THE ACCOUNTANTS MANUAL

February 2010

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Inside this issue:

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Editorial

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Accounting Academics

Total Questions: 4 **Time Allotted: 30 mins**

(1 / 4) A business commenced on 31 March, 2009 with capital Rs. 1,25,000 represented by Stock Rs. 25,000 and Cash Rs. 1,00,000. On 31 March 2009 the cash was utilized to purchase goods. At the end of an accounting period, goods of historical cost Rs. 85,000 was sold for Rs. 1,30,000. The price index on 31 March 2009 was 100 and that at the end of accounting period was 120.

Determine profit by historical cost and CPP (Current Purchasing Power) conventions and explain the difference between the two figures of profit.

(2 / 4) The Opening and closing inventory of a business at historical cost are Rs. 18,000 and Rs. 26,400 respectively. The accounting period is April 1, 2007 to March 31, 2008. Price index applicable inventory are as follows:

Date	Price Index
March 1, 2008 (Date of acquisition of opening inventory)	120
April 1, 2008	130
March 1, 2009 (Date of acquisition of closing inventory)	160
March 31, 2009	170
Average for 2008-09	150

Compute COSA (Cost of Sales Adjustments) and show current cost adjustments.

(3 / 4) The following figures have been extracted from the accounts of ABC Ltd.

	31/03/09 Rs.	31/03/10 Rs.
Trade receivables	1,800	3,000
Trade payables	1,000	1,200

The accounting year is 2009-10. The index number for receivables and payables at the beginning and year were 150 and 180 respectively. The average index for the year was 165.

Compute MWCA (Monetary Working Capital Adjustment) and show current cost adjustments.

(4 / 4) Summarised current cost balance sheet of XYZ Ltd. as at 31/03/09 and 31/03/10 are given below:

Liabilities	31/03/09 Rs. 000	31/03/10 Rs. 000	Assets	31/03/09 Rs. 000	31/03/10 Rs. 000
Share Capital	360	360	Fixed Assets	400	480
Reserves	198	222	Stock	200	230
Loans	202	242	Trade Receivables	180	190
Trade Payables	60	100	Cash	40	24
	820	924		820	924

The CCA adjustment (net debit to Profit & Loss A/c of 2009-10) was as follows:

	Rs. 000
Depreciation Adjustment (Additional depreciation)	24
Cost of Sales Adjustment (COSA)	22
Monetary Working Capital Adjustment (MWCA)	(6)
	40

Compute GA (Gearing Adjustment) and show current cost adjustment.

Accounting Academics

Answers **Time Allotted: 30 mins**

Answer: Question (1 / 4)

Current Purchasing Power Method attempts to remove the distortions in the financial statements due to changing value of rupee due to inflation/ deflation by restating the financial statements at period-end (closing) price. The General Price Index is used for conversion of historical cost values into values at closing prices (CPP values).

Opening Equity (Historical Cost) = Rs. 1,00,000 + Rs. 25,000 = Rs. 1,25,000

Closing stock (Historical cost) = Rs. 25,000 + Rs. 1,00,000 - Rs. 85,000 = Rs. 40,000

Closing Cash = Rs. 1,00,000 - Rs. 1,00,000 + Rs. 1,30,000 = Rs. 1,30,000

Closing Equity (Historical Cost) = Rs. 1,30,000 + Rs. 40,000 = Rs. 1,70,000

Profit (Historical Cost Convention) = Rs. 1,70,000 - Rs. 1,25,000 = Rs. 45,000

Opening equity at closing price = Rs. 1,00,000 x (120/100) + Rs. 25,000 x (120/100) = Rs. 1,50,000

Closing stock (Closing price) = Rs. 40,000 x (120/100) = Rs. 48,000

Closing Cash = Rs. 1,30,000 (Closing monetary assets are not converted)

Closing equity at closing price = Rs. 1,30,000 + Rs. 48,000 = Rs. 1,78,000

Profit (CPP Convention) = Rs. 1,78,000 - Rs. 1,50,000 = Rs. 28,000

The difference between two figures of profit = Rs. 45,000 - Rs. 28,000 = Rs. 17,000

Loss of purchasing power for holding monetary asset

= Rs. 1,00,000 x (120/100) - Rs. 1,00,000 = Rs. 20,000 = PPL (Op)

Increase in stock at historical cost = Rs. 40,000 - Rs. 25,000 = Rs. 15,000

Increase in stock at closing price = Rs. 48,000 - Rs. 30,000 = Rs. 18,000

Stock Adjustment (SA) = Rs. 18,000 - Rs. 15,000 = Rs. 3,000

Since increase in stock at closing price is greater than increase in stock at historical cost, the stock adjustment is representing a gain.

