

FINAL EXAMINATION
GROUP II

Suggested Answers

November, 2011



The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

SUGGESTED ANSWERS TO QUESTIONS SET AT THE
FINAL EXAMINATION – GROUP II
NOVEMBER, 2011



BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
(Set up by an Act of Parliament)

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Contents

	<i>Page Nos.</i>
Paper 5. Advanced Management Accounting	1 – 18
Paper 6. Information Systems Control and Audit	19 – 42
Paper 7. Direct Tax Laws	43 – 68
Paper 8. Indirect Tax Laws	69 – 88
Examiners' comments on the performance of the candidates	

PAPER – 5 : ADVANCED MANAGEMENT ACCOUNTING

Question No.1. is compulsory.

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

Working notes should form part of the answer.

No statistical or other table is to be distributed along with this question paper.

Question 1

- (a) New Ltd. Plans to completely manufacture a single product Z., whose selling price and variable manufacturing costs will be ₹ 100 per unit and ₹ 80 per unit respectively. If the complete production is done at its own factory, fixed machining costs will be ₹ 3,62,000 and fixed administration and selling overheads will be ₹ 30,000 for the production period.

Alternatively, the product can be finished outside by sub contracting the machining operations at ₹ 10 per unit, but this will entail an increase in the fixed administration overheads by ₹ 1,20,000 while fully avoiding the machining cost of ₹ 3,62,000

Based on the above figures and assuming a production capacity of 30,000 units for the production period, advise with relevant supporting figures, from a financial perspective, for what volumes of market demand will:

- (i) a manufacture be recommended at all ?
- (ii) a fully in-house production be recommended?
- (iii) the sub contracting option be recommended ? (5 Marks)

- (b) Pigments Ltd. is a chemical factory producing joint product s J, K and L at a joint cost of production of ₹ 9, 60,000. The sales are:

J 60,000 units ₹ at 5 per unit,

K 20,000 units at ₹ 20 per unit and

L 40,000 units at ₹ 10 per unit

The company seeks you advice regarding the following options available:

Option I: After the joint process, all of L can be further processed to make 36,000 units of M, at an additional processing cost of ₹ 1,80,000 and M can be sold at ₹ 18 per unit.

Option II: the facilities used to convert L to M may be used to make 7000 units of an additional product A, with a different raw material input. A can be made at an additional variable manufacturing cost of ₹ 12 per unit and will fetch ₹ 30 as the selling price, but the company will have to offer one unit of J as a free gift for each unit of A sold.

Evaluate the proposals using the incremental cost approach. (5 Marks)

- (c) State any 5 limitations of the assumptions of PERT and CPM (5 Marks)

(d) Classify the following items under appropriate categories of quality costs viz. Prevention Costs, appraisal Cost, Internal Failure Costs and External Failure costs:

- (i) Rework
- (ii) Disposal of scrap
- (iii) Warranty Repairs
- (iv) Revenue loss
- (v) Repair to manufacturing equipments
- (vi) Discount on defective sale
- (vii) Raw material inspection
- (viii) Finished product inspection
- (ix) Establishment of quality circles
- (x) Packaging inspection

(5 Marks)

Answers

(a)

Options		
Details	Manufacturing	Sub Contract
	Amount (₹)	Amount (₹)
Selling price	100	100
Variable Cost	80	90
Contribution	20	10
Fixed Cost	3,92,000	1,50,000
BEP (units)	19,600	15,000

Point of Indifference = level of production where both options will have same outcome.

It can be calculated as :

Difference in Fixed cost = ₹ (3,92,000 – 1,50,000)=₹ 2,42,000

Difference in contribution per unit = ₹ 10

Point of indifference = 2,42,000 /10 = 24,200 units.

It may be calculated in alternative way.

Indifference Point (x): (20x – 392000) = (10x – 150000)

10x = 242000

X = 24200

- (i) If Market demand is above 15000 : manufacture is recommended
- (ii) For Demand 24201 to 30000 units : Manufacture fully in-house.
- (iii) For Demand 15000 to 24200 units : Sub-contract

(b) Working Notes:

Particulars	Option – I Process L to M	Option – II Sell new product A
	Amount (₹)	Amount (₹)
Sale of Product M	648,000	
Sale of Product A		210000
(Less: Revenue lost on Product L)	400,000	
(Less: Revenue lost on Product J)		35000
Less: Additional Cost	180,000	84000
Incremental Profit	68000	91000
Decision : Option II is better by ₹ 23000		

(c) Limitations of the assumption of PERT and CPM

- (i) Beta distribution may not always be applicable
- (ii) The formulae for expected duration and standard deviation are simplification. In certain cases, errors due to these have been found up to 33 %
- (iii) The above errors may get compounded or may cancel each other
- (iv) Activities are assumed to be independent. But the limitations on the resources may not justify the assumption.
- (v) It may not always be possible to sort out completely identifiable activities and to state where they begin and where they end
- (vi) If there exist alternatives in outcome, they need to be incorporated by way of a decision tree analysis.
- (vii) Time estimates have a subjective element and to this extent, techniques could be weak. Contractors can manipulate and underestimate time in cost plus contract bids. In incentive contracts, overestimation is likely.
- (viii) Cost-time tradeoffs / cost curve slopes are subjective and even experts may be widely off the mark even after honest deliberations

- (d) i Rework Internal Failure
- ii Disposal of Scrap Internal Failure
- iii Warranty Repairs External Failure

iv	Revenue Loss	External Failure
v	Repairs to Manufacturing Equipment	Internal Failure
vi	Discount on Defective Sales	External Failure
vii	Raw Material Inspection	Prevention Cost
viii	Finished Product Inspection	Appraisal Cost
ix	Establishment of Quality Circles	Prevention Cost
X	Packaging Inspection	Appraisal Cost

Question 2.

