REVISION TEST PAPER

FINAL (OLD) COURSE

GROUP – II

MAY – 2010

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PAPER – 5 : COST MANAGEMENT

QUESTIONS

Basic Cost Concepts for Decision Making: Application of Differential Cost Techniques in Managerial Decision

1. Your Company received an export offer from an potential foreign company for 20,000 units of a special product P @ Rs 1800 per unit.. Cost and other information for the production of the same is given below :

(i) Material Required per unit : 3 kg of X and 2 litres of Y

Cost of Material per unit :	X	Y
Book value (Rs)	80	300
Replacement (Rs)	100	320
Net Realizable	90	250

Material X is regularly used in the production process whereas 10,000 kg stock of

Material Y is lying in stock which is to be disposed, if not used in the current year.

(ii) Labour : Skilled 2 hours @ Rs 150 and unskilled 4 hours @ Rs 100

Skilled work-force is permanent in nature and underutilized.

Unskilled workers are to be hired on per hour basis.

(iii) If the order is accepted, the production of one existing product R is to be curtailed by 5000 units. Information on price and cost of per unit of R is as follows :

Sales Price : Rs 1000

Material : : Rs 200

Unskilled Labour of 4 hours

There will be saving on fixed overhead on the basis of labour hours.

(iv) Variable Overhead is charged @ Rs 30 per hour

(v) Fixed Overhead for the whole year is estimated to Rs 60 lakhs and the productive labour hour for the year is estimated to be 3 lakhs.

(vi) Additional Fixed Overhead of Rs 20.00 lakhs will be incurred for special order.

Required to calculate the profitability of the special order based on i) historical costing system and ii) =elevant costing system

Marginal Costing - Optimum Product Mix

2. A Company Produces three products, details of costs & sales Value per unit is given below

	Products (Rs / Unit)		
	A	B	C
Sales Value	2000	3000	2500
Direct Material	500	1000	800
Direct Wages Rs 100 per hour	500	700	400
Variable Overheads	300	600	700

(i) 80% of Direct Material is imported @ Rs 500 per kg. Import is restricted to 5,000 kg.

(ii) Capacity avaiable for production of A and C is restricted to 6250 and 6000 hrs respectively.

(iii) Fixed Cost is Rs 20 lakhs.

(a) Workout most profitable product mix and profit.

(iv) Company identifies a source of alternative material as replacement of imported material. Availability of material will not be restricted but carrying cost will be @ Rs 2.75 per kg.

The company plans to modify its process to suit the new material and enhance its capacity for all products by 20% above the present one with an investment of Rs 25 lakhs at an interest of cost of 15%. Company expects 30% rise in is profit.

(b) Find out the price the company can pay to alternative source.

Decision Making : Make Or Buy

3. A Company is engaged in production of Electronic gadget and produces 5,000 units per annum. It also produces 17,000 units of components. Cost of Manufacturing is given below :

Manufacturing Cost	Total Rs Lakhs	Share of Component Production
Direct Material	80.00	10%
Direct Labour	18.00	25%
Indirect Labour	10.00	30%
Inspection & testing	6.00	20%
Power	3.00	10%
Lighting	1.00	10%
Insurane	0.96	
Depreciation	2.44	
Misc Fixed Expenses	4.00	

(a) Maket Price of the component is Rs 120. Decide whether component to make.

(b) Company received an offer of additional 1000 units of gadgets @ Rs 2500/unit. If offer is accepted, full capacity will be utilized and production of components is to be withdrawn. Decide whether the offer is to accepted.

Shut Down of Operation or Continue

4. A Company manufactures has normal capacity of production of 20,000 units of Product P . Due to Trade depression, it is expected that only 2,000 units can be produced and sold in the next quarter of the year @ Rs 1,000 per unit. Variable cost per unit is Rs 900 and fixed cost for the year is Rs 14 lakhs. The Company plans to shut down the plant and it is estimated that fixed cost for the quarter could be brought down to 1.00 lakhs. Additional cost of shut down is estimated to be Rs 40,000.

   (a) Decide whether the plant is to be shut down or not.

   (b) Calculate the shutdown point

   (c) What are other factors to be considered in the decision of shut down

Profit Optimization - Decision Making

5. ABC Ltd is producing following four products, sales and costs for last year is given below:

Rs Lakhs

Products ------→	**A**	**B**	**C**	**D**
Sales	500	600	240	200
Direct Material	160	180	68	110
Direct Wages	100	120	64	56
Factory Overheads	80	70	54	30
Selling & Dist Overheads	40	50	20	35
Total cost	380	420	206	231
Profit	120	180	34	-31

Total Profit is Rs 303 lakhs.

(i) Present production is much below the capacity. There is market demand of Products A and B and the management likes to enhance production of both A & B by 30%.

(ii) Management proposes to discontinue product D as it is loss making. However, sale of product C is in conjunction with D and D's discontinuance will affect sale of C by 25%.

(iii) 50% of Factory Overheads is variable and variable Selling & Dist. Overheads is 5% of sales. In case of Increase of Production of A & B as above in (i), Fixed Factory Overheads apportioned to A and B will rise by 25% and 20% respectively.

On discontinuance of D, Fixed Factory Overhead for product D can be eliminated by 70% and its portion of Selling & Dist Overhead can be avoided totally.

(a) Suggest whether Product D is to be discontinued.

(b) What will be profitability after enhancement of production of A & B ?

Product Pricing

6. AB Company has two departments producing several small electronic components. It has acquired a new technology to produce a electronic product X . Cost and other information for manufacturing X are given below :

Item	*Department A*	*Department B*
Direct Material	Rs 240	Rs 200
Direct Labour	2 hours @ Rs 120	3 hours @ Rs 100
Variable Overhead per hour	Rs 50	Rs 30
Fixed Overheads per hour (based on 100% capacity)	Rs 60	Rs 40
Value of Machinery on revaluation	Rs 40 lakhs	Rs 28 lakhs

(i) Technology cost Rs 25 lakhs and working capital requirement Rs 7 lakhs

(ii) Target Volume of production in the first year is 2000 units at 25% capacity

(iii) Variable Selling & Distribution .is Rs 3 lakhs

(iv) Expected net return on investment is 24%

Suggest on pricing product as (a) new one (b) established one - production at 80% capacity.

Costing of Service Sector

7. A Health Care Centre has been established 30 beds and the following variable and fixed cost for the whole year is estimated.

Variable Cost	*Rs '000*	*Fixed Cost*	*Rs '000*
Doctors' fees	900	Salary of nurses & staff	670
Food	200	Rent	900
Laundry	34	Repair & maint	100
	-	General Administration	96
Total	1134	Total	1766

(i) Health centre was open for 365 days.

(ii) Occupancy : 165 days - full, 100 days – 25 patients and balance 20 average

(iii) Cost of X-ray, Oxygen, Medicine are charged extra by a service agency..

(iv) Profit to be charged 30% above the cost.

(a) Calculate the Charge per patient-day, BEP Patient days.

(b) If BEP point is to be at 50% occupancy, what should be charge per patient-day?

Transfer Price

8. Division A produces three products X, Y and Z, cost per unit and other details are given below :

	X	Y	Z
Market Price (Rs)	500	450	400
Max Demand (units)	800	500	300
Variable Cost (Rs)	440	350	310
Labour hours required/ Unit	3	4	3

Division B requires 300 units of Y. Similar product is procured by it @ Rs 430.

Division A operates as a profit centre. Work out a transfer price not affecting Division A, if labour hours available to division A are(i) 4400 hours (ii) 5900 hours

Activity Based Costing

9. ABC Ltd is manufacturing 4 similar products W, X, Y, Z with the following details :

Products --→	*W*	*X*	*Y*	*Z*
Units	3,000	500	300	1000
Material Cost Per Unit (Rs)	50	70	160	180
Labour Costs (Rs)	50	60	100	75
Machine Time per unit (.hour)	0.5	0.5	2	4
No of Sets up	10	1	2	10
No of Purchase Order	6	1	1	5
No of Material handling	12	1	2	15

Set up cost is Rs 9000, Purchase Ordering Cost Rs 10,400, Handling Cost Rs 6000 and other factory overheads is Rs 1,27,000

In present system, total overheads are charged to production on machine hour basis.

Apply Activity based costing on the basis of relevant cost drivers and indicate the difference in cost of products under the two methods.

Material Procurement and Cash Budget

10. The budgeted stock and sales position for five months Dec 2009 – April 2010 are given below :

(Rs lakhs):

	Dec	Jan	Feb	March	April
Credit Sales	23	25	20	22	24
Cash Sales	7	7	8	8	8

(i) Opening Stock is maintained at 30% of material requirement of current month's material requirement. Material is purchased at one month's credit.

(ii) Wages, Rent and Administraive Expenses per month is Rs 3, 4 & 2 lakhs respectively.

(iii) Admin Expenses are paid during current month whereas wages and rent in the next.

(iv) Depreciation is 10% on equipment of book value of Rs 120 lakhs

Profit is 25% on sales.

(v) Credit sales is for one month & cash balance at end of December was 8 lakhs. Instalment of Interest on loan @ Rs 4 lakhs is paid every month.

(a) Prepare Material Procurement budget for 4 months : Dec 2009 Jan- March 2010.

(b) Prepare Cash Budget for 3 months : Jan – March 2010.

Budgeting

11. ABC Ltd has, over the past few years, has sales of Rs 400 lakhs with 30% contribution.

Last year's fixed cost was Rs 45 lakhs. Company plans to venture into new contract service business and also in the process of introduction of a new product.

(i) Proposal A : Value of Rs 30 lakhs with variable cost 60%, fixed cost of Rs 4 laks

Proposal B : Value of Rs 20 lakhs with variable cost 50%, fixed cost Rs 3 lakhs

(ii) New product : Expected Sales per month 6 lakh with 50% variable cost and fixed cost of Rs 1.0 lakhs per month.

(iii) Optimistic assumption : Offer for both Contract A & B will mature and be executed next year and new product will be launched from 2nd quarter of next year.

(iv) Pessimistic assumption : Only Contract A will mature and be executed next year and new product will be launched from 4th quarters of next year and there will be rise in both variable and fixed cost by 10% without scope for rise in sales value.

Prepare two budgets based on optimistic and pessimistic assumptions.

Profit Planning

12. A Company is manufacturing car components to be supplied to a car Manufacturer. For the current year, material cost per unit is Rs 100, Direct Wages Rs 40 and direct expenses Rs 10 The other information are as follows :

Semi-variable cost (Rs lakhs) at different levels of production :

Units	16,000	20,000	24,000
Indirect Material	2.00	2.60	3.20
Indirect Wages	1.02	1.50	1.98
Indirect Expenses	0.46	0.50	0.54
Selling Expenses	3.00	4.00	5.00

Fixed Expenses (Depreciation, Maintenance etc) = Rs 5.50 lakhs per year.

The company is , at present, supplying 20,000 at a price of Rs 200 expecting order of higher size at the same price. The plant has maximum capacity of producing 30,000 units. It has come to an understanding with the supplier that 1% discount in price (on present price) will be there for increase in size by each 5% from the present order. Direct Wages will increase by 5% next year. Moreover, the fixed overheads may increase by 5% for each increase in volume of production by 10% or part thereof. The marketing department assessed the probabilities of different order size :

Order Size	Probability
20,000	0.35
25,000	0.50
30,000	0.15

Prepare a budgeted profit for the next year on sale based on assessed probability with a comparison with the current year's expected profit .

Variance Analysis

13. EXEL Company is following JIT system for inventory management and it is expected that there will be no opening and closing balance for January 2010. Budgeted production of its product X during the month is 600 kg with the following standard cost per unit :

			Rs
Direct Material	4 kg @ Rs 40 per kg	:	160.00
Direct Wages	1.0 hours @ Rs 100 per hour	:	100.00
Variable overheads	1 hour @ 30	:	30.00
Fixed Overheads	1 hour @ 50	:	50.00
Standard Cost			340.00
Standard Profit			60.00
Standard Selling Price			400.00

Actual Expenses :

(i) Material 2380 kg kg at a total cost of Rs 99,960

(ii) Labour 580 hours at a cost of Rs 56840

(iii) Actual Operating Hours is 550.

(iv) Variable Overheads of Rs 19,200

(v) Fixed Overheads of Rs 31,500

(vi) Selling and Administrative Expenses Rs 5,400

(vii) Output of 585 kg was sold for Rs 2,28,150.

(a) Calculate all variances and (b) Draw an operating statement for Jan 2010.

Decision Making on Acceptance of an Order

14. A Company had the following budget of operation & profit for the current year :

	Rs Lakhs
Sales	50.00
Direct Material	20.00
Direct Labour	10.00
Factory Overheads – variable	2.00
Factory Overheads – Fixed	2.00
Administrative expenses	3.00
Sales commission	1.00
Fixed Sales Expenses	2.00
Total Costs	40.00
Profit	10.00

For fixing prices, the company charges overheads as 100% of Direct wages. It is reviewed at the fourth quarter that the company would achieve the target of normal sales and profit. However, a special order has been received from a prospective customer valued Rs 2.00 lakhs which involves no sales commission. However, it is estimated that material requirement will be of Rs 1,00,000 and wages will be Rs 60,000.

As total cost of the order taking overheads @ 100% wages is more than Rs 2.00 lakhs, the company is hesitant to accept the order. As an accountant, give your suggestion.

Decision Making

15. AB Ltd produces two products A and B, some deatails of which are given below :

	A	B
Budgeted Selling Price	Rs 3600	Rs 4300
Variable Production & selling cost	Rs 2700	Rs 3700

Total Fixed Cost is Rs 18 lakhs

For effective selling, Marketing team has given two options for combined sale of products.

Option 1 : A & B in the proportion of 2: 3

Option 2: A & B in the proportion of 3: 4

Suggest the best option.

Learning Curve Theory

16. In your company, production manager has observed that learning curve theory is very much applicable in the newly procured machine @ 90%. A batch of production is of 100 units. The average labour cost for the first batch is Rs 200. Material Cost and Overheads are Rs 150 and 50 per unit respectively. If profit margin is 25% on cost, estimate the price per unit if the order size is for (a) 800 units and (b) 1600 units (c) 2000 units

Life Cycle Costing : Introduction and Benefits

17. (a) What is life cycle costing ? What are the benefits of the technique ?

    (b) What is theory of constraints ? What are key measures suggested by it ?

Value Chain Analysis : Definition and Competitive Advantage

18. What is value Chain Analysis ? How Value Chain Approach helps in assessing competitive advantage ?

Linear Programming

19. A Company produces three product P, Q, R with raw material M_1 & M_2. Requirement and availability raw material and labour units are given in the following table. Contribution per unit of the products are given:

Products	Requirement of per unit			Availability per day
	P	Q	R	
Material M_1 (kg)	1	2	2	8 kg
Material M_2 (kg)	3	2	6	12 kg
Labour unit	2	3	4	12 unit
Contribution per unit	Rs.3	Rs.2	Rs.5	

Formulate this as a Linen Programming problem and solve it to determine optimum product mix.

Programme Evaluation and Review Technique

20. ABC Construction Company has the following 6 activities relating to a project:

Activity	Time estimate			Normal Cost (Rs.)	Crash Cost (Rs.)	Immediate Predecesson
	t_0	t_m	t_p			
A	2	3	4	6,000	8,000	-
B	4	5	6	12,000	13,500	A

C	3	5	7	16,000	22,000	A
D	2	4	6	8,000	10,000	A
E	1	2	3	6,000	7,500	C D
F	1	3	5	14,000	20,000	B E

Penalty for delay in competition of project beyond ten weeks is Rs.2,500.

a. Constrict the PERT Network and determine critical path.

b. Crash the activity sin order to achieve the optimum cost for completion of the project.

Transportation Problem

21. A Fertilize Company has the following production in its four plants with following production capacity :

Plant	A	B	C	D
Demand (Tons)	10,000	18,000	22,000	24,000

The company has three Distribution centres located at places P, Q and R. The capacity of warehouses at these places and the and the cost of transportation from different plants to these warehouses are indicated given below:

Ports	Demand (Tons)	A	B	C	D
P	20,000	50	60	100	50
Q	38,000	80	40	70	50
R	16,000	90	70	30	50

Devise distribution plan to optimize transportation cost.

Assignment Problem

22. Output of 5 operators when they worked with different 4 machines are given in the table below:

	Machine			
Operator	**M1**	**M2**	**M3**	**M4**
A	10	5	7	8
B	11	4	9	10
C	8	4	9	7
D	7	5	6	4
E	8	9	7	5

Use assignment technique to solve it.

Simulation

23. Occurrence of rain in a city on a day is dependent up whether if rained on the previous day.

If rained previous day		If not rained previous day	
Event	Probability	Event	Probability
No rain	0.50	No rain	0.75
1 cm rain	0.25	1 cm rain	0.15
2 cm rain	0.15	2 cm rain	0.06
3 cm rain	0.05	3 cm rain	0.04
4 cm rain	0.03		
5 cm rain	0.02		

Simulate the city's weather for 10 days and determine the rain fall during the period. Use the following random numbers: 67, 63, 39, 55, 29, 78, 70, 06, 78, and 76.

Time Series data Analysis

24. Explain the meaning of deseasonalisation of data. What Purpose does it serve ? Deseasonalise the following sales data with the help of seasonal index given below :

Month	Sales Rs lakhs)	Seasonal index
January	360	120
February	400	80
March	550	110
April	360	90
May	350	70
June	550	100

Testing of Hypothesis

25. Quick Courier guarantees 90% of timely delivery of letters. In the recent week, out of 81 deliveries , 6 were late. Determine whether the claim of the courier company is legitimate at 95% confidence level.

SUGGESTED ANSWERS / HINTS

1. Revised Fixed Overhead rate :

Fixed Overheads = Rs (60,00,000 – 4,00,00 + 20,00,000) = Rs 76,00,000

Total Hours (3,00,000 – 20,000 + 120,000) 4,00,000

Fixed Overhead rate per hour Rs 19.00

(i) Statement of Profit based on historical cost (for 20,000 units of P)

Item	*Unit*	*Rate (Rs)*	*Rs Lakhs*
Material X	60,000 kg	80	48.00
Material Y	40,000 ltrs	300	120.00
Skilled Labour	40,000 hrs	150	60.00
Unskilled Labour	80,000 hrs	100	80.00
Variable Cost	120,000 hrs	30	36.00
Fixed Overhead	120,000 hrs	19	22.80
Total Cost			366.80
Sales value of product P	20,000	1800	360.00
Loss			6.80

(ii) Statement of Profitability based on Relevance Cost

Loss of profit from Sale of 5000 units of Product R :

	Rs lakhs
Sales Value @ Rs 1000	50.00
Material Cost	10.00
Wages of 20000 hours unskilled workers @ Rs 100	20.00
Variable Overhead of 20000 hours @ Rs 30	6.00
Fixed Overheads of 20000 hours @ Rs 20	4.00
Total Cost	40.00
Profit	10.00

Item	*Remarks*	*Unit*	*Rate (Rs)*	*Rs Lakhs*
Material X	Replacement cost	60,000 kg	100	60.00
Material Y	Resale value	40,000 ltrs	250	100.00
Skilled Labour	Sunk cost			

Unskilled Labour		80,000 hrs	100	80.00
Variable Cost		120,000 hrs	30	36.00
Fixed Overhead	Identified portion – other not relevant			20.00
Loss of Profit from sale of R	Opportunity Cost			10.00
Total Cost				306.00
Sales value of product P		20,000	1800	360.00
Profit				54.00

2. (a)

	A	*B*	*C*	*Total*
Sales price (Rs)	2000	3000	2500	
Imported Material (Rs)	400	800	640	
Domestic Material (Rs)	100	200	160	
Direct Wages (Rs)	500	700	400	
Variable Overheads (Rs)	300	600	700	
Total VariableCost (Rs)	1300	2300	1900	
Contribution per unit (Rs)	700	700	600	
Imported Material in Kg	0.8	1.6	1.28	
Contribution per kg of imported mat (Rs)	875	437.5	468.75	
Ranking based on contribution per kg imported material	1	3	2	
Labour Hours required	5	7	4	
Contribution per labour hours (Rs)	140	100	150	
Ranking based on contribution per labour hour	2	3	1	
Units to be produced on basis Labour Hours available	1250		1500	
Imported Material required/ available in Kg	1000	2080	1920	
Optimum Product Mix	**1250**	**1300**	**1500**	
Contribution (Rs)	875000	910000	900000	
Total Contribution				2685000
Fixed Cost				2000000
Profit				685000

(b) Profitability to be maintained after process modification & capacity enhancement

	A	B	C	Total
Units to be produced	1500	1560	1800	
Sales Value	3000000	4680000	4500000	12180000
Substitute Material required (kg)	1200	2496	2304	6000
Total Variable cost per unit (excluding import material)	900	1500	1260	
Total Variable cost (excluding cost of subs material)	1350000	2340000	2268000	5958000
Contribution required + Sub Material Cost				6222000
Profit required at enhanced rate				890500
Fixed Cost (including interest on invest.)				2375000
Contribution Required				3265500
Substitute Material Cost of 6000 kg				2956500
Cost Per kg of Substitute Material				492.75
Transport Cost per kg				2.75
Price may be offered per kg for substitute material				490

3. (a)

	Cost of Gadget	Cost of component
	Rs lakhs	Rs Lakhs
Direct Material	72.00	8.00
Direct Labour	13.50	4.50
Indirect Labour	7.00	3.00
Inspection & Testing	4.80	1.20
Power	2.70	0.30
Total Variable Cost	100.00	17.00
Units Manufactured	5000	17000
Cost Per Unit (Rs)	2000.00	100.00
Contribution per unit (Rs)	500.00	20.00

Note : Insurance and lighting cost is fixed in nature. Variable cost of manufacturing of component is less than market price. Hence, decision is to make.

(b) If the order of 1000 additional units is accepted,

Contribution from the offer (500 x 1000)	= Rs 5 lakhs
Loss of Contribution of 17000 components @ Rs. 20	= Rs 3.40 lakhs
Net Gain in Contribution	= Rs 1.60 lakhs.

Hence the offer should be accepted.

4. (a) If Plant is in Operation

Contribution per unit = Rs 100

Total Contribution from 2000 units	= Rs 2.00 lakhs.
Fixed Cost for the Quarter (14 x 0.25)	= Rs 3.50 lakhs
Expected Loss in operation	= Rs 1.50 lakhs

If Plant is Shut Down

Unavoidable fixed cost for the period	= Rs 1.00 lakhs
Shutdown cost	= Rs 0.40 lakhs
Total Loss on Shut Down	= Rs 1.40

Hence, plant may be shut down.

(b) Shut Down point = (Fixed Cost – Shutdown cost) / Contribution per unit

= (3,50,000 – 1,40,000) / 100 = 2,100 units

(c) Other non-cost factors to be considered for shut-down :

(i) Difficulty in getting the skilled workers at the time of re-opening, because worker might switch over to other jobs.

(ii) Re-opening cost of plants

(iii) Effect on long shutdown on the machinery

(iv) Loss of loyalty to customers etc

5. (a) On Discontinuance of D, sale of C will be 75% and henceProfitability of C will be affected as follows :

For Product C	*Rs Lakhs*
Sale	180.00
Direct Material	51.00
Direct Wages	48.00
V Factory Overheads	20.25
Fixed Factory Overads	27.00
V Selling & Dist Overheads	9.00
Fixed Selling & Dist Overheads	8.00

Total Cost	163.25
Profit for C	16.75
Less Fixed Fac Overheads for D	7.50
Profit on discontinuance of D	9.25

Earlier profitability of products of both C and D was Rs 3 lakhs only which has been increased to Rs 9.25 lakhs. Hence, D may be discontinued.

Profitability of A and B on enhancement of its production by 30% (Rs lakhs)

	A	**B**	**Total**
Sales	650	780	1430
Direct Material	208	234	
Direct Wages	130	156	
V Factory Overheads	52	45.5	
Fixed Overheads	50	42	
V. Selling & dist. Overheads	32.5	39	
Fixed Selling & Dist Overheads	15	20	
Total cost	477.5	536.5	1014
Profit			326

Total Profit including that of C = Rs 335.25 lakhs i.e increase by Rs 32.25 lakhs.

6. Variable Cost per unit of X

Item	Dept A (Rs)	Dept B (Rs)	Total (Rs)
Direct Material	240	200	440
Direct Labour	240	300	540
Variable Overhead	100	90	190
Variable S/D Overheads			150
Total Variable Cost			1320

Fixed Cost = Rs 8000 (60 x 2 + 40 x 3) = Rs 19. 20 lakhs

Fixed Capital Employed = Rs (40+28+25+7) lakhs = 100 lakhs

Return Expected @ 24 % on capital = 24 lakhs

(a) For New Product, minimum price may be at variable cost i.e Rs 1320.

(b) When the product will be established one, unit sold will be 6400 units.

Fixed Cost + Return on Capital per unit = Rs (24 + 19.2) lakhs/ 6400 = Rs 675.

It is assumed that S/D cost will be at the same rate.

Price to be charged = Rs (1320 + 675) = Rs 1995.

7. (a) Total patient –days = 165 x 30 + 100 x 25 + 100 x 20 = 9450

Total Cost = Rs (11.34 + 17.66) = Rs 29.00 lakhs

Total Revenue required = Rs 29.00 x 1.30 lakhs = 37.70 lakhs

Charge for patient-day = Rs 37,70,000 / 9450 = Rs 400 approx

Variable Cost per patient-day = Rs 11,34,000 / 9450 = Rs 120

Contribution per patient-day = Rs 280

BEP Patient- days = 1766,000/ 280 = 6307 i.e 17.28 per day average

(b) Average 50% occupancy = patient-days = 365 x 15 =5475

Contribution required per day = 1766,000 / 5475 = Rs 322.55

Charge per Patient-day = Rs (120 + 322.55) = Rs 442.55 = Rs 445 (rounded)

8.

	X	Y	Z
Contribution Per Unit (Rs)	60	100	90
Labour Hours per unit units)	3	4	3
Contribution per L. hour (Rs)	20	25	30
Ranking on Contribution	3	2	1

(i) If only 4400 hours available, production of Division A will be :

	When sold in outside market			*Transfer to Div B*		
Product	*Units*	*Lobour Hours*	*Contribution (Rs)*	*Units*	*Lobour Hours*	*Contribution (Rs)*
Z	300	900	27000	300	900	27000
Y	500	2000	50000	800	3200	74000
X	500	1500	30000	100	300	6000
Total		4400	107000		4400	107000

On 300 units transfer of Y, loss on production of X by 400 units will cause loss of contribution of Rs 24,000. Thus, 300 units transfer should make up loss @ Rs 80 per unit. Thus, transfer price of Rs 430 satisfies the same.

