section 119(1) of the Income-tax Act, 1961, directed that corporations which are established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-servicemen and whose income qualifies for exemption from income-tax under section 10(26BBB) would also be exempt from tax deduction/collection at source on their receipts. This exemption shall be valid for 3 years from the date of issue of this order. However, this exemption shall not absolve such organisation from their statutory obligation of deducting TDS on all contractual payments made by them to other parties including sub-contractors etc.

3. Circular No.10/2008 dated 5.12.2008

Clarification regarding the meaning of the expression 'fish or fish products' used in Rule 6DD(e)(iii) of the Income-tax Rules, 1962

Under section 40A(3), disallowance is attracted in the computation of income in a case where a payment or aggregate of payments exceeding twenty thousand rupees is made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft. However, payment otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft exceeding twenty thousand rupees does not attract the aforesaid disallowance in certain circumstances as prescribed under Rule 6DD of the Income-tax Rules, 1962. Such exceptions, inter-alia, refer to payment made to the producer for the purchase of fish or fish products under sub-clause (iii) of clause (e) of rule 6DD.

In regard to this sub-clause, the following clarifications have been issued for proper implementation of Rule 6DD -

(i) The expression 'fish or fish products' used in rule 6DD(e)(iii) would include 'other marine products such as shrimp, prawn, cuttlefish, squid, crab, lobster etc.'.

(ii) The 'producers' of fish or fish products for the purpose of rule 6DD(e) would include, besides the fishermen, any headman of fishermen, who sorts the catch of fish brought by fishermen from the sea, at the sea shore itself and then sells the fish or fish products to traders, exporters etc.

However, the above exception will not be available on the payment for the purchase of fish or fish products from a person who is not proved to be a 'producer' of these goods and is only a trader, broker or any other middleman, by whatever name called.

4. Circular No.11/2008 dated 19.12.2008

Exemption under section 11 in case of an assessee claiming both to be a charitable institution as well as a mutual organisation

Section 2(15) defines charitable purpose to include the following:-

(i) Relief of the poor

(ii) Education

(iii) Medical relief, and

(iv) the advancement of any other object of general public utility.

An entity with a charitable object of the above nature was eligible for exemption from tax under section 11 or alternatively under section 10(23C) of the Act. However, it was seen that a number of entities who were engaged in commercial activities were also claiming exemption on the ground that such activities were for the advancement of objects of general public utility in terms of the fourth limb of the definition of charitable purpose. Therefore, section 2(15) was amended vide Finance Act, 2008 by adding a proviso which states that the advancement of any other object of general public utility shall not be a charitable purpose if it involves the carrying on of -

(a) any activity in the nature of trade, commerce or business; or

(b) 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 from such activity.

The following implications arise from this amendment -

(1) The newly inserted proviso to section 2(15) will not apply in respect of the first three limbs of section 2(15), i.e., relief of the poor, education or medical relief. Consequently, where the purpose of a trust or institution is relief of the poor, education or medical relief, it will constitute charitable purpose even if it incidentally involves the carrying on of commercial activities.

(2) Relief of the poor encompasses a wide range of objects for the welfare of the economically and socially disadvantaged or needy. It will, therefore, include within its ambit purposes such as relief to destitute, orphans or the handicapped, disadvantaged women or children, small and marginal farmers, indigent artisans or senior citizens in need of aid. Entities who have these objects will continue to be eligible for exemption even if they incidentally carry on a commercial activity, subject, however, to the conditions stipulated under section 11(4A) or the seventh proviso to section 10(23C) which are that -

    (i) the business should be incidental to the attainment of the objectives of the entity, and

    (ii) separate books of account should be maintained in respect of such business.

    Similarly, entities whose object is education or medical relief would also continue to be eligible for exemption as charitable institutions even if they incidentally carry on a commercial activity subject to the conditions mentioned above.

The newly inserted proviso to section 2(15) will apply only to entities whose purpose is advancement of any other object of general public utility i.e. the fourth limb of the definition of charitable purpose contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C) of the Act if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

There are industry and trade associations who claim exemption from tax u/s 11 on the ground that their objects are for charitable purpose as these are covered under any other object of general public utility. Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants.

Therefore, where industry or trade associations claim both to be charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) owing to the principle of mutuality. However, if such organizations have dealings with non-members, their claim to be charitable organizations would now be governed by the additional conditions stipulated in the proviso to section 2(15).

In the final analysis, however, whether the assessee has for its object the advancement of any other object of general public utility is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, the object of general public utility will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible.

II NOTIFICATIONS

1. Notification No. 86/2008 dated 13.8.2008

The Central Government has, vide notification no.86/2008 dated 13.8.2008, specified the cost inflation index for the financial year 2008-09. The CII for F.Y. 2008-09 is 582.

S. No.	Financial Year	Cost Inflation Index
1.	1981-82	100
2.	1982-83	109
3.	1983-84	116
4.	1984-85	125

5.	1985-86	133
6.	1986-87	140
7.	1987-88	150
8.	1988-89	161
9.	1989-90	172
10.	1990-91	182
11.	1991-92	199
12.	1992-93	223
13.	1993-94	244
14.	1994-95	259
15.	1995-96	281
16.	1996-97	305
17.	1997-98	331
18.	1998-99	351
19.	1999-2000	389
20.	2000-01	406
21.	2001-02	426
22.	2002-03	447
23.	2003-04	463
24.	2004-05	480
25.	2005-06	497
26.	2006-07	519
27.	2007-08	551
28.	2008-09	582

2. Notification No. 88/2008/F.NO. 275/43/2008-IT(B), dated 21.8.2008

The CBDT has, in exercise of the powers conferred by clause (a) of the Explanation to section 194J, notified the services rendered by following persons in relation to the sports activities as Professional Services for the purpose of the section 194J:

a. Sports Persons,

b. Umpires and Referees,

c. Coaches and Trainers,

d. Team Physicians and Physiotherapists,

e. Event Managers,

f. Commentators,

g. Anchors and

h. Sports Columnists.

3. Notification No. 90/2008, dated 28.8.2008

Section 90A(1) provides that an agreement may be entered into by any specified association in India with any specified association in the specified territory outside India which may be adopted by the Central Government by way of notification in the Official Gazette, for granting relief of tax or, as the case may be, for avoidance of double taxation. The Central Government has now notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

4. Notification No. 91/2008, dated 28.8.2008

Section 90(1) provides that the Central Government may enter into an agreement with the Government of any country outside India for granting relief of tax or, as the case may be, for avoidance of double taxation. The Central Government has now notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

5. Notification No.97/2008 dated 10.10.2008

Rule 6DD of the Income-tax Rules has been substituted. This Rule now provides for cases and circumstances in which a payment or aggregate of payments exceeding twenty thousand rupees may be made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft.

As per this rule, no disallowance under sub-section (3) of section 40A shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3A) of section 40A where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees in the cases and circumstances specified hereunder, namely:

(a) where the payment is made to -

(i) the Reserve Bank of India or any banking company;

(ii) the State Bank of India or any subsidiary bank;

(iii) any co-operative bank or land mortgage bank;

(iv) any primary agricultural credit society or any primary credit society;

(v) the Life Insurance Corporation of India;

(b) where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender;

(c) where the payment is made by -

(i) any letter of credit arrangements through a bank;

(ii) a mail or telegraphic transfer through a bank;

(iii) a book adjustment from any account in a bank to any other account in that or any other bank;

(iv) a bill of exchange made payable only to a bank;

(v) the use of electronic clearing system through a bank account;

(vi) a credit card;

(vii) a debit card.

(d) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;

(e) where the payment is made for the purchase of -

(i) agricultural or forest produce; or

(ii) the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or

(iii) fish or fish products; or

(iv) the products of horticulture or apiculture,

to the cultivator, grower or producer of such articles, produce or products;

(f) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;

(g) where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;

(h) where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed fifty thousand rupees;

(i) where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of section 192 of the Act, and when such employee -

  (i) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship; and

  (ii) does not maintain any account in any bank at such place or ship;

(j) where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;

(k) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;

(l) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

6. Notification No.1/2009 dated 5.1.2009

The Finance Act, 2008 had amended section 115WB(2)(B)(iii) to provide that any expenditure on or payment through pre-paid electronic meal card shall be excluded from hospitality expenditure and hence, would not be included for valuation of fringe benefit chargeable to tax, provided such card is not transferable and usable only at eating joints or outlets and fulfills such other prescribed conditions.

Rule 40E has now been inserted to provide that, for the purposes of section 115WB(2)(B)(iii), the non-transferable pre-paid electronic meal card has to fulfil the following conditions, namely:

(i) The card should be granted by the employer to its employees under a scheme framed by the employer specifying therein the circumstances under which the meal card can be used by the employee.

(ii) Such card should be issued by the issuing bank i.e. a banking company which issues the card to the employees of an employer in pursuance of an agreement entered into with the employer and which has entered into a contract with the member establishment authorizing him to allow purchases against the said card.

(iii) An employee should not be issued more than one card.

(iv) The card should bear the name of the employer along with the name, photograph and signature of the employee to whom the card is issued.

(v) The card should be used only by the employee to whom the card is issued.

(vi) The card should be used by the employee only for the purpose of purchasing ready to eat food or non-alcoholic beverage from a member establishment.

(vii) The aggregate amount of ready to eat food or non-alcoholic beverage purchased during a day by an employee should not exceed one hundred rupees.

(viii) The details of each transaction of purchase made by the employee against the card should be maintained by the employer and the member establishment in such manner and for such period as is required under the Act for any other similar transaction. "Member establishment" means a restaurant, hotel, canteen or an outlet which sells ready to eat food or non-alcoholic beverage, but should not include a restaurant, hotel, canteen or an outlet selling alcoholic beverage.

7. Notification No. 3/2009 dated 5.1.2009

Clause (xv) of section 80C(2) provides that the subscription to any such deposit scheme of the National Housing Bank as the Central Government may notify in this behalf would qualify for deduction under section 80C. Accordingly, in exercise of the powers conferred in section 80C(2)(xv), the Central Government has specified the National Housing Bank (Tax Saving) Term Deposit Scheme, 2008, the subscription to which would qualify for deduction under section 80C.

8. Notification No. 9/2009 dated 7.1.2009

Section 10(15)(iv)(h) exempts interest payable by any public sector company in respect of such bonds or debentures specified by the Central Government by notification in the Official Gazette. The notification would also specify the conditions subject to which the exemption would be available. Accordingly, in exercise of the powers conferred in section 10(15)(iv)(h), the Central Government has specified the issue of tax free bonds by India Infrastructure Finance Company Limited during the financial year 2008-09, the interest on which would be exempt under the said section. Further, it has been provided that such benefit shall be admissible only if the holder of such bonds registers his or her name and the holding with the said Corporation.

9. Notification No.15/2009, dated 30.1.2009

Rule 8C of the Wealth-tax Rules, 1957 has been substituted. New Rule 8C provides for the following scale of fees to be charged by a registered valuer.

(1) The fees to be charged by a registered valuer for valuation of any asset should not exceed the amount calculated at the following rates, namely:

(a) On the first Rs.5 lakh of the asset as valued	1/2 per cent of the value;
(b) On the next Rs.10 lakh of the asset as valued	1/5 per cent of the value;
(c) On the next Rs.40 lakh of the asset as valued	1/10 per cent of the value;
(d) On the balance of the asset as valued	1/20 per cent of the value.

(2) Where two or more assets are required to be valued by a registered valuer at the instance of an assessee all such assets shall be deemed to constitute a single asset for the purposes of calculating the fees payable to such registered valuer.

(3) However, where the amount of fees calculated in accordance with (1) and (2) above is less than Rs.500, the registered valuer may charge Rs.500 as his fees.

10. Notification No. 28/2009, dated 16.3.2009

Rule 37BA providing for credit for tax deducted at source for the purposes of section 199 and Rule 37-I providing for credit for tax collected at source for the purposes of section 206C(4) have been inserted with effect from 1.4.2009.

Rule 37BA provides for credit for tax deducted at source for the purposes of section 199.

Sub-rule (1) provides that credit for tax deducted at source and paid to the Central Government in accordance with the provisions of Chapter XVII, shall be given to the person to whom payment has been made or credit has been given (i.e., the deductee) on the basis of information relating to deduction of tax furnished by the deductor to the income-tax authority or the person authorised by such authority.