Additional fund required to replace good sold

= Rs. 85,000 x (120/100) - Rs. 85,000

= PPL (Op) - SA = Rs. 20,000 - Rs. 3,000

= Rs. 17,000

Answer: Question (2 / 4)

Cost of Sales Adjustments is the adjustment designed to ensure that cost of sales charged against revenue is cost of stock consumed/sold. It is the difference between cost of sales valued at replacement cost (current cost of sales) and that valued at historical cost.

Opening stock at average price = Rs. 18,000 x (150/120) = Rs. 22,500

Closing stock at average price = Rs. 26,400 x (150/160) = Rs. 24,750

Accounting Academics

Answers **Time Allotted: 30 mins**

Answer: Question (2 / 4) contd……

Computation of COSA

	Historical Cost Rs.	Average Price Rs.	Price Difference Rs.
Closing Stock	26,400	24,750	1,650
Opening Stock	18,000	22,500	4,500
Increase in stock	8,400	2,250	6,150
	Total change	Volume change	Price change

COSA = Rs. 6,150 (Increase in value of stock due to price rise)

Closing stock at current cost = Rs. 26,400 x (170/160) = Rs. 28,050

CCA Adjustment in books of the business

	Rs.	Rs.	Remarks
Stock	1,650		Rs. 28,050 - Rs. 26,400
Profit & Loss A/c	6,150		COSA
To Current Cost Reserve		7,800	Balancing figure

Answer: Question (3/ 4)

Monetary Working Capital is excess of monetary assets over monetary liabilities. It mostly consists aggregate of:

a. trade receivables, prepayments and trade bills receivables plus
b. inventories not subject to cost of sales adjustments, less
c. trade payables, accruals and trade bills payables

In addition to above, the cash float (including bank) required to support day-to-day operations of the business should be included in monetary working capital.

In times of rising prices, a business needs more funds to finance monetary working capital. The MWCA reflects this additional need for funds.

Closing MWC at average price = Rs. 1,800 x (165/180) = Rs. 1,650

Opening MWC at average price = Rs. 800 x (165/150) = Rs. 880

Computation of MWCA

	Historical Cost Rs.	Average Price Rs.	Price Difference Rs.
Closing MWC	1,800	1,650	150
Opening MWC	800	880	80
Increase in MWC	1,000	770	230
	Total change	Volume change	Price change

MWCA = Rs. 230 (Increase in value of MWC due to price rise)

Accounting Academics

Answers **Time Allotted: 30 mins**

Answer: Question (3 / 4) contd……

CCA Adjustment in books of ABC Ltd.

	Rs.	Rs.	Remarks
Profit & Loss A/c	230		MWCA
To Current Cost Reserve		230	

Answer: Question (4 / 4)

Gearing Ratio is the proportion of borrowed funds calculated on the basis of current cost balance sheet and **Gearing Adjustment** is the product of Gearing ratio and the sum of Depreciation Adjustment (DA), Cost of Sales Adjustment (COSA) and Monetary Working Capital Adjustment (MWCA).

	31/03/2009 Rs. 000	31/03/2010 Rs. 000	Average Rs. 000
Loans	202	242	
Cash (being current asset not taken in MWCA)	(40)	(24)	
Net Borrowing	162	218	190
Fixed Assets	400	480	
Stock	200	230	
Trade Receivables	180	190	
Trade Payables	(60)	(100)	
Net Operating Asset	720	800	760

Gearing ratio = (190/760) = 0.25

CCA Adjustment in books of XYZ Ltd.

	Rs. 000	Rs. 000	Remarks
Current Cost Reserve	10		GA = 0.25 x 40
To Profit & Loss A/c		10	

Auditing Fundas

Total Questions: 5 **Time Allotted: 45 mins**

(1 / 5) PQR & Associates, a firm of CA's, has three Partners P, Q and R. The firm is already having audit of 60 companies, which includes 2 branch audits of a company. The firm is offered 3 Company audits, out of which one is Private Company, other is a Foreign Company and the third one is a Public Company. Decide and advise whether PQR & Associates will exceed the ceiling prescribed u/s 224(1B) by accepting the above audit assignments.

(2 / 5) ABC Pvt. Ltd, at its AGM held on 28,09.2009 had appointed another firm X & Co, CA's as the Auditors of the Company for 2009-10. However, since the appointment of X & Co. was not made in accordance with Sec. 225, they had refused to accept the appointment made by the Company. Subsequently, the Company sent a letter to the Previous Auditor Z Associates requesting to take up the audit of the Company for 2009-10.