(ii) If only 5900 hours available, production of Division A will be :

	When sold in outside market			*Transfer to Div B*		
Product	*Units*	*Lobour Hours*	*Contribution (Rs)*	*Units*	*Lobour Hours*	*Contribution required (Rs)*
Z	300	900	27000	300	900	27000

Y	500	2000	50000	800	3200	62000
X	800	2400	48000	600	1800	36000
Total		5300	125000		5900	125000

In this case, on 300 units transfer of Y, loss on production of X by 200 units will cause loss of contribution of Rs 12,000. Thus, 300 units transfer should make up loss @ Rs 40 per unit.

In this case, transfer price may be fixed at Rs 390.

Division A will earn higher contribution of Rs 18,000 for its extra effort.

And a transfer price of Rs 430 will give Division A Rs 30,000 higher contribution.

9. Total Machine hour = 1500+250+600+4000 = 6350 hrs

Overheads rate per machine hr = Rs (1,27,000+ 9000+ 10400+6000) / 6350 = Rs 24

No of Set up = 18, Cost per set up = Rs 9000 / 18 = Rs 500

No of Purchase Orders = 13, Cost per Purchase Order = Rs 10,400 / 13 = Rs 800

No Of Material Handling = 30, Cost per material handling = Rs 6000 / 30 = 200

Other Factory Overheads rate on basis of Machine hr = Rs 1,27,000 /6350 = Rs 20

Cost of Products in present system per unit in Rupees

Products ---→	W	X	Y	Z
Material Cost (Rs)	50	70	160	180
Labour Cost (Rs)	50	60	100	75
Overheads at M/C hr rate	12	12	48	96
Total Cost	112	142	308	351

Cost of Products on the basis of Activity Based Costing per unit in rupees :

Products ---→	W	X	Y	Z
Material Cost	50.00	70.00	160.00	180.00
Labour Cost	50.00	60.00	100.00	75.00
Set Up Cost	5000/3000=1.67	500/500= 1	500/600=0.83	5000/1000=5.00
Ordering Cost	4800/3000=1.60	800/500=1.60	800/600=1.33	4000/1000=4.00
Material Handling	2400/3000= 0.80	200/500= 0.40	200/600=0.33	3000/1000=3.00
Other Factory OH	10.00	10.00	40.00	80.00
Total Cost	114.07	133.00	302.49	347.00

10. **(a)** Material Procurement Budget — Rupees in lakhs

	Dec	Jan	Feb	March	April
(a) Sales	30	32	28.0	30.0	32
(b) Profit	7.5	8	7.0	7.5	8.

(c)	Cost of Sales	22.5	24	21.0	22.5	24
(d)	Wages & other overheads	9.0	9.0	9.0	9.0	9.0
(e)	Depreciation (4 / 4)	1.0	1.0	1.0	1.0	1.0
(f)	Material requirement (c – d – e)	12.5	14.0	11.0	12.5	14
(g)	Opening Balance	3.75	4.2	3.3	3.75	4.2
(h)	Closing Balance	4.2	3.3	3.75	4.2	
(i)	Material to be procured	12.95	13.5	11.45	12.95	

(b) Cash Budget — Rupees in lakhs

	Jan	Feb	March
Opening Balance	8.0	12.05	18.55
Receipts from cash Sale	7.0	8.0	8.0
Receipts from Credit Sale	23.0	25.0	20.0
Total	38.0	45.05	46.55
Interest Payment	4.0	4.0	4.0
Payment for Material	12.95	13.5	11.45
Wages & Rent	7.0	7.0	7.0
Admin Expenses	2.0	2.0	2.0
Total	25.95	26.5	24.45
Closing Balance	12.05	18.55	22.10

11. Budget for the next year based on optimistic assumptions (Figures in Rs Lakhs)

Activities	*Revenue*	*Variable Cost*	*Fixed Cost*	*Profit*
Normal Activity	400	280	45	75
Contract service	50	28	7	15
New Product	54	27	9	18
Total	504	335	61	108

Budget based on pessimistic assumptions (Figures in Rs Lakhs)

Activities	*Revenue*	*Variable Cost*	*Fixed Cost*	*Profit*
Normal Activity	400	280	45	75
Contract service	30	19.8	4.4	5.8
New Product	18	9.9	3.3	4.8
Total	448	309.7	52.7	85.6

12. Next year Order Size = 20,000 x 0.35 + 25,000 x 0.50 + 30,000 x 0.15 = 25,000

Increase in volume by 25%

Metal price will increase by 5% and fixed expenses by 15%

	20,000 units	25,000 units
	Cost Per Unit (Rs)	
Direct material	100.00	95.00
Direct Wages	40.00	42.00
Direct Expenses	10.00	10.00
Variable cost per unit	150.00	147.00
Total Variable Cost (Rs Lakhs)	30.00	36.75
Overheads	***Rs Lakhs***	***Rs Lakhs***
Indirect Material	2.60	3.35
Indirect Wages	1.50	2.10
Indirect Expenses	0.50	0.55
Selling Expenses	4.00	5.25
Fixed Overheads	5.50	6.235
Total Overheads	13.50	17.485
Total Cost (Rs lakhs)	43.50	54.235
Sales Value	50.00	62.50
Profit	6.50	8.265

Increase in profit will by 1.765 i.e 27.2 % approx.

13. **(a)** Material Price Variance = AQ x (SR – AR) = 2520 (40 – 42) = Rs 5040 (A)

Material Usage Variance = SR x (SQ – AQ) = 160 (2400 – 2380) = 3200(F)

Labour Rate Variance = AH (SR – AR) = 580 (100- 98) = 1160 (F)

Labour Efficiency Variance = SR x (SH – AH) = 100 (600- 580) = 2000 (F)

Labour Idle Time Vriance = SR x Idle Time = 100 (580-550) = 3000 (A)

Variable Overhead Exp Var = (BVOH – AVOH) = 550 x 30 – 19,200 = Rs 2,700 (A)

Variable Overhead Efficiency Var= SR (SH – AH) = 30 (585 – 590) = 150 (A)

Fixed Overhead Expenditure Var= (BFOH – AFOH) = 600 x 50 – 31,500= Rs 1,500(A)

Fixed Overhead Volume Var= BFOH per unit(BV – AV) = 50 (600 – 585) = 750 (A)

Fixed Overhead Efficiency Var = BFOH per hr (SH – AH) = 50(585- 550) = Rs 1750(F)

Fixed Overhead Capacity Var= BFOH per hour (Bugt Capacity – Actual capacity)

= 50 (600- 550) = 2500 (A)

Sales Price Variance = AQ (SP – AP) = 585 (400 – 390) = Rs 5850 (A)

Sales Volume Variance = Std Profit per unit (Budgeted sales unit – Actual Sales Unit)

= 60 (600 - 585) = 900 (A)

(b) Operating Statement for the month of January, 2010

Budgeted Profit (before Selling & Administrative Exp) (600 x 6)			Rs 36,000
Selling & Administrative Expenses			5,400
Profit			Rs 30,600
Sales Variances :			
Price		5850 (A)	
Volume		900 (A)	6,750(A)
Actual Sales minus Standard Cost of Sales			23,850
Cost Variances :	F	A	
Material Price Variance		5040	
Material Usage Variance	3200		
Labour Rate Variance	1160		
Labour Efficiency Variance	2000		
Labour Idle Time Variance		3000	
Variable Overhead Expenditure Var		2700	
Variable Overhead Efficiency Var		150	
Fixed Overhead Expenditure Var		1,500	
Fixed Overhead Volume Var		750	
Fixed Overhead Efficiency Var	1750		
Fixed Overhead Capacity Var		2500	
	8110	15640	7, 530(A)
Actual Profit for the month			16, 320

14. It is assumed that Fixed Overheads have been assessed at normal production. Moreover, the sales commission is not involved in the case of special order.

Taking Variable Factory Overheads @ 20% of wages,

Total cost of the special order will be Rs (1.00 + 0.60 + 0.12) laks i.e Rs 1.72 lakhs

Thus, the special order, if executed will give profit of Rs 28,000.

Hence, the order should be accepted.

15.

	A	*B*	*Total*
Sales Value (Rs)	3600	4300	
Contribution per unit (Rs)	900	600	
Option 1			
Contribution per set (Rs)	1800	1800	3600
Break Even Point (set)	1000 units	1500 units	18,00,000/3600= 500 sets
Sales Value (Rs lakhs)	36	64.5	100.50
Option 2			
Contribution per set (Rs)	2700	2400	5100
Break Even Point	1059	1412	18,00,000/5100 =353
Sales Value (Rs lakhs)	28.593	33.888	62.481

As BEP in Option 2 is at lower sales, it is preferable.

16. Average cost for first 200 units = 0.90 x 200 = Rs 180

Average cost for first 400 units = 0.90 x 180 = Rs 162

Average cost for first 800 units = 0.90 x 162 = Rs 145.80

Average cost for first 1600 units = 0.90 x 145.80 = Rs 131.22

We know that learning curve equation :

Y= ax ^b

Where y = average time for producing x units

a = time spent on first unit / batch

b= co-efficient of learning curve

b= - log (1 - % decrease) / Log 2 = log (1 – 0.10) / log 2 = - 0.0458/0.3010 =- 0.15206

Thus, for 2000 units, batch = 2000/ 100 = 20

Y= 200 x 20 ^ -0.15206

Log y= log (200) - 0.15206(log 20) = 2.3010 - 0.15206 x 1.3010 = 2.103172

Thus y = antilog (2.103172) = 126.81

Thus, average labour cost for 2000 units = Rs 126.81

Thus, price to be quoted for different units are :

	First 800 units (Rs)	*First 1600 units (Rs)*	*First 2000 units (Rs)*
Material @ Rs 150	120000	240000	300000
Labour Cost	116640	209952	253620
Overheads	40000	80000	100000
Total Cost	276640	529952	653620
Profit	69160	132488	163405
Price to be quoted	345800	662440	817025

17. (a) Life cycle costing as its name implies costs the cost object i.e., product, project etc. over its projected life. It is used to describe a system that tracks and accumulates the actual costs and revenues attributable to cost object from its inception to its abandonment. The profitability of any given cost object can therefore be determined at the end of its economic life.

Life cycle costing is different to traditional cost accounting system which report cost object profitability on a calendar basis i.e. monthly, quarterly and annually. In contrast life cycle costing involves tracing cost and revenues on a product by product bases over several calendar periods. Costs and revenue can be analysed by time period, but the emphasis is on cost revenue accumutation over the entire life cycle of each product.

The benefits of product life cycle costing are summarized as follows :

(i) The product life cycle costing results in earlier actions to generate revenue or to lower costs than otherwise might be considered. There are a number of factors that need to the managed in order to maximise return on a product.

(ii) Better decisions should follow from a more accurate and realistic assessment of revenues and costs, at least within a particular life cycle stage.

(iii) Product life cycle thinking can promote long-term rewarding in contrast to short-term profitability rewarding.

(iv) It provides an overall framework for considering total incremental costs over the entire life span of a product, which in turn facilitates analysis of parts of the whole where cost effectiveness might be improved.

(b) The theory of constraints focuses its attention on constraints and bottlenecks within organisation which hinder speedy production. The main concept is to maximize the rate of manufacturing output is the throughput of the organisation. This requires to examine the bottlenecks and constraints. A bottleneck is an activity within the organization where the demand for that resource is more than its capacity to supply.

A constraint is a situational factor which makes the achievement of objectives / throughput more difficult than it would otherwise, for example of constraint may be lack of skilled labour, lack of customer orders, or the need to achieve high quality in product output.

For example let meeting the customers' delivery schedule be a major constraint in an organisation. The bottleneck may be a certain machine in the factory. Thus bottlenecks and constraints are closely examined to increase throughput.

Key measures of theory of constraints:

(i) **Throughput contribution:** It is the rate at which the system generates profits through sales. It is defined as, sales less completely variable cost, sales – direct are excluded. Labour costs tend to be partially fixed and conferred are excluded normally.

(ii) **Investments:** This is the sum of material costs of direct materials, inventory, WIP, finished goods inventory, R & D costs and costs of equipment and buildings.

(iii) **Other operating costs:** This equals all operating costs (other than direct materials) incurred to earn throughput contribution. Other operating costs include salaries and wages, rent, utilities and depreciation.

18. (a) Value chain may be defined as a series of internal processes or activities a company performs, " to design, produce, market,deliver and support its product." " A firms value chain and the way it performs individual activities are a reflection of its history, its strategy, its approach of implementing strategy , and the underlying economics of the activities themselves." For further details refer to Chapter 13 of Cost Management Book of the Institute

(b) In order to gain a competitive advantage over its competitors , a company needs to profitably satisfy or even exceed the needs and expectations of its various customers. This can be done by the use of Value Chain Analysis . This analysis can be used to better understand which segments, distribution channels, price points, product differentiation , selling propositions and value chain configurations will yield the firm its greatest competitive advantage. The use of VCA to assess competitive advantage involves the following analysis:

(i) Internal Cost Analysis : Organisations use the value chain approach to identify sources of profitability and to understand the cost of their internal processes or activities. The principal steps of internal cost analysis are :

1. Identify the firm's value-creating processes.
2. Determine the portion of the total cost of the product or services attributable to each value-creating process.
3. Identify the cost drivers for each process.
4. Identify the links between processes.
5. Evaluate the opportunities for achieving relative cost advantage.

(ii) Internal Differentiation Analysis : The value chain approach is also used by organisations to identify opportunities for creating and sustaining superior differentiation. In this situation, the primary focus is on the customer's perceived value of the products and services.

As with internal cost analysis, internal differentiation analysis requires firms to first identify their value-creating processes and primary cost drivers. They are then ready to perform a differentiation analysis using the following guidelines :

1. Identify the customers' value-crating processes;
2. Evaluate differentiation strategies for enhancing customer value; and
3. Determine the best sustainable differentiation strategies.

(iii) Vertical Linkage Analysis : Linkages among value-creating processes do not end with the activities within a firm. The greatest competitive advantage may come out of linkages between a firm's value-creating activities and those of its suppliers, channels or users.

Vertical linkage analysis is a much broader application of internal cost and differentiation analysis that includes all upstream and downstream value-creating processes throughout the industry. Vertical linkage analysis considers all links from the source of raw materials to the disposal and/or recycling of the product.

19. Let x_1, x_2, x_3 are number of units of products P, Q, R respectively. Mathematical formulation for the problem with three stock variables s_1, s_2 and s_3 :

Maximize $\cancel{Z} = 3x_1 + 2x_2 + 5x_3 + 0s_1 + 0s_2 + 0s_3$

Subject to constraints:

$x_1 + 2x_2 + 2x_3 + s_1 = 8$

$3x_1 + 2x_2 + 6x_3 + s_2 = 12$

$2x_1 + 3x_2 + 4x_3 + s_3 = 12$

$x_1, x_2, x_3, s_1, s_2, s_3 \geq 0$

We shall now the solve the problem with simples algorithm. An initial Basic feasible solution is:

$x_1 = 0, x_2 = 0, x_3 = 0, s_1 = 8, s_2 = 12 = s_3 = 12.$

SIMPLEX TABLEAU 1, II, & III

$C_J \rightarrow$ CB↓	Basic variables	Solution values	3 x_1	2 x_2	5 x_3	0 s_1	0 s_2	0 S_3	Ratio
0	s_1	8	1	2	2	1	0	0	4
0	s_2	12	3	2	6*	0	1	0	←2
0	s_3	12	2	3	4	0	0	1	3
x_3 enters	Z_J	0	0	0	0	0	0	0	

s_2 leaves	$C_J - Z_J$		3	2	5↑	0	0	0	
0	s_1	4	0	4/3	0	1	-1/3	0	-
5	x_3	2	1/2	1/3	1	0	1/6	0	←4
0	s_3	4	0	5/3	0	0	-2/3	1	-
x_1 enters	Z_J	10	5/2	5/3	5	0	5/6	0	
x_3 leaves	$C_J - Z_J$		1/2	1/3	0	0	-5/6	0	
0	s_1	4	0	4/3	0	1	-1/3	0	3
3	x_1	4	1	2/3	2	0	1/3	0	6
0	S_3	4	0	5/3	0	0	-2/3	1	12/5
	Z_J	12	3	2	6	0	1	0	
	$C_J - Z_J$		0	0	-1	0	-1	0	

Since all the entries in $C_J - Z_J$ row are either negative or zero, an optimum solution has been obtained and the maximum value of Z is 12 which occurs when $x_1 = 4$, $x_2 = 0$ and $x_3 = 0$.

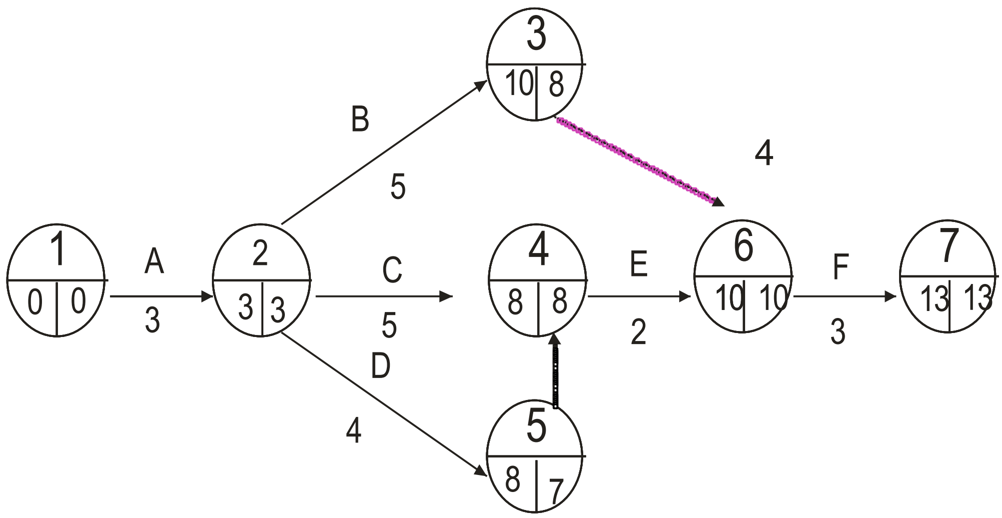
Since x_2 is a non-basic variable and the corresponding $C_J - Z_J$ entry in the final simplex tableau is 0, the optimum solution obtained is not unique. To obtain an alternate optimum solution, we perform one more iteration. Taking x_2 as an entering variable, we obtain the following tableau:

$C_J \rightarrow$	Basic variables	Solution values	3	2	5	0	0	0
CB↓			x_1	x_2	x_3	S_1	s_2	S_3
0	s_1	4/5	0	0	0	1	1/5	-4/5
3	x_1	12/5	1	0	2	0	3/5	-2/5
2	X_2	12/5	0	1	0	0	-2/5	3/5
	Z_J	12	3	2	6	0	1	0
	$C_J - Z_J$		0	0	-1	0	-1	0

The optimum solution is : $x_1 = \frac{12}{5}$, $x_2 = \frac{12}{5}$ and $x_3 = 0$ and the maximum value of Z is 12, as before. It may be noted that the entries under the columns s_1, s_2, s_3 in the $C_J - Z_J$ row of the final tableau are 0, -1, 0. Their absolute values, viz., 0, 1, 0 are known as the shadow prices of the resources. Hence the shadow prices of the resources are 0, 1 and 0 respectively.

20.

Activities	A	B	C	D	E	F
Expected duration = $\frac{1}{6}(t_0 + 4t_m + t_p)$	3	5	5	4	2	3



Critical path 1 – 2 – 4 – 6 – 7 i.e. A – C – E – F

Project cost = Normal cost + Penalty Cost

= Rs.62,000 + (13 – 10) × 2,500 = Rs.69,500

Activity	**A**	**B**	**C**	**D**	**E**	**F**
Expected duration	3	5	5	4	2	3
Crash time	2	4	3	2	1	1
Normal Cost	6,000	12,000	16,000	8,000	6,000	14,000
Crash Cost	8,000	13,500	22,000	10,000	7,500	20,000
Cost shape	2,000	1,500	3,000	1,000	1,500	3,000

Crash the critical activities where cost shape is less than 2,500/-.

Activities	**No. of days crashed**	**Cost shape**	**Crash cost (Rs.)**
A	1	2,000	2,000
E	1	1,500	1,500
	Total Crash Cost (Rs.)		3,500

Project duration = 11 weeks

Total Project cost

= Normal Cost + Crash Cost + Penalty Cost

= Rs.(62,000 + 3,500 + 2,500) = Rs.68,000

21. Following Vogel's Approximation Method (VAM), an initial feasible solution is:

From	A	B	C	D	Demand	v_i
P	50 10000	60	100	50 10000	20000	$u_1 = 0$
Q	80	40 18000	70 6000	50 14000	38000	$u_2 = 0$
R	90	70	30 16000	50	16000	$u_3 = -40$
Supply	10000	18000	22000	24000	74000	
v_j	$v_1 = 50$	$v_2 = 40$	$v_3 = 70$	$v_4 = 50$		

Since, there are 6 allocation i.e. (4 + 3 – 1) and all the opportunity cost are negative, the optimum solution has been reached.

Transportation Cost

= Rs.(10,000 × 50 + 18,000 × 40 + 6,000 × 70 + 14,000 ×50 + 16,000 × 30)

= Rs.3,32,000

22. **Step 1:** The problem is a maximization one. Convert it to minimization one as the assignment algorithm is for minimization. All elements are subtracted from the largest element 11.

As there are 5 operators and only 4 machines, one dummy machine with no output is introduced.

	Machine				
Operator	**M1**	**M2**	**M3**	**M4**	**Dummy**
A	1	6	4	3	0
B	0	7	2	1	0
C	3	7	2	3	0
D	4	6	5	7	0
E	3	2	4	6	0

Step 2: Subtract minimum elements of a column from other elements of the respective column.

	Machine				
Operator	**M1**	**M2**	**M3**	**M4**	**Dummy**
A	1	4	2	2	0
B	0	5	0	0	0
C	3	5	0	3	0
D	4	4	3	6	0
E	2	0	2	5	0

Cut all zero with minimum number of straight lines. No of Lines = 4 < No of machines

Step 4: Add minimum element not crossed i.e. 1 to the doubly crossed element and subtract all other elements by 1. Cut all Zeros by drawing lines.

	Machine				
Operator	**M1**	**M2**	**M3**	**M4**	**Dummy**
A	0	3	2	1	0
B	0	5	1	0	0
C	2	4	0	2	0
D	3	3	3	5	0
E	2	0	2	5	0

Step 5: Now, Number of lines drawn to cut zero = 5 = No of machines

Hence the solution is an optimum one.

Now, Assignment. Is as follows :

Operator	Machine	Output
A	M1	10
B	M4	10
C	M3	9
D	Dummy	0
E	M2	9
Total Output		**38 units.**

23. Assume that one the 1st day of simulation, there was no rain on the previous day.

Table 1 Rain on previous day.

Event	Probability	Cum Prob.	Range for random no.
No rain	0.50	0.50	00 – 49
1 cm rain	0.25	0.75	50 – 74
2 cm rain	0.15	0.90	75 – 89
3 cm rain	0.05	0.95	90 – 94
4 cm rain	0.03	0.98	95 – 97
5 cm rain	0.02	1.00	98 – 99

Table 2: No rain previous day

Event	Probability	Cum Prob.	Range for random no.
No rain	0.75	0.75	00 – 74
1 cm rain	0.15	0.90	75 – 89
2 cm rain	0.06	0.96	90 – 95
3 cm rain	0.04	1.00	96 – 99

Table 3: Simulation Sheet

Day	Random No.	Event	From Table	Cum Rain
1	67	No rain	2	
2	63	No rain	2	
3	39	No rain	2	
4	55	No rain	2	
5	29	No rain	2	
6	78	1 cm rain	1	1 cm
7	70	1 cm rain	1	2 cm
8	06	No rain	1	3 cm
9	78	1 cm rain	2	4 cm
10	76	2 cm rain	1	5 cm

24. Deseasonalisation means elimination of seasonal effect on the original data so that they can be analysed more rationally.

Deseasonalization is done with the help of two models : Additive Model : Yd = Y – S

Multiplicative Model : Yd = (Y / S) x 100

Where Yd = deseasonalsed data & S = Seasonal index

Month	Sales (Rs lakhs)	Seasonal index	Deseasonalised value Yd = (Y /S) X 100
January	360	120	(360/120) x 100 = 300
February	400	80	(400/80) x 100 = 500
March	550	110	(550 /110)x 100 = 500
April	360	90	(360/90) x 100 = 400
May	350	70	(350/70) x 100 = 500
June	550	100	(550/100))x 100 = 550

25. Let Ho = No difference between population and sample proportion

For delay in delivery, Sample proportion p = 6/81 = 0.074, Population proportion = 0.10

Z = (0.074 – 0.10) / SE of p

$= - 0.026 \ / \ \sqrt{(0.1 \times 0.9)/81}$ - (0.026 x 3) / 0.1 = - 0.078

Critical value of Z at 95% level of confidence = ± 1.96

As I Z I < 1.96, Ho is accepted.

PAPER – 6 : MANAGEMENT INFORMATION AND CONTROL SYSTEMS

QUESTIONS

**Note : The IT Act, 2000 has been amended. For details to IT Act (amended 2008), refer to the link http://www.icai.org/post.html?post_id=1056*

Basic Concepts of Systems

1. (a) Define systems and explain the general model of the system.

   (b) Differentiate between closed and open systems.

Transaction Processing Systems

2. Explain the four common cycles of a business activity.

Basic Concepts of MIS

3. (a) Examine the prerequisites of an effective MIS. What are the major constraints in operating an effective MIS?

   (b) What are the information requirements at the lower level for making decisions?

Systems Approach and Decision Making

4. (a) System analysts develop various categories of information systems to meet a variety of business needs. Discuss any three such systems briefly.

   (b) List out the benefits of successful materials requirement planning systems.

Decision Support and Executive Information Systems

5. (a) Trace the data flow representation of the executive decision-planning environment.

   (b) What are the set of principles that guide the design of measures and indicators to be included in an Executive Information System?

Enabling Technologies

6. (a) What are the control techniques that are essential for the security of the client/server environment?

   (b) What are the risks associated with client/server model?

System Development Process

7. (a) Read the data flow and activities listed in the table below carefully and draw the data flow diagram for the payroll processing system.