Sub-rule (2) provides that if the income on which tax has been deducted at source is assessable in the hands of a person other than the deductee, credit for tax deducted at source shall be given to the other person in cases where-

(a) the income of the deductee is included in the total income of another person under the provisions of section 60, section 61, section 64, section 93 or section 94;

(b) the income of a deductee being an association of persons or a trust is assessable in the hands of members of the association of persons, or in the hands of trustees, as the case may be;

(c) the income from an asset held in the name of a deductee, being a partner of a firm or a karta of a Hindu undivided family, is assessable as the income of the firm, or Hindu undivided family, as the case may be;

(d) the income from a property, deposit, security, unit or share held in the name of a deductee is owned jointly by the deductee and other persons and the income is assessable in their hands in the same proportion as their ownership of the asset:

However, in such cases, the deductee should file a declaration with the deductor. Such declaration filed by the deductee should contain the name, address, permanent account number of the person to whom credit is to be given, payment or credit in relation to which credit is to be given and reasons for giving credit to such person.

Also, the deductor should report the tax deduction in the name of the other person in the information relating to deduction of tax referred to in sub-rule (1). The deductor should issue the certificate for deduction of tax at source in the name of the person in whose name credit is shown in the information relating to deduction of tax referred to in sub-rule (1) and should keep the declaration in his safe custody.

Sub-rule (3) provides that the credit for tax deducted at source and paid to the Central Government, shall be given for the assessment year for which such income is assessable. Where tax has been deducted at source and paid to the Central Government and the income is assessable over a number of years, credit for tax deducted at source shall be allowed across those years in the same proportion in which the income is assessable to tax.

Sub-rule (4) provides that credit for tax deducted at source and paid to the account of the Central Government shall be granted on the basis of -

(i) the information relating to deduction of tax furnished by the deductor to the income-tax authority or the person authorized by such authority; and

(ii) the information in the return of income in respect of the claim for the credit,

subject to verification in accordance with the risk management strategy formulated by the Board from time to time.

Rule 37-I provides for credit for tax collected a source for the purposes of section 206C(4).

Sub-rule (1) provides that the credit for tax collected at source and paid to the Central Government in accordance with provisions of section 260C, shall be given to the person from whom the tax has been collected, on the basis of the information relating to collection of tax at source furnished by the collector to the income-tax authority or the person authorized by such authority.

Sub-rule (2) provides that where tax has been collected at source and paid to the Central Government, credit for such tax shall be given for the assessment year for which the income is assessable to tax. Where tax has been collected at source and paid to the Central Government and the lease or license is relatable to more than one year, credit for tax collected at source shall be allowed across those years to which the lease or license relates in the same proportion.

Sub-rule (3) provides that the credit for tax collected at source and paid to the account of the Central Government shall be granted on the basis of -

(i) the information relating to collection of tax furnished by the collector to the income-tax authority or the person authorized by such authority; and

(ii) the information in the return of income in respect of the claim for the credit,

subject to verification in accordance with the risk management strategy formulated by the Board from time to time.

11. Notification No. 37/2009 dated 21.4.2009

The CBDT has, through Notification No.10/2009 dated 19.1.09, notified the Income-tax (Third Amendment) Rules, 2009 which came into force from 1.4.2009. This notification had inserted “new commercial vehicles acquired on or after 1.1.2009 but before 1.4.2009 and put to use before 1.4.2009 for the purposes of business or profession” under the head MACHINERY AND PLANT, which would be eligible for depreciation at the rate of 50%.

Subsequently, the CBDT has, through this notification notified that the benefit of increased depreciation of 50% on commercial vehicles be extended to such vehicles acquired and put to use before 1st October 2009. Therefore, the commercial vehicles acquired on or after 1.1.2009 but before 1.10.2009 and put to use before 1.10.2009 will be eligible for depreciation at the rate of 50%.

PAPER - 8 : INDIRECT TAXES

QUESTIONS

EXCISE

Manufacture

1. Parsavnath Furnishers Limited (PFL) is engaged in procuring the duty paid Office Furniture System/Work Stations (OFS/WS) from the suppliers and erecting and installing them at site of customers, from whom it has procured the orders. After receiving the orders from its clients, a team of engineers prepares a lay out on computer aided design system where ready-made furniture systems and work stations manufactured by independent manufactures/suppliers are superimposed. Thereafter, based on the clients' specifications, orders are placed upon the manufacturer of the furniture for each works station. After procuring the various elements of furniture system from the manufacturer, they join the same together according to the site drawing and the project code.

   The assessee contends that that they are only marketing OFS/WS. However, the Revenue alleges that PFL is liable to pay duty as the said activity amounts to manufacture.

   Examine, with reference to a decided case law, if any, whether the Revenue's allegation is tenable in law?

Power of arrest under excise

2. Briefly explain the power of arrest under section 13 and section 18 of the Central Excise Act, 1944.

Appeal

3. The CESTAT passed its order on 01.01.2008. The assessee filed the application for rectification of a mistake apparent from the record in the said order on 23.05.2008. However, the Tribunal could not dispose of the application till 30.06.2008. Thereafter, the Tribunal rejected the application on the ground that the six months period had lapsed.

   Do you think that the stand taken by the Tribunal is valid in law?

Settlement Commission

4. Sonata Steel Industries (SSI) manufactures 'kitchen sink' and classifies it as 'sanitary ware'. However, the Revenue insists that the said product should be classified under the heading 'household article of iron and steel'. SSI approaches you for the professional advice asking whether it can take the issue before the Settlement Commission. You are required to provide them the required advice.

Advance Ruling

5. Can a writ petition be invoked against advance rulings?

SSI

6. Cupurus Coporations - a small scale unit - has affected clearances of goods of the value of Rs. 900 lakh during the financial year 2008-09. The said clearances include the following:

   (i) Clearance of excisable goods without payment of excise duty to a 100% EOU : Rs. 250 lakh

   (ii) Export to Nepal and Bhutan : Rs. 125 lakh

   (iii) Job work under exemption Notification No. 214/86 C.E.: Rs. 270 lakh

   (iv) Goods manufactured in rural area with the brand name of others: Rs. 120 lakh

   Examine, whether the benefit of exemption under the Notification No. 8/2003 dated 01.03.2003 would be available to the unit for the financial year 2009-10.

Refund

7. What is a Consumer Welfare Fund? How is this fund utilized?

Classification under central excise

8. When entries in Harmonized System of Nomenclature (HSN) and the Excise Tariff are not aligned, can reliance be placed upon HSN for the purpose of classification of goods?

Appeal

9. An appeal filed under section 35(2) of the Central Excise Act, 1944 by the Committee of Commissioners themselves and not by subordinate officer based on authorization is not maintainable. Examine, with the help of a decided case law, if any, the validity of the statement.

Central Excise Rules, 2002

10. Can goods lost by ‘theft’ or ‘dacoity’ be considered to be “goods lost or destroyed by natural causes or by unavoidable accident” under rule 21 of the Central Excise Rules, 2002?

Valuation

11. Dodo Foods is engaged in manufacturing Dodo soft drinks. Valuation of the soft drinks is done as per section 4A of the Central Excise Act, 1944. In order to sustain the tough market competition, the company reduced its prices from Rs. 12 to Rs. 10. Hence, on the existing stock of the soft drink bottle, MRP of Rs. 12 is scored out and MRP of Rs. 10 is printed. However, the crossed out MRP of Rs. 12 is clearly visible. Which MRP shall be considered for valuation purposes?

CENVAT Credit Rules, 2004

12. Triveni Texturisers purchased inputs from Khaitani Industries and availed the CENVAT credit of the entire excise duty paid by Khaitani Industries as reflected in the invoice. Subsequently, Khaitani Industries gave certain amount of discount for the reason of the

bulk purchases made by Triveni Texturisers during the period. This trade discount was given by issuing credit notes for the basic price. Department contends that Triveni Texturisers is not entitled to the CENVAT credit on the entire duty paid on the price initially invoiced and should reverse the credit proportionately.

Discuss whether the contention of the Revenue is justifiable.

Removal of goods from 100% EOU to Domestic Tariff Area

13. Briefly explain the procedure for removal of goods from a hundred percent export oriented unit to the domestic tariff area.

CUSTOMS

Section 121 of the Customs Act, 1962

14. Whether custom authorities are authorized to auction the confiscated goods during the period of pendency of appeal?

Valuation

15. Gulf Corporation Limited imported some goods from USA. The details of the transaction are as follows:-

Authority	Rate of exchange
CBEC	1 US $=Rs 45
RBI	1 US $=Rs 46.10

CIF value of the goods is $ 20,000

Rate of basic custom duty is 40%

Rate of education cess is 3%

If similar goods were manufactured in India, excise duty payable as per Tariff is 8%.

Calculate assessable value and total duty payable thereon.

Warehousing

16. Explain 'Warehousing without warehousing' under the Customs Act, 1962.

Appeal

17. Can there be a difference in the final order issued by Tribunal and the handwritten order in the order sheet?

Section 2 of the Customs Act, 1962

18. Define briefly, the following with reference to section 2 of the Customs Act, 1962:-

    (a) Importer

    (b) Person-in-charge

(c) Foreign going vessel

(d) Adjudicating authority

Confiscation of conveyances

19. Illustrate the conveyances which are liable to confiscation under section 115 of the Customs Act, 1962.

Baggage Rules, 1998

20. Answer the following question with reference to the Baggage Rules, 1998:-

    Amarnath, an IT professional and a person of Indian origin, is residing in Denmark for the last 14 months. He wishes to bring a used microwave oven (costing approximately Rs. 4,200 and weighing 15 kg) with him during his visit to India. He purchased the oven in Denmark 6 months back and he has been using that oven for his personal use in his kitchen. He is not aware of Indian customs rules. Could you please provide him some advice in this regard?

SERVICE TAX

Taxable services

21. Discuss, with the help of a decided case law, if any, whether the explanation inserted by Finance Act, 2008 to the definition of 'business auxiliary service' under section 65(19)(ii) of the Finance Act, 1994 as amended can be construed having retrospective effect and retroactive operation.

Credit of input services

22. M/s Ojha Cements Limited (OCL) was engaged in the business of manufacturing and selling of cement and had been duly paying the excise duty in respect of cement produced by it. OCL supplied cement to its customers "FOR destination" and bore the freight up to the door steps of the customer i.e. the destination point. The assessee had taken the CENVAT credit of the service tax paid on the aforementioned freight by it.

    The Department contended that the payment of service tax on the freight incurred by the assessee was not input service as per rule 2(l) of the CENVAT Credit Rules, 2004 and hence the CENVAT credit was not admissible on it under the said rules.

    Explain, with the help of a decided case law, if any, whether the stand taken by Department is tenable in law.

Refund of the service tax

23. Answer the following questions, with reference to the Notification No. 41/2007 dated 06.10.2007 as amended:-

    (a) What is the time limit for filing the refund claim?

    (b) Whether the limitation period for filing the refund claim would be counted from the date of exports or from the date of receipt of remittances?

(c) Whether refund would be admissible on specified taxable service received prior to the date it is notified in the said notification, if such services are used in relation to goods which are exported subsequent to the date on which such taxable services are notified under Notification No. 41/2007-ST?

Filing of return

24. Briefly answer the following questions:-

    (a) Is filing of return compulsory even if no taxable service is provided or received or no payments are received during a period (a particular half year)?

    (b) Whether a single return is sufficient when an assessee provides more than one service?

    (c) What are the returns a service tax assessee has to file?

Penal provisions

25. Briefly discuss the residual penalty under section 77 of the Finance Act, 1994 as amended.

SUGGESTED ANSWERS/HINTS

1. The facts of the given case are similar to the case of CCE v. Blow Plast Ltd. 2009 (236) E.L.T. 631 (Del.). The Tribunal arrived at the conclusion that since the supplier had cleared the complete set of elements required for the work station in a knocked down condition, it could not be said that the supplier had manufactured the parts and not the complete system.

   The High Court while affirming the Tribunal's order held that the same product as known to the trade could not be manufactured twice over. Consequently, nothing new had come into existence so as to bring the activities of the assessee within the parameters specified in section 2(f) of the Central Excise Act, 1944. What the assessee received was complete OFS/WS and what it left on its clients' sites was also complete OFS/WS. Nothing new had come into existence. Hence, no duty was payable by the assessee.

   Therefore, it can be inferred that the Revenue's allegation is not tenable in law

2. Section 13 and section 18 of the Central Excise Act, 1944 contain the provisions relating to arrest under Central Excise Act.

   Any Central Excise Officer not below the rank of Inspector can arrest any person whom he has a reason to believe to be liable to punishment under the Central Excise Act, 1944. Such an arrest can be only with the prior approval of Commissioner of Central Excise.

   The arrested person must be produced before the Magistrate within twenty four hours of the arrest. Normally, the Magistrate exercises the power to grant bail.

   As per section 18, all arrests shall be carried out in accordance with the provisions of the Code of Criminal Procedure relating to arrest.