Comment whether Z Associates can continue as Auditors of the Company for 2009-10, since no resolution was passed at the AGM of the Company for removal of Z Associates as the Auditors of the Company and they are not otherwise disqualified to be re-appointed as such.

(3 / 5) While conducting the audit of a Limited Company for the year ended 31st March, the Auditor wanted to refer to the Minutes Books. The Board of Directors refused to show the Minutes Books to the Auditor. What will be the position of the Auditor in the above case?

(4 / 5) A Company had a Branch Office, which recorded a turnover of Rs. 1,99,000 in the earlier year. The Auditor's Report of earlier year had no reference regarding the Branch although the Branch Audit had not been carried out by the Statutory Auditor. Comment.

(5 / 5) A Company has established several plants at different places in India and ends the accounting year on 31st March. Recently it has established another plant, which went into commercial production on 1st July and wants to adopt a separate accounting year for the newly established plant. How would you deal with the above situation?

Answers **Time Allotted: 45 mins**

Answer: Question (1 / 5)

As per section 224(1B), No company or its Board of Directors shall appoint or re-appoint any person or Firm as its Auditors if:

(a) such person is in full time employment elsewhere, or

(b) Such person or Firm holds the office of Auditor of the specified number of companies or more than the specified number of companies.

The ceiling limit is 20 Company Audits per person. Of this 20, not more than 10 shall be in respect of companies having paid-up share capital of Rs.25 lakhs or more. However, Audit of the following are excluded while computing the ceiling limits:

(a) Branches,

(b) Corporations which are not Companies,

(c) Foreign Companies,

(d) Guarantee Companies,

(e) Private Companies, and

(f) Sec. 233A Special Audits.

Auditing Fundas

Answers **Time Allotted: 45 mins**

Answer: Question (1 / 5) contd….

In view of above, the position of the Firm is as below:

Eligible Number of Audits for (P, Q & R at 20 each)	=	60
Less:		
Existing Audits (excluding Branch Audit 60 -2)	=	58
Balance that can be taken	=	2

Hence, of the three audits which are offered, the ceiling limit is not applicable in respect of Private Company and the Foreign Company so the same can be undertaken by PQR & Associates. Since the Company is eligible to undertake two more Company Audits, the audit of the Public Company that is offered can also be undertaken by PQR & Associates.

Answer: Question (2 / 5)

The appointment / reappointment of Auditors at the AGM is one of the items of ordinary business to be transacted at that meeting. At any AGM, a retiring Auditor shall be re-appointed except in cases mentioned in Section 224(2). The expression "shall be re-appointed at each AGM" postulates some action on the part of the Company resulting in the re-appointment of the retiring Auditor. Hence, a specific resolution is required to re-appoint the Retiring Auditor. He cannot be deemed to be appointed or re-appointed automatically at the AGM (i.e. without any resolution).

For appointing a person other than the retiring Auditor, full compliance with Section 225 is necessary. Non-compliance would render the appointment of the new Auditor illegal and ineffective. Hence, in the given case, the appointment of X & Co CA's is invalid.

Where Auditors are not appointed or reappointed at the AGM in accordance with Section 224(2), Section 225 and Section 190, Central Government is empowered to appoint Auditors u/s 224(3).

In the given case, the Company has not properly appointed X & Co or validly re-appointed Z & Associates at its AGM. Hence, Z Associates cannot continue as Auditors of the Company for the year 2009-10.

Answer: Question (3 / 5)

Section 227 provides that the Company Auditor has a right of access at all times to all the books of accounts and vouchers. This includes all statutory records of the Company such as Minutes Books, Fixed Assets Register, etc. required to be verified during the audit. As part of audit work, it is necessary to refer to the Minutes book and note the decisions of the Directors and Shareholders. This is required to verify the actions of the Company and to vouch specific transactions.

If the Directors have refused to produce the Minutes Books, the Auditor may consider extending the audit procedure and to qualify his report in any appropriate manner. The Auditor shall also report whether he has obtained all information and explanations, which, to the best of his knowledge and belief, were necessary for the purpose of his audit. This has to be answered in the negative or with a qualification.

Auditing Fundas

Answers **Time Allotted: 45 mins**

Answer: Question (4 / 5)

Under the Companies (Branch Audit Exemptions) Rules, 1961 formulated u/s 228(4), exemptions are available to Branch Audit having regard to quantum of activity. A branch shall be exempted from audit if the 'quantum of activity' does not exceed:

(a) Rs.2 Lakhs, or

(b) 2% of the average of the Total Turnover of the Company, whichever is higher.