Activities	Data Inputs	Data Outputs
Update employee/roll file	New employee form Employee change form Employee/payroll file	Updated employee/ payroll file

Pay employees	Time cards Employee/ payroll file Tax tables	Employee cheques Payroll register Updated employee/payroll file Payroll cheques Payroll cash disbursements voucher
Prepare reports	Employee/ payroll file	Payroll report
Pay taxes	Employee/ payroll file	Tax report Tax payment Payroll tax cash disbursements voucher Updated employee/payroll file
Update general ledger	Payroll tax cash Disbursements voucher Payroll cash Disbursements voucher	Updated general ledger

(b) What is a data dictionary? What are its uses?

Systems Design

8. (a) What are the different formats in which information can be presented? Discuss briefly, the guidelines to be considered while designing a graphic format.

(b) What is a system manual? What information is included in it?

System's Acquisition, Software Development and Testing

9. (a) Discuss in brief, salient features of consideration while selecting a computer system. Also suggest contents in a point scoring table for evaluation of a "ready to use software".

(b) Briefly describe various steps involved in system testing.

Systems Implementation and Maintenance

10. (a) Explain strategies that can be adopted for converting an old information system to the new system.

(b) Explain the role of system maintenance in the development of an Information system.

Design of Computerised Commercial Applications

11. (a) List out the various outputs of the Inventory control system.

(b) What is a share accounting system? List out the facilities provided in the share accounting system.

Enterprise Resource Planning: Redesigning Business

12. Explain the general model of the Enterprise Resource Planning.

13. (a) List out some of the entities forming a data model in business modelling.

    (b) ABC company has presence across India in manufacturing of medicine. The management of the company intends to centralize and integrate the information flow across its different manufacturing units in a uniform manner at various levels of the company. Presently the company has its functioning at different units being automated as per the local requirements, technical expertise and on an ad-hoc basis. The technical advisor of the company recommends that the company should go for the implementation of the ERP Package. List out the reasons for ERP adoption by the company?

Controls in EDP Set-up: General Controls

14. Explain the various types of threats to operating system integrity.

15. Explain the role of insurance in covering residual risks that exist in the computer system.

16. How can the firewall control or avoid denial of service attacks?

Controls in EDP Set-up: Application Controls

17. Explain the three levels of input validation controls.

18. List out the various checks that can be performed during a validation run. Briefly explain the various types of Transaction checks.

Detection of Computer Frauds

19. (a) List out the various sources from where the information can be recovered to investigate computer frauds.

    (b) What steps can be taken to detect computer fraud as soon as possible?

Cyber Laws and Information Technology Act 2000

20. Define some of the following terms as mentioned in Information Technology Act, 2008 (Amended):

    (a) Asymmetric crypto system

    (b) Electronic form

    (d) Electronic record

    (e) Electronic signature

    (f) Electronic signature certificate

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

Audit of Information Systems

22. (a) What is the purpose of an IS audit? While performing an IS audit, what are the objectives to be ascertained by the Auditors.

    (b) Write briefly about Test Data Processing.

Information Security

23. (a) Briefly describe the objectives of information security policy.

    (b) Discuss various ways to protect computer held information.

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

24. (a) List out the various CASE tools with specific examples of each tool.

    (b) Explain the process of exchange of data by CASE tools.

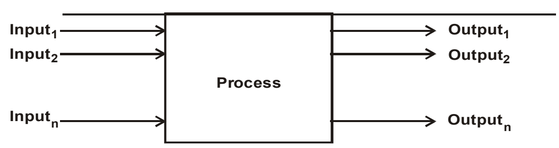
25. Briefly explain the components of analysis and design work-bench.

SUGGESTED ANSWERS/HINTS

1. (a) The term system may be defined as a set of interrelated elements that operate collectively to accomplish some common purpose or goal. A business is also a system where economic resources such as people, money, material, machines, etc are transformed by various organisational processes (such as production, marketing, finance etc.) into goods and services. A computer based information system is also a system which is a collection of people, hardware, software, data and procedures that interact to provide timely information to authorised people who need it.

Systems can be abstract or physical. An abstract system is an orderly arrangement of interdependent ideas or constructs. A physical system is a set of elements which operate together to accomplish an objective. A general model of a physical system is input, process and output. This is, of course, very simplified because a system may have several inputs and outputs as shown below:

Simple system model



System with many inputs and outputs

For details to above points, refer to study material, Chapter-1, Section 1.1.

(b) Closed and Open Systems: A Closed System is self-contained and does not interact or make exchange across its boundaries with its environment. Closed systems do not get the feedback they need from the external environment and tend to deteriorate. A Closed Systems is the one that has only controlled and well defined input and output. Participants in a closed system become closed to external feed back without fully being aware of it. Some of the examples of closed systems are manufacturing systems, computer programs etc.

Open System actively interact with other systems and establish exchange relationship. They exchange information, material or energy with the environment including random and undefined inputs. Open systems tend to have form and structure to allow them to adapt to changes in their external environment for survival and growth. Organisations are considered to be relatively open systems.

For details to above points, refer to study material, Chapter-1, Section 1.3.

2. The four common cycles of a business activity are:

(i) ***Revenue cycle:*** Events related to the distribution of goods and services to other entities and the collection of related payments. It involves processing cash sales, credit sales, and receipt of cash following a credit sale.

(ii) ***Expenditure cycle:*** Events related to acquisition of goods and services from other entities and the settlement of related obligations.

(iii) ***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.

(iv) ***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.

3. (a) The main prerequisites of an effective MIS are as follows:

(i) **Database:** It can be defined as a "superfile" which consolidates data records formerly stored in many data files. The data in a database is organized in such a way that access to the data is improved and redundancy is reduced. The characteristics of database are:

- The database is sub-divided into major information subsets needed to run a business wherein each subsystem utilizes same data and information kept in same file to satisfy its information needs.
- It is user-oriented.
- It is capable of being used as a common data source, to various users, helps in avoiding duplication of efforts in storage and retrieval of data and information.

- It is available to authorized persons only.
- It is controlled by a separate authority established for the purpose, known as Data Base Management System (DBMS).
- The maintenance of data in database requires computer hardware, software and experienced computer professionals.

(ii) **Qualified system and management staff:** The second prerequisite is that it should be manned by qualified officers. For this, the organisational management base should comprise of two categories of officers.

- Systems and Computer experts: They, in addition to their expertise in their subject area should be capable of understanding management concepts to facilitate the understanding of problems faced by the concern. They should also be clear about the process of decision making and information requirements for planning and control functions.
- Man*agement experts*: They should understand quite clearly the concepts and operations of a computer.

(iii) **Support of Top Management:** The management information system to be effective, should receive the full support of the top management. The reasons for this are as follows:

- Subordinate managers are usually lethargic about activities which do not receive the support of their superiors.
- The resources involved in computer-based information systems are large and are growing larger in view of importance gained by management information system.

(iv) **Control and Maintenance of MIS:** Control of the MIS means the operation of the system as it was designed to operate. Sometimes users develop their own procedures or short cut methods to use the system, which reduce its effectiveness. To check such habits of users, the management at each level in the organization should device checks for the information system control. At times, there may be the need for improvements to the system. Formal method and documenting always must be provided. Maintenance is closely related to control.

(v) **Evaluation of MIS:** The evaluation of MIS should take into account the following points:

- Examining whether enough flexibility exists in the system, to cope with any expected or unexpected information requirement in future.
- Ascertaining the views of users and the designers about the capabilities and deficiencies of the system.
- Guiding the appropriate authority about the steps to be taken to maintain effectiveness of MIS.

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 organizing 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.

For details to above points, refer to study material, Chapter-3 Section 3.1.5.

(b) The information requirements at lower level for making decisions are classified into two types.

(i) External Information

(ii) Internal Information

The information requirement at lower level for making decisions is given in the chart below:

External Information	Internal Information
Sensitive changes affecting material supplies and sales.	Unit sales and expenses.
	Current performances.
	Shortages and bottle-necks.
	Operating efficiencies and inefficiencies.
	Input-output ratios.
	Maintenance reports.

4. (a) Systems analysts develop the following types of information systems to meet a variety of business needs:

(i) Transaction processing systems

(ii) Management information systems

(iii) Decision support systems

(iv) Executive information systems

(v) Expert systems.

Three of the above categories of systems are discussed below:

(i) **Transaction Processing Systems:** These systems are aimed at expediting and improving the routine business activities that all organisations engage. Standard operating procedures, which facilitate handling of transactions, are often embedded in computer programs that control the entry of data, processing of details, search and presentation of data and information. Transaction processing systems if properly computerised provide speed and accuracy and can be programmed to follow routines without any variance.

(ii) **Management Information Systems (MIS):** Transaction processing systems are operations oriented. In contrast, MIS assist managers in decision making and problem solving. They use results produced by the transaction processing systems, but they may also use other information. In any organization, decisions must be made on many issues that recur regularly and require a certain amount of information. Because the decision making process is well understood, the manager can identify the information that will be needed for the purpose. In turn, the information systems can be developed so that reports are prepared regularly to support these recurring decisions.

(iii) **Decision Support Systems:** Not all decisions are of a recurring nature. Some occur only once or recur infrequently. Decision support systems (DSS) are aimed at assisting managers who are faced with unique (non-recurring) decision problems. In well structured situations, it is possible to identify information needs in advance, but in an unstructured environment, it becomes difficult to do so. As information is acquired, the manager may realize that additional information is required. In such cases, it is impossible to pre-design system report formats and contents. A DSS must, therefore, have greater flexibility than other information systems. Finally, we can say that DSS is of much more use when businesses are of an unstructured or semi-structured in nature. A decision support system is an integrated piece of software incorporating data base, model base and user interface. While the decision-support system can be of use at the tactical level, it is the strategic level that could make best use of it.

For details to above points, refer to study material, Chapter- 2 to 5.

(b) The benefits of successful Materials Requirement Planning (MRP) systems include:

(i) Significantly decreased inventory levels and corresponding decreases in inventory carrying costs.

(ii) Fewer stock shortage, which cause production interruptions and time-consuming schedule juggling by managers,

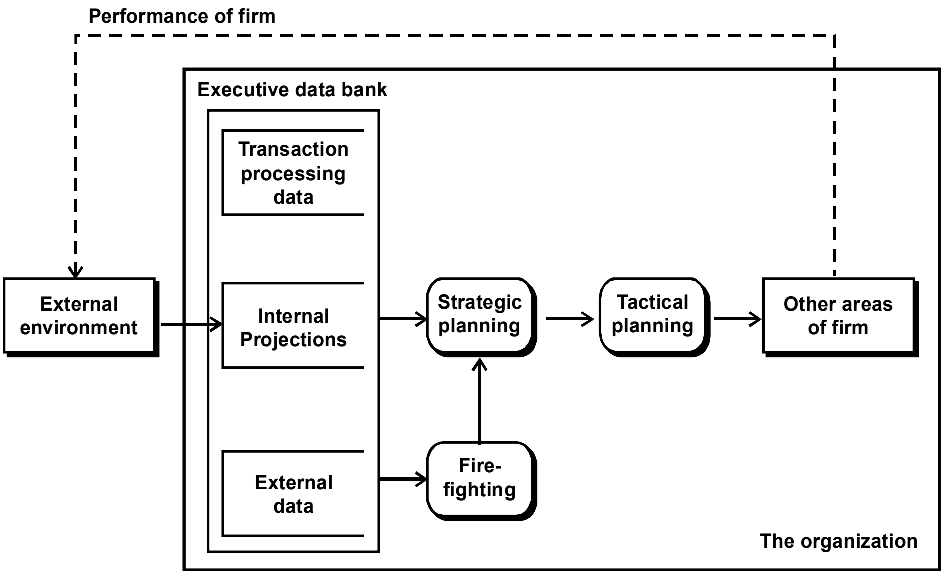
(iii) Increased effectiveness of production supervisors and less production chaos.

(iv) Better customer service - an increased ability to meet delivery schedules and to set delivery dates earlier and more reliably.

(v) Greater responsiveness to change. MRP gives manufacturing a better feel for the effects of economic swings and changes in product demand can be translated into schedule changes quickly.

(vi) Closer coordination of the marketing, engineering, and finance activities with the manufacturing activities.

5. (a) The data flow representation of the executive decision planning environment is given below:



(b) A practical set of principles to guide the design of measures and indicators to be included in an Executive Information System (EIS) are as follows:

(i) EIS measures must be easy to understand and collect. Wherever possible, data should be collected naturally as part of the process of work. An EIS should not add substantially to the workload of managers or staff.

(ii) EIS measures must be based on a balanced view of the organization's objective. Data in the system should reflect the objectives of the organisation in the areas of productivity, resource management, and quality and customer service.

(iii) Performance indicators in an EIS must reflect everyone's contribution in a fair and consistent manner. Indicators should be as independent as possible from variables outside the control of managers.

(iv) EIS measures must encourage management and staff to share ownership of the organization's objectives. Performance indicators must promote both team-work and friendly competition. Measures will be meaningful for all staff; people must feel that they, as individuals, can contribute to improving the performance of the organization.

(v) EIS information must be available to everyone in the organization. The objective is to provide everyone with useful information about the organization's performance. Information that must remain confidential should not be part of the EIS or the management system of the organization.

(vi) EIS measures must evolve to meet the changing needs of the organization.

6. (a) The control techniques that are essential for the security of the client/server environment are as follows:

- Access to data and application is secured by disabling the floppy disk drive and USB drives etc.
- Diskless workstation prevents unauthorized access.
- Unauthorized users may be prevented from overriding login scripts and access by securing automatic boot or start-up batch files.
- Network monitoring can be done to know about the client so that it will be helpful for later investigation, if it is monitored properly. Various network-monitoring devices are used for this purpose. Since this is a detective control technique, the network administrator must continuously monitor the activities and maintain the devices, otherwise these tools become useless.
- Data encryption techniques can be used to protect data from unauthorized access.
- Authentication systems can be provided to a client, so that they can enter into system, only by entering login name and password.
- Smart cards can be used. It uses intelligent hand held devices and encryption techniques to decipher random codes provided by client-server based operating systems. A smart card displays a temporary password based on an algorithm and must be re-entered by the user during the login session for access onto the client-server system.
- Application controls may be used and users will be limited to access only those functions in the system those are required to perform their duties.

(b) The four categories of risks associated with client / server model are briefly discussed below:

(i) **Technological Risks:** The technological risk is quite simple. The first risk is – Will the new system work? But more important is the risk that in the long run the system may become obsolete. To resolve this issue, the firm and the IT consultant / division should understand system standards and market trends and use them in their decision making processes while deciding what system to incorporate into their organization.

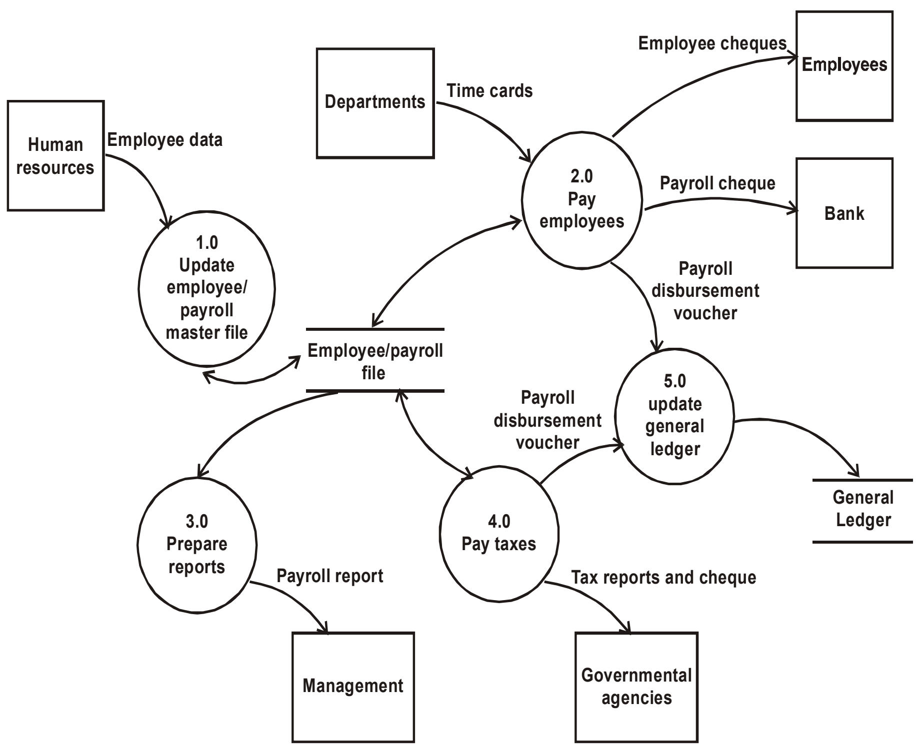
(ii) **Operational Risk:** These risks parallel the technological risks in both the short and long run. Respectively, they are – Will you achieve the performance you need from the new technology and will the software that you chose be able to grow or adapt to the changing needs of the business.

(iii) **Economic Risk:** In the short run, firms are susceptible to hidden costs associated with the initial implementation of new client / server system. Cost will rise in the short term since one need to maintain the old system (mainframe) and the new client server architecture development. In the long run, the concern centre's around the support costs of the new system.

(iv) **Political Risks:** Finally, political (people) risks involved in this transition are addressed. Here, the short-term question is – will end users and management be satisfied? The answer to this is definitely not if the system is difficult to use or is plagued with problems.

For details to above points, refer to study material, Chapter-6, Section 6.6

7. (a) The data flow diagram for the payroll processing system is given below:



(b) Data Dictionary: A data dictionary is a computer file that contains descriptive information about the data items in the files of a business information system. Thus, a data dictionary is a computer file about data. Each computer record of a data dictionary contains information about a single data item used in a business information system. This information may include:

(i) Codes describing the data item's length (in characters), data type (alphabetic, numeric, alphanumeric, etc.), and range (e.g., values from 1 to 99 for a department code)

(ii) The identity of the source document(s) used to create the data item.

(iii) The names of the computer files that store the data item.

(iv) The names of the computer programs that modify the data item.

(v) The identity of the computer programs or individuals permitted to access the data item for the purpose of file maintenance, upkeep, or inquiry.

(vi) The identity of the computer programs or individuals not permitted to access the data item.

Name of data field	File in which stored	Source document	Size in bytes	Type
Inventory quantity on hand	Inventory master file	Form number ABC 123	4	Numeric

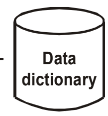


Figure: A sample record from a data dictionary.

Data dictionaries have a variety of uses. One is as a documentation aid to programmers and system analysts, who study, correct, or enhance either the database or the computer programs that access it. As suggested in points (v) and (vi) in the previous list, a data dictionary is also useful for file security – e.g., to prohibit certain employees from gaining access to sensitive payroll data.

Accountants and auditors can also make good use of a data dictionary. For example, a data dictionary can help establish an audit trail because it can identify the input sources of data items, the computer programs that modify particular data items, and the managerial reports on which the data items are output. When an accountant is participating in the design of a new system, a data dictionary can also be used to plan the flow of transaction data through the system.

Finally, a data dictionary can serve as an important aid when investigating or documenting internal control procedures. This is because the details about edit tests, methods of file security, and similar information can be stored in the dictionary.

8. (a) The manner in which data are physically arranged is referred to as format. This arrangement is called output format when referring to data output on a printed report or on a display screen. The different formats in which information can be presented are as follows:

(i) Tabular format: In general, end users are most accustomed to receiving information in a tabular form. Accountants and those who regularly review financial data rely exclusively on tabular information. Common examples of tabular reports are inventory control, accounts payable, general ledger, sales analysis and production scheduling reports. In general, the tabular format should be used when details dominate and few narrative comments or explanations are needed, details are presented in discrete categories, each category must be labeled and totals must be drawn or comparison made between components.

Certain information in a tabular format is more important and should be more visible than other information. This will vary by applications, but in general we can list down the items that should be included in tabular outputs:

(i) Exceptions to normal expectations.

(ii) Major categories or groups of activities or entities.

(iii) Summaries of major categories or activities.

(iv) Unique identification information.

(v) Time dependent entities.

The system analyst must design tabular output to show these elements distinctively.

(ii) Graphic Format: Graphic systems are available across a wide range of prices and capabilities and from personal computers up to mainframes. Management presentations have been enhanced by graphics and visuals for a long-time. Due to the availability of low cost but powerful computer software that uses data from existing data bases and produces high quality charts and diagrams, graphics outputs are becoming very popular. Graphics are used for several reasons. They are used to improve the effectiveness of output reporting for the targeted recipients, to manage information volume and to suit personal preferences.

Graphics are superior to tabular and narrative forms of information display for detecting trends in business performance. Comparisons are also easier through graphics than through tabular data. Graphic presentations also facilitate remembering large amounts of data throughout a series of reports.

In designing graphical output, the systems analyst must determine the purpose of the graph, the kind of data that need to be displayed, its audience and the effects on the audience of different kinds of graphical outputs. Graphic output also contains text, the design of which is an important aspect. Each graphic report, whether printed or displayed, should include a title and the date of preparation. For a series, page numbers should also be included. Labels can increase the accuracy with which people read data in bar graph form. However, placement of the label affects readability. Consistent spacing in all labels and using a common family of type styles maximize readability. All vertical and horizontal axes should be proportional. The use of all capital letters in long words, titles or foot notes impedes readability and thus should be avoided. Abbreviation should not be used.

Graphical output can be enormously useful to decision-makers if they are trained how to interpret it and when to use it.

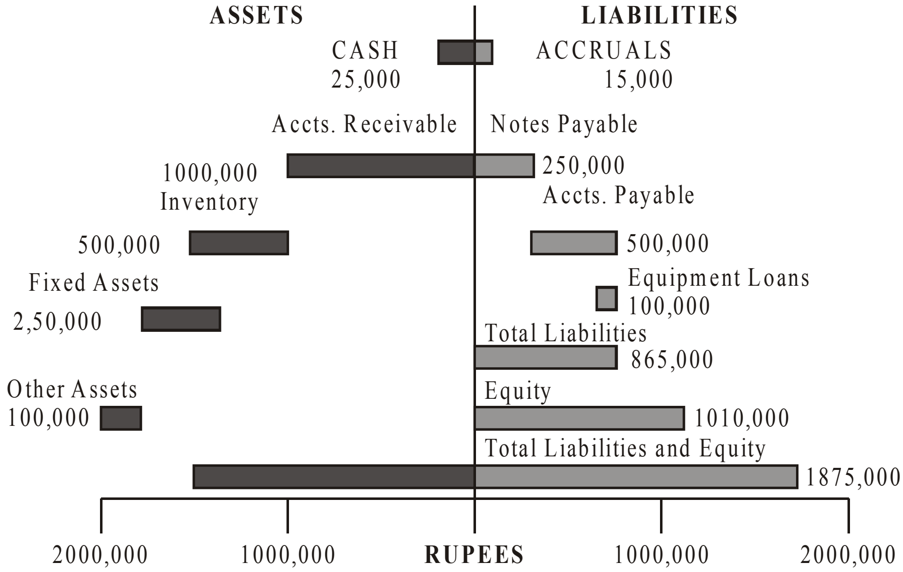


Figure : A sample graphic output

For details to above points, refer to study material, Chapter-8, Section 8.2.3.

(b) The basic output of the system design is a description of the task to be performed, complete with layouts and flowcharts. This is called the job specifications manual or system manual. The information included in the system manual contains:

(i) General description of the existing system.

(ii) Flow of the existing system.

(iii) Outputs of the existing system: The documents produced by existing system are listed and briefly described, including distribution of copies.

(iv) General description of the new system: Its purposes and functions and major differences from the existing system are stated together with a brief justification for the change.

(v) Flow of the new system: This shows the flow of the system from and to the computer operation and the flow within the computer department.

(vi) Output Layouts.

(vii) Output distribution: The distribution of the new output document is indicated and the number of copies, routing and purpose in each department shown. The output distribution is summarized to show what each department will receive as a part of the proposed system.

(viii) Input layouts: The inputs to the new system are described and complete layouts of the input documents and input disks or tapes provided.

(ix) Input responsibility: The source of each input document is indicated as also the user department responsible for each item on the input documents.

(x) Macro-logic-the overall logic of the internal flows will be briefly described by the systems analyst, wherever useful.

(xi) Files to be maintained: The specifications will contain a listing of the tape, disk or other permanent record files to be maintained, and the items of information to be included in each file. There must be complete layouts for intermediate or work file; these may be prepared later by the programmer.

(xii) List of programs: A list of the programs to be written shall be a part of the systems specifications.

(xiii) Timing estimates: A summary of approximate computer timing is provided by the systems analyst.

(xiv) Controls: This shall include type of controls, and the method in which it will be operated.

(xv) Audit trail: A separate section of the systems specifications shows the audit trail for all financial information. It indicates the methods with which errors and defalcation will be prevented or eliminated.

(xvi) Glossary of terms used.

9. (a) The following points may be considered while selecting a computer system:

- Today all computer systems available in the market have good hardware, competent software and roughly similar facilities. Due to rapid advances in computer technology, more recent computers are better in performance and the lower in cost. Hence as far as possible, the latest possible technology should be acquired in general.
- Commercial data processing involves mainly reading-in-data, printing data, storing and retrieving information from media. For commercial work computer performance is affected by the speed and capabilities of input/output and storage peripherals in contrast to scientific, engineering and operations problems which require good computational facilities, hence the efficiency of a computer system in handling such problems will depend on the main storage available. A comparison along these lines may be made.
- The software supplied by the manufacturer may make a significant difference if it contains a package of special applicability to the jobs envisaged. The selection of computer can also be made on software considerations. While all manufacturers supply general software packages for documentation and linear programming etc, a few manufacturers also offer packages specially designed for a particular industry such as Accounting applications in banking and insurance. Obviously, a manufacturer who has a package for users' special needs will enjoy a significant advantage.

- Modern computers are marketed as series of compatible, increasingly powerful and interchangeable peripherals. After some period, work expands beyond to fit in the existing computer needing higher capacity machine. Also, in case of breakdown, compatibility allows a wider range of machines to be used as back-up. Thus, the choice of a computer really becomes the choice of the model within the series, based on the long-range plan of expansion. But dependence on vendor/server is preferable to reprogramming which can be prohibitively expensive or time consuming. The selection of the computer configuration and a plan for its gradual expansion, as a properly considered model can save a great deal of money. The computer systems must be forward and backward compatible.
- Outside assistance in computer selection can be had from computer manufacturers, independent consultants specializing in computers, or management consulting firms. The distinction between vendor selection and machine selection is essentially a matter of business judgment. Once, however, the vendor is selected, he can be counted upon to provide useful guidance for machine also.