- (a) The budget and actual operating data for 2010-11 pertaining to 4 products in a store are given below: (10 Marks)

Product	Budgeted data for 2010-11			Actual operating results in 2010-11		
	Gallons	Selling price (₹ per gallon)	Variable costs (₹ per gallon)	Gallons	Selling price (₹ per gallon)	Variable costs (₹ per gallon)
V	2,50,000	1.2	0.5	1,80,000	1.00	0.45
C	3,00,000	1.5	0.6	2,70,000	1.35	0.50
S	2,00,000	1.8	0.7	3,30,000	2.00	0.75
A	50,000	2.5	1.00	1,80,000	3.00	1.20

You are required to compute for the individual products and in total:

- the sales margin price variance
- the sales margin mix variance and
- the sales margin volume variance

Indicate whether the variances are favorable (F) or unfavorable (A or U) (10 Marks)

- (b) A city corporation has decided to carry out road repairs on 4 main roads in the city.

The Government has agreed to make a special grant of ₹ 50 lacs towards the cost with the condition that the repairs should be carried out at lowest cost. Five contractors have sent their bids. Only road will be awarded to one contractor. The bids are given below:

	Road	Cost of Repairs (₹ in lacs)			
		R ₁	R ₂	R ₃	R ₃
Contractors	C ₁	9	14	19	15
	C ₂	7	17	20	19
	C ₃	9	18	21	18
	C ₃	10	12	18	19
	C ₄	10	15	21	16

You are informed that C_2 should get R_1 and C_4 should get R_2 to minimize costs.

- (i) What is the minimum cost allocation?
- (ii) How much is the minimum discount that the eliminated contractor should offer for meriting a contract?
- (iii) Independent of (ii) above, if the corporation can negotiate to get a uniform discount rate from each contractor, what is the minimum rate of discount so that the cost is within the grant amount? (6 Marks)

Answer

(a) Working Notes:

Product	Budget Margin (BM)		Actual Margin (AM)	
	Budgeted Price – Budgeted Variable Cost		Actual Price – Budgeted Variable Cost	
V	1.2 – 0.5	= 0.7	1 – 0.5	= 0.5
C	1.5 – 0.6	= 0.9	1.35 – 0.6	= 0.75
S	1.8 – 0.7	= 1.1	2.0 – 0.7	= 1.3
A	2.5 – 1.0	= 1.5	3.0 – 1.0	= 2.0
	Actual Quantity x Actual Margin (1)		Actual Quantity x Budgeted Margin (2)	
V	1,80,000 x 0.5	= 90,000	1,80,000 x 0.7	= 1,26,000
C	2,70,000 x 0.75	= 2,02,500	2,70,000 x 0.9	= 2,43,000
S	3,30,000 x 1.3	= 4,29,000	3,30,000 x 1.1	= 3,63,000
A	1,80,000 x 2.0	= 3,60,000	1,80,000 x 1.5	= 2,70,000
	9,60,000	= 10,81,500	9,60,000	= 10,02,000
	Actual Qty in Budgeted mix x Budgeted Margin (3)		Budgeted Quantity x Budgeted Margin (4)	
V	3,00,000 x 0.7	= 2,10,000	2,50,000 x 0.7	= 1,75,000
C	3,60,000 x 0.9	= 3,24,000	3,00,000 x 0.9	= 2,70,000
S	2,40,000 x 1.1	= 2,64,000	2,00,000 x 1.1	= 2,20,000
A	60,000 x 1.5	= 90,000	50,000 x 1.5	= 75,000
	9,60,000	8,88,000	8,00,000	= 7,40,000
	Sales Margin – Price Variance (5) = (1) – (2)	Sales Margin Mix Variance (6) = (2) – (3)	Sales Margin Volume Variance (7) = (2) – (4)	
V	36,000 (A)	84,000 (A)	49,000 (A)	
C	40,500 (A)	81,000 (A)	27,000 (A)	
S	66,000 (F)	99,000 (F)	1,43,000 (F)	
A	90,000 (F)	1,80,000 (F)	1,95,000 (F)	
	79,500 (F)	1,14,000 (F)	2,62,000 (F)	

- (b) (i) There are 5 rows and 4 columns hence insert a dummy column R_5 .
- C_2 has been allocated to R_1
 - C_4 has been allocated to R_2 . Hence the assignment is restricted to

	R_3	R_4	R_5
C_1	19	15	0
C_3	21	18	0
C_5	21	16	0

Column Minimum

	R_3	R_4	R_5
C_1	0	0	0
C_3	2	3	0
C_5	2	1	0

	R_3	R_4	R_5
C_1	0	0	1
C_3	1	2	0
C_5	1	0	0

Hence C_1 has been allotted to R_3 , C_3 to R_5 and C_5 to R_4 .

Hence the Minimum cost is = $7+12+19+16+0 = 54$ Lacs

- (ii) C_3 should reduce 2 lacs for R_1 , 6 lacs for R_2 , 2 lacs for R_3 and 2 lacs for R_4

Minimum Discount = 2 Lacs for any of R_1 , R_3 , R_4

- (iii) Minimum rate of Discount $(54-50) = 4/54 = 7.41\%$

Question 3

- (a) PQ Ltd, makes two products P and Q, which are similar products with slight difference in dimensions, but use the same manufacturing processes and facilities. P{production may be made interchangeably after altering machine set-up. Production time is the same for both products. The cost structure is as follows:

(Figures ₹ per unit)	P	Q
Selling Price	100	120
Variable manufacturing cost (directly linked to units produced)	45	50

Contribution	55	70
Fixed manufacturing cost	10	10
Profit	45	60

Fixed cost per unit has been calculated based on the total practical capacity of 20,000 units per annum (which is either P or Q both put together). Market demand is expected to be the deciding factor regarding the product mix for the next 2 years. The company does not stock inventory of finished goods. The company wished to know whether ABC system is to be set up at a cost of ₹ 10,000 per month for the purpose of tracking and recording the fixed overhead costs for allocation to products.