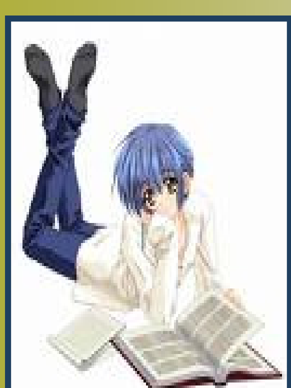
In the given case, the turnover of the Branch Office is below Rs.2 lakhs for the earlier year. However, the other information as to the Total Turnover of the Company has not been furnished. It may be presumed that the exemption was available to the Branch Office based on quantum of activity.

Even if exemption is available, it is necessary that the fact must be mentioned in the Audit Report. The Auditor shall remain responsible for not drawing reference to the exemption available to the Branch Office. However, there is no liability for the Auditor appointed for the current year. He shall not be responsible for the audit of earlier period accounts.

Answer: Question (5 / 5)

Section 210 requires the Board of Directors of every Company to lay before the AGM a Balance Sheet as at the end of the financial year and a Profit and Loss Account for the period comprised in the financial year. The Company may follow its own accounting year but there is no scope u/s 210(3) to adopt different accounting years for the segments constituted within the Company.

In the above case, the new plant, which went into commercial production on 1st July, is only a business segment of the Company. It is a part and parcel of the existing Company, which alone is the entity recognised u/s 210 for the purpose of Financial Statements. Hence, a business segment / plant cannot have a different accounting year other than the one adopted by the Company.



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Financial Issues

Total Questions: 4 **Time Allotted: 30 mins**

(1 / 4) ABC Ltd. is setting up a project with a capital outlay of Rs. 60,00,000. It has two alternatives in financing the project cost.

Alternative (a): 100% equity finance (6,00,000 equity shares of Rs. 10 each)

Alternative (b): Debt-equity ratio 2:1 (The rate of interest payable on the debts is 18% p.a. & 2,00,000 equity shares of Rs. 10 each)

The corporate tax rate is 40%. Calculate the indifference point between the two alternative methods of financing.

(2 / 4) PQR Ltd. has earnings before interest and taxes (EBIT) of Rs. 10 million. The company currently has outstanding debt of Rs. 20 million at a cost of 7%.

(a) Using the net income (NI) approach and a cost of equity of 12.5%

(i) Compute the total value of the firm and firm's overall weighted average cost of capital (Ko) and
(ii) determine the firm's market debt/equity ratio.

(b) Assume that the firm issues an additional Rs. 10 million in debt and uses the proceeds to retire stock; the interest rate and the cost of equity remain the same

(i) Compute the new total value of firm and the firm's overall cost of capital and

(ii) determine the firm's market debt/equity ratio.

(3 / 4) Jupiter Company's equity shares are being traded in the market at Rs. 54 per share with a price-earning ratio of 9. The company's dividend payout is 72%. It has 1,00,000 equity share of Rs. 10 each and no preference shares. Book value per share is Rs. 42. Calculate:

(i) Earnings per share **(ii) Net income**

(iii) Dividend yield; and **(iv) Return on equity.**

(4 / 4) RST Ltd. sells goods at a gross profit of 25% considering depreciation as part of the cost of production. Its annual figures are as follows:

	Rs.
Sales at two months credit	18,00,000
Materials consumed (suppliers extend two months' credit)	4,50,000
Wages paid (monthly in arrear)	3,60,000
Manufacturing expenses outstanding at the end of the year (cash expenses are paid one month in arrear)	40,000
Total Administrative Expenses, paid as above	1,20,000
Sales promotion expenses, paid quarterly in advance	60,000

The company keeps one month's stock each of raw materials and finished goods, and believes in keeping Rs. 1,00,000 in cash. Assuming a 15% safety margin, ascertain the requirements of working capital requirement of the company on cash costs basis. Ignore work-in-progress.

Financial Issues

Answers **Time Allotted: 30 mins**

Answer: Question (1 / 4)

The difference point between the two alternatives is calculated by:

$$\frac{(EBIT\ )(1-t)}{N1} = \frac{(EBIT\ )(1-t)}{N2}$$

Where,	EBIT	=	Earning before interest and taxes
	I	=	Interest charges
	t	=	Tax rate
	N1	=	Number of Equity shares in Alternative (a)
	N2	=	Number of Equity shares in Alternative (b)

Putting the values, the break-even point would be as follows:

$$\frac{(EBIT)(1-0.40)}{6{,}00{,}000} = \frac{(EBIT-7{,}20{,}000)(1-0.40)}{2{,}00{,}000}$$

$$\frac{(EBIT)(0.60)}{3} = \frac{0.60(EBIT-7{,}20{,}000)}{1}$$

EBIT = 10,80,000

Therefore, it can be seen that the EBIT at indifference point explains that the earnings per share for the two alternatives is equal.