Point scoring Table for 'Ready to use' software:-

Software Evaluation Criteria	Possible points	Vendor A	Vendor B	Vendor C
Does the software's meet the mandatory specifications?	10	7	9	6
Will program modifications, if any, be minimal to meet company needs?	10	8	9	7
Does the software contain adequate controls?	10	9	9	8
Is the performance (speed, accuracy, reliability etc.) adequate?	10	7	9	6
Are other users satisfied with the software?	8	6	7	5
Is the software user-friendly?	10	7	8	6
Can the software be demonstrated and test-driven?	9	8	8	7
Does the software have an adequate warranty?	8	6	7	6
Is the software flexible and easily maintained?	8	5	7	6
Is online inquiry of files and	10	8	9	7

records possible?				
Will the vendor keep the software up to date?	10	8	8	7
Total	**123**	**94**	**106**	**85**

It may be noted that the data shown above are indicative only.

For details to above points, refer to study material, Chapter 9, Section 9.1.

(b) The various steps involved in system testing are as follows:

- Preparation of realistic test data in accordance with the system test plan,
- Processing the test data using the new equipment,
- Thorough checking of the results of all system tests, and
- Reviewing the results with future users, operators and support personnel.

One of the most effective ways to perform system-level testing is to perform parallel operations with the existing system. Parallel operations consist of feeding both systems the same input data and comparing data files and output results. Despite the fact that the individual programs were tested, related conditions and combinations of conditions that were not envisioned are likely to occur. Last minute changes to computer programs are necessary to accommodate these new conditions.

During parallel operations, the mistakes detected are often not those of the new system, but of the old. These differences should be reconciled as far as it is feasible economically. Those responsible for comparing the two systems should clearly establish that the remaining deficiencies are caused by the old system. A poor checking job at this point can result in complaints later from customers, top management, salespersons, and others. Again, it is the responsibility of the system developers and analysts to satisfy themselves that adequate time for dual operations has been undertaken for each functional area changed.

For details to above points, refer to study material, Chapter-9, Section 9.7

10. (a) There are five strategies for converting from the old system to the new system. They are as follows:

(i) *Direct changeover*: Conversion by direct changeover means that on a specified date, the old system is dropped and the new system is put into use. Direct changeover can only be successful if extensive testing is done beforehand. An advantage of the direct changeover is that users have no possibility of using the old system other than the new. Adaptation is a necessity. Direct changeover is considered a risky approach to conversion, and disadvantages are numerous.

(ii) *Parallel conversion*: This refers to running the old system and the new system at the same time, in parallel. This is the most frequently used conversion approach, but its popularity may be in decline because it works best when a computerised system replaces a manual one. Both systems are run simultaneously for a specified period of time and the reliability of results is examined. When the same results are gained over time, the new system is put into use and the old one is stopped. The advantage of running both systems in parallel includes the possibility of checking new data against old data in order to catch any errors in processing in the new system. Parallel processing also offers a feeling of security to users, who are not forced to make an abrupt change to the new system.

(iii) *Gradual conversion*: Gradual conversion attempts to combine the best features of the earlier two plans, without incurring the risks. In this plan, the volume of transactions is gradually increased as the system is phased in. The advantages include allowing users to get involved with the system gradually and the possibility of detecting and recovering from the errors without a lot of downtime. Disadvantages of gradual conversion include taking too long to get the new system in place and its inappropriateness for conversion of small, uncomplicated systems.

(iv) *Modular prototype conversion*: This approach to conversion uses the building of modular, operational prototypes to change from old systems to new in a gradual manner. As each module is modified and accepted, it is put into use. One advantage is that each module is thoroughly tested before being used. Another advantage is that users are familiar with each module as it becomes operational.

(v) *Distributed conversion*: This refers to a situation in which many installations of the same system are contemplated, such as in banking or in franchises such as restaurants or clothing stores. One entire conversion is done (with any of the four approaches considered already) at one site. When that conversion is successfully completed, other conversions are done for other sites. An advantage of distributed conversion is that problems can be detected (and contained) rather than inflicting them, in succession, on all sites.

For details to above points, refer to study material, Chapter-10, Section 10.3.

(b) Most information systems require at least some modification after development. The need for modification arises from a failure to anticipate all requirements during system design and/or from changing organisational requirements. The changing organisational requirements continue to impact most information systems as long as they are in operation. Consequently periodic systems maintenance is required for most of the information systems. Systems maintenance involves adding new data elements, modifying reports, adding new reports, changing calculations, etc.

Maintenance can be categorised in the following two ways:

1. Scheduled maintenance is anticipated and can be planned for. For example, the implementation of a new inventory coding scheme can be planned in advance.
2. Rescue maintenance refers to previously undetected malfunctions that were not anticipated but require immediate solution. A system that is properly developed and tested should have few occasions of rescue maintenance.

One problem that occurs in systems development and maintenance is that as more and more systems are developed, a greater portion of systems analyst and programmer time is spent on maintenance. An information system may remain in an operational and maintenance mode for several years. The system should be evaluated periodically to ensure that it is operating properly and is still workable for the organisation. When a system becomes obsolete i.e. new opportunities in terms of new technology are available or it no longer satisfies the organisation's needs, the information system may be replaced by a new one generated from a fresh system development process.

11. (a) The various outputs of the inventory control system include the following:

(i) Inventory transactions listing for control purpose.

(ii) Inventory ledger

(iii) Customer's report

(iv) Back-orders file report

(v) Excess-stock

(vi) Under-stock

(vii) Slow-moving

(viii) ABC class items

Exception reports

(ix) Items-to-do ordered file.

Data describing filled orders, back-orders and miscellaneous sales order transactions is major systems output and becomes the primary input into the billing and sales analysis system. Information concerning back orders, out-of-stock items, re-order points, economic order quantity is sent to the purchasing or production department for entry into their information system. Various exception reports analyse inventory status in order to help management to meet the objectives of inventory control.

(b) Share is an investment option used by many persons. A person may purchase shares either from the company (at the time of a public or a rights issue) or from the share market. A share accounting system needs to maintain an updated list of shareholders. For each shareholder, the main information held is the name and address, names of joint holders (if any), the number of shares held, and the identification of the certificates through which these shares are held.

When a person purchases shares from a share holder, a share transfer form along with the certificates is sent by the buyer to the company for incorporating the transfer. The system records a change in ownership for the shares from the seller to the buyer. Periodically, the company declares a dividend. Dividend warrants (cheques) need to be mailed on a particular day to the various shareholders who hold shares. Calculation of income tax to be deducted at source is also done before the printing and mailing dividend warrants.

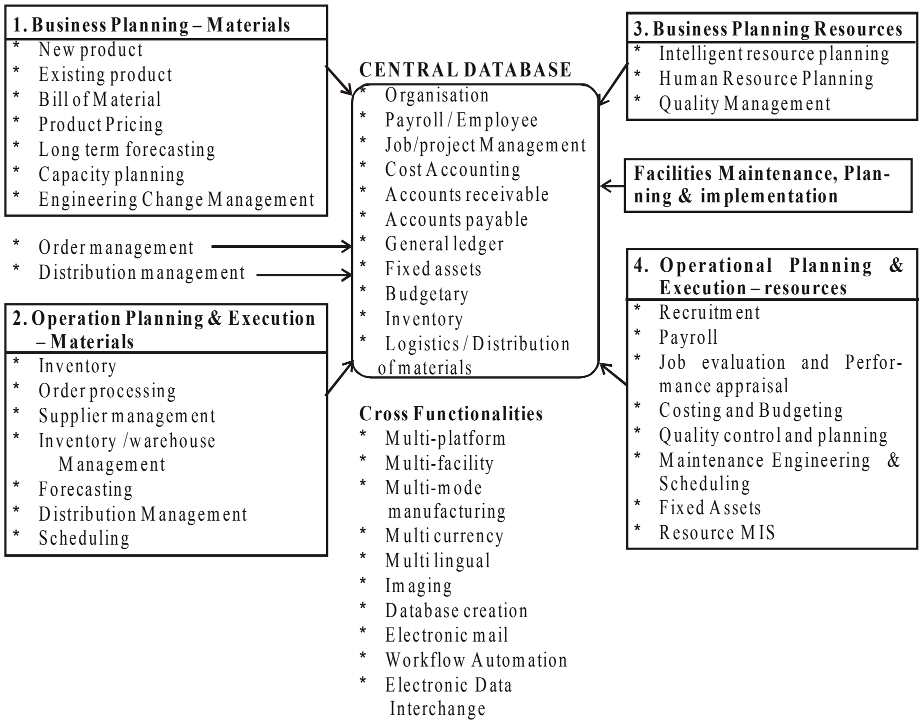
Other facilities usually provided in share accounting system are:

- Bank mandate facility, where the shareholder's dividend warrant is sent to a bank account at the shareholder's request.
- Splitting of share certificates, where a single certificate containing a large number of shares is replaced with a number of certificates containing a smaller number of shares.
- Consolidation of shares, where many certificates belonging to a single shareholder are combined into one share certificate.
- Mailing annual reports and invitations to various meetings.

12. An Enterprise resource planning system is a fully integrated business management system covering functional areas of an enterprise like Logistics, Production, Finance, Accounting and Human Resources. It organizes and integrates operation processes and information flows to make optimum use of resources such as men, material, money and machine. ERP is a global, tightly integrated closed loop business solution package and is multifaceted.

In simple words, Enterprise resource planning promises one database, one application, and one user interface for the entire enterprise, where once disparate systems ruled manufacturing, distribution, finance and sales. Taking information from every function it is a tool that assists employees and managers' plan, monitor and control the entire business. A modern ERP system enhances a manufacturer ability to accurately schedule production, fully utilize capacity, reduce inventory, and meet promised shipping dates.

A general model of ERP is shown below.



13. (a) The list of some of the entities forming a data model in business modelling is given in a table below:

Entity	Description
External data	Entities outside the firm that interact with it, such as customers, suppliers, competitors and distributors. Also includes predictive data regarding economy and future events in external environment.
Internal data	Data generated from the firm's transaction processing system, internal forecasts or parameters monitored.
Funding data	Includes information on specific sources of funds as well as availability terms and conditions etc.
Marketing research data	Mainly consumer related data that can be used to support marketing decisions and result of surveys.
Production data	Shop floor data on production processes including standards and actual of time and material resources concerned.
Inventory data	Includes inventories of raw materials goods in progress and finished goods.
Personnel data	Mostly includes profiles of employees, their skill levels, experience and past performance on various assignments.

Sales forecast	Product-wise and period-wise forecast for various products sold by the company.
Payroll data	Data about salaries, tax deductions, statutory forms and other deductions
General ledger	Integrated transaction data from pay roll and account receivable. It is the basis for budgeting and planning data.

(b) Some of the major reasons for ERP adoption by the company are as follows:

- ERP provides complete integration of systems not only across departments but also across companies under the same management.
- ERP facilitates company-wide Integrated Information System covering all functional areas like manufacturing, selling and distribution, payables, receivables, inventory, accounts, human resources, purchases etc.
- ERP eliminates most business problems like material shortages, productivity enhancements, customer service, cash management, inventory problems, quality problems, prompt delivery etc.
- Has end to end Supply Chain Management to optimize the overall Demand and Supply Data.
- ERP provides multi-platform, multi-facility, multi-mode manufacturing, multi-currency, multi-lingual facilities.
- It supports strategic and business planning activities, operational planning and execution activities, creation of Materials and Resources. All these functions are effectively integrated for flow and update of information immediately upon entry of any information.
- ERP performs core activities and increases customer service, thereby augmenting the corporate image.
- ERP bridges the information gap across organisations.
- ERP is the solution for better project management.
- ERP allows automatic introduction of the latest technologies like Electronic Fund Transfer (EFT), Electronic Data Interchange (EDI), Internet, Intranet, Video conferencing, E-Commerce etc.
- ERP provides intelligent business tools like decision support system, Executive information system, Data mining and easy working systems to enable better decisions.

For details to above points, refer to study material, Chapter-12, Section 12.1.

14. The various threats to operating system integrity are:

(i) *Accidental threats*: These types of 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.

(ii) *Intentional threats*: These types of 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:

- 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.
- Individuals both internal and external to the organisation who browse the operating system to identify and exploit security flaws.
- An individual who intentionally (or accidentally) inserts a computer virus or other form of destructive program into the operating system.

For details to above points, refer to study material, Chapter-13, Section 13.2.2

15. The risk to computer system can be controlled through system design, installation of security measures and regular security audit. However, some residual risks always exist that cannot be covered. One way of handling this residual risk is to transfer it contractually to a third party by way of insurance of the computer installation.

If a decision is made to purchase insurance cover, management must be careful to ensure that they consider all major potential losses; the replacement cost of purchased or leased hardware must be covered, special construction relating to raised floors and air conditioning must be covered etc. The types of insurance policies that might be obtained are:

- Data processing policy
- Valuable papers and records policy
- Business interruption insurance
- Extra expense insurance.
- Errors and omissions insurance.

16. Denial of service attacks can severely hamper an organisation's ability to use the Internet to conduct commerce. Although this activity cannot currently be prevented, there are two actions that management and accountants can take to limit the exposure. First, the firewalls at the source site can be programmed to block messages with non-internal addresses. This would prevent attackers from hiding their locations from the targeted site and would assure the organisation's management that no undetected attacks could be launched from its site. This strategy will not, however, prevent attacks from areas of the Internet that do screen outgoing transmissions.

Second, security software is available for the targeted sites that scan for half open connections. The software looks for SYN packets that have not been followed by an ACK packet. The clogged ports can then be restored to allow legitimate connections to be made.

For details to above points, refer to study material, Chapter-13, Section 13.8.1.

17. The three levels of input validation controls are:

(i) **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.

(ii) **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.

(iii) **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, refer to study material, Chapter 14, Section 14.1.

18. The checks which could be performed during a validation run can be categorized 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. 11-Module 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.

The various types of 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) The various sources from where the information can be recovered to investigate computer frauds are as follows:

- Free space: It refers to areas of a file system not currently allocated for data storage. These areas may have been used before and may contain deleted data, which has not yet been overwritten.
- Lost chains: It refers to areas of the disk allocated for data storage but currently without a name or disconnected from the file system.
- Slack space: It refers to disk space allocated to files in allocation blocks normally of several hundred to several thousand bytes in size. Files rarely occupy a complete number of allocation blocks so some of the last allocation

block will be unused. This area may contain data, which has not been overwritten.

- Deleted files: Files that have been "undeleted" by the processing software and made available for interrogation.
- The contents of the Windows SWAP file: This is a disk cache created by Windows each time it is run. It is a storage area in which all kinds of data may be kept. The file may be large and is hidden from the user. It is seldom deleted and can contain entire documents, memoranda and database information. It can thus be extremely valuable to an investigator.
- Internet cache files or temporary Internet files: When the Internet is accessed through Windows, copies of the web pages looked at by the user are copied to the user's computer. These copies are stored in a folder called Temporary Internet files. They can be of great interest to the investigator as it might provide a route map of Internet access.

(b) The following steps can be taken to detect fraud as soon as possible.

(i) *Conduct Frequent Audits*: One way to increase the likelihood of detecting fraud and computer abuses is to conduct periodic external and internal audits as well as special network security audits. Auditors should regularly test system controls and periodically browse data files looking for suspicious activities. However, care must be exercised to make sure employees' privacy rights are not violated.

(ii) *Use a Computer Security Officer*: Most frauds are not detected by internal or external auditors. The study shows that assigning responsibility for fraud deterrence and detection to a computer security officer has a significant deterrent effect. This person should be independent of the information system function. The security officer can monitor the system and disseminate information about improper system uses and their consequences.

(iii) *Use Computer Consultants*: Many companies use outside computer consultants or in-house teams to test and evaluate their security procedures and findings are closely evaluated, and corresponding protective measures are implemented. Some companies dislike this approach, because neither they want their weaknesses to be exposed nor do they want their employees to know that the system can indeed be broken into.

(iv) *Monitor system Activities*: All system transactions and activities should be recorded in a log. The log should indicate who accessed what data, when, and from which terminal. These logs should be reviewed frequently to monitor system activity and trace any problems to their source.

There are a number of risk analysis and management software packages that can review computer systems and networks. These systems evaluate security measures already in place and test for weaknesses and vulnerabilities. A series of reports is then generated that explain the weaknesses found and suggest improvements.

(v) *Use Fraud Detection Software*: People who commit fraud tend to follow certain patterns and leave behind telltale clues, such as things that do not make sense. Software has been developed to search out these fraud symptoms.

20. Some of the important terms as defined in the Information Technology Act 2008 (Amended) are:

(a) "*asymmetric crypto system*" means a system of a secure key pair consisting of a private key for creating a digital signature and a public key to verify the digital signature;

(b) "*electronic form*" with reference to information means any information generated, sent, received or stored in media, magnetic, optical, computer memory, micro film, computer generated micro fiche or similar device;

(c) "*electronic record*" means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche;

(d) "Electronic signature" means authentication of any electronic record by a subscriber by means of the electronic technique specified in the second schedule and includes digital signature

(e) "Electronic Signature Certificate" means an Electronic Signature Certificate issued under section 35 and includes Digital Signature Certificate"

For details to IT Act (Amended 2008), refer to the link http://www.icai.org/post.html?post_id=1056

21. The chapter VIII of the Information Technology Act 2008 (Amended) 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.

Subject to the provisions of sub-section (2), the Certifying Authority which has issued a Digital Signature Certificate may suspend such Digital Signature Certificate -

(a) On receipt of a request to that effect from -

(i) The subscriber listed in the Digital Signature Certificate; or

(ii) Any person duly authorized to act on behalf of that subscriber;

(b) If it is of opinion that the Digital Signature Certificate should be suspended in public interest

A Digital Signature Certificate shall not be suspended for a period exceeding fifteen days unless the subscriber has been given an opportunity of being heard in the matter.

On suspension of a Digital Signature Certificate under this section, the Certifying Authority shall communicate the same to the subscriber.

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.

For details to IT Act (Amended 2008), refer to the link http://www.icai.org/post.html?post_id=1056

22. (a) The purpose of an IS audit is to review and evaluate the internal controls that protect the system. When performing an IS audit, Auditors should ascertain that the following objectives are met:

(i) Security provisions protect computer equipment, programs, communications, and data from unauthorized access, modification, or destruction.

(ii) Program development and acquisition is performed in accordance with management's general and specific authorization.

(iii) Program modifications have the authorization and approval of management.

(iv) Processing of transactions, files, reports, and other computer records is accurate and complete.

(v) Source data that is inaccurate or improperly authorized is identified and handled according to prescribed managerial policies.

(vi) Computer data files are accurate, complete, and confidential.

(b) **Test Data Processing:** One way to test a program is to process a hypothetical series of valid and invalid transactions. The program should process all of the valid transactions correctly and identify and reject all of the invalid ones. All logic paths should be checked for proper functioning by one or more of the test transactions. Examples of invalid data include records with missing data, fields containing unreasonably large amounts, invalid account numbers or processing codes, non-numeric data in numeric fields, and records out of sequence.

Several resources are available when preparing test data. For example:

- A listing of actual transactions.
- The test transactions that the programmer used to test the program.
- A test data generator program, which automatically prepares test data based on program specifications.

In a batch processing system, the company's program and a copy of relevant files are used to process the test data. The results are compared with the pre-determined correct output; discrepancies indicate processing errors or control deficiencies that should be thoroughly investigated.

23. (a) Security Objective: The objective of information security is "the protection of the interests of those relying on information, and the information systems and communications that deliver the information, from harm resulting from failures of availability, confidentiality, and integrity".

For any organization, the security objective is met when:

- information systems are available and usable when required (availability);
- data and information are disclosed only to those who have a right to know it (confidentiality); and
- data and information are protected against unauthorized modification (integrity). The relative priority and significance of availability, confidentiality, and integrity vary according to the data within the information system and the business context in which it is used.

(b) The various ways to protect computer held information can be classified into two types: Preventative and Restorative.

(i) *Preventative Information Protection*: This type of protection is based on use of security controls. Information security controls are generally grouped into three types of control: Physical, Logical, and Administrative. Organizations require all three types of controls. The organization's Information Security Policy through the associated Information Security Standards documentation mandates use of these controls. Here are some examples of each type of control:

- Physical: Doors, Locks, Guards, Floppy Disk Access Locks, Cables locking systems to desks/walls, CCTV, Paper Shredders, Fire Suppression Systems
- Logical (Technical): Passwords, File Permissions, Access Control Lists, Account Privileges, Power Protection Systems
- Administrative: Security Awareness, and User Account Revocation Policy.

(ii) *Restorative Information Protection*: Security events that damage information will happen. If an organization cannot recover or recreate critical information in an acceptable time period, the organization will suffer and possibly have to go out of business. Planning and operating an effective and timely information backup and recovery program is vital to an operation. Information backup does not simply involve backing up "just the valuable information," but it frequently also means backing up the system as well, since the information may need services that the system provides to make the information usable.

The key requirement of any restorative information protection plan is that the information can be recovered. This is frequently an issue that many organizations fail to properly address. There is a common belief that if the backup program claimed it wrote the information to the backup media, it can be recovered from the backup media. However, there are many variables that can prove that belief wrong.

Here are a few questions any restorative information protection program must address:

- Has the recovery process been tested recently?
- How long did it take?
- How much productivity was lost?
- Did everything go according to plan?
- How much extra time was needed to input the data changes since the last backup?

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

24. (a) The table given below lists a number of different types of CASE tools and gives specific examples of each tool.

Tool type	**Example**
Management tools	PERT tools, estimation tools
Editing tools	Text editors, diagram editors, word processors
Configuration management tools	Version management system, change management system
Prototyping tools	High level language tools, user interface generators
Method support tools	Design editors, data dictionaries, code generators
Language processing tools	Compilers, interpreters
Program analysis tools	Cross reference generators, static analyzers, dynamic analyzers
Testing tools	Test data generators, file compactors
Debugging tools	Interactive debugging system
Documentation tools	Page layout program, image editors
Reengineering tools	Cross reference systems, program restructuring systems

(b) Data integration is the process of exchange of data by CASE tools. The result from one tool can be passed as input to another tool. There are a number of different levels of data integration:

(a) *Shared files*: All tools recognize a single file format. The most general purpose shareable file format is where files are made of lines of characters.

(b) *Shared data structures*: The tools make use of shared data structures which usually include program or design language information.

(c) Shared repository: The tools are integrated around an object management system which includes a public share data model describing the data entities and relationships which can be manipulated by the tools.

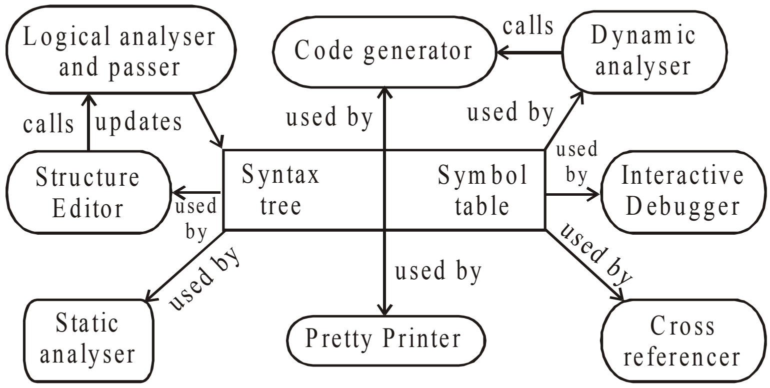
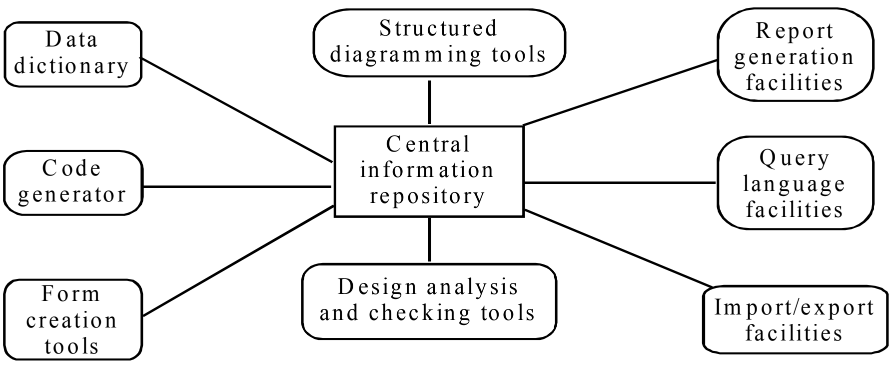


Figure: Integration through shared data structure

25. Analysis and design work benches are designed to support the analysis and design stages of the software process where models of the system are created. A typical model is shown in the figure below:



The components of this model are:

(i) *Diagram editors* to create data flow diagrams, structured charts, entity relationship diagram and so on.

(ii) *Design analysis and checking tools* which process the design and then submit report on errors and anomalies. These are integrated with editing system so that user errors are trapped at an early stage in the process.

(iii) *Repository query languages* which allow the designer to find the designs and associate design information in the repository.

(iv) *A* data dictionary which maintains precise and unambiguous information about all data elements used in a system design.

(v) *Report definition and generation* tools which take information from the central store and automatically generate system documentation.

(vi) *Forms definition tools* which allow screen and document formats to be specified.

(vii) *Import-export facilities* which allow the interchange of information from the central repository with other development tools.

(viii) *Code generators* which generate code or code skeletons automatically from the design captured in the central store.

PAPER – 7 : DIRECT TAXES

QUESTIONS

1. **Basic Concepts**

   "The Finance (No.2) Act, 2009 has expanded the scope of definition of "charitable purpose"- Elucidate.

2. **Residential Status and Scope of total income**

   Explain the tax consequence of the following transactions –

   (a) Mr.X, a non-resident, purchases goods in India for the purpose of export and earns profit on such transaction.

   (b) Salary received by Mr.Y, a non-resident, from the Government of India for the services rendered by him in Canada.

3. **Incomes which do not form part of total income**

   "The New Pension System Trust (NPS Trust) set up in February, 2008 to manage the assets and funds under the New Pension System in the interest of the beneficiaries enjoys a pass-through status" – Discuss the correctness or otherwise of this statement.

4. **Charitable or religious trusts and institutions**

   Discuss the tax treatment of voluntary contributions received by electoral trusts. Is there any deduction under the Income tax Act, 1961 in respect of donations made to electoral trusts? Explain.