3. In case of Sree Ayyangar SPG & WVG Mills Ltd. v. CIT 2008 (229) ELT 164 (SC), the Supreme Court while interpreting section 254(2) of the Income Tax Act, 1961 held that once the assessee had moved the application within four years from the date of order, the Tribunal could not reject that application on the ground that four years had lapsed, which included the period of pendancy of the application before the Tribunal. Therefore, it concluded that if the assessee had moved the application within four years from the date of the order, the Tribunal was bound to decide the application on the merits and not on the ground of limitation.

   Applying the ratio of the aforementioned case in the given situation, it can be inferred that limitation period for filing rectification of mistake is not the time limit for deciding the rectification of mistake under section 35C(2) of the Central Excise Act, 1944. Hence, in the instant case, the Tribunal is not justified in rejecting the application on the ground that the six months period has lapsed as the application had been filed before the expiry of six months.

4. As per section 32E of the Central Excise Act, 1944, an application cannot be made in Settlement Commission for interpretation of classification of goods. Since, this case relates to interpretation of classification of goods, hence, application shall not be admitted by the Settlement Commission.

5. Recently, the Delhi High Court, in case of UAE Exchange Centre Ltd. v. UOI 2009 (236) E.L.T. 223 (Del.), has held that the ruling by Advance Rulings Authority is binding on the applicant, transaction on which the ruling is sought and the departmental officers concerned. It does not exclude the jurisdiction of the Courts either expressly or by implication. There is no provision which gives finality to the decision of the Authority. The High Court viewed that the Courts would have jurisdiction to entertain actions under Article 226 of the Constitution (writ petition) impugning the ruling given by the Authority. Therefore, a writ petition can be invoked against advance rulings.

6. Cupurus Coporations will be eligible for benefit of exemption under Notification No. 8/2003 dated 01.03.2003 only if value of clearances during preceeding financial year - 2008-09 does not exceed 400 lakhs.

   Calculation of value of clearances during the financial year 2008-09:-

Particulars	Rs.
Total value of clearances	900 lakhs
Less : Clearance to 100% EOU (Note – 1)	250 lakhs
Less: Clearance under exemption Notification No. 214/86 (Note - 2)	270 lakhs
Total value of clearances	380 lakhs

   Since, the value of clearances for home consumption in financial year 2008-09 didn't exceed Rs. 400 lakh, the benefit of exemption shall be available during financial year 2009-10.

Notes : For the purpose of computing the limit of 400 lakh:-

1. clearances to 100 % EOU shall be excluded as these clearances are otherwise exempt also,
2. clearance under exemption Notification No. 214 / 86 shall be excluded,
3. export to Nepal & Bhutan shall be treated clearance for home consumption and hence not excluded,
4. goods bearing the brand name of others are excluded but if produced in rural area then it qualifies for exemption and hence not excluded.

7. Meaning of Consumer Welfare Fund:-

The Consumer Welfare Fund has been established by the Central Government under the provisions of section 12C of the Central Excise Act, 1944 wherein the following amounts are credited:-

(i) the refund of duty of excise/customs, which is not to be granted to the applicant,

(ii) 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, and

(iii) surplus amount of service tax referred to in section 73A(6) of the Finance Act, 1994 as amended.

Utilization of funds:-

Section 12D of the Central Excise Act, 1944 provides that:-

(1) any money credited to the fund shall be utilized by the Central Government for the welfare of the consumers in accordance with such rules framed in this behalf.

(2) The Central Government shall maintain or, if it thinks fit, specify the authority, which shall maintain, proper and separate account and other relevant records in relation to the Fund in such form as may be prescribed in consultation with the Comptroller and Auditor General of India.

8. The Supreme Court in case of Camlin Ltd. v. CCEx., Mumbai 2008 (230) E.L.T. 193 (SC) has held that when the entries in the Harmonised System of Nomenclature (HSN) and the Excise Tariff are not aligned, reliance cannot be placed upon HSN for the purpose of classification of goods under the said Tariff. It further added that in the instant case, the Tribunal erred in relying upon the HSN for the purpose of classification of the impugned product. The Tribunal failed to appreciate that since the entries under the HSN and the entries under the said Tariff are completely different, the Tribunal could not base its decision on the entries in the HSN.

9. The statement is not valid. The Gujarat High court, in case of Commr. Of C.Ex. & Cus. v. Shree Ganesh Dyeing & Ptng. Works 2008 (232) ELT 775 (Guj.), has decided the issue as to whether the appeal filed by Commissioner himself and not by subordinate officer based on authorization, is maintainable. In the instant case, the assessee raised a preliminary objection as to maintainability of the appeal on the ground that the appeal

had been filed by Commissioner himself, instead of by the Central Excise Officer authorised by the Commissioner, as required by section 35B(2) of the Central Excise Act, 1944.

The Court, while analyzing section 35B(2) of the Central Excise Act, 1944, held that section 35B(2) is made up of two parts or two stages. The first stage is formation of an opinion by Commissioner that the order made by the appellate authority is not legal or proper. The second stage is filing of an appeal against order of appellate authority by directing any Central Excise Officer authorised by the Commissioner in this behalf to file an appeal on behalf of the Commissioner. Thus, the Commissioner is vested with a discretion, in the first instance to form an opinion as to whether appellate order is legal or proper and then exercise the discretion to decide whether an appeal should be preferred or not, having come to the conclusion that the order is not proper or legal.

The High Court further clarified that when a person is statutorily entitled to delegate powers to another person to file an appeal on behalf of the first named person, it goes without saying that the power which can be delegated is the power which the first named person would be entitled to exercise. Hence, until and unless the Commissioner himself is entitled to file an appeal, there is no question of the Commissioner authorising another officer to file appeal on behalf of the Commissioner. The language of the latter part of sub-section (2) of section 35B of the Act itself makes this more than abundantly clear when the provision uses the phrase 'to appeal on his behalf'.

Therefore, if an appeal has been preferred by Commissioner or the authorised officer, the appeal would be valid and shall be treated to be a valid appeal in eyes of law.

Note : Section 35B(2) was amended vide the Finance Act, 2005 to provide that instead of Commissioner of Central Excise, a Committee of Commissioners of Central Excise shall review the orders of Commissioner of Central Excise (Appeals) and direct any Central Excise Officer authorized by him to appeal on its behalf to the Appellate Tribunal. However, the principle enunciated in this judgment will hold good in respect of amended section 35B (2) as well.

10. The question as to whether goods lost by 'theft' or 'dacoity' can be considered to be "goods lost or destroyed by natural causes or by unavoidable accident" under rule 21 of the Central Excise Rules, 2002 was decided by the larger bench of the Tribunal in case of Gupta Metal Sheets v. CCE 2008 (232) E.L.T. 796 (Tri.-LB). It clarified that the term 'loss' cannot be understood in the limited sense of 'loss to the manufacturer'. In the context of the Central Excise Law, it has to be understood as being unavailable for consumption in the market. In case of theft or dacoity, the goods are not 'lost' or 'destroyed'; they rather enter the market for consumption, albeit stealthily, after being removed from the approved premises or the place of storage. As per rule 49 of the erstwhile Central Excise Rules, 1944 (now rule 21 of the Central Excise Rules, 2002); loss must be attributable to any natural cause or unavoidable accident.

'Natural cause' refers to some natural phenomenon i.e. vagary of nature or some act of nature like fire, flood or a similar natural calamity. The act of forcibly removing the goods by any means - non-violent or violent - amounting to theft or dacoity under the Indian Penal Code cannot be said to be a natural cause.

Considering the definitions of 'theft' and 'robbery' in the Indian Penal Code, the Tribunal held that 'theft' or 'dacoity' involves forcible removal of goods by non-violent or violent means, as the case may be, and this cannot be said to be a natural cause. The Tribunal opined that theft or dacoity is an incident and not an accident, much less unavoidable. Theft and dacoity are committed by a design and they cannot be said to be accident by any logic. By taking due care and caution, they can be avoided and, therefore, it cannot be said that theft or dacoity is 'unavoidable accident'.

In view of the above, the Tribunal held that 'theft' or 'dacoity' cannot be called unavoidable accident within the meaning of the rule 49 of erstwhile Central Excise Rules, 1944 (now rule 21 of the Central Excise Rules, 2002) and the goods lost in theft or dacoity would not be eligible for remission.

11. Circular no. 673/64/2002-CX dated 28.10.2002 provides that once MRP is scored out, (even if it remains visible) and another MRP is printed on the package, it can not be said that the package has two MRPs printed on it, since the scored out MRP could not be considered as an MRP either by the seller or by the consumer. Hence, the scored out MRP is to be ignored. Therefore, in the instant case, the new MRP of Rs. 10 shall be considered for the purpose of valuation.

12. No, the contention of the Revenue is not justifiable in law.

    In ACS Hydraulics Pvt. Ltd. v. CCE 2008 (227) ELT 425 (Tri.), the Tribunal held that there was no loss to the Revenue as far as the payment of duty was concerned by the supplier of the goods on the proper correct assessable value. Therefore, the Department could not direct the appellant to reverse the credit or to disallow the credit as the supplier had paid the duty and taken credit which was equivalent to duty shown in the invoice issued by the supplier.

    Besides, Circular No. 877/15/2008-CX dated 17.11.2008 has also clarified that in such cases, the entire amount of duty paid by the manufacturer, as shown in the invoice, would be available as credit irrespective of the fact that subsequent to clearance of the goods, the price is reduced by way of discount or otherwise.

    In view of the above discussion, it can be concluded that Triveni Texturisers is entitled to the CENVAT credit on the entire duty paid on the price initially invoiced and need not reverse the credit proportionately.

13. Rule 17 of the Central Excise Rules, 2002 provides that where any goods are removed from a hundred percent export oriented unit to domestic tariff area, such removal shall be made under an invoice in the procedure specified under rule 11 of the said rules. Further, removal shall be made only after payment of appropriate duty by crediting the duty payable to the account of the Central Government in the manner specified in rule 8 or by utilizing the CENVAT credit.

Such unit is required to maintain appropriate accounts related to production in the prescribed form giving the following details :

(i) description of goods

(ii) quantity removed

(iii) duty paid.

Such unit shall submit a monthly return in the specified form (E.R - 2) in respect of the excisable goods manufactured, and receipt of inputs and capital goods, in the unit, to the Superintendent of Central Excise within 10 days from the close of the month to which the return relates.

The proper officer may on the basis of information contained in the return filed by the unit, and after such further enquiry as he may consider necessary, scrutinize the correctness of the duty assessed by the assessee on the goods removed, in the manner to be prescribed by the Board.

Every assessee shall make available to the proper officer all the documents and records for verification as and when required by such officer.

14. Bombay High Court, in case of Shabir Ahmed Abdul Rehman v. UOI 2009 (235) ELT 402 (Bom.), decided the similar issue in favour of assessee. In this case, Revenue confiscated the gold carried by the petitioner from Muscat. The petitioner informed the custom authorities that he was filing an appeal against the order of confiscation. Revenue informed the petitioner that the confiscated goods had been handed over to the warehouse of the Custom House for disposal and consequently, auctioned the confiscated goods.

    The High Court held that handing over the confiscated gold immediately after serving the order of confiscation itself was improper. In any event, after receiving letter from the petitioner, the custom authorities ought to have stopped the auction sale of the confiscated gold. The action of the custom authorities in selling the gold during the pendency of the appeal was not justified.

    Hence, it can be concluded that the custom authorities are not authorized to auction the confiscated goods during the period of pendency of appeal.

15. Computation of assessable value and total custom duty payable:-

Particulars	
CIF Value	$ 20,000
Add : Landing charges @ 1% of CIF value (Note – 1)	$ 200
	$ 20,200
Assessable value (in Rupees) =$20,200 × Rs. 45 (Note -2)	Rs. 9,09,000
Add : Basic custom duty @ 40% (Rs. 9,09,000 × 40%)	Rs. 3,63,600
	Rs. 12,72,600

Add : Countervailing duty (Rs. 12,72,600 × 8.24%)	Rs. 1,04,862.20
	Rs.13,77,462.24
Education cess [(Rs. 3,63,600 + Rs. 1,04,862.20) × 3%]	Rs. 14,053.87
Total custom duty payable (Rs. 3,63,600 + Rs. 1,04,862.20 + Rs. 14,053.87)	Rs. 4,82,516.11

Notes :-

(1) Landing charges at the rate of 1% of the CIF value of the imported goods, shall be added, whether ascertainable or not [First proviso to rule 10(2) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

(2) Applicable exchange rate is Rs. 45/- per $ as notified by CBEC because explanation to section 14(1) provides that rate of exchange shall be the rate as notified by CBEC.