Support your advice with appropriate reasons. (6 Marks)

Independent of the above, if you are told to assume that fixed costs stated above, consist of a non-cash component of depreciation to plant at 90,000 for the year, will you advice change? Explain. (2 Marks)

(b) In a company, division A makes product A and Division B makes product B.

One unit of A needs one unit of B as input. State the unit transfer price to be adapted by the transferring Division A to B in each of the following independent situations:

- There is a ready market for A. There are no constraints for production or demand for A and A does not incur any external selling cost.
- Supply is more than demand for A. External market resorts to distress price for A and this is expected to last for a temporary period. The product cannot be stocked until better times.
- Product A is highly specialized. Internal specifications are too many that B has to only buy from A.
- A has excess capacity. It can transfer any quantity to B. Goal congruence is to be achieved.
- A has no spare capacity, has adequate demand in a competitive market.
- A has no spare capacity and has adequate demand in a competitive market. But on units transferred to B, it incurs ₹ 10 per unit as additional transport cost and ₹ 10,000 as fixed expenses irrespective of the number of units transferred.

(8 Marks)

Answer

(a) Working Notes

#	Data	Reasoning	Decision
i.	Similar Products	OH Cost based on production units is appropriate. ABC will	ABC system not required for OH

	Similar Production Resources	also yield identical results	allocation
ii	Present OH Cost = 10/u. Proposed Increase due to ABC system : $120000/20000 = 6/u$	Current OH cost of 10/u will increase by 6 per unit due to installing ABC system (60% increase)	For allocation purpose, ABC not justified
iii.	Both have +ive contribution / u. Market demand determines the mix	OH allocation has no role in decision making	No need for ABC System
iv.	For the purpose of OH allocation, ABC need not be installed. However, if the fixed overheads of ₹ 2,00,000 are analysed by activity and thereby a saving of at least ₹ 1,20,000 be expected (which is the cost of installing ABC system), then, ABC system may be installed		
v.	For the non cash component of depn = 90,000 , FC that can be saved is a maximum of 1,10,000 (2,00,000 – 90,000). Hence, this is clearly less than ABC cost installation. Hence <u>do not install ABC System</u>		

(b) Transfer Price

- i) Market Price = Transfer price
- ii) For any quantity that the market can absorb, Price offered by B or Market price whichever is higher
For quantity that the market can no longer absorb, any price that B may offer
- iii) Maximum Transfer price = Total Cost + Profit subject to maxim price B can pay to keep its ultimate product profitable.
Minimum transfer price = variable cost
- iv) Transfer Price = Variable Cost to A
- v) Transfer price = Either Market Price or Variable Cost + Opportunity Cost of diverting market sale
- vi) Transfer price = Variable Cost + Opportunity Cost + specific cost + (fixed cost/units transferred)

$$\text{Transfer Price/unit} = (\text{Market Price} + 10) + (10,000/\text{units transferred})$$

The question has an error. It says "one unit of A needs one unit of B". Hence students can assume B transfers to A. Then, considering each sub division independently,

- i) B will offer A at market price of B less any avoidable selling expenses on units transferred to A.
- ii) A will stop buying from B since stock already exists.
- iii) Maximum Transfer price = Total Cost + Profit subject to maximum price B can pay to keep its ultimate product profitable.
Minimum transfer price = variable cost
- iv) Transfer Price = Variable Cost to A
- v) A will pay up to market price of B, less any avoidable selling expenses for transfers to A
- vi) Transfer price = Variable Cost + Opportunity Cost + specific cost + (fixed cost/units transferred)

$$\text{Transfer Price/unit} = (\text{Market Price} + 10) + (10,000/\text{units transferred})$$

Question 4

- (a) Alfa Mills prepared the following budget for its production department for 2010-11 10 for 12,000 units of production.

	₹
Raw Material @ ₹ 3 per unit	36,000
Labour 2 hours/unit @ ₹ 2.5 per hour	60,000
Production overheads:	
Power (variable)	3000
Repairs (variable)	1500
Indirect labour (80% variable)	2400
Factory Rent (Fixed)	3600
Factory Insurance (Fixed)	1800
Other Manufacturing Expenses (50% variable)	600
Total Production Cost	1,08,900

You are required to present the flexible budget classified under fixed and variable costs for

- (i) Production of 10,000 units
- (ii) Production of 15,000 units, for which raw material price increases by 10% for the entire quantity and labour rate increases by ₹ 0.5 per hour for the full direct labour hours.

(8 Marks)

- (b) Happy Holidays company contracts to take children on excursion trips Relevant information for a proposed excursion trip is given below:

Revenue per trip per child	4000
Expenses that have to be incurred:	
Train fare per child per trip	1700
Meals per child per trip	300
Craft Materials per child per trip	600
Room rent per trip (4 children can be accommodated in a room)	760
Local Transport at picnic spots (per vehicle) (each vehicle can seat 6 children excluding the driver)	1200

Fixed costs that are required to be covered in a trip ₹ 5,18,130 .