Answer: Question (2 / 4)

(a) EBIT = Rs. 10,000,000

I = Rs. 20,000,000 x 7% = Rs. 1,400,000

Ke = 12.5%

(i) The total value of the firm, VF can be found as follows:

EAE = EBIT - I = Rs. 10,000,000 - Rs. 1,400,000 = Rs. 8,600,000

$$VE = \frac{EAE}{Ke} = \frac{Rs.8{,}600{,}000}{0.125} = Rs.\ 68{,}800{,}000$$

VF = VE + VD = Rs. 68,800,000 + Rs. 20,000,000 = Rs. 88,800,000

Therefore,

$$Ko = \frac{EBIT}{VF} = \frac{Rs.10{,}000{,}000}{Rs.88{,}800{,}000} = 11.26\%$$

Financial Issues

Answers **Time Allotted: 30 mins**

Answer: Question (2 / 4) contd….

(ii) The firm's market debt/ equity ratio is

$$\frac{VD}{VE} = \frac{Rs.20,000,000}{Rs.68,800,000} = 29.07\%$$

(b)

(i) I = Rs. 30,000,000 x 7% = Rs. 2,100,000

EAE = EBIT - I = Rs. 10,000,000 - Rs. 2,100,000 = Rs. 7,900,000

$$VE = \frac{EAE}{Ke} = \frac{Rs.7,900,000}{0.125} = Rs.\ 63,200,000$$

VF = VE + VD = Rs. 63,200,000 + Rs. 30,000,000 = Rs. 93,200,000

Therefore,

$$Ko = \frac{EBIT}{VF} = \frac{Rs.10,000,000}{Rs.93,200,000} = 10.73\%$$

(ii) The debt equity ratio is:

$$\frac{VD}{VE} = \frac{Rs.30,000,000}{Rs.63,200,000} = 47.47\%$$

Answer: Question (3 / 4)

(i) Earnings per share (EPS)

Price Earning Ratio = Price per share / _Earning per share

Or P/E X EPS = Price per share

Or 9 EPS = Rs. 54

Or EPS = Rs. 6

(ii) Net income

= EPS X No. of shares = Rs.6 X 1,00,000 = Rs. 6,00,000

(iii) Dividend yield

Dividend per share / Price per share = 4.32 / 54 = 0.08 or 8%

Dividend Per share = (Net Income X Dividend payout) / No. of common stock

= (Rs 6,00,000 X 0.72) / 1,00,000 = Rs. 4.32

Financial Issues

Answers **Time Allotted: 30 mins**

Answer: Question (3 / 4) contd….

(iv) Return on equity

= Net income / owner's equity

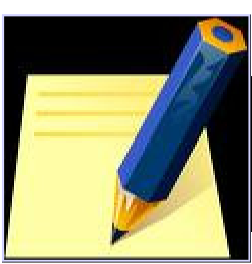
= Rs. 6,00,000 / (54 x 1,00,000) = 11.11% (based on market value)

= Rs. 6,00,000 / (42 x 1,00,000) = 14.285% (based on book value)

Answer: Question (4 / 4)

Computation of Working capital of RST Ltd. on Cash Costs Basis

A: Current Assets	**Rs.**
Debtors 1/6 of Rs. 14,70,000 (cash costs)	2,45,000
Advance payment: Sales promotion expenses (60,000 X 3/12)	15,000
Stock of Raw Material (Rs. 4,50,000 / 12)	37,500
Finished goods (Rs. 12,90,000 / 12)	1,07,500
Cash in hand	1,00,000
A	5,05,000
B: Current Liabilities	
Sundry Creditors (Rs. 4,50,000/12 months) x 2 months	75,000
Manufacturing expenses outstanding	40,000
Administrative expenses outstanding (Rs. 1,20,000/12 months)	10,000
Wages outstanding (Rs. 3,60,000/12 months)	30,000
B	1,55,000
(A - B)	3,50,000
Add: 15% Safety margin	52,500
Working Capital Requirement	**4,02,500**



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Total Questions: 2 **Time Allotted: 15 mins**