16. Warehousing without warehousing (Section 49 of the Customs Act, 1962)

Section 49 allows the importer to store the goods in a public warehouse, but the goods shall not be treated as warehoused goods for the purpose of the Customs Act, 1962 and accordingly warehousing provisions shall not apply to such goods. This may arise in following two cases:-

(i) Where due to some genuine difficulty, the importer is unable to clear the goods for home consumption within the stipulated time, the goods may be deposited in a warehouse without double duty bond. This facility is available irrespective of whether the goods are dutiable or not.

(ii) If the importer makes a declaration and for any reason the importer is unable to furnish all the particulars of the goods, he can seek permission to deposit the goods in a public bonded warehouse appointed under section 57 pending receipt of the necessary information and the supporting documents under section 49.

17. The High Court in case of Dinkar Khindria v. UOI 2008 (231) ELT 47 (Del.) held that a difference in the Final Order issued by Tribunal and the Handwritten Order in Order Sheet i.e. a change of order by Members of the Tribunal, amounts to tampering with the judicial records. Once an order is passed and it is signed by the members, the same cannot be altered unless law provides for a review of the same and that too only after hearing the parties. The High court held that Tribunal should ensure that such unsavory incidents should not occur in the course of their conduct of judicial proceedings.

18. (a) Importer: [Section 2(26)]:

Importer in relation to any goods at any time between their importation and the time when they are cleared for home consumption, includes any owner or any person holding himself out to be the importer.

(b) Person-in-charge: [Section 2(31)]:

Person-in-charge means-

(a) in relation to a vessel, the master of the vessel;

(b) in relation to an aircraft, the commander or the pilot-in-charge of the aircraft;

(c) in relation to a railway train, the conductor, guard or other person having the chief direction of the train;

(d) in relation to any other conveyance, the driver or other person-in-charge of the conveyance.

(c) Foreign going vessel or aircraft: [Section 2(21)]:

The term is defined to mean any vessel or aircraft for the time being engaged in the carriage of goods or passengers between any port or airport in India and any port or airport outside India, whether touching any intermediate port or airport in India or not, and includes-

- any naval vessel of any foreign Government taking part in any naval exercise;

- any vessel engaged in fishing or any other operations outside the territorial waters of India;

- any vessel or aircraft proceeding to a place outside India for any purpose whatsoever;

(d) "Adjudicating authority" [Section 2(1)]

means any authority competent to pass any order or decision under the Customs act, 1962, but does not include the Central Board of Excise and Customs constituted under the Central Boards of Revenue Act,1963 (54 of 1963), Commissioner of Central Excise (Appeals) or Appellate Tribunal;

19. The following conveyances shall be liable to confiscation:-

(a) any vessel which is or has been within the Indian customs waters, any aircraft which is or has been in India, or any vehicle which is or has been in a customs area, while constructed, adapted, altered or fitted in any manner for the purpose of concealing goods;

(b) any conveyance from which the whole or any part of the goods is thrown overboard, staved or destroyed so as to prevent seizure by an officer of customs;

(c) any conveyance which having been required to stop or land under section 106 fails to do so, except for good and sufficient cause;

(d) any conveyance from which any warehoused goods cleared for exportation, or any other goods cleared for exportation under a claim for drawback, are unloaded, without the permission of the proper officer;

(e) any conveyance carrying imported goods which has entered India and is afterwards found with the whole or substantial portion of such goods missing, unless the master of the vessel or aircraft is able to account for the loss of, or deficiency in, the goods.

20. As per rule 5 of the Baggage Rules, 1998, Amarnath is entitled to bring the used household articles upto an aggregate value of Rs. 12,000 free of duty. Hence, Amarnath can clear the used Microwave oven free of duty within the permissible allowance.

21. In a recent case, the Apex Court in the case of Union of India & Ors v. M/s Martin Lottery Agencies Ltd. 2009 (14) STR 593 (SC) ruled that by reason of an explanation, a substantive law may also be introduced. If a substantive law is introduced, it will have no retrospective effect. Subject to the constitutionality of the Finance Act, 2009 as amended in view of the explanation appended to this, the Supreme Court opined that the service tax, if any, would be payable only with a prospective effect and not with retrospective effect.

    It further opined that in a case of this nature, the Court must be satisfied that the Parliament did not intend to introduce a substantive change in the law. As stated herein before, for the aforementioned purpose, the expressions like 'for the removal of doubts' are not conclusive. The said expressions appear to have been used under assumption that organizing games of chance would be rendition of service. It held that the explanation is not clarificatory or declaratory in nature. Hence, it could not be construed having retrospective effect and retroactive operation.

22. No, the stand taken by the Department is not tenable in law.

    The facts of the given case are similar to the case of Ambuja Cements Ltd. v. UOI 2009 (14) S.T.R. 3 (P & H). In this case, the High Court observed that the 'input service' has been defined under rule 2(l) of the CENVAT Credit Rules, 2004 to mean any service used by the manufacturer whether directly or indirectly and also includes, inter alia, services used in relation to inward transportation of inputs or export goods and outward transportation up to the place of removal.

    Further, the Board's Circular No. 97/8/2007-ST dated 23-8-2007 contemplates compliance of certain conditions where the sale has taken place at the destination point. These conditions are as follows:-

    (i) the ownership of goods and the property in the goods remained with the seller of the goods till the delivery of the goods in acceptable condition to the purchaser at his door step;

    (ii) the seller bore the risk of loss of or damage to the goods during transit to the destination; and

    (iii) the freight charges were an integral part of the price of goods.

    The first requirement was fulfilled because:-

    (i) the supply of cement by appellant to its customer was 'FOR destination',

    (ii) the freight up to the door step of the customer was borne by the appellant, and

    (iii) the service tax on the freight charges was paid by the appellant.

Moreover, for transportation purposes insurance cover has also been taken by the appellant which further shows that the ownership of the goods and the property in the goods has not been transferred to the seller till the delivery of the goods in acceptable condition to the purchaser at his door step. Accordingly, the second condition also stood fulfilled.

Since, the delivery of the goods is at "FOR destination' price, the third condition that the freight charges were integral part of the excisable goods also stood fulfilled.

In view of above discussion, the High Court opined that the questions of law deserved to be answered in favour of the assessee-appellant and against the Revenue. Hence, it held that the assessee was entitled to the credit of the service tax paid on the freight up to the door steps of the customer.

23. (a) Notification No. 32/2008 ST dated 18.11.2008 has extended the time-limit for filing the refund claim from sixty days to six months from the end of the relevant quarter during which the said goods have been exported.

(b) Circular No. 112/06/2009 dated 12.03.2009 clarifies that it is clearly prescribed in the notification that limitation period of six month is to be computed from the date of exports.

(c) Circular No. 112/06/2009 dated 12.03.2009 clarifies that being prospective in nature refund is not admissible on such services received prior to the date they are notified in the said notification, even if the goods, in relation to which these services are used, are exported after the date when such services are notified under Notification No. 41/2007-ST.

24. (a) Filing of return within the prescribed time limit is compulsory, even if it may be a nil return, failing which penal action is attracted.

(b) A single return is sufficient because the ST-3 Return is designed to capture details of each service separately with in the same return.

(c) (i) ST-3 Return – For all the registered assessee, including input service distributors.

(ii) ST-3A Return – The assessee who is making provisional assessment under rule 6(4) of the Service Tax Rules, 1994 is required to file a memorandum in form ST-3A accompanying the return.

25. Penalty for contravention of rules and provisions of the Finance Act, 1994 as amended for which no penalty is specified elsewhere [Section 77]:

(1) Any person,

(a) who is liable to pay service tax, or required to take registration, fails to take registration in accordance with the provisions of section 69 or rules made under this Chapter shall be liable to pay a penalty which may extend to Rs. 5,000 or Rs. 200 for every day during which such failure continues, whichever is higher, starting with the first day after the due date, till the date of actual compliance;

(b) who fails to keep, maintain or retain books of account and other documents as required in accordance with the provisions of this Chapter or the rules made thereunder, shall be liable to a penalty which may extend to Rs.5,000;

(c) who fails to,

(i) furnish information called by an officer in accordance with the provisions of this Chapter or rules made thereunder; or

(ii) produce documents called for by a Central Excise Officer in accordance with the provisions of this Chapter or rules made thereunder; or

(iii) appear before the Central Excise Officer, when issued with a summon for appearance to give evidence or to produce a document in an inquiry, shall be liable to a penalty which may extend to Rs. 5,000 or Rs. 200 for every day during which such failure continues, whichever is higher, starting with the first day after the due date, till the date of actual compliance;

(d) who is required to pay tax electronically, through internet banking, fails to pay the tax electronically, shall be liable to a penalty which may extend to Rs.5,000;

(e) who issues invoice in accordance with the provisions of the Act or rules made thereunder, with incorrect or incomplete details or fails to account for an invoice in his books of account, shall be liable to a penalty which may extend to Rs.5,000.

(2) Any person, who contravenes any of the provisions of this Chapter or any rules made thereunder for which no penalty is separately provided in this Chapter, shall be liable to a penalty which may extend to Rs.5,000.

IMPORTANT AMENDMENTS MADE BETWEEN 01.05.2008 TO 30.04.2009

Students may note that the Study Material for Indirect Taxes contains all the relevant amendments made by the Finance Act, 2008. Further, circulars/notifications issued up to 30.04.2008 have also been incorporated therein. The following are the amendments which have been made between 01.05.2008 to 30.04.2009. It may be carefully noted that for the students appearing in November 2009 exams, the amendments made by the notifications, circulars and other legislations up to 30.04.2009 are relevant.

A. EXCISE

1. Following amendments have been made in the Central Excise Rules, 2002:

(i) Rule 12(2A) inserted- Annual Installed Capacity Statement

This rule provides that every assessee shall submit to the Superintendent of Central Excise, an Annual Installed Capacity Statement declaring the annual production capacity of the factory for the financial year to which the statement relates in Form ER-7 by the 30th April of the succeeding financial year.

However, the Central Government may specify assessee or class of assessees who may not require to submit such an Annual Installed Capacity Statement.

For the year 2007-08, the said statement shall be furnished by 31st October, 2008.

[Notification No. 38/2008 CE (NT) and Notification No. 39/2008 CE (NT) dated 29.09.2008]

(ii) Amendments to rule 17 - Removal of goods by a 100% EOU for DTA

Notification No. 23/2008 CE (NT) dated 23.05.2008 has amended rule 17 of the Central Excise Rules, 2002 with effect from 01.06.2008as follows:-

(a) Rule17(1) Monthly payment of duty by 100% EOUs

In case of removal of excisable goods from 100% Export Oriented Unit (EOU) to Domestic Tariff Area (DTA), the duty leviable on such goods shall be paid by utilizing the CENVAT credit or by crediting the duty payable to the account of the Central Government in the manner specified in rule 8. Thus, duty can be paid monthly in case of removals from 100% EOUs also.

(b) Rule17(4) Scrutiny by the proper officer

The proper officer may on the basis of information contained in the return filed by the unit under rule 17(3), and after such further enquiry as he may consider necessary, scrutinize the correctness of the duty assessed by the assessee on the goods removed, in the manner to be prescribed by the Board.

(c) Rule17(5) Furnishing of documents and records by assessee

Every assessee shall make available to the proper officer all the documents and records for verification as and when required by such officer.

(d) Amendment of Form ER-2

Notification No. 24/2008 CE (NT) dated 23.05.2008 has amended Form ER-2- form prescribed for monthly return for 100% EOU in respect of goods manufactured, goods cleared and receipt of inputs and capital goods.

2. CENVAT Credit Rules, 2004:

I. Amendments in CENVAT Credit Rules, 2004

(a) Rule 3(7)(a) CENVAT credit admissible on inputs received from 100% EOU/unit in EHTP/STP

Rule 3(7)(a) provided that CENVAT credit in respect of inputs/capital goods produced or manufactured, by a 100% Export Oriented Undertaking (EOU) or by a unit in an Electronic Hardware Technology Park (EHTP) or in a Software Technology Park (STP) and which pays excise duty levied under section 3 of the Excise Act read with serial number 2 of Notification No. 23/2003-CE, dated 31.03.2003, used in the manufacture of the final products or in providing an output service, in any other place in India, shall be admissible equivalent to the amount calculated in the following manner namely :-

=Assessable Value [(1+BCD/400)×(CVD/100)]

wherein, BCD stands for Basic Custom Duty

CVD stands for Countervailing Duty

Notification No. 48/ 2008-Central Excise (N.T.) dated 05.12.2008 has amended the aforesaid formula. Consequently, the CENVAT credit in respect of inputs cleared from 100% EOU, by a unit in EHTP, or by a unit in STP to any other place in India shall be as follows:-

=Assessable Value [(1+BCD/200)×(CVD/100)]

(b) Proviso to rule 3(1)(xi) of the CENVAT Credit Rules, 2004

The amount equal to excise duty paid on the capital goods at the time of debonding of the unit in terms of the para 8 of Notification No. 22/2003 CE dated 31.03.2003 (which exempts certain goods when brought into 100% EOU / STP complex) shall be allowed as CENVAT credit.