Find the minimum number of children to cross the break-even point and start earning a profit.
(6 Marks)

Answer

(a)

Flexible Budget				
Item of Cost	10000 units		15000 units	
	Working	₹	Working	₹
Variable Costs				
Raw Material	3*10000	30,000	3*15000*1.1	49,500
Labour	2*2.5*10000	50,000	2*3*15000	90,000
Power	3000/12000*10000	2,500	3000/12000*15000	3,750
Repair	1500/12000*10000	1,250	1500/12000*15000	1,875
Indirect Labour – Variable	2400*80%/12000*10000	1,600	2400*80%/12000*15000	2,400
Other Mfg Cost – Variable	600*50%/12000*10000	250	600*50%/12000*15000	375
Sub-total variable costs		85600		147900
Fixed Costs				
Indirect Labour – Fixed	2400*20%	480	2400*20%	480
Other Mfg Cost – Fixed	600*50%	300	600*50%	300
Factory Rent		3,600		3,600

Factory Insurance		1,800		1,800
Sub-total fixed costs		6180		6180
Total Production Cost		91,780		154,080

(b)

Item Description	₹
Revenue per trip	4,000
Less: Variable Cost	
Train Fare	1,700
Meals per Child	300
Craft Materials	600
Total Variable Cost	2,600
Contribution per child	1,400

$$\text{Relevant Range} = \frac{5,18,130}{1010} = 513$$

Step Fixed Cost

Items	₹
Room Rent (760/4)	190
Transport Cost (1200/6)	200
Total Step Fixed Cost	390

$$\text{Net Contribution} = 1400 - 390 = ₹ 1010.$$

Details	Amount
Sales	4000
Variable Cost	-2600
Contribution	1400

At 513 Students

General Fixed Cost		518,130
Room Rent	129*760	98,040
Transportation	86*1200	103,200
Total Fixed Cost		719,370
Gross Contribution	513*1400	718,200
Loss		(1,170)

$$\text{BEP} = 513 + 1170/1400 = 513.83. \text{ Hence the Minimum Students will be 514}$$

Relevant Range for Earning Profit will be 514 to 516

Particulars	514	516
General Fixed Cost	518,130	518,130
Room Rent	98,040	98,040
Transportation	103,200	103,200
Total Fixed Cost	719,370	719,370
Gross Contribution	719,600	722,400
Profit	230	3,030

Question 5.

- (a) Quickcomp is a successful version of a software package that is widely used. Fastercomp is the next version, for which the development is complete and it is ready to be sold immediately in the market as budgeted. However, for Fastercomp, user manuals, training modules and diskettes have not yet been made, whereas, for the Quickcomp version, these are overstocked by 5,000 units. Release of Fastercomp will render the Quickcomp version not saleable.

The following information is provided:

	Quickcomp	Fastercomp
Selling price per unit ₹	14,000	14,000
Variable cost per unit ₹ (consisting of user manuals, training modules and diskettes)	1000	4000
Development Cost per unit ₹ (total cost of development spread over the expected sales quantity during the product's life-cycle)	7,000	10,000
Marketing/Administration Cost per unit ₹ (Fixed budgeted annual outflow divided by the expected sales quantity for each product for the year)	3500	4000
Total Costs per unit ₹	11,500	18,000
Operating Income per unit	2,500	1,000

From a purely financial perspective, the company wants your advice whether to delay the release of the new version by 2 months by when the inventory of the existing version would have sold out or to release the new version immediately. Support your advice with relevant figures. (6 Marks)

- (b) Given below is the relevant portion of the first iteration of a linear program under the simplex method, using the usual notations.

			X_1	X_2	X_1	X_2	X_3
Quantity	Basic Variable	Contribution Per unit	50	40	0	0	0
150	S_1	0	3	5	1	0	0
20	S_2	0	0	1	0	1	0
296	S_3	0	8	5	0	0	1

- (i) Write the initial liner program with the objective function and the in equations.
The following questions are to be answered independent of each other and based on the iteration given above:
- (ii) What is the opportunity cost of bringing one unit of x_1 into the solution?
- (iii) If we bring 4 units of x_1 into the solution, by how much will the basic variables changes?
- (iv) What will be the change in the value of the objective function if 4 units of x_2 are brought into the solution?
- (v) What will be the quantity of the incoming variable? (10 Marks)

Answer**(a)**

Particulars	Quickcomp	Fastercomp	Remarks
Sale Price	14,000	19,000	Given
Less:			
Variable Cost	-	4,000	Quickcomp Variable Cost is Sunk cost
Development Cost	-	-	Sunk Cost
Marketing Cost	-	-	Sunk Cost
Profit	14,000	15,000	
Incremental Profit is ₹ 1000/- Unit.			
Better to Release Fastercomp now in order to get higher profit by ₹ 5000 x 1000 = 50 lacs.			

- (b)** (i) Maximize $Z = 50x_1 + 40x_2$
Subject to
 $3x_1 + 5x_2 \leq 150$
 $x_2 \leq 20$
 $8x_1 + 5x_2 \leq 296$
 $x_1, x_2 \geq 0$
- (ii) Opportunity Cost of bringing one unit of x_1 into the solution is ₹ 40, (i.e. the contribution lost on not bringing one unit of the next best choice, which is x_2).

(iii)

Change in basic variable per unit of x_1	Change in basic variables for 4 units of x_1	Implication
3	12	S_1 will be reduced by 12
0	0	S_2 will not be impacted
8	32	S_3 will be reduced by 32 units if we bring 4 units of x_1 into the solution

- (iv) Objective function value will increase by $4 \times 40 = ₹ 160$ if we bring in 4 units of x_2 into the solution.
- (v) x_1 having highest contribution will be the incoming variable. Maximum no of units of x_1 that can come in = Maximum ratio, which is minimum of $(150/3, 20/0, 296/8)$ = Minimum of $(50, \infty, 37)$. Hence quantity of incoming variable x_1 is 37 units.