Moral	Ethics
Moral is defined as relating to principles of right and wrong.	Ethics relates to what is good or bad, and having to do with moral duty and obligation.
Latin word "mos", meaning "custom". Custom is defined by a group over time. Societies have "custom".	Greek word "ethos", meaning "character". Character is a personal attribute. People have "character".
Morals are accepted from an authority. (cultural, religious, etc.)	Ethics are accepted because they follow from personally accepted principles.
Moral Norms can usually be expressed as general rules and statements, e.g. "always tell the truth".	Ethical Norms are comparatively abstract and cannot be described in general rules and statements.
Morals are typically first absorbed as a child from family, friends, school, religious teachings and other associations.	Ethics are adopted / absorbed by an individual gradually by taking reasonable actions / decisions in appropriate situations.
Morals work on a smaller scale than ethics, more reliably, but by addressing human needs for belonging and emulation.	Ethics has a much wider scope, and includes evaluation of moral standards of an individual or society, to see whether these standards are reasonable or unreasonable in concrete situations and issues.

Consumer Interest	Public Interest
Areas which benefit the "Consumers" as a whole, constitute Consumer Interest.	Areas in which the society as a whole has some interest is called Public Interest.
Consumer is a member of a broad class of people who purchase, use, maintain and dispose of products and services.	Society refers to the collection of sub-systems, e.g. consumers, manufacturers, distributors, input suppliers, service providers, etc.
Consumer is only a sub-system of a larger system i.e. general public / society. Hence, Consumer Interest is restricted in scope.	Public Interest is wider in scope than Consumer Interest.
Consumers are affected by pricing policies, financing practices, quality of goods & services and various trade practices.	Public Interest reflects the morals during period and the established interest of the society.
If Consumer Welfare is at the centre of any Governmental policy, such measures / decisions are said to be taken in "Consumer Interest".	Government Policy decisions which are intended to benefit the society as a whole, constitute Public Interest.
Formulation of Competition Act, Regulation of Consumer Protection Councils, Consumer Courts / Adalats, etc. are examples of Consumer Interest.	Maintaining law and order, providing for the defence of the country, maintenance of monuments of national importance, etc. are examples of Public Interest.

Tax Teasers

Total Questions: 5 **Time Allotted: 40 mins**

(1 / 5) X was born in 1976 in India. His parents were also born in India in 1948. His grand parents were, however, born in England. 'X' was residing in India till 15-3-2007. Thereafter, he migrated to England and took the citizenship of that country on 15-3-2009. He visits India during the previous year 2009-10 for 90 days. Determine the residential status of 'X' for assessment year 2010-11.

(2 / 5) R Ltd., a foreign company, enters into an agreement on 1-4-2001 with G Ltd., an Indian Company. The agreement relates to a matter included in the industrial policy of the Central Government and is in accordance with the policy. During the year ended 31-3-2010, a royalty of Rs. 1,20,00,000 is paid by G Ltd., to R Ltd. R Ltd., has spent Rs. 20,00,000 on expenses covered u/s 28 to 44C. Compute the Tax payable by R Ltd., assuming

a. G Ltd. pays the Income-tax payable by R Ltd., as per the terms of the agreement.

b. The agreement did not provide that G Ltd., will bear the tax, but it was mutually agreed between the parties that royalty of Rs. 80,00,000 will be paid net of taxes.

It may further be assumed that the special rate of income-tax in the above case is 20% + surcharge + education cess + SHEC @ l%.

(3 / 5) Compute net income of R, a resident of Ladakh from information given below:

a. Salary @ Rs. 35,000 p.m.

b. D.A. @ Rs. 11,000 p.m. [Rs. 5,500 p.m. enters into pay for service benefits]

c. Advance salary for two months Rs. 70,000

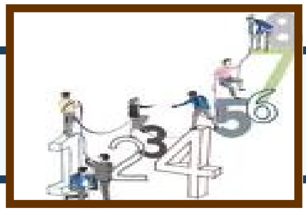
d. Employer's contribution to RPF Rs. 7,000 p.m.

e. Income from operations confined to collection of news and views in India for transmission outside India Rs. 1,00,000

(4 / 5) R purchased 500 listed equity shares of Rs. 10 each for Rs. 40 per share in 1989-90 and incurs an expenditure of Rs. 400 on brokerage. In May 1993 he receives 100 bonus shares. In September, 2009 he gets 100 rights shares for Rs. 20 each. He sold 100 bonus shares in November, 2009 at Rs. 30 per share and 100 right shares @ 30 per share in December 2009. The bonus shares as well as right shares have been kept in a separate depository. Both the sales were made through the stock exchange. Rs. 15 were paid as securities transaction tax. Find out the capital gains for the assessment year 2010-11.