(c) Rule 6(6)(i) Benefit under rule 6(6) extended to a developer of a SEZ

Rule 6(6)(i) provided that CENVAT credit shall be admissible on the inputs used in the manufacture of the final product cleared without payment of duty to a unit in a Special Economic Zone (SEZ).

Notification No. 50/2008 – CE (N.T.) dated 31.12.2008 has extended this benefit to "a developer of a Special Economic Zone (SEZ)" also.

II. Clarifications relating to CENVAT Credit Rules, 2004

(a) Clarification of certain issues relating to rule 6(3) of the CENVAT Credit Rules, 2004

A. Circular No. 868/6/2008 CX dated 09.05.2008 has clarified the following issues with regard to rule 6(3) of the CENVAT Credit Rules, 2004*:

S.No.	Question	Answer
1.	Whether an assessee availing option (i) or option (ii) under rule 6(3) is allowed to take CENVAT credit of duty paid on inputs and input services which are used for both dutiable and exempted goods or services?	Yes, credit on such inputs and input services is allowed. However, an assessee following option (i) or (ii) under rule 6(3) shall not be allowed to take CENVAT credit of duty paid on those inputs and input services which are used exclusively for the manufacture of exempted goods or provision of exempted services [refer Explanation II of rule 6(3)]. For the purpose of the calculation of amount under formula given under rule 6(3A), the total CENVAT credit taken on inputs and input services does not include

		excise duty paid on inputs or service tax paid on input services which are used exclusively for the manufacture of exempted goods or provision of exempted services.
2.	Whether an assessee availing option (i) in respect of certain exempted goods/services can also avail option (ii) in respect of other exempted goods or services simultaneously?	An assessee opting for either of the option is required to avail the said option for all the exempted goods manufactured by him and all the exempted services provided by him and the option once exercised during a financial year (F.Y.) cannot be withdrawn during the remaining part of the FY. Therefore, the same assessee cannot avail both option (i) and option (ii) simultaneously during a financial year. [Explanation I to Rule 6(3)].
3.	Assessee opting for option (i) is required to pay an amount equivalent to 10% of value of exempted goods or 8% of value of exempted services. What is the scope of term "value" for the said purpose?	Value of the exempted goods is the transaction value as determined in terms of section 4 of the Central Excise Act, 1944 or value determined under section 4A. However, in case of goods chargeable to specific rate of duty, the value, shall be the transaction value to be determined under section 4. Value of the exempted service is the gross amount charged for providing the exempted service [without abatement].
4.	What is the accounting code to be followed by the assessee who is required to pay 8% or other amount for the exempted service under Rule 6(3)?	For the present, the assessee can pay the said amount under the accounting code applicable for service tax i.e. 0044.
5.	Whether input services distributor can also opt for option (i) or option (ii)?	As ISD does not provide any service, and is like a trader, the question of availing either of the options would not arise.
6.	Whether export of service without payment of service tax under Export of Service Rules shall be treated as exempted service for the purpose of rule 6(3)?	No, export of services without payment of service tax are not to be treated exempted services.

7.	What is the manner for calculation of CENVAT Credit amount attributable to inputs used in or in relation to the manufacture of exempted goods?	It is required to be done on the basis of actual consumption of inputs used and the quantification may be made based upon the stores/production records maintained by the manufacturer. Further, a certificate from Cost Accountant/Chartered Accountant giving details of quantity of inputs used in the manufacture of exempted goods, value thereof and CENVAT credit taken on these input may be submitted at the end of the year.
8.	Whether credit in respect of input services covered by rule 6(5) would be required to be taken into account for determination of amount payable as per formula provide in rule 6(3A)?	No, the credit attributable to services mentioned in sub-rule (5) shall not be taken into account for determination of amount under rule 6(3A).

*Note - Rule 6(3) pertains to an assessee opting not to maintain separate CENVAT credit accounts for dutiable and exempted outputs. Such assessee has to opt for one of the following two options:

(i) Pay an amount equal to 10% of the value of the exempted goods or 8% of the value of the exempted services. Exempted service includes non-taxable service also.

OR

(ii) Pay an amount equivalent to the CENVAT credit attributable to inputs and input services used in or in relation to manufacture of exempted goods or for provision of exempted services. Rule 6(3A) prescribes the conditions and procedure to determine the amount of CENVAT credit attributable to exempted outputs.

Schemes under rule 6(3) are optional and each individual scheme is comprehensive and self-contained. An assessee can exercise the option in relation to all his activities as an assessee and the option is not available only in relation to a part of his activity and the option once exercised cannot be withdrawn during the said financial year.

B. Rule 11D not applicable to amount collected under rule 6(3) of the CENVAT Credit Rules, 2004

It has been clarified that so long as the amount of 8% or 10% is paid to the Government in terms of rule 6(3) of the CENVAT Credit Rules, 2004*, the provisions of section 11D shall not be applied even if the amount is recovered from the buyers. As per section 11D, the Central Government shall be liable to recover any amount which has been collected as excise duty and not paid to the credit of the Central Government. It is to be noted that the CENVAT credit can be taken by the buyer only if it is a payment of duty in terms of rule 3(1) of the aforementioned rules. Therefore, the CENVAT credit of the said amount of 8% or 10% cannot be taken since such payment is not a payment of duty in terms of rule 3(1) of the said rules. So, the said 10% amount should be shown in the invoice as "10% amount paid under rule 6 of the CENVAT Credit Rules, 2004".

[Circular No. 870/08/2008-CX dated 16.05.2008]

*Note - W.e.f. 01.04.2008, rule 6(3) of the CENVAT Credit Rules, 2004 has been amended and it provides for payment of an amount equal to 10% of value of the exempted goods, instead of 10% of the price of the exempted goods as provided earlier. The value is to be determined as per section 4 or 4A of the Central Excise Act, 1944 read with rules made thereunder.

(b) Clarification regarding reversal of CENVAT credit in case of trade discount

Sometimes, the supplier allows trade discount to the manufacturer. However, the manufacturer avails the CENVAT credit of the entire excise duty paid by the supplier as reflected in the invoice. The issue raised was whether proportionate credit should be reversed in such a case.

Circular No. 877/15/2008-CX dated 17.11.2008 has clarified that in such cases, the entire amount of duty paid by the manufacturer, as shown in the invoice, would be available as credit irrespective of the fact that subsequent to clearance of the goods, the price is reduced by way of discount or otherwise.

However, if the duty paid is also reduced, along with the reduction in price, the reduced excise duty would only be available as credit. It may however be confirmed that the supplier, who has paid duty, has not filed/claimed the refund on account of reduction in price.

3. Pan Masala notified for the purpose of charging duty on the basis of capacity of production

Section 3A, as inserted by the Finance Act, 2008, contains the provisions to charge excise duty on the basis of capacity of production in respect of notified goods.

Notification No. 29/2008 CE (NT) dated 01.07.2008 has notified pan masala [falling under tariff item 2106 90 20 of the First Schedule to the Central Excise Tariff Act, 1985 (except the pan masala containing not more than 15% betel nut)] and pan masala containing tobacco, commonly known as gutkha (falling under tariff item 2403 99 90 of the said Tariff Act) manufactured with the aid of packing machine and packed in pouches, for the purpose of section 3A.

In this regard, Notification No. 30/2008 CE (NT) dated 01.07.2008 has notified the Pan Masala Packing Machines (Capacity Determination and Collection of Duty) Rules, 2008. They have come into force on the 1st day of July, 2008.

Further, Notification No. 32/2008 CE (NT) dated 28.08.2008 has granted rebate of duty on Pan Masala containing tobacco (gutkha) on which duty of excise has been paid under section 3A of the Central Excise Act, 1944, on their exportation out of India on or after

1st July, 2008, to any country except Nepal and Bhutan subject to the conditions, limitations and procedures prescribed therein.

4. Condition of paying excise duty from account current, done away with, in the following cases:

(a) Notification No. 39/2004 CE (NT) dated 25.11.2004 inter alia exempts class of manufacturers, who manufacture certain specified excisable goods prescribed therein and have paid excise duty of less than Rs.100 lakh from account current during the preceding financial year, from filing the annual information relating to principal inputs and monthly return of receipt and consumption of each of the principal inputs.

Notification No. 41/2008 CE (NT) dated 29.09.2008 has amended the said notification so as to remove the condition of paying the stipulated amount of duty from account current i.e., in cash. Now, the duty can be paid by utilizing the CENVAT credit also.

Consequently, now the manufacturers of the prescribed excisable goods shall be exempted from filing the annual information relating to principal inputs and monthly return of receipt and consumption of each of the principal inputs if they have paid the duty of less than Rs.100 lakh during the financial year, by any mode - either in cash or by utilizing CENVAT credit.

(b) Notification No. 17/2006 CE (NT) dated 01.08.2006 inter alia exempts the assessees who have paid excise duty of less than Rs.100 lakh from account current during the financial year, from filing of the Annual Financial Information Statement.

Notification No. 42/2008 CE (NT) dated 29.09.2008 has amended the said notification so as to remove the condition of paying the stipulated amount of duty from account current i.e., in cash. Now, the duty can be paid by utilizing the CENVAT credit also.

Consequently, now the asseessees shall be exempted from filing the Annual Financial Information Statement if they have paid the duty of less than Rs.100 lakh during the financial year, by any mode - either in cash or by utilizing CENVAT credit.

5. Proviso to clause (2) of Notification No. 35/2001 CE (NT) dated 26.06.2001* amended

If a person has more than one premise requiring registration, he may obtain a single registration for all such premises if following conditions are satisfied:-

(i) Such person manufactures Compressed Natural Gas (falling under heading 2711 of the of First Schedule to the Central Excise Tariff Act, 1985), and

(ii) all the premises fall within the jurisdiction of one Chief Commissioner of Central Excise, and

(ii) he has submitted the details of all such premises along with the application for registration.

However, prior intimation shall be given before starting any additional premises subsequent to obtaining such registration:

Further, if the assessee is registered under the existing provision, he may apply for fresh registration or file amendment to the registration as the case may be, in accordance with provisions of this notification.

[Notification No.43/2008-CE (NT) dated 06.10.2008]

*Note - Clause (2) of Notification No. 35/2001 CE (NT) dated 26.06.2001 prescribes that if the person has more than one premises requiring registration, separate registration certificate shall be obtained for each of such premises.

6. SSI exemption extended to SSIs producing specified packing materials bearing the brand name of another person

Notification No. 47/2008 CE dated 01.09.2008 has amended Notification No. 8/2003 CE dated 01.03.2003 to extend the benefit of small scale exemption of excise duty to SSIs producing goods bearing the brand name or trade name of another person if these goods are in the nature of packing materials, namely, printed cartons of paper or paper board, metal containers, HDPE woven sacks, adhesive tapes, stickers, PP caps, crown corks, metal labels.

However, this exemption shall be restricted to Rs.90 lakh for the remaining part of the financial year 2008-09.

7. LTUs to pay duty electronically only

The Large Taxpayer Units (LTUs) shall pay the central excise and service tax dues electronically only, through internet banking.

However, in case of difficulties in e-payment, a large taxpayer is permitted to pay the duty through banks (except in such cases where e-payment is mandatory) in the jurisdiction of the LTU Commissionerate only.

[Circular No.878/16 /2008-CX dated 21.11.2008]

8. Guidelines for provisional attachment of property under section 11DDA of the Central Excise Act, 1944

The key points of guidelines issued to implement section 11DDA of the Act to maintain uniformity in its implementation are as follows:-

(a) The types of offences which may be considered for provisional attachment of property (resorted only when the duty or CENVAT Credit alleged is more than Rs. 25 lakhs) are as follows:

1. When the goods are removed without the cover of an invoice and without payment of duty, or without declaring the correct value.
2. CENVAT Credit has been taken without receipt of goods or on the basis of Excise duty invoices or other documents which a person has a reason to believe as not genuine.
3. Excise duty invoice is issued without delivery of goods.
4. Refund or rebate is claimed in a fraudulent manner.

(b) The property which is attached is immovable property/ properties which is/ are used for commercial purpose. If immovable property is not sufficient to protect the interest of revenue then movable property can be attached

(c) The property provisionally attached shall be of value as nearly as may be equivalent to that of the amount demanded in the proceedings under section 11A or Section 11D of the Act.