Question 6

- (a) The number of days of total float (TF), earliest start times (EST) and duration in days are given for some of the following activities.

Activity	TF	EST	Duration
1 – 2	0	0	5
1 – 3	0		
1 – 4	5		
2 – 4	0	4	
2 – 5	1		
3 – 6	2	12	
4 – 6	0	12	
5 – 7	3		
6 – 7		23	
6 – 8	2		
7 – 8	0	23	6
8 – 9		30	

- (i) Draw the network.
- (ii) List the paths with their corresponding durations and state when the project can be completed. (10 Marks)
- (b) State the pricing policy most suitable in each of the following independent situations:
- (i) The company makes original equipments and does defence contract work. There are other companies which also undertake such projects.

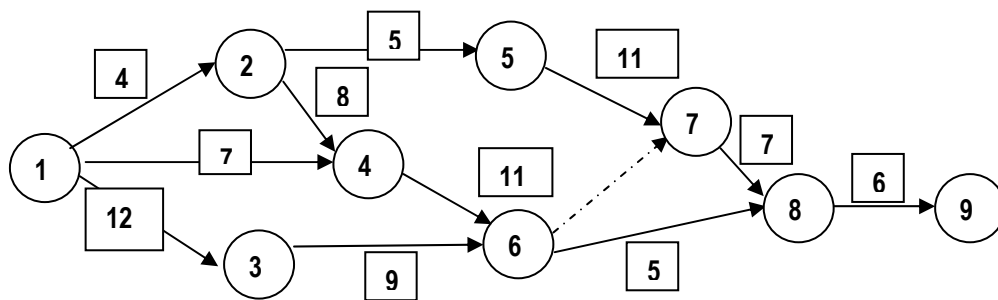
- (ii) The product made by a company is new to the market. It is expected to enjoy a long-term demand. Competition is expected very soon, since the product will be desirable to most customers.
- (iii) Stock of processed ready-to-eat product, whose shelf-life will soon be over in the next 2 months. The product is going to be discontinued.
- (iv) A company sells a homogeneous product in a highly competitive market.

(Candidates need to only write the pricing policy with the corresponding sub-division numbers of the questions. The situations need not be copied into the answer books) (4 Marks)

- (c) Two companies, H and L, have the same values for turnover and net profit and make a similar product. H has a higher P/V ration than L. Which company will perform better when: (i) the market demand is high ? (ii) the market demand is low? (2 Marks)

Answer

(a)



Network Diagram: 6-7 dummy

6-8-9 and 7-8-9

1-2-5-7 and 1-2-4-6

1-4-6 and 1-3-6

Activity	Duration	Early Start	Late Start	Late Finish	Total Float
1-2	4	0	0	4	0
1-3	12	0	2	14	0
1-4	7	0	5	12	5
2-4	8	4	4	12	0
2-5	5	4	8	13	1
3-6	9	12	14	23	2

4-6	11	12	12	23	0
5-7	11	9	12	23	3
6-7	0	23	23	23	0
6-8	5	23	25	30	2
7-8	7	23	23	30	0
8-9	6	30	30	36	0

PATH	DURATION
1-2-5-7-8-9	32
1-2-4-6-7-8-9	36
1-2-4-6-8-9	34
1-4-6-7-8-9	31
1-4-6-8-9	29
1-3-6-7-8-9	34
1-3-6-8-9	32

- (b) (i) Sealed Bid Pricing
(ii) Penetration Pricing
(iii) Any price that the market will pay (even below variable cost any cash received)
(iv) Going rate pricing or market price
- (c) (i) In case Market Demand is High – Product H (Lower Variable Cost and Higher Fixed Cost)
(ii) In case Market Demand is Low – Product L

Question 7

Answer any 4 out of the following 5 questions:

- (a) what are the steps involved in the simulation process? (4 Marks)
(b) What are the limitations of the learning curve theory ? (4 Marks)
(c) Briefly explain the phases in the life cycle of a product. (4 Marks)
(d) Explain briefly Pareto analysis and mention some of its uses. (4 Marks)
(e) Explain the concept of Just In time approach in a production process. (4 Marks)

Answer**(a) Steps in Simulation Process**

1. Define the problem or system you intend to simulate.
2. Formulate the model you intend to use.
3. Test the model; compare its behavior with the behavior of the actual problem environment.
4. Identify and collect the data needed to test the model.
5. Run the simulation.
6. Analyse the results of the simulation and, if desired, change the solution you are evaluating.
7. Rerun the simulation to test the new solution.
8. Validate the simulation, that is, increase the chances that any inferences you draw about the real situation from running the simulation will be valid.

(b) Limitations of Learning Curve Theory

1. All activities of a firm are not subject to learning effect. (Activities that have not been performed in the present operational mode, those performed by new or unfamiliar employees are subjected to learning effect, while those performed by familiar or experienced workmen will not be subjected to learning effect)
2. It is correct that learning effect does take place and average time taken is likely to reduce. But in practice it is highly unlikely that there will be a regular consistent rate of decrease. Therefore any cost prediction based on conventional learning curves should be viewed with caution.
3. Considerable difficulty arises in obtaining valid data that will form basis for computation of learning effect.
4. Even slight change in circumstances quickly renders the learning curve obsolete. While the regularity of conventional learning curves can be questioned, it would be wrong to ignore learning effect altogether in predicting costs for decision purposes.

(c) Phases in Life Cycle of a Product

Phase	Characteristics
Introduction	Product is launched. Profits are almost non-existent. Competition is almost negligible.
Growth	Sales/ Profits rise rapidly. Competition enters. At phase end, profits begin to decline.
Maturity	Sales increases but at a declining rate. Some firms extend their product lines with new models.