5. **Salaries**

   Specify two fringe benefits which have been brought under the scope of perquisites taxable in the hands of employees by amending section 17(2) consequent to the abolition of fringe benefit tax.

6. **Income from house property**

   In the following cases, state the head of income under which the receipt is to be assessed and comment -

   (a) Anirudh let out his property to Abhinav. Abhinav sublets it. How is subletting receipt to be assessed in the hands of Abhinav.

   (b) Anish has built a house on a leasehold land. He has let-out the above property and has considered the rent from such property under the head "Income from other sources" and deducted expenses on repairs, security charges, insurance and collection charges in all amounting to 50% of receipts.

7. **Profits and gains of business or profession**

   (a) The Finance (No.2) Act, 2009 has introduced investment-linked tax incentives for specified businesses. In this context, explain the concept of investment-linked tax incentives and name the specified businesses eligible for such benefits.

(b) XYZ Ltd. commenced operations of the business of laying and operating a cross-country natural gas pipeline network for distribution on 1st April, 2009. The company incurred capital expenditure of Rs.32 lakh during the period January to March, 2009 exclusively for the above business, and capitalized the same in its books of account as on 1st April, 2009. Further, during the financial year 2009-10, it incurred capital expenditure of Rs.95 lakh (out of which Rs.60 lakh was for acquisition of land) exclusively for the above business. Compute the deduction under section 35AD for the A.Y.2010-11, assuming that XYZ Ltd. has fulfilled all the conditions specified in section 35AD.

8. **Profits and gains of business or profession**

Mr. A, a civil contractor and builder, paid a compensation of Rs.5 lakh to the tenants for vacating the premises. This was in pursuance of an agreement for development of the property. Mr. A claimed the expenditure as revenue expenditure. Discuss the correctness of the claim of Mr.A. Would the tax treatment of such compensation be different if Mr.A was not a civil contractor?

9. **Capital Gains**

"Section 50C can be invoked only in the case of registration of property pursuant to transfer. In a case where only an agreement for sale is entered into and no registration has taken place, the provisions of section 50C cannot be made applicable."

Discuss the correctness or otherwise of this statement.

10. **Income from other sources**

Mr. Rajesh received interest of Rs.3 lakh on enhanced compensation on 17.8.2009. Out of this interest, Rs.75,000 relates to the previous year 2006-07, Rs.1,00,000 relates to previous year 2007-08 and Rs.1,25,000 relates to previous year 2008-09. Discuss the tax implication, if any, of such interest income for A.Y.2010-11.

11. **Income from other sources/Capital Gains**

Mr. Ganesh received the following gifts during the P.Y.2009-10 from his friend Mr. Sundar, -

(1) Cash gift of Rs.51,000 on his birthday, 19th June, 2009.

(2) 50 shares of Beta Ltd., the fair market value of which was Rs.60,000, on his birthday, 19th June, 2009.

(3) 100 shares of Alpha Ltd., the fair market value of which was Rs.70,000 on the date of transfer. This gift was received on the occasion of Diwali. Mr. Sundar had originally purchased the shares on 10-8-2009 at a cost of Rs.50,000.

Further, on 20th November, 2009, Mr. Ganesh purchased land from his sister's mother-in-law for Rs.5,00,000. The stamp value of land was Rs.7,00,000.

On 15th February, 2010, he sold the 100 shares of Alpha Ltd. for Rs.1 lakh.

Compute the income of Mr. Ganesh chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2010-11.

12. **Deductions from Gross Total Income**

(a) The Finance (No.2) Act, 2009 has expanded the scope of deduction under section 80E – Elucidate.

(b) What are the conditions to be satisfied by an undertaking developing and building housing projects for claiming benefit of deduction under section 80-IB(10)?

13. **Relief under section 89**

Mr. Ravi, working in a public sector company, opted for voluntary retirement scheme and received Rs.8 lakh as VRS compensation. He claimed Rs.5 lakh as exemption under section 10(10C). Further, in respect of the balance amount of Rs.3 lakh, he claimed relief under section 89(1). Mr.Ravi seeks your opinion on the correctness of the above tax treatment.

14. **Assessment of Firms/LLPs**

(a) Explain the tax treatment of Limited Liability Partnership under the Income-tax Act, 1961.

(b) M/s.ABC, a partnership firm, has 3 partners, namely, A, B & C. The firm has paid salary of Rs.3 lakh to each of its partners during the P.Y.2009-10 and the same is authorized by the partnership deed. The net profit of the firm as shown in the profit and loss account computed in the manner laid down in Chapter IV-D is Rs.4 lakh, after providing for salary to the partners. Compute the disallowance as per section 40(b)(v).

15. **Assessment of Companies – Computation of Minimum Alternate Tax**

Hyper Ltd. earned a net profit of Rs.7.25 lakh after debit/credit of the following items to its profit and loss account for the year ended on 31.3.2010:

(a)	**Items debited to Profit and Loss Account**	**Rs.**
	Provision for income-tax	1,20,000
	Interest on income-tax	11,000
	Dividend distribution tax	20,000
	Provision for deferred tax	12,000
	Provision for doubtful debts	18,000
	Securities Transaction Tax	15,000
	Transfer to Special Reserve	20,000
	Provision for gratuity based on actuarial valuation	30,000
	Provision for losses of subsidiary company	22,000
	Proposed dividend	25,000
	Preference dividend	18,000

Expenditure to earn agricultural income	6,000
Expenditure to earn LTCG exempt under section 10(38)	4,000
Depreciation (including depreciation of Rs.10,000 on revaluation)	50,000

(b) Items credited to Profit and Loss Account

Amount credited to P& L A/c from General Reserve	10,000
Amount credited to P& L A/c from Revaluation Reserve	15,000
Agricultural income	30,000
LTCG exempt under section 10(38)	16,000

The company provides the following additional information:

Brought forward Business Loss/Unabsorbed Depreciation:

Assessment Year	Amount as per books	
	Loss	Depreciation
2007-08	Nil	50,000
2008-09	60,000	40,000
2009-10	20,000	30,000

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.4,00,000.

16. **Income-tax Authorities**

"An Additional Director and Additional Commissioner are not empowered to issue a warrant of authorization under section 132(1) to the other income-tax authorities for conducting search and seizure operations" – Is this statement correct? Discuss.

17. **Assessment Procedure**

Explain the significant features of Alternate Dispute Resolution Mechanism.

18. **Collection and Recovery of tax**

Explain whether the following contracts fall within the meaning of "work" under section 194C –

(i) Manufacturing a product for A as per A's requirement using raw material purchased from B.

(ii) Manufacturing a product for A as per A's requirement using raw material purchased from A himself.

If yes, what would be the value on which tax should be deducted at source under section 194C?

19. **Appeals & Revision**

An order of assessment passed under section 143(3) read with section 147 was served on Mr. X on 1.8.2009. Mr. X filed an application under section 264 for revision before the Commissioner on 17.8.2009. The Commissioner, however, refused to accept the application on the ground that it was a premature application. Discuss the correctness of the contention of the Commissioner.

20. **Penalties and Prosecution**

"The scope of levy of penalty under Explanation 5A to section 271(1) has been expanded retrospectively with effect from 1st June, 2007" – Elucidate.

21. **Double Taxation Relief**

The Central Government is empowered, under section 90(1), to enter into agreement with any country outside India or a specified non-sovereign territory. What are the purposes for which the Central Government can enter into such agreement?

22. **Miscellaneous Provisions**

What are the modes by which any notice or requisition under the Income-tax Act may be served on the assessee?

23. **Wealth-tax**

What is the basic exemption limit above which wealth-tax is leviable?

24. **Wealth-tax**

Ms. Poorna has a house property at Mumbai, which she has rented out to Ms. Jayashree. The cost of acquisition of the property (acquired in the year 2000) is Rs.40 lakh. Determine the value of her property as on the valuation date 31.3.2010, from the following particulars –

(i) The annual value of the property as per municipal records is Rs.6 lakh.

(ii) The monthly rent which the property fetches is Rs.45,000.

(iii) Municipal taxes @ 10% of the municipal value of the property are paid partly by Ms. Jayashree (40%) and partly by Ms. Poorna (60%).

(iv) The cost of repairs of the house property is entirely borne by Ms. Jayashree.

(v) Ms. Jayashree has given an interest-free deposit of Rs.2 lakh to Ms. Poorna.

(vi) The unexpired period of lease on the valuation date is 20 years.

25. **Wealth-tax**

Bentac Constructions Ltd. furnishes the following particulars of its wealth for the valuation date as on 31.3.2010:

		Rs.in lacs
(i)	Land in urban area (held as stock in trade since 1998)	67
(ii)	Motor cars (including one imported car worth Rs.32 lacs used for hiring)	43
(iii)	125 acres of land acquired at Ghaziabad township on 15.5.2009 for construction of commercial complex	150
(iv)	Residential flats of 950 sq feet each provided to 2 employees (salary of one employee exceeds Rs.5 lacs per annum)	22
(v)	Farm house of 8 acres at a remote village	7
(vi)	Cash in hand as per cash book	5
	Liabilities:	
(i)	Loan for purchase of land at urban area	45
(ii)	Loan for purchase of land at Ghaziabad	100
(iii)	Wealth-tax liability for A.Y. 2009-10	10
(iv)	Loan for construction of residential flats	14

Compute the net wealth of the company for the A.Y.2010-11.

SUGGESTED ANSWERS/HINTS

1. Section 2(15) defines "charitable purpose" to include relief of the poor, education, medical relief, and the advancement of any other object of general public utility. However, the "advancement of any other object of general public utility" shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity.

Section 2(15) has now been amended to specifically include within its ambit, the preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest. Prior to the amendment, these would have been included under "advancement of any other object of general public utility" and hence, would have been subject to the restriction mentioned above. However, now, they would not be subject to the restrictions which are applicable to the "advancement of any other object of general public utility".

2. **(a)** Under section 9, any income derived, *inter alia,* from a business connection in India or from a source of income in India shall be deemed to accrue or arise in India *Explanation 1(b)* to section 9(1) makes it clear that in case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for export.

Consequently, there is no tax consequence on the transaction of purchase of goods for export by Mr.X.

(b) Salary accrues at the place where the services are rendered. However, as per section 9(1)(iii), salary payable by the Government to an Indian citizen for services rendered abroad shall be deemed to accrue or arise in India. In this case, the Government of India pays salary to Mr.Y, a non-resident, for services rendered by him in Canada. If Mr.Y is an Indian citizen, his salary would be taxable in India and if he is not an Indian citizen, then it will not be chargeable to tax in India.

3. This statement is correct.

The New Pension System (NPS), operational since 1st January, 2004, is compulsory for all new recruits to the Central Government service from 1st January, 2004. Thereafter, it has been opened up for employees of State Government and private sector.

NPS Trust has been set-up on 27th February, 2008 as per the provisions of the Indian Trust Act, 1882 to manage the assets and funds under the NPS in the interest of the beneficiaries. The Finance (No.2) Act, 2009 has exempted the NPS Trust from the applicability of –

(i) income-tax on any income received by any person for, or on behalf of, the NPS Trust [Section 10(44)]

(ii) dividend distribution tax in respect of dividend paid to any person for, or on behalf of, the NPS Trust [Section 115-O]; and

(iii) securities transaction tax on all purchases and sales of equity and derivatives by the NPS Trust.

Further, the NPS Trust shall receive all income without any deduction of tax at source.

Thus, the NPS Trust, which was set up to manage the assets and funds under the New Pension System in the interest of the beneficiaries, would enjoy a "pass-through status".

4. Tax treatment of voluntary contributions received by electoral trusts

(i) In the year 2003, by an amendment carried out by the Election and Other Related Laws (Amendment) Act, 2003, sections 80GGB & 80GGC were introduced allowing 100% deduction in respect of the contribution made to registered political parties.

(ii) The Finance (No.2) Act, 2009 has widened the scope of deductions under these sections by allowing deduction to also the contribution/donation made to the electoral trusts as may be approved by the CBDT in accordance with the scheme to be made by the Central Government.

(iii) The deduction shall be 100% of the amount donated.

(iv) Further, voluntary contribution received by such electoral trust shall be treated as its income under section 2(24), but shall be exempt under new section 13B, if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with the surplus if any, brought forward from any earlier previous year.

(v) Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules made by the Central Government.

5. The Finance (No.2) Act, 2009 has inserted section 115WM to provide that the provisions of Chapter XII-H relating to Fringe Benefit Tax shall not apply in relation to A.Y.2010-11 and thereafter.

Consequently, the following fringe benefits have been brought under the scope of perquisites taxable in the hands of the employees by amending section 17(2) –

(1) the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer or former employer, free of cost or at concessional rate to the assessee.

(2) the amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds Rs.1 lakh.

6. (a) Sub-letting receipt is to be assessed as "Income from Other Sources" or as "Profits and gains of business or profession" in hands of Mr. Abhinav, depending upon the facts and circumstances of each case. It is not assessable as income from house property, since one of the conditions for assessing an income under this head is that the assessee should be the owner of the property. In this case, since Abhinav is not the owner of the house property, sub-letting receipt cannot be assessed under the head "Income from house property".

(b) In this case, the receipt is assessable as "Income from house property" since ownership of land is not a pre-requisite for assessment of income under this head. 30% of Net Annual Value is allowable as a deduction under section 24.

7. (a) Although there are a plethora of tax incentives available under the Income-tax Act, they do not fulfill the intended purpose of creating infrastructure since these incentives are linked to profits and consequently have the effect of diverting profits from the taxable sector to the tax-free sector. Therefore, with the specific objective of creating rural infrastructure and environment friendly alternate means for transportation of bulk goods, investment-linked tax incentives have been introduced for specified businesses, namely, –

- setting-up and operating 'cold chain' facilities for specified products;
- setting-up and operating warehousing facilities for storing agricultural produce;
- laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network.

100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above businesses would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

(b) The amount of deduction allowable under section 35AD for A.Y.2010-11 would be –

Particulars	Rs.
Capital expenditure incurred during the P.Y.2009-10 (excluding the expenditure incurred on acquisition of land) = Rs.95 lakh – Rs.60 lakh	35 lakh
Capital expenditure incurred prior to 1.4.2009 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2009	32 lakh
Total deduction under section 35AD for A.Y.2010-11	**67 lakh**

8. The Bombay High Court has, in *CIT v. Shriram Builcons Ltd. (2008) 306 ITR 328*, held that any compensation paid to tenants for vacating the premises in the course of business of the assessee, who was a civil contractor and builder, pursuant to an agreement for development of property, was revenue expenditure. However, if the assessee was not a civil contractor, the compensation so paid would be allowed as cost of improvement when he transfers his property.

9. This statement is not correct.

So far, the scope of section 50C did not include within its ambit, transactions which were not registered with stamp duty valuation authority, and executed through an agreement to sell or power of attorney. Therefore, in order to prevent tax evasion on this account, section 50C has been amended by the Finance (No.2) Act, 2009, to provide that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed **or assessable** by an authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed **or assessable** shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain. **The term "assessable" has been added to cover transfers executed through an agreement to sell or power of attorney.**

Explanation 2 has been inserted after section 50C(2) to define the term 'assessable' to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

10. (i) As per section 145(1), income chargeable under the head "Profits and gains of business or profession" or "Income from other sources", shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(ii) Further, the Hon'ble Supreme Court has, in *Rama Bai v. CIT (1990) 181 ITR 400*, held that arrears of interest computed on delayed or on enhanced compensation shall be taxable on accrual basis. The tax payers faced genuine difficulty on account of this ruling, since the interest would have accrued over a number of years, and consequently the income of all the years would undergo a change.

(iii) Therefore, to remove this difficulty, clause (b) has been inserted in section 145A to provide that the interest received by an assessee on compensation or on enhanced compensation shall be deemed to be his income for the year in which it is received, irrespective of the method of accounting followed by the assessee.

(iv) Clause (viii) has been inserted in section 56(2) to provide that income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A shall be assessed as "Income from other sources" in the year in which it is received.

(v) Clause (iv) has been inserted in section 57 to allow a deduction of 50% of such income. It is further clarified that no deduction would be allowable under any other clause of section 57 in respect of such income.

Therefore, in this case, the entire interest of Rs.3,00,000 would be taxable in the year of receipt, namely, P.Y.2009-10, under the head "Income from Other Sources".

Particulars	**Rs.**
Interest on enhanced compensation taxable u/s 56(2)(viii)	3,00,000
Less: Deduction under section 57(iv) @50%	1,50,000
Interest chargeable under the head "Income from other sources"	**1,50,000**

11. Computation of "Income from other sources" of Mr.Ganesh for the A.Y.2010-11

	Particulars	**Rs.**
(1)	Cash gift received before 1.10.2009 is taxable under section 56(2)(vi) since it exceeds Rs.50,000	51,000
(2)	Value of shares of Beta Ltd. gifted by Mr.Sundar on 19th June, 2009 is not taxable since only gift of property after 1st October, 2009 is chargeable to tax under section 56(2)(vii).	-
(3)	Fair market value of shares of Alpha Ltd. is taxable since the gift was made after 1st October, 2009 and the aggregate fair market value exceeds Rs.50,000.	70,000
(4)	Purchase of land for inadequate consideration on 20.11.2009 would attract the provisions of section 56(2)(vii), since the difference between the stamp value and consideration exceeds Rs.50,000. Sister's mother-in-law does not fall within the definition of "relative" under section 56(2).	

Stamp Value	7,00,000	
Less: Consideration	5,00,000	2,00,000
Income from Other Sources		**3,21,000**

Computation of "Capital Gains" of Mr. Ganesh for the A.Y.2010-11

Sale Consideration	1,00,000
Less: Cost of acquisition [deemed to be the fair market value charged to tax under section 56(2)(vii)]	70,000
Short-term capital gains	**30,000**

12. **(a)** (i) Section 80E provides for a deduction to an assessee, being an individual, on account of any amount paid by him in the previous year by way of interest on loan taken from any financial institution or any approved charitable institution for the purpose of pursuing his higher education or higher education of his relative.

(ii) Prior to the amendment by the Finance (No.2) Act, 2009, the deduction was available only for pursuing full time studies for any graduate or post-graduate course in engineering, medicine, management or for post-graduate course in applied sciences or pure sciences including mathematics and statistics.

(iii) The scope of this section has now been expanded to cover all fields of studies (including vocational studies) pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorized by the Central Government or State Government or local authority to do so. Therefore, interest on loan taken for pursuing any course after Class XII or its equivalent, will qualify for deduction under section 80E.

(iv) Further, the definition of "relative", in relation to an individual, has been amended to include, in addition to spouse and children of the individual, the student for whom the individual is the legal guardian.

(b) Section 80-IB(10) provides for 100% deduction of the profits derived by an undertaking from developing and building housing projects. This benefit is available subject to fulfillment of certain conditions, namely -

(a) The project is approved by a local authority before 31st March, 2008.

(b) The project is constructed on a plot of land having a minimum area of one acre.

(c) The built-up area of each residential unit should not exceed 1,000 sq.ft. in the cities of Delhi and Mumbai (including areas falling within 25 kms. of municipal limits of these cities) and 1,500 sq.ft. in other places.

(d) The built-up area of the shops and other commercial establishments included in the housing project should not exceed 5 per cent of the total built-up area of the housing project or 2,000 sq.ft., whichever is less.

(e) The project has to be completed within 4 years from the end of the financial year in which the project is approved by the local authority.

(f) The undertaking which develops and builds the housing project shall not be allowed to allot more than one residential unit in the housing project to the same person, not being an individual. Where the person is an individual, no other residential unit in such housing project should be allotted to any of the following persons:-

(1) the individual himself or spouse or minor children of such individual;

(2) the Hindu undivided family in which such individual is the karta;

(3) any person representing such individual, the spouse or minor children of such individual or the Hindu undivided family in which such individual is the karta.

13. An employee opting for voluntary retirement scheme receives a lump-sum amount in respect of his balance period of service. This amount is in the nature of advance salary. Under section 10(10C), an exemption of Rs.5 lakh is provided in respect of such amount to mitigate the hardship on account of the employee going into the higher tax bracket consequent to receipt of the amount in lump-sum upon voluntary retirement.

However, some tax payers have resorted to claiming both the exemption under section 10(10C) (upto Rs.5 lakh) and relief under section 89 (in respect of the amount received in excess of Rs.5 lakh). This tax treatment has been supported by many court judgements also, for example, the Madras High Court ruling in *CIT v. G.V. Venugopal (2005) 273 ITR 0307* and *CIT v. M. Abdul Kareem (2009) 311 ITR 162* and the Bombay High Court ruling in *CIT v. Koodathil Kallyatan Ambujakshan (2009) 309 ITR 113* and *CIT v. Nagesh Devidas Kulkarni (2007) 291 ITR 0407.* However, this does not reflect the correct intention of the statute.

Therefore, in order to convey the true legislative intention, section 89 has been amended to provide that no relief shall be granted in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or a scheme of voluntary separation (in the case of a public sector company), if exemption under section 10(10C) in respect of such compensation received on voluntary retirement or termination of his service or voluntary separation has been claimed by the assessee in respect of the same assessment year or any other assessment year.

Correspondingly, section 10(10C) has been amended to provide that where any relief has been allowed to any assessee under section 89 for any assessment year in respect of any amount received or receivable on his voluntary retirement or termination of service or voluntary separation, no exemption under section 10(10C) shall be allowed to him in relation to that assessment year or any other assessment year.

Therefore, in view of the above amendment, Mr. Ravi's tax treatment is incorrect. He has to either opt for exemption of upto Rs.5 lakh under section 10(10C) or relief under section 89(1), but not both.

14. (a) Tax treatment for Limited Liability Partnership (LLP)

(i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 has incorporated the taxation scheme of LLPs in the Income-tax Act on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

(ii) Consequently, the following definitions in section 2(23) have been amended -

(1) The definition of 'partner' to include within its meaning, a partner of a limited liability partnership;

(2) The definition of 'firm' to include within its meaning, a limited liability partnership; and

(3) The definition of 'partnership' to include within its meaning, a limited liability partnership.

The definition of these terms under the Income-tax Act would, in effect, also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. Section 2(q) of the LLP Act, 2008 defines a 'partner' as any person who becomes a partner in the LLP in accordance with the LLP agreement. An LLP agreement has been defined under section 2(o) to mean any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to the LLP.

(iii) The LLP Act provides for nomination of "designated partners" who have been given greater responsibility. Therefore, clause (cd) has been inserted in section 140, which lays down the "Authorised signatories to the return of income", to provide that the designated partner shall sign the return of income of an LLP. However, where, for any unavoidable reason such designated partner is not able to sign and verify the return or where there is no designated partner as such, any partner can sign the return.

(iv) New section 167C provides for the liability of partners of LLP in liquidation. In case of liquidation of an LLP, where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP. This provision would also apply where tax is due from any other person in respect of any income of any previous year during which such other person was a LLP.

(v) Since the tax treatment accorded to a LLP and a general partnership is the same, the conversion from a general partnership firm to an LLP will have no tax implications if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. However, if there is a change in rights and obligations of partners or there is a transfer of asset or liability after conversion, then the provisions of section 45 would get attracted.

(vi) The LLP shall be entitled to deduction of remuneration paid to working partners, if the same is authorized by the partnership deed, subject to the limits specified in section 40(b)(v), i.e., -

(a)	On the first Rs.3,00,000 of book profit or in case of a loss	Rs.1,50,000 or 90% of book profit, whichever is higher
(b)	On balance book profit	60% of book profit

(vii) The LLP shall be entitled to deduction of interest paid to partners if such payment is authorized by the partnership deed and the rate of interest does not exceed 12% simple interest per annum.

(viii) The LLP shall comply with section 184, which requires that -

(1) the partnership is evidenced by an instrument;

(2) the individual shares of the partnership are specified in that instrument;

(3) a certified copy of the LLP agreement shall accompany the return of income of the LLP of the previous year relevant to the assessment year in which assessment as a firm is first sought.

(ix) If the LLP does not comply with section 184, it shall not be entitled to deduction of payments of interest or remuneration made by it to any partner in computing the income under the head “Profits and gains of business or profession”.

(b) The LLP shall be entitled to deduction of remuneration paid to working partners, if the same is authorized by the partnership deed, subject to the limits specified in section 40(b)(v), i.e., -

(a)	On the first Rs.3,00,000 of book profit or in case of a loss	Rs.1,50,000 or 90% of book profit, whichever is higher
(b)	On balance book profit	60% of book profit

Particulars	Rs.
Net profit as per profit and loss account	4,00,000
Add: Salary paid to partners A, B & C (3,00,000 × 3)	9,00,000
Book profit	**13,00,000**
Deduction in respect of partners' remuneration is subject to limits specified in section 40(b)(v) -	
On first Rs.3 lakh of book profit [3,00,000 × 90%]	2,70,000
On balance Rs.10 lakh of book profit [10,00,000 × 60%]	6,00,000
	8,70,000

The excess amount of Rs.30,000 (i.e., Rs.9,00,000 – Rs.8,70,000) would be disallowed as per section 40(b)(v).

15. Computation of book profit under section 115JB

Particulars		Rs.	Rs.
Net Profit as per Profit & Loss Account			7,25,000
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	1,20,000		
Interest on income-tax	11,000		
Dividend distribution tax	20,000	1,51,000	
Provision for deferred tax		12,000	
Provision for doubtful debts		18,000	
Transfer to Special Reserve		20,000	
Provision for losses of subsidiary company		22,000	
Dividend paid or proposed			
Proposed dividend	25,000		
Preference dividend	18,000	43,000	
Expenditure to earn agricultural income [exempt u/s 10(1)]		6,000	
Depreciation		50,000	3,22,000
			10,47,000

***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 General Reserve	10,000	
Depreciation (excluding depreciation on account of revaluation of fixed assets) (i.e. Rs.50,000 – Rs.10,000)	40,000	
Amount credited to P& L A/c from Revaluation Reserve (to the extent of depreciation on revaluation)	10,000	
Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less taken on cumulative basis	80,000	
Agricultural Income [since it is exempt under section 10(1)]	30,000	1,70,000
Book Profit		**8,77,000**
15% of book profit		1,31,550
Add: Education cess @ 2%	2,631	
Secondary and higher education cess @ 1%	1,316	3,947
Tax liability under section 115JB		1,35,497
Tax liability under section 115JB (rounded off)		**1,35,500**
Total income computed as per the provisions of the Income-tax Act	**4,00,000**	
Tax payable @ 30%		1,20,000
Add: Education cess @ 2%	2,400	
Secondary and higher education cess @ 1%	1,200	3,600
Tax Payable as per the Income-tax Act		**1,23,600**

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 15% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 15% 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 15% of book profit, the book profit of Rs.8,77,000 is deemed to be the total income and income-tax is payable @ 15% thereof plus education cess @2% and secondary and higher education cess @1%. The tax liability, therefore, works out to Rs.1,35,500 (rounded off).