(d) Provisional attachment of the property shall be made only between sunrise and sunset.

(e) After attachment, the proper officer shall prepare an inventory and specify in it the place where it is lodged or kept and shall hand over a copy of the same to the defaulter or the person from whose charge the property is destrained.

(f) All such property as is by the Code of Civil Procedure, 1908 exempted from attachment and sale for execution of a Decree of a Civil Court shall be exempt from provisional attachment. The decision of the Commissioner of Central Excise in this regard shall be final.

[Circular No. 874/12/2008-CX dated 30.06.2008]

B. CUSTOMS

Clarification in respect of procedure for sanctioning the custom duty refunds under section 27(2) of the Customs Act, 1962

It has been clarified that in terms of sub-section (2) of section 27, the concerned Assistant/Deputy Commissioner of Customs has to go through:-

(i) the facts of the case and the material placed before him in order to determine whether the amount claimed by an applicant is refundable to him or not, and

(ii) the details of audited Balance Sheet and other related financial records, certificate of the Chartered Accountant etc., submitted by the applicant in order to decide whether the applicant had not passed on the incidence of the duty and interest thereon, if any, to any other person.

The Order-in-Original passed by the Assistant/Deputy Commissioner of Customs in the adjudication process should be a speaking order providing specific details including the relevant financial records that are relied upon to arrive at a conclusion whether the burden of duty or interest, as the case may be, has been passed on or not.

Refund orders issued in a routine and casual manner thereby sanctioning the amount but crediting the same to the Consumer Welfare Fund without going through the factual details of the case and the due process as provided in the first proviso cannot be considered as a complete and speaking order

[Circular No.7/2008-Cus dated 28.05.2008].

C. SERVICE TAX

Notification No. 18/2008 ST dated 10.05.2008 has notified 16.05.2008 as the date on which the services introduced by the Finance Act, 2008 have become effective. Further, the amendments made in the existing service vide the Finance Act, 2008 have also become effective from 16.05.2008.

Exemptions:

1. Notification No. 41/2007 ST dated 06.10.2007 which exempts certain specified taxable services received by an exporter and used for export of goods

A. Amendment in Notification No. 41/2007 ST dated 06.10.2007

(a) Insertion of four more services

Notification No. 24/2008 ST dated 10.05.2008 (with effect from 16.05.2008) and Notification No. 33/2008 ST dated 07.12.2008 (with effect from 18.11.2008) have amended Notification No.41/2007 ST dated 06.10.2007 which exempts certain specified taxable services received by an exporter and used for export of goods. The following services received by an exporter and used for export of goods have also been exempted vide these notifications subject to fulfillment of conditions specified therein:-

S.No.	Section of the Finance Act, 1994 as amended	Description of taxable service	Conditions
1.	Section 65(105)(zm)	services of purchase or sale of foreign currency, including money changing provided to an exporter in relation to export goods.	exporter shall produce evidence to prove that the services specified in column (3) are in relation to goods exported.
2.	Section 65(105)(zzk)	services of purchase or sale of foreign currency, including money changing provided to an exporter in relation to export goods.	exporter shall produce evidence to prove that the services specified in column (3) are in relation to goods exported.
3.	Section 65(105)(zzzzj)	services of supply of tangible goods for use, without transferring right of possession and effective control of tangible goods, provided to an exporter in relation to goods exported by the exporter.	exporter shall produce evidence to prove that the services specified in column (3) are used in relation to export of goods.
4.	Section 65(105)(j)	services provided by a clearing and forwarding agent in relation to export	exporter shall produce,- (i) invoice issued by clearing and forwarding

S.No.	Section of the Finance Act, 1994 as amended	Description of taxable service	Conditions
		goods exported by the exporter.	agent for providing services specified in column (3) specifying: (a) number and date of shipping bill, (b) description of export goods, (c) number and date of the invoice issued by the exporter relating to export goods, (d) details of all the charges, whether or not reimbursable, collected by the clearing and forwarding agent from the exporter in relation to export goods, (ii) details of other taxable services provided by the said clearing and forwarding agent and received by the exporter, whether or not relatable to export goods.

(b) Condition of not availing the drawback of service tax paid relaxed

As per Notification No. 41/2007 ST dated 06.10.2007, the exporter could claim the refund of the service tax paid during the course of export of goods provided that the said goods have been exported without availing drawback of service tax paid under the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995.

However, now the condition of not availing the drawback of service tax paid has been relaxed by Notification No. 33/2008 ST dated 07.12.2008. Consequently, now the exporter, who is availing drawback of service tax paid, can also claim the refund of the service tax paid during the course of export of goods.

Moreover, the form prescribed for claiming the refund has been suitably amended to give effect to the above amendment.

(c) Time Limit for filing the refund claim extended

The time-limit for filing the refund claim under the aforesaid notification has been extended from sixty days to six months from the end of the relevant quarter during which the said goods have been exported [Notification No. 32/2008 ST dated 18.11.2008].

Clarification in this regard:-

In view of the amended condition, CBEC vide Circular No. 112/06/2009 dated 12.03.2009 has clarified that consequent upon revision of limitation period, any refund claim that is filed within such revised limitation period would be admissible if it is otherwise in order. Consequently, refund claims of service tax on specified taxable services used for exports of goods made in the quarter Mar-Jun 08 could be filed till 31st Dec 08.

The circular further clarifies that the limitation period of six months shall be computed from the date of exports and not from the date of receipt of remittances.

(d) Amendment in the conditions for two services

S.No.	Sub-clause of clause (105) of section 65	Description of taxable service	Conditions
1.	Section 65(105)(zzh)	Services provided by a technical testing and analysis agency in relation to technical testing and analysis of said goods where such technical testing and analysis is required to be undertaken as per the written agreement between the exporter and the buyer of the said goods	(i) the exporter furnishes a copy of the written agreement entered into with the buyer of the said goods requiring testing and analysis of the said goods; In this regard, Notification No. 32/2008 ST dated 18.11.2008 has clarified that where the buyer of the said goods does not require testing and analysis of the said goods, but testing is statutorily stipulated by domestic rules and regulations, the exporter shall furnish copy of such rules or regulations stipulating testing and analysis of the said goods.
2.	Section 65(105)(zzb)	Services provided by a commission agent, located outside India, and engaged	(vi) <u>Earlier condition:-</u> the refund of service tax shall

		under a contract or agreement or any other document by the exporter in India, to act on behalf of the exporter, to cause sale of goods exported by him.	be restricted to:- (i) actual amount of service tax paid or (ii) service tax calculated on two per cent of FOB value of export goods, whichever is less. <u>Amended condition:-</u> Notification No. 33/2008 ST dated 07.12.2008 has modified the above condition as follows:- The refund of service tax shall be restricted to:- (i) actual amount of service tax paid Or (ii) service tax calculated on ten per cent of FOB value of export goods, whichever is less.

B. Clarification on certain procedural issues involved in implementation of Notification No. 41/2007-ST dated 6/10/2007

Circular no. 106 /9 /2008-ST dated the 11.12.2008 and Circular No. 112/06/2009 dated 12.03.2009 have been issued in order to resolve the procedural difficulties in implementation of above mentioned notification. Following issues have been clarified:-

S.No.	Issue	Clarification
1.	One of the conditions of the notification is that the exporter claiming exemption has actually paid the service tax on the specified services. The other condition is that the refund claim shall be accompanied by document	(i) The invoices/challans/bills issued by supplier of taxable service, in conformity with rule 4A of the Service Tax Rules, 1994, are reasonable evidence that the services on which refund is being sought are taxable service. The compliance of condition

	evidencing payment of service tax. In this regard the following issues have been raised. (i) Whether the invoices/bills/challan issued by the service provider, showing service tax amount could be treated as evidence that the exporter has paid the service tax?	that exporter has actually paid the service tax rests with the exporter claiming refund. Therefore, in so far as this condition is concerned, the refund claim should be processed based on furnishing of appropriate invoices/ bills/ challan by the person claiming refund and undertaking to the effect of payment of service tax by him. For the purposes of compliance verification, random checks should be carried out independently and where the refund amount is significant, post refund audit may also be carried out.
	(ii) The invoices produced by the exporters are at times not complete (i.e. does not have STC code of service provider).	(ii) As regards incomplete invoices/bills etc, rule 4A of the Service Tax Rules, 1994 prescribes the statutory requirement. Compliance of this rule requires that the invoices/challan/bills should be complete in all respect. Therefore, the exporter claiming refund of service tax under Notification No. 41/2007-ST should ensure in their own interest that invoices/bills/challan should contain requisite details (name, address and registration no. of service provider, serial number and date of invoice, name and address of service receiver, description, classification and value of taxable service and the service tax payable thereon). Refund claim cannot be allowed on the basis of invoices not having complete details as required verification cannot be carried out by the department on the basis of incomplete invoices.
2.	It has been directed that refund claim must be disposed of within thirty days. Commissioners have stated that it is not practically feasible in all cases to	The difficulties arising in processing of claims may be brought to the notice of the Board. This should enable the field formations to dispose of the pending

	dispose of the refund claim within this time frame in view of procedural and other issues involved in processing of claim.	refund claims expeditiously. Therefore, every effort should be made by field formations to adhere to the prescribed timelines.
3.	The bank deducts certain commissions from the export remittance in lieu of service provided by them. Refund is not allowed on such deduction. Refund should be allowed on the gross remittances.	Refund is admissible on the basis of gross amount received for the exports and deductions made by the banks from export remittances, in lieu of services provided by bank, should not be deducted while granting refund.
4.	For exporters exporting to a customer regularly, the foreign exchange remittance certificates (FIRC) are made on running account basis by the banks. Therefore, it is often not possible to show the linkage between the export invoice and the remittance. This has resulted in denial of refund. Further in case where payments are received by cheque, banks do not issue FIRC and refunds are denied.	In such cases where FIRCs are issued on consolidated basis, the exporters should submit self-certified statement alongwith FIRC showing the details of export in respect of which the FIRC pertains. Refunds should be allowed on such certified statements. However, exporters should maintain a register showing running account which should be reconciled between the export and the remittance periodically. In cases where banks do not issue FIRC for the reason that payments are received by cheque, refund may be allowed on the basis of duly certified bank statement.
5.	Whether refund would be admissible on specified taxable service received prior to the date it is notified in the said notification, if such services are used in relation to goods which are exported subsequent to the date on which such taxable services are notified under notification No. 41/2007-ST.	Being prospective in nature refund is not admissible on such services received prior to the date they are notified in the said notification, even if the goods, in relation to which these services are used, are exported after the date when such services are notified under notification No. 41/2007-ST.
6.	Authorities granting refund are insisting on original documents such as invoice, BL, SB, BRC etc. Such	Normally, certified copy of the documents should be accepted. Only in case of in-depth enquiry original

	documents are required under the law to be kept in the Head office for audit. Refunds are denied on this ground.	documents can be verified.
7.	The service provider providing services to the exporter provides various services. But he has registration of only one service. The refund is being denied on the grounds that the taxable services that are not covered under the registration are not eligible for such refunds.	Notification No. 41/2007 ST provides exemption by way of refund from specified taxable services used for export of goods. Granting refund to exporters, on taxable services that he receives and uses for export do not require verification of registration certificate of the supplier of service. Therefore, refund should be granted in such cases, if otherwise in order. The procedural violations by the service provider need to be dealt separately, independent of the process of refund.
8.	Whether refunds under Notification No. 41/2007-ST, dated 6.10.2007 would be admissible for the quarter July-Sep 2007.	The Notification No.41/2007-ST exempts service tax on specified taxable services used for export of goods. This exemption is operated through the route of refund. Being prospective in nature, refund could only be sanctioned on taxable services provided on or after the date they are notified in the said notification, i.e., 6.10.2007.

2. Exemption from service tax leviable on taxable services provided to GTA for use in transportation of goods by road

Notification No. 29/2008 ST dated 26.06.2008 has exempted from the whole of the service tax, the service of supply of a goods carriage [taxable under section 65(105)(zzzzj)], (without transferring right of possession and effective control of such goods carriage), provided by any person to a goods transport agency for transportation of goods by road in the said goods carriage.

Notification No. 1/2009 ST dated 05.01.2009 has exempted from the whole of the service tax, the following mentioned services, provided to a goods transport agency for transportation of goods by road in the said goods carriage, subject to the condition

that the invoice issued by such service provider, providing services should mention the name and address of the goods transport agency and also the name and date of the consignment note, by whatever name called, issued in his behalf:-

(a) Services provided by a clearing and forwarding agent in relation to clearing and forwarding operations,

(b) Services provided by a manpower recruitment or supply agency in relation to the recruitment or supply of manpower, temporarily or otherwise

(c) Services provided by a cargo handling agency in relation to cargo handling services

(d) Services provided by a storage or warehouse keeper in relation to storage and warehousing of goods

(e) Services provided by any person in relation to business auxiliary service

(f) Services provided by any other person, in relation to packaging activity

(g) Services provided by any other person, in relation to support services of business or commerce, in any manner

(h) Services provided by a processing and clearing house in relation to processing, clearing and settlement of transactions in securities, goods or forward contracts including any other matter incidental to, or connected with, such securities, goods and forward contracts.