Saturation and decline	Drop in sales volume, need for product demand disappears. Better and cheaper substitutes are available in the market.
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(d) Pareto Analysis

Pareto Analysis is based on 80:20 rule that was a phenomenon first observed by Vilfredo Pareto, a nineteenth century Italian economist. He noticed that 80% of the wealth of Milan was owned by 20% of its citizens. This phenomenon or some kind of approximation of it says, (70:30) can be observed in many different business situations. The Management can use it in a number of different circumstances to direct management attention to the key control mechanism or planning aspects.

That is, about 70 to 80% of the value corresponds to 30 to 20 % of the volume.

Use of Pareto Analysis

1. Prioritize problems, goals and objectives
2. Identify root causes
3. Select and define key quality improvement programs
4. Select key employee relations improvement programs
5. Select key customers relations and service programs
6. Maximise research and product development times
7. Verify operating procedures and manufacturing processes
8. Product or services sales and distribution
9. Allocate physical, financial and human resources

(e) Just in Time in Production Process

1. Products, Spare parts/materials are received directly at production floor. Inspection is completed before delivery of materials.
2. Setup time is minimized while also reducing long production runs, thereby eliminating defectives, scrap and product obsolescence.
3. Work-in-progress is reduced by use of kanban card or working cells or both.
4. Workers are trained on a variety of machines, allowed to stop machines when they identify a problem, fix it or call the repair team and adequately compensated.
5. Supporting systems such as administration, accounting and cost reporting are suitably modified to shift from the conventional mode to the improved JIT requirements.

PAPER – 6: INFORMATION SYSTEMS CONTROL AND AUDIT

Question No. 1 is compulsory.

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

Question 1

ABC Udyog, a leading automobile company is having several manufacturing units, located in different parts of the world and manufacturing several types of automobiles. The units are working on legacy systems using an internet and collating information, but using different software and varied platforms (Operating Systems) which do not allow communication with each other. This results in huge inflow of duplicate data.

The company wishes to centralize and consolidate the information flowing from its manufacturing units in a uniform manner across various levels of the organizations, so that the necessary data required for preparing MIS reports, budget, and profit/loss accounts etc. could be available timely.

The company decided to engage XYZ consultancy Services for the development of new system. Being a Senior Project Leader of the Consultancy Services, you are entrusted with the responsibilities of handling this project.

Read the above carefully and answer the following with justifications:

- (a) What areas are required to be studied in order to know about the present system? Write the problems that the ABC Udyog is presently facing. (5 Marks)
- (b) Will you suggest ERP solution to overcome the problems? If yes, explain why. (5 Marks)
- (c) What kind of training you will recommend to enrich the human resources for effective utilization of the proposed new system and standards? (5 Marks)
- (d) What are various backup techniques? Which backup technique, you will recommend and why? (5 Marks)

Answer

- (a) The following are the major areas, which should be studied in depth in order to understand the present system:
 - (i) **Review historical aspects:** A brief history of the organization is a logical starting point for an analysis of the present system. The historical facts shall identify the major turning points and milestones that have influenced its growth. A review of annual reports and organization charts can identify the growth of management levels as well as the development of various functional areas and departments.
 - (ii) **Analyze inputs:** A detailed analysis of the present inputs is important since they are basic to the manipulation of data. Source documents are used to capture the originating data for any type of system.

- (iii) **Review data files maintained:** The analyst should investigate the data files maintained by each department, noting their number and size, where they are located, who uses them and the number of times per given time interval these are used.
- (iv) **Review methods, procedures and data communications:** A system analyst also needs to review and understand the present data communications used by the organization. S/he must review the types of data communication equipments, including data interface, data links, modems, dial-up and leased lines and multiplexers.
- (v) **Analyze outputs:** The outputs or reports should be scrutinized carefully by the system analysts in order to determine 'how well they will meet the organization's needs'.
- (vi) **Review internal controls:** A detailed investigation of the present information system is not complete until internal controls are reviewed. Locating the control points helps the analyst to visualize the essential parts and framework of a system.
- (vii) **Model the existing physical system and logical system:** As the logic of inputs, methods, procedures, data files, data communications, reports, internal controls and other important items are reviewed and analyzed in a top down manner; the process must be properly documented.
- (viii) **Undertake overall analysis of present system:** The final phase of the detailed investigation includes the analysis of the present work volume; the current personnel requirements; the present benefits and costs and each of these must be investigated thoroughly.

Presently, ABC Udyog is facing the following major problems:

- The company having its branches all over the world, is engaged in manufacturing of several types of automobiles. The units are working on legacy systems using an internet and collating information. Each unit is using different type of software on varied platforms (operating systems), therefore, *they are not able to communicate with each other*. Because of this reason, *there is a huge inflow of data which could not be consolidated for analysis*.
 - Lack of communication among units has resulted *into duplication of the data entry*, which is very costly. In addition, *timely availability of necessary and relevant data* required for the preparation of MIS Reports, budget, profit/loss account etc. is another important concern in the present system.
 - It is confronted with the problem of *centralizing and consolidating the information flowing in from its various units* in uniform manner across various levels of the organization. Hence, there is an urgent need of a system that would entrust the company to address these important issues.
- (b) Yes, we recommend that ABC Udyog should implement ERP Solution to overcome the above mentioned problems. ERP implementation will bring different business functions, personalities, procedures, ideologies and philosophies on one platform. In addition, ERP effectively integrates different modules and brings worthwhile and beneficial changes throughout the organization.