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

Particulars	Rs.
Tax on book profit under section 115JB	1,35,500
Less: Tax on total income computed as per the other provisions of the Act	1,23,600
Tax credit to be carried forward	**11,900**

Notes:

1. Securities transaction tax does not form part of income-tax and hence, should not be added back to net profit for computing book profit.
2. Provision for gratuity based on actuarial valuation is a provision for meeting an ascertained liability. Therefore, it should not be added back for computing book profit.
3. The Finance (No.2) Act, 2009 has now provided that the net profit should also be increased by the amount set aside as provision for diminution in the value of any asset, if the same has been debited to profit and loss account, for computing the book profit. Therefore, provision for doubtful debts has to be added back to net profit for computing book profit.
4. 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.

16. This statement is not correct.

Under section 132(1), the income-tax authorities listed therein are empowered to authorise other income-tax authorities to conduct search and seizure operations.

The authorities empowered to issue authorization are:

(1) Director General or Chief Commissioner;

(2) Director or Commissioner; and

(3) such Joint Director or Joint Commissioner as are empowered by the CBDT to do so.

Sections 2(28C) and 2(28D) define Joint Commissioner and Joint Director, respectively, to include Additional Commissioner and Additional Director. Accordingly, Additional Directors and Additional Commissioners have been issuing warrant of authorisation since 1st June, 1994. However, there have been Court rulings holding that Joint Directors or Joint Commissioners referred to in section 132 does not include Additional Director or Additional Commissioner and, consequently, the warrants of authorisation issued by the latter are illegal.

Therefore, a clarificatory amendment has now been made in section 132 to provide explicitly that Additional Director and Additional Commissioner always had the power to issue warrant of authorisation under the said provisions, whether or not specifically empowered by the CBDT to do so. Further, it has also been clarified that Joint Commissioner and Joint Director always had the power to issue warrant of authorization, whether or not specifically empowered by the CBDT to do so.

Thus, in effect, the warrants of authorization issued by Additional Director/Additional Commissioner/Joint Director/Joint Commissioner up to 30th September, 2009 are valid, whether or not they have been specifically empowered by the CBDT to issue such warrants. However, with effect from 1st October, 2009, an Additional Director/Additional Commissioner/Joint Director/Joint Commissioner can issue warrant of authorization only if he has been specifically empowered to do so by the CBDT.

17. An alternate dispute resolution mechanism which will aid speedy resolution of disputes on a fast track basis has now been provided for under the Income-tax Act. The significant features of the alternate dispute resolution mechanism are briefed hereunder –

(1) The Assessing Officer shall, forward a draft order of assessment to the eligible assessee if he proposes to make, on or after 1st October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.

"Eligible assessee" means,-

(i) any person in whose case such variation arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 92CA; and

(ii) any foreign company.

(2) The eligible assessee shall, within thirty days of the receipt by him of the draft order,-

(a) file his acceptance of the variations to the Assessing Officer; or

(b) file his objections, if any, to such variation with,—

(i) The Dispute Resolution Panel; and

(ii) The Assessing Officer.

"Dispute Resolution Panel" means a collegium comprising of three commissioners of Income-tax constituted by the CBDT for this purpose.

(3) The Assessing Officer has to complete the assessment on the basis of the draft order, if —

    (a) the assessee intimates the acceptance of the variation to the Assessing Officer; or

    (b) no objections are received within the period of 30 days specified in (2) above.

(4) The Assessing Officer shall, notwithstanding anything contained in section 153, pass the assessment order within one month from the end of the month in which,—

    (a) the acceptance is received; or

    (b) the period of filing of objections expires.

(5) The Dispute Resolution Panel shall, in a case where any objections are received, issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

(6) The Dispute Resolution Panel shall issue such directions, after considering the following, namely:—

    (a) Draft order;

    (b) Objections filed by the assessee;

    (c) Evidence furnished by the assessee;

    (d) Report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority;

    (e) Records relating to the draft order;

    (f) Evidence collected by, or caused to be collected by, it; and

    (g) Result of any enquiry made by, or caused to be made by it.

(7) The Dispute Resolution Panel may, before issuing any such directions -

    (a) make such further enquiry, as it thinks fit; or

    (b) cause any further enquiry to be made by any income tax authority and report the result of the same to it.

(8) The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order. However, it cannot set aside any proposed variation or issue any direction as mentioned in (5) above, for further enquiry and passing of the assessment order.

(9) If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.

(10) Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.

(11) If any direction is prejudicial to the interest of the assessee or the interest of the revenue, then, the same can be issued only after an opportunity of being heard is given to the assessee or the Assessing Officer, as the case may be.

(12) Such direction has to be issued within nine months from the end of the month in which the draft order is forwarded to the eligible assessee.

(13) Upon receipt of such direction, the Assessing Officer has to complete the assessment in accordance with the same, within one month from the end of the month in which the direction is received. There is no requirement of providing any further opportunity of being heard to the assessee,

(14) The CBDT is empowered to make rules for the efficient functioning of the Dispute Resolution Panel and speedy resolution of the objections filed by the eligible assessee.

18. The definition of "work" under section 194C has been amended to resolve the issue as to whether outsourcing constitutes work or not. Accordingly, as per the new definition, "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer, as such a contract is a contract for 'sale'. Therefore, if a product is manufactured for A using the raw material purchased from B, it would be a contract from 'sale' and not a works contract.

It may be noted that the term "work" would include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. Therefore, if a product is manufactured for A using the raw material purchased from A himself, it would fall within the definition of work under section 194C.

In such a case, tax shall be deducted on the invoice value excluding the value of material purchased from A if such value is mentioned separately in the invoice. Where the material component has not been separately mentioned in the invoice, tax shall be deducted on the whole of the invoice value.

19. Mr.X, who is aggrieved by the order of the Assessing Officer under section 143(3) read with section 147 passed on 1.8.2009, had moved an application for revision of order under section 264 on 17.8.2009. The order passed by the Assessing Officer under section 143(3) read with section 147 is an order appellable before the Commissioner (Appeals). The time limit for filing an appeal is 30 days from the date of order i.e. upto 31.8.2009. This time limit had not expired on 17.8.2009 and Mr.X had also not waived his right of appeal while filing the application for revision on 17.8.2009 before the Commissioner of Income-tax. The application filed before the Commissioner of Income-tax for revision under section 264 by Mr.X will only be considered when the conditions specified under section 264(4) have been complied with. One of the conditions is that the Commissioner shall not revise any order where an appeal against the order lies to the Commissioner (Appeals) or Appellate Tribunal and the time within which such appeal may be made has not expired, unless Mr.X has waived his right of appeal. In the present case, the time limit had not expired on 17.8.2009 and Mr.X had also not waived the right of appeal while filing the application for revision before the Commissioner of Income-tax on 17.8.2009 under section 264. Therefore, the Commissioner's refusal to entertain such application is correct.

20. *Explanation 5A* to section 271(1) is applicable in respect of searches conducted on or after 1st June, 2007. This *Explanation* provides that where an assessee is found to be the owner of any –

– asset and he claims that such assets have been acquired by him by utilizing his income for any previous year; or

– income based on any entry in the books of account or documents or transactions and he claims that such entry represents his income for any previous year,

which has ended before the date of the search and the due date for filing of the return has expired and return has not been filed, such income would be deemed to be concealed income, even if such income is declared in the return of income filed on or after the date of search.

The scope of *Explanation 5A* has been expanded retrospectively w.e.f. 1st June, 2007 to cover cases where the assessee has filed the return of income for any previous year before the date of search and the income found during the course of search relating the such previous year is not disclosed in the return of income. In such cases also, the assessee would be deemed to have concealed the particulars of income and would be liable for penalty under section 271.

The provisions of penalty covered under *Explanation 5A* to section 271(1) in respect of search initiated on or after 1.6.2007 is summarized in the table below –

	Relevant previous year	**Penalty**
(1)	Previous year which has ended before the date of search, in respect of which the due date has expired, but the return has not been furnished. For example, in respect of P.Y.2009-10, if the date of search is 15.11.2010, then the previous year has ended before that date (i.e., on 31.3.2010) and the due date of filing return (31.7.2010/30.9.2010, as the case may be) has also expired, but the return has not been furnished. In such a case, penalty would be attracted under this section.	100% to 300% of the tax sought to be evaded.
(2)	Previous year which has ended before the date of search, in respect of which return has been furnished, but income found during the search has not been disclosed in the return. In such a case also, penalty would be attracted under this section.	100% to 300% of the tax sought to be evaded.

21. Section 90(1) provides that the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India, -

(a) for the granting of relief in respect of -

(i) income on which income-tax has been paid both in India and in that country or specified territory; or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory to promote mutual economic relations, trade and investment; or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory; or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory or investigation of cases of such evasion or avoidance; or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory.

22. Section 282 has been substituted w.e.f. 1.10.2009 to provide that the service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -

(1) by post or such courier services as approved by the CBDT; or

(2) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or

(3) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or

(4) by any other means of transmission as may be provided by rules made by the CBDT in this behalf.

The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

23. As per section 3, wealth-tax liability is attracted in the hands of every individual, HUF and company at the rate of 1% of the net wealth in excess of Rs.15 lakh. This limit was fixed way back in 1992. Accordingly, in order to provide for inflation-adjustment, the limit has now been enhanced by the Finance (No.2) Act, 2009 to Rs.30 lakh for the valuation of net wealth as on 31.3.2010 and thereafter.

24. Valuation of house property at Mumbai of Ms. Poorna on valuation date 31.3.2010

Particulars	**Rs.**
Actual Rent (Rs.45,000 x 12)	5,40,000
Add: (i) Municipal taxes borne by the tenant (4% of Rs.6 lakh)	24,000
(ii) Repairs borne by the tenant - 1/9th of actual rent received	60,000
(iii) 15% of amount of deposit of Rs.2 lakh	30,000
Annual Rent	**6,54,000**

The annual rent so worked out has to be compared with the municipal value and the higher of the two has to be adopted as Gross Maintainable Rent. The municipal value is Rs.6,00,000 whereas the annual rent works out to Rs.6,54,000. Therefore, the annual rent is higher and shall be adopted for calculating the Net Maintainable Rent.

Computation of Net Maintainable Rent (NMR)		**Rs.**
Gross Maintainable Rent, being the annual rent		6,54,000
Less: Corporation Tax (10% of Rs.6 lakh)	60,000	
15% of Gross Maintainable Rent	98,100	1,58,100
Net Maintainable Rent (NMR)		**4,95,900**

Capitalised value of NMR		
Capitalised value (Rs.4,95,900 × 8)	39,67,200	
Cost of acquisition	40,00,000	
Capitalised value is the higher of the above		40,00,000

Therefore, the value of house property on valuation date 31.3.2010 is Rs.40 lakh.

25. Computation of net wealth of Bentac Constructions Ltd. for A.Y.2010-11

		Particulars	**Rs. in lacs**
Assets [as per the definition of assets under section 2(ea)]			
(i)		Land in urban area (held as stock in trade since 1998) – taxable since it is held as stock-in-trade for more than 10 years	67
(ii)		Motor cars (excluding imported car not being an asset since it is used for hiring) [43 lac – 32 lac]	11
(iii)		Land at Ghaziabad township – Since the assessee is engaged in construction business, land and building would form part of his stock-in-trade. Hence, not taxable.	Nil
(iv)	(a)	Residential flat provided to an employee drawing salary less than Rs.5 lacs per annum – not an asset	Nil
	(b)	Residential flat provided to an employee drawing salary exceeding Rs.5 lacs per annum is an asset [22 × 1/2]	11
(v)		Farm house at a remote village is not an asset as it is not situated within 25 km of a municipality	Nil
(vi)		Cash in hand as per cash book is not an asset since it represents cash recorded in the books	Nil
			89

Less: **Liabilities**

(i)	Loan for purchase of land in urban area – deductible since it is incurred in relation to land in urban area, which is an asset chargeable to wealth-tax.	45	
(ii)	Loan for purchase of land at Ghaziabad – not deductible since the land, being stock-in-trade, is not an asset under section 2(ea).	Nil	
(iii)	Wealth-tax liability for A.Y.2009-10 – wealth tax liability is not deductible	Nil	
(iv)	Loan for construction of residential flats - the portion relating to taxable asset (1/2) is deductible i.e. $\frac{1}{2} \times 14 lacs$	7	52
	Net Wealth		**37**

IMPORTANT CIRCULARS/NOTIFICATIONS ISSUED BETWEEN 1.5.2009 AND 31.10.2009

I CIRCULARS

1. Circular No. 4/2009, dated 29.6.2009

Section 195 mandates deduction of income tax from payments made or credit given to non-residents at the rates in force. The Reserve Bank of India has also mandated that except in the case of certain personal remittances which have been specifically exempted, no remittance shall be made to a non-resident unless a no objection certificate has been obtained from the Income Tax Department. This was modified to allow such remittances without insisting on a no objection certificate from the Income Tax Department, if the person making the remittance furnishes an undertaking (addressed to the Assessing Officer) accompanied by a certificate from an Accountant in a specified format. The certificate and undertaking are to be submitted (in duplicate) to the Reserve Bank of India / authorised dealers who in turn are required to forward a copy to the Assessing Officer concerned. The purpose of the undertaking and the certificate is to collect taxes at the stage when the remittance is made as it may not be possible to recover the tax at a later stage from non-residents.

There has been a substantial increase in foreign remittances, making the manual handling and tracking of certificates difficult. To monitor and track transactions in a timely manner, section 195 was amended vide Finance Act, 2008 to allow CBDT to prescribe rules for electronic filing of the undertaking. The format of the undertaking (Form 15CA) which is to be filed electronically and the format of the certificate of the Accountant (Form 15CB) have been notified vide Rule 37BB of the Income-tax Rules, 1962.

The revised procedure for furnishing information regarding remittances being made to non-residents w.e.f. 1st July, 2009 is as follows:-

(i) The person making the payment (remitter) will obtain a certificate from an accountant (other than employee) as defined in the Explanation to section 288 in Form 15CB.

(ii) The remitter will then access the website to electronically upload the remittance details to the Department in Form 15CA (undertaking). The information to be furnished in Form 15CA is to be filled using the information contained in Form 15CB (certificate).

(iii) The remitter will then take a print out of this filled up Form 15CA (which will bear an acknowledgement number generated by the system) and sign it. Form 15CA (undertaking) can be signed by the person authorised to sign the return of income of the remitter or a person so authorised by him in writing.

(iv) The duly signed Form 15CA (undertaking) and Form 15CB (certificate), will be submitted in duplicate to the Reserve Bank of India / authorized dealer. The Reserve Bank of India / authorized dealer will in turn forward a copy of the certificate and undertaking to the Assessing Officer concerned.

(v) A remitter who has obtained a certificate from the Assessing Officer regarding the rate at or amount on which the tax is to be deducted is not required to obtain a certificate from the Accountant in Form 15CB. However, he is required to furnish information in Form 15CA (undertaking) and submit it along with a copy of the certificate from the Assessing Officer as per the procedure mentioned from Sl.No.(i) to (iv) above.

2. Circular No. 5/2009, dated 2.7.2009

The CBDT has issued this circular in supercession to all circulars and instructions issued by it relating to the procedure for representation before the Board for Industrial and Financial Reconstruction (BIFR) and the Appellate Authority for Industrial and Financial Reconstruction (AAIFR). This circular prescribes the following procedure to be followed before the BIFR and AAIFR in respect of granting income-tax reliefs/concessions to be given to sick companies for its rehabilitation under the Sick Industrial Companies (SICA) Act, 1985.

(i) The Director General Income Tax (Administration), [DGIT (Admn.)] will be the Nodal agency for co-ordination between the BIFR and the CBDT and between the AAIFR and the CBDT.

(ii) It will be the responsibility of DGIT (Admn.) to represent the CBDT before BIFR and AAIFR in every case in which income-tax reliefs is sought under the Draft Rehabilitation Scheme or in the Sanctioned Scheme circulated by BIFR/AAIFR.

(iii) The DGIT (Admn.) will consider each case of income-tax reliefs/concessions under the Direct Tax Laws on merits of each individual case for the purpose of consent as contemplated in section 19(2) of the SICA, 1985. In cases where the company and the Assessing Officer have quantified the income-tax reliefs, the DGIT (Admn.) will communicate the consent or denial of consent to BIFR at the time of hearing itself after obtaining the approval of CBDT. Where the information from the company and the Assessing Officer is incomplete, the DGIT (Admn.) will obtain the necessary information from the concerned parties and put up the file for the consideration of CBDT and subsequently intimate the BIFR.

(iv) It is the responsibility of DGIT (Admn.) to obtain the approval of CBDT in every case in which income-tax relief/concessions is sought and to communicate the approval of CBDT to BIFR and the concerned Assessing Officer. The decision thus communicated by the DGIT (Admn.) on behalf of the CBDT is binding on all Assessing Officers.

(v) The Assessing Officer should give the income-tax reliefs to sick companies only after obtaining the approval as mentioned above. In cases where BIFR/AAIFR is taking a different view from that of the CBDT, it will be the responsibility of DGIT (Admn.) to file appeal before the appellate authority (AAIFR) or before the Delhi High Court, as the case may be. It is also hereby clarified that in cases where the sick companies file appeals against the order of BIFR/AAIFR in any of the High Court other than Delhi High Court, it will be the responsibility of concerned Chief Commissioner of Income Tax (Administration) to defend the case in the respective High Court.

3. Circular No. 7/2009 dated 22.10.2009

The CBDT has, through this circular, withdrawn the following circulars:

a) Circular No. 23 issued on 23rd July 1969 regarding taxability of income accruing or arising through, or from, business connection in India to a non-resident, under section 9 of the Income-tax Act, 1961.

b) Circulars No. 163 dated 29th May, 1975 and No.786 dated 7th February, 2000 which provided clarification in respect of certain provisions of Circular No 23 dated 23rd July, 1969.

II NOTIFICATIONS

1. Notification No. 67/2009 dated 9.9.2009

The Central Government has, vide notification no.67/2009 dated 9.9.2009, specified the cost inflation index(CII) for the financial year 2009-10. The CII for F.Y. 2009-10 is 632.

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
29.	2009-10	632

2. Notification No. 70/2009, dated 22.9.2009

The CBDT has, in exercise of the powers conferred by section 139(1B), made an amendment in the notification of the Government of India relating to qualifications of an e-Return intermediary. The qualifications of an e-Return Intermediary, as amended, are detailed hereunder -

(1) An e-Return Intermediary shall have the following qualifications, namely:-

(a) it must be a public sector company as defined in section 2(36A) of the Act or any other company in which public are substantially interested within the meaning of section 2(18) of the Act and any subsidiary of those companies; or

(b) a company incorporated in India, including a bank, having a net worth of rupees one crore or more; or

(c) a firm of Chartered Accountants or Company Secretaries or Advocates, if it has been allotted a permanent account number; or

(d) a Chartered Accountants or Company Secretaries or Advocates or Tax Return Preparers, if he has been allotted a permanent account number; or

(e) a Drawing or Disbursing Officer (DDO) of a Government Department.

(2) The e-intermediary shall have at least class II digital signature certificate from any of the Certifying authorities authorized to issue such certificates by the Controller of Certifying authorities appointed under section 17 of the Information Technology Act, 2002.

(3) The e-intermediary shall have in place security procedure to the satisfaction of e-Return Administrator to ensure that confidentiality of the assessees information is properly secured.

(4) The e-intermediary shall have necessary archival, retrieval and, security policy for the e-Returns which will be filed through him, as decided by e-Return Administrator from time to time.

(5) The e-intermediary or its Principal Officer must not have been convicted for any professional misconduct, fraud, embezzlement or any criminal offence.

PAPER - 8 : INDIRECT TAXES

QUESTIONS

EXCISE

Classification

1. Dagar Ltd. manufactures coconut oil and sells them in packings of 50 ml or 100 ml. The packing of the oil specifies it to be 'pure coconut oil'. Majority of the consumers use the said coconut oil as hair oil. Dagar Ltd. classifies the coconut oil as 'vegetable oil' under Chapter 15 of the Central Excise Tariff. However, the Department contends that coconut oil manufactured by Dagar Ltd. is meant for sale as 'hair oil'; therefore, it should be classified as 'hair oil' under Chapter 33.

   Explain whether the contention of the Department is correct in law?

Valuation of excisable goods

2. MB Motors manufactures motor vehicles. It gets complete motor vehicles manufactured by sending the chassis of the motor vehicles to BD Works, independent body builders (job-worker), for building the body as per the design/specification given by it. The practice followed is that the chassis is transferred to BD Works on payment of appropriate central excise duty on stock transfer basis and is not sold to them. BD Works avails the CENVAT credit of the duty paid on the chassis and clears the same on payment of duty to the Depot of MB Motors. The duty is discharged by BD Works on the assessable value comprising the value of chassis and the job charges. The Depot of MB Motors sells the vehicles at a higher price than the price on which duty had been paid.

   Discuss whether the practice followed is correct in terms of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000.

CENVAT Credit

3. What is the quantum of CENVAT credit that can be availed in respect of inputs and capital goods cleared on or after 07.09.2009 from an export-oriented undertaking or by a unit in electronic hardware technology park or in a software technology park?

4. Rokasa Ltd. was engaged in the manufacture of a pharmaceutical product, viz. Rovamox Pediatric Drops. Rokasa Ltd. contended that the plastic droppers supplied along with the bottle containing the drops were inputs used in or in relation to manufacture of the final product and hence, claimed CENVAT credit of the duty paid on the droppers. However, the Revenue argued that CENVAT credit was not admissible as these droppers were kept separately in the cartons along with the sealed bottle of the pediatric drops and were neither used in the manufacture of pediatric drop nor used in relation to its manufacture.

   Briefly discuss whether the stand taken by the Department is correct or not with the help of a decided case law.

Assessment

5. Explain the concept of provisional assessment under rule 7 of the Central Excise Rules, 2002.

Power of the Central Government to impose restrictions in certain type of cases

6. Rule 12CC of the Central Excise Rules, 2002 empowers the Central Government to withdraw facilities or impose restrictions on a manufacturer, first stage or second stage dealer, or an exporter in certain cases. State such cases.

Offences

7. List the persons in respect of whom the provisions relating to compounding of offences do not apply.

Penalty

8. A show cause notice was issued against 'P' on 12.08.2009 asking him to pay Rs.3,50,000 which was short paid by him with an intent to evade payment of excise duty. The adjudication order confirming the demand was communicated to 'P' on 15.11.2009. 'P' filed an appeal against the order with the Commissioner of Central Excise (Appeals). The appeal was decided in favour of the revenue. The order of the Commissioner of Central Excise (Appeals) asking 'P' to pay the duty, interest under section 11AB and penalty equal to duty demanded under section 11AC was communicated to 'P' on 02.01.2010. 'P' plans to pay the full duty and interest within 30 days from 02.01.2010 and avail the benefit of reduced penalty (25% of duty) under the first proviso to section 11AC. Can 'P' avail the benefit of reduced penalty? Discuss.

9. Discuss, with the help of a decided case law, the conditions and the circumstances that would attract the imposition of penalty under section 11AC of the Central Excise Act, 1944?

Remission of duty

10. Bharat Zinc Ltd. (BZ Ltd.) was engaged in the manufacture of lead and zinc concentrates. At the time of carrying out the physical stock taking, some difference was found between the physically verified stock and the stock as per the books. According to BZ Ltd., this difference was due to de-bagging, shifting of concentrates, seepage of rain water and storage and loading on trucks. BZ Ltd. applied for the remission of duty under rule 21 of the Central Excise Rules, 2002. Revenue claimed that the shortage could have been avoided or minimized by the assessee, as they were neither due to natural causes, nor due to unavoidable accident. Thus, the prayer for remission was declined.

    You are required to examine the veracity of the Revenue's claim with the help of a decided case law.

Appeal

11. With reference to section 35G of the Central Excise Act, 1944, discuss whether the High Court has power to condone the delay in filing an appeal?

Advance Ruling

12. Who can apply for an advance ruling under central excise provisions?

Audit

13. Does central excise law have any audit mechanism to cover a case where the value of the excisable goods has not been correctly declared or determined by a manufacturer? Discuss.

CUSTOMS

Additional duty of customs

14. For the purpose of computing additional duty under section 3(1) of the Customs Tariff Act, 1975, what will be the value of an article imported into India where a tariff value has been fixed under section 3(2) of the Central Excise Act, 1944 for the like article manufactured in India?

Appointment of customs port, airport etc.

15. Discuss the provisions of section 7 of the Customs Act, 1962 relating to appointment of customs port, airports etc.?

Restrictions on custody and removal of imported goods

16. Who takes the custody of the imported goods which have entered the customs area but have not been cleared for home consumption or warehousing? Discuss the responsibilities and liabilities of such person.

Refund

17. The Finance (No. 2) Act, 2009 has inserted section 26A in the Customs Act, 1962, which provides for refund of import duty in certain cases. With reference to the said section, state the cases where the import duty shall be refunded to the person who has paid such duty.

Warehousing

18. Priyanshi imported certain goods in March 2009. An "Into Bond" bill of entry was presented on 14th March, 2009 and goods were cleared from the port for warehousing. Assessable value was $10,00,000. The order permitting the deposit of the goods in warehouse for three months was issued on 21st March, 2009. Priyanshi did not clear the imported goods even after the warehousing period got over on 20th June, 2009. She did not obtain any extension of time as well.

    A notice was issued under section 72 demanding duty and other charges. Priyanshi cleared the goods on 28th July, 2009. Compute the amount of duty payable by Priyanshi while removing the goods on the basis of following information:

	14.03.2009	20.06.2009	28.07.2009
Rate of Exchange	Rs.48.20	Rs.48.40	Rs.48.50

per US $			
Basic customs duty	15%	10%	12%

Assume that no additional duty or special additional duty is payable.

Advance Rulings

19. Explain the amendments made by the Finance (No. 2) Act, 2009 in section 28F of the Customs Act, 1962.

Seizure of goods

20. Krishna Telecoms were engaged in the business of providing telecommunication services in various States in India. For their business Krishna Telecoms imported Optic Fibre Cables (OFC) and classified them under Heading 85.44 of the Customs Tariff. However, the Department claimed that the goods should be classified under Heading 90.01. The Commissioner of Customs (Appeals), when the matter was brought before him, held that the impugned goods were classifiable under Heading 85.44 of the Customs Tariff. The Department has filed an appeal before CESTAT against the said order which has yet not been decided.