(5 / 5) R is the owner of a flour mill and some agricultural land near the mill. During the year 2009-10, he has shown a profit of Rs. 36 lacs from the business of flour mill. Scrutiny of accounts reveals that he has used 5,000 quintals of wheat produced in his own farms and cost of this wheat has not been debited to P&L account. The market price of the wheat. during the season was Rs. 600 per quintal. Compute his agricultural and business income and calculate the tax payable by him assuming he does not have any other income.

The cost of cultivation of wheat (which includes cost of seeds, manure and fertilisers, etc.) was Rs. 18,00,000.



Tax Teasers

Answers **Time Allotted: 40 mins**

Answer: Question (1 / 5)

In this case, X is neither a citizen of India nor a person of Indian origin, because neither he nor his parents nor his grand parents were born in undivided India.

Although in this case, he does not satisfy the first condition of category A but he satisfies the second condition as he was in India for more than 60 days during the relevant previous year and his stay in the four preceding, previous years was as under:

2008-09	Nil
2007-08	Nil
2006-07	349 days
2005-06	365 days
	714 days

He is therefore, Resident in India.

For determining whether he is "ordinarily resident in India", he has to satisfy both the conditions of category B. He is resident for more than one previous year in the preceding 10 years and the second condition is also satisfied as he is in India for 730 days or more in the 7 preceding previous years as prior to 16.3.2007 he was always in India. Hence, he is resident and ordinarily resident in India.

Answer: Question (2 / 5)

(a) As per section 10(6A), if as per the terms of the agreement entered into upto 31-5-2002 and tax on royalty is payable by the Government or Indian concern, the tax so paid will not be included in the total income of the foreign company as such, it will be an exempt income in the hands of the foreign company. Therefore, in the instant case, the total royalty income will not be grossed up and income from royalty will be Rs. 80,00,000. No deduction is allowed in respect of any expenditure u/s 28 and 44C.

	Rs.
Therefore,	
the total income of R Ltd. is	1,20,00,000
Tax payable @ 21.115% (Note 1)	25,33,800
Less: tax paid by G Ltd.	25,33,800
Net Tax payable	Nil

(b) Since section 10(6A) is not applicable as the terms of agreement do not provide for payment of tax by G Ltd., the total income will be computed as under:

Net Income	=	Rs. 1,20,000,000		
Gross Income	=	Net Income x 100 / (100 - TDS)		
	=	1,20,00,000 x 100 / 78.885	=	1,52,12,017

Tax payable by R Ltd. @ 21.115 % on Rs. 1,52,12,017	32,12,017
Less: Tax to be borne by X Ltd.	32,12,017
Balance Tax payable	Nil

Note 1: Tax @ 20% + surcharge @ 2.5% = 20.5 + education cess @ 2% + SHEC @ I% on 20.5% = 21.115%.

Tax Teasers

Answers **Time Allotted: 40 mins**

Answer: Question (3 / 5)

Computation of Net Salary		**Rs.**
Salary		4,20,000
DA (which enters into pay)		66,000
DA (which does not enter into pay)		66,000
Advance salary for 2 months		70,000
Employer's contribution to RPF @ Rs. 7,000 p.m.	84,000	
Less: Exempted @ 12% of salary (4,20,000 + 66,000)	58,320	25,680
Gross salary		6,47,680
Less: Deduction under section 16		Nil
Net salary		6,47,680
Business income: Income from collection of news and views		1,00,000
Gross total income		7,47,680

Answer: Question (4 / 5)

Income from capital gain

Bonus share:	Sales consideration (30 x 100)	3,000
	Less: Cost of acquisition	Nil
	Long-term capital gain (Exempt)	3,000
Right share:	Sales consideration (100 x 30)	3,000
	Less: Cost acquisition (20 x 100)	2,000
	Short-term capital gain	1,000

Note 1: Long-term capital gain on sale of listed shares is exempt u/s 10(38) and short-term capital gain shall be taxable @ 15% provided these shares are sold through recognised stock exchange.

Note 2: Securities transaction tax is not allowed as deduction.