Others:

3. Following amendments have been made in the Service Tax Rules, 1994:

(i) Amendments in rule 6

(a) Explanation to third proviso to rule 6(1)

For the removal of doubts, it is hereby declared that where the transaction of taxable service is with any associated enterprise, any payment received towards the value of taxable service, in such case shall include any amount credited or debited, as the case may be, to any account, whether called 'Suspense account' or by any other name, in the books of account of a person liable to pay service tax.

[Notification No. 19/2008 ST dated 10.05.2008]

(b) Rule 6(7B) - option to pay 0.25% of the gross amount in case of services provided in relation to purchase or sale of foreign currency

The person liable to pay service tax in relation to purchase or sale of foreign currency, including money changing, provided by a foreign exchange broker, including an authorised dealer in foreign exchange or an authorized money changer, referred to in sub-clauses (zm) and (zzk) of clause (105) of section 65 of the Finance Act, 1994 as amended shall have the option to pay an amount calculated at the rate of 0.25% of the gross amount of currency exchanged towards discharge of his service tax liability instead of paying service tax at the rate specified in section 66 of Chapter V of the Act.

However, such option shall not be available in cases where the consideration for the service provided or to be provided is shown separately in the invoice, bill or, as the case may be, challan issued by the service provider.

Illustration

Buying rate $US 1 = Rs.38, selling rate $US 1 = Rs.40

(i) Person exchanged $100 for equivalent rupees

Transaction value = Rs.3800 (Rs.38 x 100)

Service tax payable = Rs.9.5 (0.25% x 3800)

(ii) Person exchanged equivalent rupees for $100

Transaction value = Rs.4000 (40 x 100)

Service tax payable = Rs.10 (0.25% x 4000).

[Notification No. 19/2008 ST dated 10.05.2008]

(c) Rule 6(1A) - amendment of Form ST-3

Notification No. 31/2008 ST dated 02.09.2008 has amended service tax return Form ST-3. Sub-rule (1A) empowers the assessee to pay advance service tax on his own volition and adjust the amount so paid against the service tax which he is liable to pay for the subsequent period.

(ii) Amendment in rule 4A

With effect from 16.05.2008, in rule 4A, the words "to a customer" have been substituted by the words "to any person".

[Notification No. 19/2008 ST dated 10.05.2008]

(iii) Amendment in rule 4B

With effect from 16.05.2008, in rule 4B, the words "to the customer" have been substituted by the words "to the recipient of service".

[Notification No. 19/2008 ST dated 10.05.2008]

(iv) Form No. ST-3 amended for the returns prepared by SRTPs

Notification No. 10 / 2009-ST dated 17.03.2009 has amended Form No. ST-3 in Service Tax Rules, 1994 to furnish the details of name and identification of Service Tax Return Preparers in case the return has been prepared by them.

4. Following amendments have been made in the Export of Services Rules, 2005 and the Taxation of Services (Provided from Outside India and Received in India) Rules, 2006:

(a) With effect from 16.05.2008, Export of Services Rules, 2005 and the Taxation of Services (Provided from Outside India and Received in India) Rules, 2006 have been amended vide Notification No. 20/2008 ST dated 10.05.2008 and Notification No. 21/2008 ST dated 10.05.2008 so as to categorise the newly specified taxable services under Rule 3. Taxable services have been categorised as under:

Sl. No.	Taxable service	Sub-clause of section 65(105)	Export of Services Rules, 2005	Taxation of Services (Provided from Outside India and Received in India) Rules, 2006
1.	Information technology software services	zzzze	*Category 3 [Rule 3(1)(iii)]	Category 3 [Rule 3(iii)]
2.	Investment management services provided under ULIP	zzzzf	*Category 3 [Rule 3(1)(iii)]	Category 3 [Rule 3(iii)]
3.	Stock exchange services in relation to securities	zzzzg	*Category 2 [Rule 3(1)(ii)]	Category 2 [Rule 3(ii)]
4.	Commodity exchange services	zzzzh	Category 2 [Rule 3(1)(ii)]	Category 2 [Rule 3(ii)]
5.	Processing and clearing house services	zzzzi	Category 2 [Rule 3(1)(ii)]	Category 2 [Rule 3(ii)]
6.	Supply of tangible goods services	zzzzj	Category 3 [Rule 3(1)(iii)]	Category 3 [Rule 3(iii)]
7.	Internet telecommunication services	zzzu	Category 3 [Rule 3(1)(iii)]	Category 3 [Rule 3(iii)]

Note – (1) Category 1 [Rule 3(1)(i)] – For services under this category, criterion of services being in relation to an immovable property situated outside India is prescribed.

(2) Category 2 [Rule 3(1)(ii)] – For services under this category, criterion of services as are performed outside India is prescribed.

(3) Category 3 [Rule 3(1)(iii)] – For services under this category, criterion of location of recipient of service outside India is prescribed.

(b) Similarly, Notification No. 21/2008 ST dated 10.05.2008 has amended the "Taxation of Service (Provided from Outside India and Received in India) Rules, 2006" by inserting a proviso after clause (iii) of rule 3. The proviso lays down that where the supply of tangible goods service [section 65(105)(zzzzj)] is received by a recipient located in India, then such taxable service shall be treated as taxable service provided from outside India and received in India subject to the condition that the tangible goods supplied for use are located in India during the period of use of such tangible goods by such recipient."

(c) Notification No. 20/2008 ST dated 10.05.2008 has amended Export of Services Rules, 2005 by inserting a second proviso after the first proviso to clause (iii) of sub-rule (1) of rule 3. The new proviso provides that where the supply of tangible goods service [section 65(105)(zzzzj)] is provided to a recipient located outside India, then such taxable service shall be treated as export of taxable service subject to the condition that the tangible goods supplied for use are located outside India during the period of use of such tangible goods by such recipient.

5. Amendments to abatement notification - Notification No.1/2006 ST dated 01.03.2006

(a) With effect from 16.05.2008, Notification No. 22/2008 ST dated 10.05.2008 has made the following amendments in Notification No.1/2006 ST dated 01.03.2006 which prescribes various abatements in respect of certain taxable services specified therein:

In the said notification,

S.no.	in case of	for the words	the words that have been substituted are
1.	mandap keeper services	to the client	to any person
2.	convention services	client	recipient of service
3.	erection, commissioning or installation service	customer	recipient of service

(b) Abatement of 30% from the gross amount charged in case of services in relation to chit

Notification No. 27/2008 ST dated 27.05.2008 has amended Notification No. 1/2006 ST dated 01.03.2006 so as to provide an abatement of 30% in case of services provided in relation to chit from the gross amount charged for such service.

"Chit" has been defined to mean a transaction whether called chit, chit fund, chitty, kuri, or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of grain instead) by way of periodical installments over a definite period and that each subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount.

6. With effect from 16.05.2008, Notification No. 23/2008 ST dated 10.05.2008 has amended the following notifications in the manner given below:

S.No.	In Notification No.	for the words	the words that have been substituted are
1	18/2002 ST dated 16.12.2002: It exempts the taxable services provided by a consulting engineer to a client on transfer of technology from so much of the service tax leviable thereon as is equivalent to the amount of cess paid on the said transfer of technology under the provisions of section 3 of the Research and Development Cess Act, 1986.	to a client	to any person
2	33/2004 ST dated 03.12.2004: It exempts the taxable service provided by a goods transport agency to a customer, in relation to transport of fruits, vegetables, eggs or milk by road in a goods carriage, from the whole of service tax leviable thereon.	to a customer	to any person
3	34/2004 ST dated 03.12.2004: It exempts the taxable service provided by a goods transport agency to a customer, in relation to transport of goods by road in a goods carriage, from the whole of service tax where- (i) the gross amount charged on consignments transported in a goods carriage does not exceed rupees one thousand five hundred; or (ii) the gross amount charged on an individual consignment transported in a goods carriage does not exceed rupees seven hundred fifty.	to a customer	to any person

7. Conditions specified for exemption to services provided to a developer or units of special economic zone-Notification No. 4/2004 dated 31.03.2004 superseded

Notification No.9/2009-ST dated 03.03.2009 has exempted service tax paid on the services provided in relation to the authorized operations in a Special Economic Zone, and received by a developer or units of a Special Economic Zone, whether or not the said taxable services are provided inside the Special Economic Zone.

Provided that

(a) Approval of list of services

The developer or units of Special Economic Zone shall get the services required in relation to the authorised operations in the Special Economic Zone approved from the Approval Committee (hereinafter referred to as the specified services);

(b) Actual use of specified services

The developer or units of Special Economic Zone claiming the exemption actually uses the specified services in relation to the authorised operations in the Special Economic Zone;

(c) Exemption in the form of refund

The exemption claimed by the developer or units of Special Economic Zone shall be provided by way of refund of service tax paid on the specified services used in relation to the authorised operations in the Special Economic Zone;

(d) Actual payment of service tax

The developer or units of Special Economic Zone claiming the exemption has actually paid the service tax on the specified services;

(e) No CENVAT credit of service tax paid on specified services

No CENVAT credit of service tax paid on the specified services used in relation to the authorised operations in the Special Economic Zone has been taken under the CENVAT Credit Rules, 2004;

(f) Exemption under no other notification claimed

Exemption or refund of service tax paid on the specified services used in relation to the authorised operations in the Special Economic Zone shall not be claimed except under this notification.

Conditions to be satisfied:-

(a) the person liable to pay service tax under sub-section (1) or sub-section (2) of section 68 of the said Finance Act shall pay service tax as applicable on the specified services provided to the developer or units of Special Economic Zone and used in relation to the authorised operations in the Special Economic Zone, and such person shall not be eligible to claim exemption for the specified services:

Provided that where the developer or units of Special Economic Zone and the person liable to pay service tax under sub-section (2) of section 68 for the said services are the same person, then in such cases exemption for the specified services shall be claimed by that person;

(b) the developer or units of Special Economic Zone shall claim the exemption by filing a claim for refund of service tax paid on specified services;

(c) the developer or units of Special Economic Zone shall file the claim for refund to the jurisdictional Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be;

(d) the developer or units of Special Economic Zone who is not registered as an assessee under the Central Excise Act, 1944 (1 of 1944) or the rules made thereunder, or the said Finance Act or the rules made thereunder, shall, prior to filing a claim for refund of service tax under this notification, file a declaration in the Form annexed hereto with the respective jurisdictional Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be;

(e) the jurisdictional Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be, shall, after due verification, allot a service tax code (STC) number to the developer or units of Special Economic Zone within seven days from the date of receipt of the said Form;

(f) the claim for refund shall be filed, within six months or such extended period as the Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be, shall permit, from the date of actual payment of service tax by such developer or unit to service provider;

(g) the refund claim shall be accompanied by the following documents, namely:-

   (i) a copy of the list of specified services required in relation to the authorised operations in the Special Economic Zone, as approved by the Approval Committee;

   (ii) documents for having paid service tax;

   (iii) a declaration by the Special Economic Zone developer or unit, claiming such exemption, to the effect that such service is received by him in relation to authorised operation in Special Economic Zone.

(h) the Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be, shall, after satisfying himself that the said services have been actually used in relation to the authorised operations in the Special Economic Zone, refund the service tax paid on the specified services used in relation to the authorised operations in the Special Economic Zone;

   (i) where any refund of service tax paid on specified services is erroneously refunded for any reasons whatsoever, such service tax refunded shall be recoverable under the provisions of the said Finance Act and the rules made thereunder, as if it is a recovery of service tax erroneously refunded.

8. Clarification regarding levy of service tax on services provided by “commercial training or coaching centers”

Circular No. 107/01/2009 – ST dated 28.01.2009

Section 65(26) provides that commercial training or coaching means any training or coaching provided by a commercial training or coaching centre;

Section 65(27) defines commercial training or coaching centre as-

- any institute or establishment providing commercial training or coaching for imparting skill or knowledge or lessons
- on any subject or field other than the sports,
- with or without issuance of a certificate and
- includes coaching or tutorial classes but
- does not include

(i) preschool coaching and training centre or

(ii) any institute or establishment which issues any certificate or diploma or degree or any educational qualification recognised by law for the time being in force;

The aforesaid circular clarifies on the following mentioned issues:-

A. Commercial nature of the institute

The commercial training or coaching does not mean that such institute must have ‘commercial’ (i.e. profit making) intent or motive. It has to be interpreted in a wider sense.