    Meanwhile, the customs authorities (DRI officers) have seized the consignment of OFC imported and cleared by Krishna Telecom on payment of duty assessed under Heading 85.44 and forced Krishna Telecoms to pay the differential duty between Headings 85.44 and 90.01 by threat and coercion.

    Examine the validity of the action of the customs authorities, with the help of a decided case law.

Miscellaneous

21. Whether officers of the other Departments are required to assist officers of customs in the execution of the Customs act, 1962? If yes, then list such officers.

SERVICE TAX

Banking and other financial services

22. With reference to banking and other financial services, state whether service tax is applicable in the following cases:

    (i) Services provided by State Bank of India to the Central Board of Direct Taxes in relation to collection of advance income-tax.

    (ii) Discount charged by SB Ltd., a non-banking financial company, on the facility of bill discounting provided by it. Such discount is shown separately in the bill issued for this purpose.

    (iii) Rich Bank, a Scheduled Bank, purchases foreign currency from Generous Bank, another Scheduled Bank.

Construction services in respect of residential complexes

23. With reference to construction services in respect of residential complexes, answer the following questions:
    (i) What does a "residential complex" mean?
    (ii) Which activities are covered within "construction of complex"?
    (iii) Does the service tax law provide for any exemption for this service? Explain.

Business auxiliary services

24. With reference to business auxiliary services state whether service tax is applicable in following cases:
    (i) Manufacture of non-excisable goods on behalf of the client.
    (ii) Services provided by commission agents in relation to sale of jute.
    (iii) Commission received by distributors for distribution of mutual fund units.

Appeals

25. The Finance (No. 2) Act, 2009 has substituted section 84 of the Finance Act, 1994 with a new section 84. Explain the provisions of new section.

SUGGESTED ANSWERS/HINTS

1. The Department's contention is correct. *Circular No. 890/10/2009 CX dated 03.06.2009* has been issued in respect of classification of coconut oil sold in small packs say of 50 ml or 100 ml. When the coconut oil is sold in small containers, following indications are found on containers or labels:

A. 'hair oil'

B. 'edible oil'

C. 'pure coconut oil' or 'coconut oil'

When 'hair oil' is printed on the container/label, it is classified as 'hair oil' under chapter 33. Further, the coconut oil falling under the other two categories ('edible oil', 'pure coconut oil' or 'coconut oil') should also be classified as 'hair oil' under Chapter 33 as they are meant for sale as 'hair oil'.

The circular explains that Chapter Note 2 of Chapter 33 prescribes a condition that Heading No.3305 (which covers hair oil also) applies to products **put up in packing of a kind sold by retail for such use.** Thus, if a particular packing of coconut oil is generally sold in retail as hair oil, in that case, the said product would be classified under heading 3305.

Further, Section Note 2 to Section VI also provides that goods classifiable in Heading 3305 by reason of being put up for retail sales are to be classified in the said heading and in no other heading of the schedule. This Section Note further supports the interpretation that though a product is capable of being classified under more than one heading, even then because of the nature of its retail packing, which is indicative of its use as hair oil, the classification under heading 3305 would get priority. However, if the same coconut oil is packed in say 1 litre or 2 litre packages, which are generally used by consumers for edible purposes (even though some customers may use it as hair oil), it would be classified under Chapter 15.

Hence, the classification of coconut oil would depend upon the fact as to how the majority of the customers use the said product. Therefore, if coconut oil is packed in packages which are generally meant for sale in retail as hair oil, in that case the said product would be classified as hair oil under Heading 3305, even though few consumers may use it as edible oil.

Thus, the circular settles that coconut oil packed in containers upto 200 ml may be considered as generally used as hair oil and shall be classified under Heading 3305.

2. As per rule 10A (ii) of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 the assessable value for the purpose of charging central excise duty, in cases where the job-worker transfers the excisable goods to the Depot/Sale office/Distributor and/or any other sale point of the principal manufacturer, shall be the transaction value on which goods are sold by the principal manufacturer from such a place. Accordingly, after the insertion of Rule 10A, the practice of discharging the duty on cost construction method by BD Works is not legally correct.

Circular No. 902/22/2009 CX dated 20.10.2009 also clarifies that wherever goods are manufactured by a person on job work basis on behalf of a principal, then value for the purpose of payment of excise duty may be determined in terms of the provisions of Rule 10A of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 subject to fulfilment of the requirements of the said rule.

Thus, BD Works should pay the duty on the transaction value on which vehicles are sold by MB Motors from its depot.

3. Sub-rule (7) of the CENVAT Credit Rules, 2004 *inter alia* provides that credit in respect of inputs and capital goods cleared on or after 07.09.2009 from an export-oriented undertaking or by a unit in electronic hardware technology park or in a software technology park, as the case may be, on which such undertaking or unit has paid –

A. excise duty leviable under section 3 of the Excise Act read with serial number 2 of the *Notification No. 23/2003 CE, dated 31.03.2003*; and

B. the education cess and the secondary and higher education cess on the excise duty referred to in (A),

shall be the aggregate of –

I. that portion of excise duty referred to in (A), as is equivalent to -

   i. the additional duty leviable under section 3(1) of the Customs Tariff Act, which is equal to the duty of excise under section 3(1)(a) of the Excise Act;

ii. the additional duty leviable under section 3(5) of the Customs Tariff Act; and

II. the education cess and the secondary and higher education cess referred to in (B).

4. No, the stand taken by the Department is not correct. The facts of the given case are similar to the case of *CCEx., Mumbai v. Okasa Ltd. 2009 (241) E.L.T. 359 (Bom.)*. In the instant case, the High Court has observed that for the purpose of dispensation or administration of the drugs in proper quantity as per the medical prescription, dropper has to be supplied along with the bottle containing the drug. Further, since as per the directions given by the Controller of Drugs for India, such droppers were mandatory for sale of the drug, they would be considered as "packing material".

Therefore, the High Court held that the plastic dropper packed with the pediatric drops should be construed to be an input used in or in relation to the manufacture of the final product.

5. Rule 7 of the Central Excise Rules, 2002 contains the provisions in respect of provisional assessment. Provisional assessment can be requested by the assessee. Department itself cannot order provisional assessment.

An assessee can request for provisional assessment if he:

(i) is unable to determine the value of the excisable goods or

(ii) is unable to determine the applicable rate of duty.

In aforesaid cases, assessee may request Assistant/Deputy Commissioner in writing giving reasons for provisional assessment of duty. After such request, the Assistant/ Deputy Commissioner may by order allow payment of duty on provisional basis. The Assistant/Deputy Commissioner shall also specify the rate or value at which duty will be provisionally paid. Payment of duty on provisional basis will be allowed subject to execution of bond for payment of differential duty.

The Assistant/Deputy Commissioner should pass the order for final assessment within 6 months from the date of order of provisional assessment. If after final assessment, any differential amount becomes payable, interest shall be payable from the first day of the month succeeding the month for which such amount is determined, till the date of payment thereof. However, if a refund arises consequent to the order of final assessment, interest shall be payable on such refund from the first day of the month succeeding the month for which such refund is determined, till the date of refund. The refund shall be subject to the provisions of unjust enrichment.

6. *Notification No. 32/2006 CE(NT) dated 30.12.2006* issued under rule 12CC specifies that Member (Central Excise), Central Board of Excise and Customs may order for withdrawal of facilities or impose restrictions where a manufacturer, first stage or second stage dealer, or an exporter including a merchant exporter is prima facie found to be knowingly involved in any of the following:

(a) removal of goods without the cover of an invoice and without payment of duty;

(b) removal of goods without declaring the correct value for payment of duty, where a portion of sale price, 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 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 excise duty invoice without delivery of goods specified in the said invoice;

(f) claiming of refund or rebate based on the excise duty paid invoice or other documents which a person has reason to believe as not genuine;

(g) removal of inputs as such on which CENVAT credit has been taken, without paying an amount equal to credit availed on such inputs in terms of sub-rule (5) of rule 3 of the CENVAT Credit Rules, 2004.

7. Finance (No. 2) Act, 2009 has inserted a proviso in section 9A(2) to provide that in the case of following persons the provisions relating to compounding of offences will not apply:

(a) a person who has been allowed to allowed to compound once in respect of any of the offences under the provisions of clause (a), (b), (bb), (bbb), (bbbb) or (c) of section 9(1);

(b) a person who has been accused of committing an offence under this Act which is also an offence under the Narcotic Drugs and Psychotropic Substances Act, 1985.

(c) a person who has been allowed to compound once in respect of any offence under this Chapter for goods of value exceeding rupees one crore.

(d) a person who has been convicted by the court under this Act on or after 30.12.2005.

8. No, 'P' cannot avail the benefit of reduced penalty. *Circular No. 898/18/09 CX dated 15.09.2009* has clarified that the benefit of reduced penalty under provisos to section 11AC is not available at appeal stage, i.e. the reduced penalty cannot be paid *within 30 days of the communication of the order in appeal*. The circular explains that in order to avail the benefit of 25% penalty, the duty, interest and penalty are required to be paid *within 30 days of communication of the order passed by the adjudicating authority*.

Further, the reading of proviso (4) would also support this interpretation because the said proviso stipulates that wherever duty amount is increased at any appellate stage, in that case in order to avail the benefit of 25% penalty, the assessee is required to pay differential amount within 30 days of the passing of the order by the appellate authority. A combined reading of all the four provisos would, therefore, make it clear that the benefit of 25% penalty is applicable only when the assessee has paid duty, interest and the reduced penalty within 30 days of communication of the order passed by the adjudicating authority. However, if the penalty amount is increased at the appellate stage, in that case the 25% of differential amount of penalty can be paid within 30 days of communication of said appellate order.

9. The conditions and the circumstances that would attract the imposition of penalty under section 11AC of the Central Excise Act, 1944 have been laid down by the Apex Court in case of *UOI v. Rajasthan Spinning & Weaving Mills 2009 (238) ELT 3 (SC)*.

In the instant case, the Apex Court has observed that mandatory penalty under section 11AC of the Central Excise Act, 1944 is not applicable to every case of non-payment or short-payment of duty. In order to levy the penalty under section 11AC, conditions mentioned in the said section should exist. Supreme Court ruled that the penalty would not be waived on the ground that the assessee had deposited the balance amount of excise duty (that was short paid at the first instance) before the show cause notice was issued. The Apex Court elaborated that the payment of the differential duty whether before/after the show cause notice is issued cannot alter the liability for penalty. The conditions for penalty to be imposed are clearly spelt out in section 11AC of the Act.

Supreme Court clarified that both section 11AC as well as proviso to sub-section (1) of section 11A use the same expressions : *"....by reasons of fraud, collusion or any wilful mis-statement or suppression of facts, or contravention of any of the provisions of this Act or of the rules made thereunder with intent to evade payment of duty,..."*. Hence, it drew the inference that the penalty provision of section 11AC would come into play only if the notice under section 11A(1) states that the escaped duty was the result of any conscious and deliberate wrong doing and in the order passed under section 11A(2), there is a legally tenable finding to that effect.

10. No, Revenue's claim is not valid in law. The facts of the given case are similar to the case of *UOI v. Hindustan Zinc Limited 2009 (233) E.L.T. 61 (Raj.)* wherein the High Court has held that the expressions "natural causes" and "unavoidable accident" are required to be given, reasonable and liberal meaning, otherwise the provisions of rule 21, so far as they relate to admissibility of remission, on these two grounds, would be rendered altogether ineffective. The Court has observed that if the contention of Revenue is accepted, no loss or destruction would fall under these two categories as in either case, grounds may be projected, on the anvil of requirement of appropriate storage, or safety measures, and so on and so forth. Even in cases of "unavoidable accident", it could always be contended that the accident could have been avoided by taking recourse of one or more measures. Thus, a bit liberal rather more practical approach is required to be taken in the matter.

The High Court further elaborated that the aspect of satisfaction under rule 21 is essentially a subjective satisfaction of authority concerned and in the instant case; the Tribunal had independently recorded its satisfaction about the loss, or destruction having been sustained by the assessee under the circumstances as covered by rule 21.

11. Section 35G(2) of the Act provides that the Commissioner of Central Excise or the other party aggrieved by any order passed by the Appellate Tribunal may file an appeal to the High Court and such appeal under this sub-section shall be filed within 180 days from the date on which the order appealed against is received by the Commissioner of Central Excise or the other party.

With effect from 01.07.2003, the Finance (No. 2) Act, 2009 has inserted sub-section (2A) to provide that the High Court may admit an appeal after the expiry of the period of 180 days referred to in sub-section (2), if it is satisfied that there was sufficient cause for not filing the same within that period.

12. An applicant as defined under section 23A(c) of the Central Excise Act, 1944 can apply for advance ruling. As per section 23A(c), the following can apply for advance ruling:

(i) (a) a non-resident setting up a joint venture in India in collaboration with a non-resident or a resident; or

(b) a resident setting up a joint venture in India in collaboration with a non-resident; or

(c) a wholly owned subsidiary Indian company, of which the holding company is a foreign company,

who or which, as the case may be, proposes to undertake any business activity in India;

(ii) a joint venture in India; or

(iii) a resident falling within any such class or category of persons, as the Central Government may, by notification in the Official Gazette, specify in this behalf (a public sector company has been notified for this purpose),

and which or who, as the case may be, makes application for advance ruling under sub-section (1) of section 23C.

Here, "joint venture in India" means a contractual arrangement whereby two or more persons undertake an economic activity which is subject to joint control and one or more of the participants or partners or equity holders is a non-resident having substantial interest in such arrangement.

13. Section 14A of the Central Excise Act, 1944 provides for a special audit for valuation purposes. Section 14A lays down that any Central Excise Officer not below the rank of an Assistant/Deputy Commissioner of Central Excise can order for valuation audit at any stage of enquiry, investigation or any other proceedings before him if he is of the opinion that the value has not been correctly declared or determined by a manufacturer or any person. However, for ordering such an audit prior approval of the Chief Commissioner of Central Excise is necessary.

The Central Excise officer will direct such manufacturer/person to get the accounts of his factory, office, depots, distributors or any other place, as may be specified by the said Central Excise Officer, audited by a Cost Accountant or Chartered Accountant. Such Cost Accountant or Chartered Accountant will be nominated by the Chief Commissioner of Central Excise in this behalf.

The Cost Accountant or the Chartered Accountant has to submit the duly signed and certified audit report within the period specified by the Central Excise Officer. Such period can be extended by the Central Excise Officer at the request of the manufacturer/person for material and sufficient reason. However, the maximum period of submission of audit report shall be 180 days from the date of receipt of the cost audit order by the manufacturer. This audit shall be in addition to any other audit under any other law for the time being in force or otherwise.

The manufacturer/person shall be given an opportunity of being heard in respect of any material gathered on the basis of audit and proposed to be utilized in any proceedings under the Central Excise Act or rules made thereunder.

14. Section 3(1) of the Customs Tariff Act, 1975 levies on any article which is imported into India, an additional duty of customs, equal to the excise duty for the time being leviable on a like article if produced or manufactured in India. Finance (No.2) Act, 2009 has inserted a second proviso after the first proviso in section 3(2). The new proviso lays down that in the case of an article imported into India, where the Central Government has fixed a tariff value for the like article produced or manufactured in India under section 3(2) of the Central Excise Act, 1944, the value of the imported article shall be deemed to be such tariff value.

15. Section 7 of the Customs Act, 1962 empowers the Board to appoint by notification in the Official Gazette:

(a) the ports and airports which alone shall be customs ports or customs airports for the unloading of imported goods and the loading of export goods or any class of such goods;

(b) the places which alone shall be inland container depots for the unloading of imported goods and the loading of export goods or any class of such goods;

(c) the places which alone shall be land customs stations for the clearance of goods imported or to be exported by land or inland water or any class of such goods;

(d) the routes by which alone goods or any class of goods specified in the notification may pass by land or inland water into or out of India, or to or from any land customs station from or to any land frontier;

(e) the ports which alone shall be coastal ports for the carrying on of trade in coastal goods or any class of such goods with all or any specified ports in India.

16. Section 45(1) of the Customs Act, 1962 provides that all imported goods unloaded in a customs area shall remain in the custody of such person as may be approved by the Commissioner of Customs until they are cleared for home consumption or are warehoused or are transshipped. This person is called the custodian.

Responsibility of custodian of goods [Section 45(2)]: During the time the goods are in the custody of the custodians, they have the following responsibilities:

(i) maintaining a proper record of goods received from the carriers and sending a copy of the same to the customs authorities;

(ii) not permitting such goods to be removed from the customs area or allowing them to be dealt with otherwise except under the specific permission of the Customs Authorities.

Liability of the custodian [Section 45(3)]: If any imported goods are pilfered after unloading in any customs area, while in the custody of the custodian, such custodian shall be liable to pay duty on such goods. The duty shall be paid at the rate prevailing on the day of delivery of the import manifest/import report to the proper officer under section 30 for the arrival of the conveyance in which such goods were carried.

17. Sub-section (1) of section 26A provides that in the following cases the import duty paid on clearance of imported goods for home consumption shall be refunded to the person who has paid such duty if on importation the goods are capable of being easily identified as such imported goods:

(a) *Goods are defective/not as per specifications*: The goods are found to be defective or otherwise not in conformity with the specifications agreed upon between the importer and the supplier of goods. Further, the goods should not have been worked upon, repaired or used after importation except where such use was indispensable to discover the defects or non-conformity with the specifications;

(b) *Goods identified as imported goods:* The goods are identified to the satisfaction of the Assistant Commissioner of Customs or Deputy Commissioner of Customs as the goods which were imported;

(c) *No drawback claimed:* The importer does not claim drawback under any other provisions of this Act; and

(d) *Importer exports the goods/relinquishes title to goods/destroys or renders them commercially valueless:*

(i) the goods are exported; or

(ii) the importer relinquishes his title to the goods and abandons them to customs; or

(iii) such goods are destroyed or rendered commercially valueless in the presence of the proper officer

in the prescribed manner within 30 days from the date on which the proper officer makes an order for the clearance of imported goods for home consumption under section 47. However, the period of 30 days may, on sufficient cause being shown, be extended by the Commissioner of Customs for a period not exceeding 3 months.

It may be noted that the provisions of this section do not apply to the goods regarding which an offence appears to have been committed under this Act or any other law for the time being in force.

18. Computation of customs duty

Applicable rate of duty (Note 1)	10%
Relevant rate of exchange (Note 2)	Rs.48.20
Assessable Value	US $ 10,00,000 × Rs.48.20
	= Rs.4,82,00,000
Customs duty @ 10%	Rs.48,20,000
Add: Education cess @ 2% and secondary and higher education cess @ 1% of customs duty	Rs.1,44,600
Total duty payable	Rs.49,64,600

Note 1: In *Kesoram Rayon v. CC 86 ELT 464 = (1996) 5 SCC 576*, it has been held that goods which are not removed from the warehouse within the permissible period are deemed to be improperly removed on the day they ought to have been removed. In other words, the last date on which goods should have been removed is taken as the 'deemed date of removal' and the relevant rate of duty is the rate prevalent on that date. Hence, the applicable rate of duty is 10%, the rate prevalent on 20.06.2009, the last date when warehousing period gets over.

Note 2: The relevant rate of exchange will be the rate as in force on the date on which bill of entry for warehousing is presented. Subsequent changes in foreign exchange rate are not relevant. Hence, relevant exchange rate is 1 US $ = Rs.48.20 prevalent on 14.03.2009, the date on which bill of entry for warehousing is presented .

19. Section 28F of the Customs Act, 1962 contains the provisions relating to constitution of Authority for Advance Rulings. Sub-section (1) of section 28F empowers the Central Government to constitute an Authority for giving advance rulings to be called as "the Authority for Advance Rulings (Central Excise, Customs and Service Tax)", by notification in the Official Gazette. Sub-section (2) provides that the Authority shall consist of certain Members appointed by the Central Government. With effect from such date as the Central Government may, by notification in the Official Gazette, specify, the Finance (No. 2) Act, 2009 has inserted sub-sections (2A), (2B), (2C) and (2D) after sub-section (2) in section 28F of the Customs Act. The said sub-sections are discussed as under:

Sub-section (2A)

Notwithstanding anything contained in sub-sections (1) and (2), or any other law for the time being in force, the Central Government may, by notification in the Official Gazette, authorise an Authority constituted under section 245-O of the Income-tax Act, 1961, to act as an Authority under this Chapter.

Sub-section (2B)

On and from the date of publication of notification under sub-section (2A), the Authority constituted under sub-section (1) shall not exercise jurisdiction under Chapter V-B of the Act.

Sub-section (2C)

For the purposes of sub-section (2A), the reference to "an officer of the Indian Revenue Service who is qualified to be a Member of Central Board of Direct Taxes" in clause (b) of sub-section (2) of section 245-O of the Income Tax Act, 1961 shall be construed as reference to "an officer of the Indian Customs and Central Excise Service who is qualified to be a Member of the Board".

Sub-section (2D)

On and from the date of the authorization of Authority under sub-section (2A), every application and proceeding pending before the Authority constituted under sub-section (1) shall stand transferred to the Authority so authorised from the stage at which such proceedings stood before the date of such authorization.

20. The action of the customs authorities is not valid. The facts of the given case are similar to the case of *Vodafone Essar South Ltd. v. UOI 2009 (237) E.L.T. 35 (Bom.)*. In the instant case, the Bombay High Court has held that the action of the Directorate of Revenue Intelligence (D.R.I. officers) in seizing the goods and collecting money from the petitioners is wholly unjustified and uncalled for, because of the following five reasons:-

(i) When the Commissioner of Customs (Appeals) in petitioner's own case had held that OFC imported by them were classifiable under Heading 85.44 of the Customs Tariff, the petitioners were not wrong in classifying the goods imported after the said order under Heading 85.44 ibid.

(ii) Decision of Commissioner (Appeals) was neither stayed by CESTAT nor by any other competent authority. Hence, mere fact that appeal filed by Revenue against the decision of Commissioner (Appeals) was pending could not be a ground to hold the petitioner guilty of misclassification of goods.

(iii) D.R.I. officers were bound by the decision given by Commissioner of Customs (Appeals).

(iv) The OFCs were cleared on payment of duty assessed under Heading 85.44. Therefore, till the assessment was set aside, the customs authorities could not have seized the goods assessed and cleared under Heading 85.44, on the ground that the goods were liable to be assessed under Heading 90.01.

(v) In the absence of any reassessment order passed determining the duty liability, there would be no question of recovering differential duty.

21. Section 151 of the Customs Act, 1962 provides that the following officers are empowered and required to assist officers of customs in the execution of the Customs Act, 1962:

(a) officers of the Central Excise Department;

(b) officers of the Navy;

(c) officers of Police;

(d) officers of the Central or State Governments employed at any port or airport;

(e) such other officers of the Central or State Governments or a local authority as are specified by the Central Government in this behalf by notification in the Official Gazette.

22. (i) Service tax will not be applicable in this case as *Notification No. 13/2004 ST dated 10.09.2004* exempts the taxable services provided by a banking company or a financial institution including a non-banking financial company, or any other body corporate or ay other person to the Government of India or a State Government in relation to collection of any duties or taxes levied by the Government of India or a State Government from the whole of service tax leviable thereon.

(ii) Service tax will not be applicable in this case as *Notification No. 29/2004 ST dated 22.09.2004* exempts the value of taxable service provided to a customer, by a banking company or a financial institution including a non-banking financial company, or any other body corporate or any other person, in relation to,-

(a) overdraft facility;

(b) cash credit facility; or

(c) discounting of bills, bills of exchange or cheques,

which is equivalent to the amount of interest on such overdraft, cash credit or, as the case may be, discount from the service tax subject to the condition that the said interest amount is shown separately in an invoice, a bill or, as the case may be, a challan issued for this purpose.

(iii) Service tax will not be applicable in this case as *Notification No 19/2009 ST dated 07.07.2009* exempts taxable services of the nature referred to in sub-clause (zm) or (zzk), as the case may be, of clause (105) of section 65 of the Finance Act, provided to a Scheduled bank, by any other Scheduled bank, in relation to inter-bank transactions of purchase and sale of foreign currency from the whole of the service tax leviable thereon.

23. (i) As per section 65(91a) of the Finance Act, 1994, a "residential complex" means any complex comprising of—

(i) a building or buildings, having more than twelve residential units;

(ii) a common area; and

(iii) any one or more of facilities or services such as park, lift, parking space, community hall, common water supply or effluent treatment system,

located within a premises and the layout of such premises is approved by an authority under any law for the time being in force, but does not include a complex which is constructed by a person directly engaging any other person for designing or planning of the layout, and the construction of such complex is intended for personal use as residence by such person.

Here,

(a) "personal use" includes permitting the complex for use as residence by another person on rent or without consideration;

(b) "residential unit" means a single house or a single apartment intended for use as a place of residence.

(ii) As per section 65(30)(a) of the Finance Act, 1994, "construction of complex" means—

(a) construction of a new residential complex or a part thereof; or

(b) completion and finishing services in relation to residential complex such as glazing, plastering, painting, floor and wall tiling, wall covering and wall papering, wood and metal joinery and carpentry, fencing and railing, construction of swimming pools, acoustic applications or fittings and other similar services; or

(c) repair, alteration, renovation or restoration of, or similar services in relation to, residential complex.

(iii) Yes. *Notification No. 1/2006 ST dated 01.03.2006* exempts 67% of the value of the taxable service provided to any person by any other person in relation to construction of complex from the service tax leviable thereon. This exemption shall not apply in cases where the taxable services provided in relation to a residential complex are only completion and finishing services. Further, this exemption is not available in cases where,

(i) the CENVAT credit of duty paid on inputs or capital goods or the CENVAT credit of service tax on input services, used for providing such taxable service has been taken under the provisions of the CENVAT Credit Rules, 2004; or

(ii) the service provider has availed the benefit under *Notification No. 12/2003 ST dated 20.06.2003*.

The "gross amount charged" shall include the value of goods and materials supplied or provided or used for providing the said taxable service by the service provider.

24. (i) The Finance (No. 2) Act, 2009 has amended the definition of business auxiliary service under section 65(19) of the Finance Act, 1994 so as to exclude any activity that amounts to manufacture of excisable goods. Therefore, manufacture of non-excisable goods for or on behalf of the client shall attract service tax.