Following are the major reasons to implement ERP solutions:

- It 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 etc. All these functions are effectively integrated for flow and update of information immediately upon entry of any information.
 - It facilitates company-wide Integrated Information System covering all functional areas like manufacturing, selling and distribution, payables, receivables, inventory, accounts, human resources, purchases etc.
 - It provides complete integration of systems not only across the departments but also across the companies under the same management.
 - It is the solution for better project management.
 - It allows automatic introduction of the latest technologies like Electronic Fund Transfer (EFT), Internet, Intranet, Video conferencing, E-Commerce etc.
 - It eliminates most business problems like material shortages, productivity enhancements, customer service, cash management, inventory problems, quality problems, prompt delivery etc.
 - It provides intelligent business tools like decision support system, Executive information system, Data mining and easy working systems to enable better decisions.
- (c) The human resources involved in the proposed new system and standards can be enriched by the following activities/trainings:
- **Training Personnel:** A system can succeed or fail depending on the way it is operated and used. Therefore, the quality of training received by the personnel involved with the system in various capacities helps in the successful implementation of the proposed system and standards. Thus, training is a major component of systems implementation. When a new system is acquired, which often involves new hardware and software, both users and computer experts need training organized by the vendor through hands-on learning techniques.
 - **Training Systems Operators:** The effective implementation of new systems and standards also depend on the computer-centre personnel, who are responsible for keeping the equipment running as well as for providing the necessary support services. Their training must ensure that they are able to handle all possible operations, both routine and extra-ordinary. As part of their training, operators should be given a trouble shooting list that identifies possible problems and remedies for them. Training also involves familiarization with run procedures, which involve working through the sequence of activities needed to use a new system on an on-going basis.

- **User's training:** User's training deals with the operation of the system itself. The users need to have the skill for using the functionality relevant to their roles. They should understand the basic concepts of ERP and also how to perform the day-to-day activities in the ERP system.
- **Managers' Training:** Others, who require training, include managers, who should have at least an appreciation of 'what the system does'. Ideally, the project manager should have a good understanding of all the aspects of the system so that s/he can be effective in dealing with any issues raised. It is also required to have managers directly involved in evaluating the effectiveness of training activities because training deficiencies can translate into reduced user productivity level.
- **System Administrators' Training:** The system administrators need to be able to setup the system and then maintain it. They will require knowledge about how to handle system security and deal with technical problems. They will need to develop a level of understanding of the functionality so that, at some stage after implementation when the project team is disbanded, they are able to manage the system smoothly.
- **Training other Personnel:** A selected number of people will require more specific technical training so that they can design databases, write scripts, manage users, generate reports and run query in the database for specific requirements.

(d) Various back-up techniques are described as follows:

- (i) **Full Backup:** A full backup captures all the files on the disk or within the folder selected for backup. With a full backup system, every backup generation contains every file in the backup set. However, the amount of time and space such a backup takes prevents it from being a realistic proposition for backing up a large amount of data.
- (ii) **Incremental Backup:** An incremental backup captures files that were created or changed since the last backup, regardless of backup type. This is the most economical method, as only the files that changed since the last backup are backed up. This saves a lot of backup time and space.

Normally, incremental backup are very difficult to restore. You will have to start with recovering the last full backup, and then recovering from every incremental backup taken since.

- (iii) **Differential Backup:** A differential backup stores files that have changed since the last full backup. Therefore, if a file is changed after the previous full backup, a differential backup takes less time to complete than a full back up. Comparing with full backup, differential backup is obviously faster and more economical in using the backup space, as only the files that have changed since the last full backup are saved.

Restoring from a differential backup is a two-step operation: Restoring from the last full backup; and then restoring the appropriate differential backup. The downside to

using differential backup is that each differential backup will probably include files that were already included in earlier differential backups.

- (iv) **Mirror back-up:** A mirror backup is identical to a full backup, with the exception that the files are not compressed in zip files and they can not be protected with a password. A mirror backup is most frequently used to create an exact copy of the backup data.

In the present system, we recommend incremental backup because ABC Udyog has manufacturing units working on the legacy systems. Secondly, incremental backup is the most economical method, as only the files that changed since the last backup are backed up. This saves a lot of backup time and space, which is the current need of the automobile company.

Question 2

- (a) Define the term "Information". Discuss various important attributes that are required for useful and effective information. (8 Marks)
- (b) At the end of analysis phase, the System Analyst prepares a document called "Systems Requirement Specifications (SRS)". Write the contents of SRS. (4 Marks)
- (c) What is the significance of Post Implementation Review? How it is performed? (4 Marks)

Answer

- (a) **Information:** Information is the data that have been put into a meaningful and useful context. It has been defined by Davis and Olson as-"Information is data that has been processed into a form that is meaningful to the recipient and is of real or perceived value in current or progressive decision". For example, data regarding sales by various salesmen can be merged to provide information regarding total sales through sales personnel. This information is of vital importance to a marketing manager who is trying to plan for future sales.

Attributes of Information: The important attributes of useful and effective information are as follows:

- **Availability:** This is a very important property of information. If information is not available at the time of need, it is useless. Data is organized in the form of facts and figures in databases and files from where various information is derived for useful purpose.
- **Purpose:** Information must have purposes at the time, it is transmitted to a person or machine, otherwise it is simple data. Information communicated to people has a variety of purposes because of the variety of activities performed by them in business organizations. The basic purpose of information is to inform, evaluate, persuade, and organize.
- **Mode and format:** The modes of communicating information to humans are sensory (through sight, hear, taste, touch and smell) but in business they are either

visual, verbal or in written form. Format of information should be so designed that it assists in decision making, solving problems, initiating planning, controlling and searching.