Answer: Question (5 / 5)

Computation of agricultural and business income of Mr. R (For the A. Y. 2010-11)

	Rs.
Net profit as per P&L account	36,00,000
Less: Cost of wheat brought from own farms at market price (600 x 50,000)	30,00,000
Business income	6,00,000
Market value of wheat	30,00,000
Less: Cost of cultivation	18,00,000
Agricultural income	12,00,000
Tax on agricultural and non-agricultural (12,00,000 + 6,00,000 = 18,00,000)	4,44,000
Tax on agricultural income (12,00,000 + Rs. 1,60,000 = 13,60,000	3,12,000
	1,32,000
Add: Education cess @ 2%	2,640
Add. SHEC @ 1%	1,320
	1,35,960

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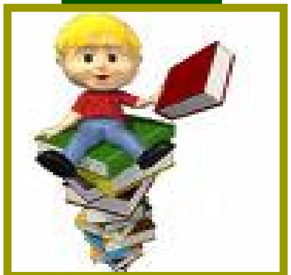

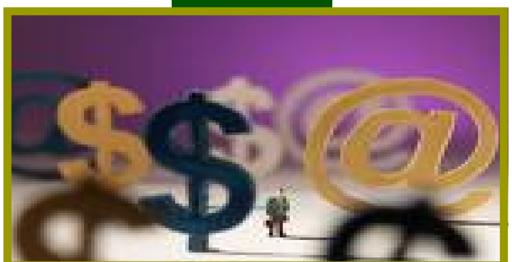

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Smaller Facts Overlooked

Total Questions: 8 **Time Allotted: 30 mins**

Can an assessee in response to the notice issued under section 153A file a revised return?

The proceedings under section 153A are initiated to assess or reassess undisclosed income. The said proceedings are beneficial to revenue and an assessee cannot use the same to reduce his tax burden. Similar decision has been held in the case of Charchit Agarwal vs. Asst. CIT where return of income in which the assessee changed the method of valuation of closing stock resulting in reduction of profit, filed by assessee in response to notice issued under section 153A has been rejected.

Can interest free loans appearing in the balance sheet be treated as income?

The decision has been held in the case of Asst CIT vs Subhash Verma that loans shown by the assessee in his balance sheet on which no interest has been paid cannot be treated as bogus on presumption that no interest was paid on such sundry credits and no sensible person would advance to a stranger loan which is free of interest.

Is interest on interest becomes payable to an assessee if the interest amount is not refunded alongwith the tax amount.

When refund of tax becomes payable as a result of order passed in an appeal or other proceedings under Act, this refund is to be given along with interest, which is to be calculated as per section 244A; if that interest is paid along with excess tax, no further payment is to be made; it is only when excess amount of tax is refunded but interest is not refunded along therewith, that retention of interest amount would be unjustified and interest on interest would also become payable. Motor & General Finance Ltd. vs CIT.

Are expenses incurred on ground of commercial expediency covered by term `activities relating to business' even if they benefit somebody else also?

In CIT v. Chandulal Keshavlal & Co. it was held that if a transaction is of a nature which is entered in the course of a business of the assessee and is commercially expedient then it does become a deductible allowance. If as a result of the transaction the assessee benefits, it is immaterial that a third party also benefits thereby.

Smaller Facts Overlooked

Total Questions: 8 **Time Allotted: 30 mins**

Does commercial duplication of software in CDs constitutes 'manufacture or processing of goods' in terms of section 80-IA?

It has been held in the case of CIT vs Oracle Software India Ltd. that commercial duplication process, by which a blank CD is transformed into software loaded disc dedicating it to a specific use, constitutes 'manufacture or processing of goods' in terms of section 80-IA, as it stood at relevant time.

Are salaries paid to an accountant for accounting charges attracts provisions of section 40(a)(ia) of Income Tax Act 1961?

Salaries paid to an accountant does not always attracts provisions of section 40(a)(ia). It has been held in the case of Samanwaya vs Asst. CIT that expenditure incurred by an assessee by way of salary to the accountants was for accounting charges and was not paid to a chartered accountant, same would not attract provision of section 194J and therefore the provision of section 40(a)(ia) is also not attracted.

Can a statement recorded at the time of survey/ search form basis for addition to the assessee's taxable income?

It has been held in the case of Dy. CIT vs Premsons that in order to make an addition on the basis of surrender during search or survey, it is sine qua non that there should be some other material to co-relate the undisclosed income with such statement. No addition to the taxable income can be made or sustained simply on basis of statement recorded at time of survey/search.

In which year the gain/ loss arising on forward contract should be recognised?

Where assessee enters into a contract for purchase of foreign currency on a future date at pre-determined rates, difference between forward contract rate and exchange rate on date of entering into contract has to be recognized as income or expenses which are ascertained and definite in terms of contract and would be allowed as business expenditure in year of entering into forward contract itself, though as per contract, part payment is to be made in succeeding years - CIT vs Industrial Finance Corporation of India Ltd.