(ii) *Notification No. 13/2003 ST dated 20.06.2003* exempts the business auxiliary services provided by commission agents in relation to sale or purchase of agricultural produce from service tax.

Agricultural produce means any produce resulting from cultivation or plantation, on which either no further processing is done or such processing is done by the cultivator like tending, pruning, cutting, harvesting, drying which does not alter its essential characteristics but makes it only marketable and includes all cereals, pulses, fruits, nuts and vegetables, spices, copra, sugar cane, jaggery, raw vegetable fibres such as cotton, flax, **jute**, indigo, unmanufactured tobacco, betel leaves, tendu leaves, rice, coffee and tea but does not include manufactured products such as sugar, edible oils, processed food and processed tobacco.

Therefore, services provided by commission agents in relation to sale of jute shall not attract service tax.

(iii) Distributors receive commission from mutual fund for providing services relating to purchase and sale of mutual fund units. Services provided by such distributors are in the nature of commission agent and are, thus, liable to service tax under business auxiliary service *[Circular No. 96/7/2007 ST dated 23.08.2007].*

25. The Finance (No. 2) Act, 2009 has amended section 84 of the Finance Act, 1994 to abolish the revision procedure prescribed therein and to prescribe the procedure of filing departmental appeals before the Commissioner (Appeals) in service tax cases similar to the central excise procedure. Accordingly, section 84 pertaining to revision by Commissioner has been substituted with a new section relating to appeals to Commissioner of Central Excise (Appeals). The provisions of new section 84 are:

(1) The Commissioner of Central Excise may, of his own motion, call for and examine the record of any proceedings in which an adjudicating authority subordinate to him has passed any decision or order under this Chapter for the purpose of satisfying himself as to the legality or propriety of any such decision or order and may, by order, direct such authority or any Central Excise Officer subordinate to him to apply to the Commissioner of Central Excise (Appeals) for the determination of such points arising out of the decision or order as may be specified by the Commissioner of Central Excise in his order.

(2) Every order under sub-section (1) shall be made within a period of three months from the date of communication of the decision or order of the adjudicating authority.

(3) Where in pursuance of an order under sub-section (1), the adjudicating authority or any other officer authorised in this behalf makes an application to the Commissioner of Central Excise (Appeals) within a period of one month from the date of communication of the order under sub-section (1) to the adjudicating authority, such application shall be heard by the Commissioner of Central Excise (Appeals), as if such application were an appeal made against the decision or order of the adjudicating authority and the provisions of this Chapter regarding appeals shall apply to such application.

Explanation — For the removal of doubts, it is hereby declared that above mentioned provision would come into effect from 19.08.2009. All cases decided before this date would continue to be governed by the existing provisions only.

IMPORTANT AMENDMENTS MADE BETWEEN 01.05.2009 TO 31.10.2009

Students may note that the Study Material for Indirect Tax Laws contain all the relevant amendments made by the Finance (No. 2) Act, 2009. Further, circulars/notifications issued up to 30.04.2009 and Budget notifications have also been incorporated therein. The following are the amendments which have been made between 01.05.2009 to 31.10.2009. It may be carefully noted that for the students appearing in May 2010 exams, the amendments made by the notifications, circulars and other legislations up to 31.10.2009 are relevant.

A. EXCISE

1. ***Notification No. 14/2009 CE (NT) dated 10.06.2009*** has amended rule 6 of the Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001 so as to cast a responsibility on the said Assistant or Deputy Commissioner of Central Excise of ensuring that the goods received are used by the manufacturer for the intended purpose. This has been done by substituting the words "The said Assistant Commissioner or Deputy Commissioner shall ensure that the goods received are used by the manufacturer for the intended purpose and where the subject goods are not used" for the words "Where the subject goods are not used".

2. ***Notification No. 15/2009 CE (NT) dated 10.06.2009*** has amended *Notification No. 32/2006 CE (NT) dated 30.12.2006,* which prescribes withdrawal of facilities or imposition of restrictions on a manufacturer, first stage or second stage dealer, or an exporter involved in any of the prescribed contraventions, in the following manner:

   (i) Facilities may be withdrawn or restrictions may be imposed on a manufacturer, first stage or second stage dealer, or an exporter involved in removal of inputs as such on which CENVAT credit has been taken, without paying an amount equal to credit availed on such inputs in terms of sub-rule (5) of rule 3 of the CENVAT Credit Rules, 2004. This has been done by inserting clause (g) after clause (f) in paragraph 1 of the notification.

   (ii) Two more restrictions have been imposed if a manufacturer is prima facie found to be knowingly involved in committing the prescribed offences, namely:

      (a) the assessee may be required to maintain records of receipt, disposal, consumption and inventory of the principal inputs on which CENVAT credit has not been taken.

      (b) the assessee may be required to intimate the Superintendent of Central Excise regarding the receipt of principal inputs in the factory on which CENVAT credit has or has not been taken, within a period specified in the order and the said inputs shall be made available for verification upto the period specified in the order.

This has been done by inserting clause (iii) and clause (iv) after clause (ii) in paragraph 2, in sub paragraph (1).

(iii) After explanation II, Explanation III has been inserted, which provides that “principal inputs”, means any input which is used in the manufacture of final products where the cost of such input constitutes not less than 10% of the total cost of raw materials for the manufacture of unit quantity of a given final products.

3. ***Notification No. 21/2009 CE (NT) dated 20.08.2009*** has notified a public sector company as class of persons for the purpose of the sub-clause (iii) of section 23A(c) of the Central Excise Act, 1944. A “public sector company” shall have the same meaning as is assigned to it in clause (36A) of section 2 of the Income-tax Act, 1961.

4. ***Notification No.22/2009 CE (NT) dated 07.09.2009*** has inserted a second proviso after the first proviso in rule 3(7)(a) of the CENVAT Credit Rules, 2004. The second proviso lays down that the CENVAT credit in respect of inputs and capital goods cleared on or after 07.09.2009 from an export-oriented undertaking or by a unit in electronic hardware technology park or in a software technology park, as the case may be, on which such undertaking or unit has paid –

   A. excise duty leviable under section 3 of the Excise Act read with serial number 2 of the *Notification No. 23/2003 CE, dated 31.03.2003*; and

   B. the education cess and the secondary and higher education cess on the excise duty referred to in (A),

   shall be the aggregate of –

   I. that portion of excise duty referred to in (A), as is equivalent to -

      i. the additional duty leviable under section 3(1) of the Customs Tariff Act, which is equal to the duty of excise under section 3(1)(a) of the Excise Act;

      ii. the additional duty leviable under section 3(5) of the Customs Tariff Act; and

   II. the education cess and the secondary and higher education cess referred to in (B).

5. **Circular No. 889/09/2009 CX dated 21.05.2009** provides that the judgements of Hon’ble Supreme Court in the case of U.O.I Vs. Rajasthan Spinning & Weaving Mills and Commissioner of Customs & Central Excise Vs. Lanco Industries Ltd. in Civil Appeal No.3525 of 2009 arising out of S.L.P (Civil) No.4078 of 2008 have clarified that when the conditions spelled out under section 11AC of the Central Excise Act, 1944 are fulfilled, there is no discretion to reduce the mandatory penalty equal to duty even though the duty is paid before the issue of show cause notice.

6. ***Circular No. 890/10/2009 CX dated 03.06.2009*** has been issued to settle the classification dispute relating to coconut oil sold in small packs say of 50 ml or 100 ml. The two contending classifications are: Chapter 15 covering various types of vegetable oil including coconut oil and Chapter 33 covering cosmetics including hair oil. When the coconut oil is sold in small containers, following indications have been found on containers or labels.

A. 'hair oil'

B. 'edible oil'

C. 'pure coconut oil' or 'coconut oil'

When 'hair oil' is printed on the container/label, there is no dispute and it is classified as 'hair oil' under chapter 33. Disputes arise in respect of other two categories ('edible oil', 'pure coconut oil' or 'coconut oil'). Department contends that coconut oil falling under these two categories are meant for sale as 'hair oil', therefore, it shall be classified as 'hair oil' underChapter 33. The manufacturers plead that as they are not printing the specific use of such oil as 'hair oil' it should be classified as 'vegetable oil' under Chapter 15, irrespective of the fact that consumer may use it as 'hair oil'.

The circular explains that the Chapter Note 2 of Chapter 33 prescribes a condition that Heading No.3305 (which covers hair oil also) applies to products **put up in packing of a kind sold by retail for such use.** Thus, if a particular packing of coconut oil is generally sold in retail as hair oil, in that case, the said product would be classified under heading 3305.

Further, the Section Note 2 to Section VI also provides that goods classifiable in Heading 3305 by reason of being put up for retail sales are to be classified in the said heading and in no other heading of the schedule. This Section Note further supports the interpretation that though a product is capable of being classified under more than one heading, even then because of the nature of its retail packing, which is indicative of its use as hair oil, the classification under heading 3305 would get priority.

However, if the same coconut oil is packed in say 1 litre or 2 litre packages, which are generally used by consumers for edible purposes (even though some customers may use it as hair oil), it would be classified under Chapter 15.

Hence, the classification of coconut oil would depend upon the fact as to how the majority of the customers use the said product. Therefore, if coconut oil is packed in packages which are generally meant for sale in retail as hair oil, in that case the said product would be classified as hair oil under Heading 3305, even though few consumers may use it as edible oil.

Thus, the circular settles that coconut oil packed in containers upto 200 ml may be considered as generally used as hair oil and shall be classified under Heading 3305.

7. ***Circular No. 898/18/09 CX dated 15.09.2009*** has clarified that the benefit of reduced penalty under provisos to section 11AC is not available at appeal stage, i.e. the reduced penalty cannot be paid *within 30 days of the communication of the order in Appeal*. The circular explains that in order to avail the benefit of 25% penalty, the duty, interest and penalty are required to be paid *within 30 days of communication of the order passed by the adjudicating authority*. Further, the reading of proviso (4) would also support this interpretation because the said proviso stipulates that wherever duty amount is increased at any appellate stage, in that case in order to avail the benefit of 25 % penalty, the assessee is required to pay differential amount within 30 days of the passing of the order

by the appellate authority. A combined reading of all the four provisos would, therefore, make it clear that the benefit of 25% penalty is applicable only when the assessee has paid duty, interest and the reduced penalty within 30 days of communication of the order passed by the adjudicating authority. However, if the penalty amount is increased at the appellate stage, in that case the 25% of differential amount of penalty can be paid within 30 days of communication of said appellate order.

8. ***Circular No. 900/20/2009 CX dated 06.10.2009*** has been issued to permit bringing of duty-paid packing materials into export warehouse under Rule 20 of Central Excise Rules. Para 7.2 of the Board's *Circular No. 581/18/2001-CX dated 29.06.01* provides that duty paid goods are not permitted to be brought into the warehouse. However, it is a fact that number of times packing material in small quantity is required at a short notice and the supplier may not be interested to follow the detailed procedure of removal of goods without payment of duty. Therefore, it has been decided that duty paid packing material can be brought into the export warehouse, but exporter would not be allowed to claim export benefit like rebate for the duty paid on the said packing material.

   In view of above, in the above referred Circular, after para 7.2, following is inserted,-

   "However, an exporter desirous of bringing duty paid packing material required for packaging of other material in the warehouse, may submit a written request to the jurisdictional AC/DC of the Division, who may grant the permission for a period of one year at a time. The exporter will maintain proper account of such goods and shall not claim any export benefit like rebate of duty paid on the said material."

9. ***Circular No. 902/22/2009 CX dated 20.10.2009*** has been issued with regard to assessable value in respect of goods manufactured on job work basis. Some manufacturers of motor vehicles were getting complete motor vehicles manufactured by sending the chassis of the motor vehicles to independent body builders for building the body as per the design/specification of the manufacturer. The practice followed was that the chassis was transferred to the body builder on payment of appropriate central excise duty on stock transfer basis and was not sold to them. The body builder avails the CENVAT credit of the duty paid on the chassis and cleared the same on payment of duty to the Depot/Sales Office/Distributer of the motor vehicle manufacturer. The duty was discharged by the body builder on the assessable value comprising the value of chassis and the job charges. The Depot/Sales office of the motor vehicle manufacturer sold the vehicles at a higher price than the price on which duty had been paid.

   As per rule 10A (ii) of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 the assessable value for the purpose of charging central excise duty, in the cases where the job-worker transfer the excisable goods to the Depot/Sale office/Distributer and/or any other sale point of the principal manufacturer, shall be the transaction value on which goods are sold by the principal manufacturer from such a place. Accordingly, after the insertion of Rule 10A, the practice of discharging the duty on cost construction method by the body builder is not legally correct. Therefore, the circular clarifies that wherever goods are manufactured by a person on job work basis on behalf of a principal, then value for the purpose of payment of excise duty may be determined in terms of the provisions of Rule 10A of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 subject to fulfilment of the requirements of the said rule.

10. ***Circular No. 903/23/2009 CX dated 20.10.2009*** has clarified that textile quilted products like quilts, quilted bed spreads, etc. will be classified under heading 9404 and not under heading 5811 as heading 5811 covers quilted textile products which are further used in the manufacture of quilts, quilted bedspreads, etc. while it is heading 9404 which covers the final finished products like quilts and other articles of bedding and furnishing.

The HSEN to Chapter Heading 5811 reads as follows:

'These materials are commonly used in the manufacture of quilted garments, bedding or bedspreads, mattress pads , clothing, curtains, place-mats, underpads (silencers) for table linen etc.

The heading does not cover:

a. Plastic sheets quilted, whether by stitching or heat sealing to a padded core (generally Chapter 39);

b. Stitches or quilted textile products in which the stitches constitute designs giving them the character of embroidering;

c. Made up goods of this Section;

d. Articles of bedding or similar furnishing of Chapter 94 padded or internally fitted.'(emphasis supplied).

The made up goods are defined by Section Note 7 of Section XI.

In this context, the term 'used in the manufacture' is important to note. It means that heading 5811 covers only materials which are further used in making of quilted final products like bedding or bedspreads. Further HSEN to this Chapter Heading also state that the heading does not cover made up goods of this Section (Section Note 7) and articles of bedding or similar furnishing of Chapter 94 which are padded or internally fitted. Thus, the articles of bedding and furnishing fall in Chapter 94.

The HS explanatory notes to Chapter 9404 clarify that the heading covers:

'A. Mattresses supports,…

B. Articles of bedding and similar furnishing which are sprung or stuffed or internally fitted with any material (cotton, wool, horsehair, down, synthetic fibers etc or are of cellular rubber or plastics (whether or not covered with woven fabrics, plastics. etc). For example:

1. Mattresses, including mattresses with a metal frame:

2. Quilts and bedspread (including counterpanes and also quilts for baby - carriages) eiderdowns and duvets (whether of down or any other filling/mattress protectors, bolsters, pillows/cushions, pouffes, etc.'

Quilts, quilted bedspread etc. are articles of bedding and are covered under the Explanation (B) (2) as mentioned above.

11. ***Circular No. 904/24/09 CX dated 28.10.2009*** has clarified that in view of the amendment made by the Finance Act, 2008 in the definition of excisable goods, bagasse, aluminium/zinc dross and other such products termed as waste, residue or refuse which arise during the course of manufacture and are capable of being sold for consideration would be excisable goods and chargeable to payment of excise duty.

    It is further clarified that in case the rate of duty in respect of such products is Nil in the tariff or they are exempt from duty in terms of any exemption notification, and if CENVAT credit has been taken on the inputs which are used for manufacture of dutiable and exempted goods, then in terms of rule 6 of CENVAT Credit Rules, 2004, the assessee is required to reverse the proportionate credit or pay 5% amount.

    Excisability of bagasse and similar waste products arising during the course of manufacture has been under dispute for a long period of time. There are number of Tribunal's judgments that being waste, these are not excisable products. Departmental appeal in respect of excisability of bagasse in one such case i.e Balrampur Chinni Mills Ltd. is reportedly still pending in the Supreme Court. Generally, the courts have been taking a view that the waste or refuse or residue arising during the course of manufacture cannot be treated as excisable goods even if such waste fetches some price in the market. However, all these matters pertain to the period prior to 2008.

    In the budget of 2008, the definition of "excisable goods" in clause (d) of Section 2 of the Central Excise Act, 1944 was amended by adding an explanation that for the purposes of this clause, "goods" include any article, material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable.

B. CUSTOMS

1. ***Notification No. 124/2009 Cus. (NT) dated 20.08.2009*** has notified

    (i) a public sector company

    (ii) a resident who proposes to import goods claiming for assessment under heading 9801 (items eligible for project import) of the First Schedule to the Customs Tariff Act, 1975

    as class of persons for the purpose of the sub-clause (*iii*) of section 28E(c) of the Customs Act,1962.

    "Public sector company" shall have the same meaning as is assigned to it in clause (36A) of section 2 of the Income-tax Act, 1961. "Resident" shall have the same meaning as is assigned to it in clause (42) of section 2 of the Income-tax Act, 1961.

C. SERVICE TAX

Notification No. 26/2009 ST dated 19.08.2009 has notified 01.09.2009 as the date on which the services introduced by the Finance (No. 2) Act, 2009 would become effective. Further, the amendments made in the existing services vide the Finance (No. 2) Act, 2009 would also become effective from 01.09.2009.

Exemptions

1. ***Notification No. 31/2009 ST dated 01.09.2009*** has exempted the taxable service provided by a sub-broker, to a stock-broker as defined in clause (101) of Section 65 of the Finance Act,1994, in relation to sale or purchase of securities listed on a registered stock exchange from the whole of the service tax leviable thereon.
2. ***Notification No. 32/2009 ST dated 01.09.2009*** has exempted the taxable service provided by any person, to a client as defined under business auxiliary service in relation to the manufacture of pharmaceutical products, medicines, perfumery, cosmetics or toilet preparations containing alcohol, which are charged to excise duty under Medicinal and Toilet Preparations (Excise Duties) Act, 1955 from the whole of the service tax leviable thereon.
3. ***Notification No. 33/2009 ST dated 01.09.2009*** has exempted the taxable service provided to any person in relation to transport of goods by rail from the whole of the service tax leviable thereon provided, nothing contained in this notification shall apply to any service provided or to be provided, by any person other than government railway, in relation to transport of goods in containers by rail.

   In other words, the exemption has been granted to:

   (i) service provided or to be provided by government railway, in relation to transport of goods by rail, whether in container or otherwise;

   (ii) service provided or to be provided by any person, other than government railway, in relation to transport of goods otherwise than in containers, by rail.

   Thus, services provided by persons, other than government railways, in relation to transport of goods in containers by rail would alone be taxable. An abatement of 70% of the gross amount charged for providing such service is available vide *Notification No. 1/2006 ST dated 01.03.2006.*
4. ***Notification No. 39/2009 ST dated 23.09.2009*** exempts the taxable service under the category of business auxiliary service provided by a person (service provider) to any other person (service receiver) during the course of manufacture or processing of alcoholic beverages by the service provider, for or on behalf of the service receiver, from so much of value which is equivalent to the value of inputs, excluding capital goods, used for providing the same service, subject to the following conditions, namely:-

   (a) that no Cenvat credit has been taken under the provisions of the Cenvat Credit Rules, 2004;

   (b) that there is documentary proof specifically indicating the value of such inputs; and

   (c) where the service provider also manufactures or processes alcoholic beverages, on his or her own account or in a manner or under an arrangement other than as mentioned aforesaid, he or she shall maintain separate accounts of receipt, production, inventory, despatches of goods as well as financial transactions relating thereto.

Here, 'input' and 'capital goods' shall have the meaning as is assigned to them under rule 2 of the CENVAT Credit Rules, 2004.

5. ***Notification No. 40/2009 ST dated 30.09.2009*** has amended *Notification No.17/2009 ST dated 07.07.2009* which exempts certain specified taxable services received by an exporter and used for export of goods. The following service (inserted at point no. 17 in the original notification) received by an exporter and used for export of goods has also been exempted vide this notification:

17.	(zzzzl)	Service provided for transport of export goods through national waterway, inland water and coastal shipping.	i. The exporter shall- 1. produce the Bill of Lading or a Consignment Note or a similar document by whatever name called, issued in his name; 2. produce evidence to the effect that the said transport is provided for export of relevant goods.

Other amendments

6. *Notification No. 9/2009 ST dated 03.03.2009* was issued to provide refund of service tax paid on taxable services specified in section 65(105) of the Finance Act, 1994 which are provided in relation to the authorised operations (as defined under SEZ Act, 2005) in a Special Economic Zone (SEZ), and received by a developer or units of a SEZ, whether or not the said taxable services are provided inside the SEZ.

Notification No. 15/2009 ST dated 20.05.2009 has been issued to amend the aforesaid *Notification 9/2009 ST dated 03.03.2009* to provide unconditional exemption to services consumed within the SEZ without following the refund route thus dispensing with the requirement of first paying the tax by the service provider and then claiming the refund thereof by developer/unit. The exemption by way of refund would be limited to situations only when taxable services provided to SEZ are consumed partially or wholly outside SEZ.

This has been done by making the following amendments in *Notification No. 9/2009 ST dated 03.03.2009*:

A. Conditions (a) to (f) mentioned in paragraph 1 for claiming the exemption have been amended in the following manner:

(i) The condition (c) for claiming the exemption has been substituted with the following condition:

"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 except for services consumed wholly within the special economic zone;"

(ii) The condition (d) for claiming the exemption has been substituted with the following condition:

"the developer or units of special economic zone claiming the exemption, by way of refund in accordance with clause (c), has actually paid the service tax on the specified services;"

(iii) Another condition (g) has been added after condition (f) for claiming the said exemption. The new condition (g) reads as follows:

"(g) the developer or unit of a special economic zone shall maintain proper account of receipt and utilisation of the taxable services for which exemption is claimed."

B. The manner of giving exemption mentioned in paragraph 2 has been amended. In paragraph 2, for the words, "shall be subject to the following conditions", the words, ",except for services consumed wholly within the Special Economic Zone, shall be subject to the following conditions" shall be substituted.

7. ***Notification No. 27/2009 ST dated 20.08.2009*** has notified a public sector company as class of persons for the purpose of the sub-clause (iii) of section 96A(b) of the Finance Act, 1994. A "public sector company" shall have the same meaning as is assigned to it in clause (36A) of section 2 of the Income-tax Act, 1961.

8. ***Notification No. 25/2009 ST dated 19.08.2009*** has substituted the explanation in rule 3 of the Export of Services Rules, 2005 with the following explanation:

"For the purposes of this rule "India" includes the installations, structures and vessels in the continental shelf of India and the exclusive economic zone of India."

9. The Taxation of Services (Provided from Outside India and Received in India) Rules, 2006 and the Export of Services Rules, 2005 have been amended vide ***Notification No. 37/2009 ST dated 23.09.2009*** and ***Notification No. 38/2009 ST dated 23.09.2009*** so as to categorise the new taxable services introduced vide the Finance (No. 2) Act, 2009 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.	Cosmetic and plastic surgery service	zzzzk	*Category 2 [Rule 3(1)(ii)]	Category 2 [Rule 3(ii)]
2.	Service provided in relation to	zzzzl	*Category 2 [Rule 3(1)(ii)]	Category 2 [Rule 3(ii)]

	transport of coastal goods and goods transported through inland water including National Waterways			
3.	Legal consultancy service	zzzzm	*Category 1 [Rule 3(1)(i)] and Category 3 [Rule 3(1)(iii)]	Category 1 [Rule 3(i)] and 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.

10. ***Notification No. 34/2009 ST dated 01.09.2009*** has amended *Notification No. 1/2006 ST dated 01.03.2006* granting abatement of 70% to the service provided or to be provided, by any person other than government railway, in relation to transport of goods in containers by rail so as to rename the service as transport of goods in containers by rail.

11. ***Circular No. 115/09/2009 ST dated 31.07.2009*** has clarified the following two issues:

    Issue: Whether service tax is payable on commission paid to Managing Director/Directors (whole time, or Independent) by the company under business auxiliary service?

    Clarification: Some Companies make payments to Managing Director/Directors (Whole-time or Independent), terming the same as 'commissions'. The said amount paid by a company to their Managing Director/Directors (Whole-time or Independent) even if termed as commission, is not the 'commission' that is within the scope of business auxiliary service and hence service tax would not be leviable on such amount.

    Issue: Whether service tax is payable by Independent Directors who are part of the Board of Directors under management consultant's service?

    Clarification: The Managing Director/Directors (Whole-time or Independent) being part of Board of Directors perform management function and they do not perform consultancy or advisory function. The definition of management consultant service makes it clear that what is envisaged from a consultant is advisory service and not the actual performance of the management function. The payments made by Companies, to Directors cannot be termed as payments for providing management consultancy service. Therefore, it is clarified that the amount paid to Directors (Whole-time or Independent) is not chargeable to service tax under the category 'Management Consultancy service'. However, in case such directors provide any advice or consultancy to the company, for which they are being compensated separately, such service would become chargeable to service tax.

12. ***Circular No. 116/10/2009 ST dated 15.09.2009*** has clarified the following issue:

    Issue: Whether service tax is leviable on construction of canals for Government projects?

    Clarification: As per section 65(25b) of the Finance Act, 1994 "commercial or industrial construction service" is chargeable to service tax if it is used, occupied or engaged either wholly or primarily for the furtherance of commerce or industry. As the canal system built by the Government or under Government projects, is not falling under commercial activity, the canal system built by the Government will not be chargeable to service tax. However, if the canal system is built by private agencies and is developed as a revenue generating measure, then such construction should be charged to service tax.

13. ***Circular No. 117/11/2009 ST dated 31.10.2009*** has clarified that service tax will not be leviable on services provided by a tour operator in connection with Haj & Umrah pilgrimage. The amount charged to the pilgrims in India undertaking Haj and Umrah pilgrimage, is for services provided by the Government of Saudi Arabia and the tour takes place outside India. As per Rule 3(1)(ii) of the Export of Services Rules, 2005, (*Circular No. 111/05/2009 ST dated 24.02.2009*), the service in respect of tour operator is export if such service is performed outside India. It is also provided therein that where such taxable service is partly performed outside India, it shall be treated as performed outside India.

    Therefore, it is clarified that service tax is not chargeable on the services provided in respect of tour undertaken for carrying out Haj and Umrah Pilgrimage in Saudi Arabia by Indian pilgrims considering these as export of service, provided they fulfill the other conditions of export as provided in Export of Service Rules.

Note: The Budget Notifications issued on 07.07.2009 are given in the Supplementary Study Paper 2009. Further, they have also been incorporated in the Study Material of Indirect Tax Laws (Edition 2009). Therefore, the same have not been given here again.