B. Vocational Training Institutes - whether institutes offering general course on improving communication skills, how to be effective in group discussions or personal interviews, personality development, general grooming and finishing etc are covered

The circular clarifies that such institutes are not covered under the definition of vocational training institute because they only improve the chances of success for a candidate possessing required skill and do not impart training to enable the trainee to seek employment or self-employment.

C. Post school education

(a) Institutes falling under the category of institutes/establishments which issue diploma or certificate recognized by the law for the time being in force-hence not taxable under the category of “commercial coaching and training services”

1. University as defined under section 2(f) of the UGC Act, 1956

2. Deemed University as defined under section 3 of the UGC Act, 1956

3. A college or institution, recognized by UGC, run by a trust/registered society/body corporate/body incorporated under Central or State Act as an institution affiliated to or form as constituent member with a university, providing education up to a bachelors degree, masters degree or diploma of a duration of minimum one academic year.

4. Autonomous colleges as per National Policy on Education, 1986.

(b) Institutes not falling under the category of institutes/establishments which issue diploma or certificate recognized by the law for the time being in force-hence taxable under the category of "commercial coaching and training services"

An institution or establishment which is derecognized by the professional councils (such as All India Council for Technical Education-AICTE, Medical Council of India-MCI, Indian Council for Agricultural Research-ICAR, Bar Council of India-BCI) created through independent Union Acts.

(c) Deemed to be University not required to obtain the approval of AICTE to start any programme in technical or management education leading to an award, including degrees in disciplines covered under the AICTE Act, 1987

From the year 2005 onwards, a technical institution or establishment (which is otherwise recognized being a university, or affiliate college) has to obtain AICTE approval to fall under the category of institutes/establishments which issue diploma or certificate recognized by the law for the time being in force. However 'Deemed to be University' have been exempt from this requirement.

(d) Taxability of the courses conducted

In India, due to change in legal provisions, an institute/establishment may be recognized by the law at one time and not recognized at other. However, the taxability of the courses conducted would depend on the legal status of such institute or establishment at the point of time when such service is provided (i.e. course is conducted).

9. Whether the theatre owners are required to pay service tax on the rent received by them from distributors?

Screening of movie is not taxable except in the following case:-

Where the distributor leases out the hall for screening of the movie,

(i) the theater owner gets a fixed rent from the distributor.

(ii) the profit or loss from exhibiting the film is borne by the distributor.

In such a case, the theatre owner provides the taxable service of 'renting of immovable property' for furtherance of business or commerce and is accordingly liable to pay service tax on the rent received from the distributor.

[Circular No. 109/03/2009 dated 23.02.2009]

10. Service Tax (Provisional Attachment of Property) Rules, 2008

These rules introduced by Notification No.30/2008 ST dated 01.07.2008 with effect from 01.07.2008 provide as follows:-

Rule 3 - Procedure for provisional attachment of property

(a) The Assistant or the Deputy Commissioner of Central Excise, after due verification of the facts and circumstances of the case, for the purpose of protecting the interest of revenue, during the pendency of any proceeding under section 73/73A of the Finance Act, 1994, may forward a proposal for provisional attachment of property belonging to a person on whom a notice has been served under section 73(1)/73A(3) of the Act, to the Commissioner in the format prescribed in these Rules.

(b) The Commissioner may cause service of a notice on such person who can make a submission in this regard within 15 days of service of the notice.

(c) Upon consideration of submission, the Commissioner may pass an order to attach the property provisionally.

Rule 4 - The property that can be attached

(1) Value of property attached shall be of value as nearly as may be equivalent to that of the amount of pending revenue against such person.

(2) The movable property of such person shall be attached only if the immovable property available for attachment is not sufficient to protect the interest of revenue.

Rule 5 - Obligations of person whose property has been attached provisionally

The said person or his representative shall not mortgage, lease, transfer, deliver or deal with the attached property in any manner except with the previous approval of the Commissioner of Central Excise.

Rule 6 - Period for which order of provisional attachment of property remains in force

Every such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of the service of the order passed.

However, Chief Commissioner of Central Excise may grant an extension for a maximum period of two years.

11. Guidelines in respect of provisional attachment of property

Circular No. 103/06/2008 ST dated 01.07.2008 has issued the following guidelines in respect of provisional attachment of property for the purposes of protecting the interests of revenue during the pendency of any proceedings under section 73 or section 73A of the Act:

1. The following types of offences committed by a service provider or an exporter may be considered for provisional attachment of property:-

   (a) Provision of a taxable service without the cover of an invoice or any other document, as prescribed, and without payment of tax;

(b) Provision of a taxable service without declaring the correct value for payment of service tax, where a portion of value of taxable service, in excess of invoice price, is received by him or on his behalf but not accounted for in the books of account.

(c) Taking of CENVAT credit without the receipt of goods or services specified in the document based on which the said credit has been taken;

(d) Taking of CENVAT credit on invoices or other documents which a person has reasons to believe as not genuine;

(e) Issue of service tax invoice or any other document, without providing or to be providing a taxable service, as specified in the said invoice or other document;

(f) Claiming of refund or rebate in a fraudulent manner such as on invoice or other documents which a person has reason to believe as not genuine.

2. The provisional attachment of property shall be resorted only in a case where the service tax or CENVAT credit alleged to be involved is more than Rs.25 lakh.

3. Personal property of a sole proprietor or partners shall not be attached. Personal property means any movable or immovable property which is in personal use of the sole proprietor or partner. However, immovable property/ properties which is/ are used for commercial purpose may be provisionally attached. Movable property should be attached only if the immovable property available for attachment is not sufficient to protect the interests of revenue.

   It should also be ensured that such attachment does not hamper the normal business of the assessees. This would mean that inputs required for provision of a service should not be attached by the department.

4. Provisional attachment of the property shall not be excessive, that is to say, the property provisionally attached shall be of value as nearly as may be equivalent to that of the amount demanded in the proceedings under section 73 or section 73A of the Act.

5. The provisional attachment of the property of the concerned person shall be made after sunrise and before sunset and not otherwise.

6. After provisional attachment of the property, the Central Excise Officer shall prepare an inventory of the property attached and specify in it the place where it is lodged or kept and shall hand over a copy of the same to defaulter or the person from whose charge the property is distrained.

7. All such property as is by the Code of Civil Procedure, 1908 exempted from attachment and sale for execution of a decree of a Civil Court shall be exempt from provisional attachment. The decision of the Commissioner of Central Excise in this regard shall be final.

12. Clarification of issues relating to service tax levy on goods transport road services

Circular No. 104/07/2008-ST dated 06.08.2008 has clarified the following issues relating to service tax levy on goods transport by road services:

(i) Issue: GTA provides service to a person in relation to transportation of goods by road in a goods carriage. The service provided is a single composite service which may include various intermediary and ancillary services such as loading/unloading, packing/unpacking, transshipment, temporary warehousing. For the service provided, GTA issues a consignment note and the invoice issued by the GTA for providing the said service includes the value of intermediary and ancillary services. In such a case, whether the intermediary or ancillary activities is to be treated as part of GTA service and the abatement should be extended to the charges for such intermediary or ancillary service?

Clarification: GTA provides a service in relation to transportation of goods by road which is a single composite service. GTA also issues consignment note. The composite service may include various intermediate and ancillary services provided in relation to the principal service of the road transport of goods. Such intermediate and ancillary services may include services like loading/unloading, packing/unpacking, transshipment, temporary warehousing etc., which are provided in the course of transportation by road. These services are not provided as independent activities but are the means for successful provision of the principal service, namely, the transportation of goods by road. The contention that a single composite service should not be broken into its components and classified as separate services is a well-accepted principle of classification. As clarified earlier vide F.No. 334/4/2006-TRU dated 28.2.2006 (para 3.2 and 3.3) and F. No. 334.1/2008-TRU dated 29.2.2008 (para 3.2 and 3.3), a composite service, even if it consists of more than one service, should be treated as a single service based on the main or principal service and accordingly classified. While taking a view, both the form and substance of the transaction are to be taken into account. The guiding principle is to identify the essential features of the transaction. The method of invoicing does not alter the single composite nature of the service and classification in such cases is based on essential character by applying the principle of classification enumerated in section 65A. Thus, if any ancillary/intermediate service is provided in relation to transportation of goods, and the charges, if any, for such services are included in the invoice issued by the GTA, and not by any other person, such service would form part of GTA service and, therefore, the abatement of 75% would be available on it.

(ii) Issue: GTA providing service in relation to transportation of goods by road in a goods carriage also undertakes packing as an integral part of the service provided. It may be clarified whether in such cases service provided is to be classified under GTA service.

Clarification: Cargo handling service [Section 65(105)(zr)] means loading, unloading, packing or unpacking of cargo and includes the service of packing together with transportation of cargo with or without loading, unloading and unpacking. Transportation is not the essential character of cargo handling service but only incidental to the cargo handling service. Where service is provided by a person who is registered as GTA service provider and issues consignment note for transportation of goods by road in a goods carriage and the amount charged for the service provided is inclusive of packing, then the service shall be treated as GTA service and not cargo handling service.

(iii) Issue: Whether time sensitive transportation of goods by road in a goods carriage by a GTA shall be classified under courier service and not GTA service?

Clarification: On this issue, it is clarified that so long as, (a) the entire transportation of goods is by road; and (b) the person transporting the goods issues a consignment note, it would be classified as 'GTA Service'.

13. Clarifications of service tax issues relating to units in SEZ

Circular No. 105/08/2008 -ST dated 16.09 2008 has clarified the service tax issues relating to units in Special Economic Zones. It has been observed that there has been lack of clarity in the field formations administering service tax as regards the applicability of service tax levy on units located in SEZ. This lack of clarity has resulted in certain problems especially with respect to service tax administration. The issues and the proposed actions are mentioned below:

(i) Non-payment of service tax by SEZ units providing taxable service outside SEZ

There is no exclusion to SEZs in the Chapter V of the Finance Act, 1994 Taxable services received by SEZ units and SEZ developers for consumption within the SEZ are exempt for service tax under notification No. 4/2004-ST, dated 31.3.2004. However, service tax is applicable on taxable services provided by SEZ units, except such services which are exempt by notification No. 4/2004-ST. The C &AG, has pointed out instances, where SEZ units in Chennai & Cochin were providing taxable services like manpower supply service, technical testing and analysis service etc., to units / persons outside SEZ, without payment of service tax. In this regard the Ministry of Commerce (MOC) has observed that monitoring and collection of service tax does not come under the jurisdiction of the Development Commissioner and that such responsibility rests with the jurisdictional service tax (or CX & ST) authorities under the Central Board of Excise and Customs. Therefore, field formations should ensure that SEZs units, providing taxable services to any person for consumption in DTA (or providing any taxable service which is otherwise not exempt), or is otherwise liable to pay service tax under the service tax law, take registration with the jurisdictional service tax authorities and discharge their service tax liability in terms of the Finance Act, 1994.

(ii) Refund of Service Tax on taxable services used for the purposes of exports of goods by SEZ units

Refund of service tax paid on certain taxable services used in export of goods is permitted under notification 41/2007-ST. This notification prescribes that the refund would be allowed by the jurisdictional Deputy Commissioner/Assistant Commissioner of Central Excise. Doubts have arisen as to the authority that would process these claims when made by SEZ, i.e., the SEZ authorities or jurisdictional service tax authorities. As stated above, the Ministry of Commerce has already opined that administering the service tax law is responsibility of CBEC. Refund of service tax is to be processed by the respective jurisdictional authority administering service tax law. Accordingly, it is clarified that the SEZ units, claiming refund of service tax, should take registration with the jurisdictional ST authorities and file their claims there.

RECENT AMENDMENTS IN DIRECT TAX LAWS AND INDIRECT TAX LAWS

Students are advised to study thoroughly the Supplementary Study Paper-2008 on Direct Tax Laws and Indirect Tax Laws for the Final Course. This contains the amendments made by the Finance Act, 2008 as well as the significant Notifications/Circulars issued between 01.05.2007 and 30.04.2008. This Supplementary Study Paper is available at various branch and regional sales counters of the Institute. This RTP contains the significant amendments made through notifications/circulars issued between 1.5.2008 and 30.04.2009.

This is very important since considerable weightage is being given to the latest amendments in the examinations. Students may note that the Board of Studies has come out with a publication "Select Cases in Direct and Indirect Taxes [2008] – An Essential Reading for Final Course". This contains important recent judgements of Supreme Court, High Court and Appellate Tribunal in both Direct Taxes and Indirect Taxes.