- **Decay:** Value of information usually decays with time and usage and so it should be refreshed from time to time. For example, we access the running score sheet of a cricket match through Internet sites and this score sheet is continually refreshed at a fixed interval or based on status of the state.
- **Rate:** The rate of transmission/reception of information may be represented by the time required to understand a particular situation. Quantitatively, the rate for humans may be measured by the number of numeric characters transmitted per minute, such as sales reports from a district office. For machines the rate may be based on the number of bits of information per character (sign) per unit of time.
- **Frequency:** The frequency with which information is transmitted or received affects its value. Financial reports prepared weekly may show so little changes that they have small value, whereas monthly reports may indicate changes big enough to show problems or trends.
- **Completeness:** The information should be as complete as possible. The classical ROI or Net Present Value (NPV) models just provide a point estimate and do not give any indication of the range within which these estimates may vary. Hartz's model for investment decisions provides information on mean, standard deviation and the shape of the distribution of ROI and NPV. With this complete information, the manager is in a much better position to decide whether or not to undertake the venture.
- **Reliability:** It is just not authenticity or correctness of information; rather technically it is a measure of failure or success of using information for decision making. If information leads to correct decision on many occasions, we say the information is reliable.
- **Validity:** It measures the closeness of the information to the purpose which it purports to serve. For example, some productivity measure may not measure, for the given situation, what they are supposed to do e.g., the real rise or fall in productivity. The measure suiting the organization may have to be carefully selected or evolved.
- **Quality:** Quality refers to the correctness of information. Information is likely to be spoiled by personal bias. For example, an over-optimistic salesman may give rather too high estimates of the sales. This problem, however, can be circumvented by maintaining records of salesman's estimates and actual sales and deflating or inflating the estimates in the light of this.
- **Transparency:** If information does not reveal directly 'what we want to know for decision-making', it is not transparent. For example, total amount of advance does not give true picture of utilization of fund for decision about future course of action; rather deposit-advance ratio is perhaps more transparent information in this matter.

- **Value of information:** It is defined as difference between the value of the change in decision behavior caused by the information and the cost of the information. In other words, given a set of possible decisions, a decision-maker may select one on basis of the information at hand. If new information causes a different decision to be made, the value of the new information is the difference in value between the outcome of the old decision and that of the new decision, less the cost of obtaining the information.
 - **Adequacy:** To be useful, an information must be adequate so that the desired actions can be initiated. Required information should flow on different directions within the organization and to and from its environment. Further, the type of information that flows within the organization or across, it should have adequate and relevant contents.
- (b) At the end of the analysis phase, the System Analyst prepares a document called "Systems Requirement Specifications (SRS)". A SRS contains the following:
- **Introduction:** Goals and Objectives of the software context of the computer-based system;
 - **Information Description:** Problem description; Information content, flow and structure; Hardware, software, human interfaces for external system elements and internal software functions.
 - **Functional Description:** Diagrammatic representation of functions; Processing narrative for each function; Interplay among functions; Design constraints.
 - **Behavioral Description :** Response to external events and internal controls
 - **Validation Criteria:** Classes of tests to be performed to validate functions, performance and constraints.
 - **Appendix:** Data flow / Object Diagrams; Tabular Data; Detailed description of algorithms charts, graphs and other such material.
 - **SRS Review :** It contains the following :
 - The development team makes a presentation and then hands over the SRS document to be reviewed by the user or customer.
 - The review reflects the development team's understanding of the existing processes. Only after ensuring that the document represents existing processes accurately, should the user sign the document. This is a technical requirement of the contract between users and development team / organization.
- (c) A Post Implementation Review answers the question "Did we achieve what we set out to do in business terms?" It examines the efficacy of all elements of the working business solution to see if further improvements can be made to optimize the benefits delivered.

After a development project is completed, a post implementation review should be performed to determine if the anticipated benefits were achieved. Reviews help to control project development activities. The full scope of a post implementation review ("PIR") will depend largely on the scale and complexity of the project.

The post implementation review is performed jointly by the project development team and the appropriate end users. Alternatively, an independent group not associated with the development process, either internal or external, should carry out the audit, to meet the following objectives:

- *Business objectives* e.g. delivered within budget and deadline; producing predicted savings and benefits, etc.;
- *User expectations* e.g. user friendly, carries the workload, produces the required outputs, good response time, reliable, good ergonomics, etc.;
- *Technical requirements* e.g. capable of expansion, easy to operate and maintain, interfaces with other systems, low running cost, etc.

The PIR is undertaken after any changes and tuning that are necessary to achieve a stable system have been completed, and any significant problems have had a chance to surface. Sufficient time should also be allowed for the system's users to become familiar with it. These criteria should be met between six and twelve months after implementation. If the PIR is delayed beyond twelve months there will be an increasing risk that changing requirements - leading to further releases of the system - will obscure the outcome from the original development; also, that the need for a PIR will be overtaken by other priorities.

Question 3

- (a) *How will you define a risk assessment? Briefly explain various review areas to be focused upon.* (8 Marks)
- (b) *Following are involved in the System Development Life Cycle(SDLC). Discuss their roles:*
- (i) *Project Manager*
 - (ii) *System Analyst*
 - (iii) *Database Administrator (DBA)*
 - (iv) *IS Auditor* (4 Marks)
- (c) *Draw the flowchart to find the sum of first 50 even numbers, starting from 2.* (4 Marks)

Answer

- (a) Risk assessment is the analysis of threats to resources (assets) and the determination of the amount of protection necessary to adequately safeguard the resources, so that vital systems, operations, and services can be resumed to normal status in the minimum time in case of a disaster. Risk assessment is a useful technique to assess the risks involved

in the event of unavailability of information, to priorities applications, identify exposures and develop recovery scenarios.

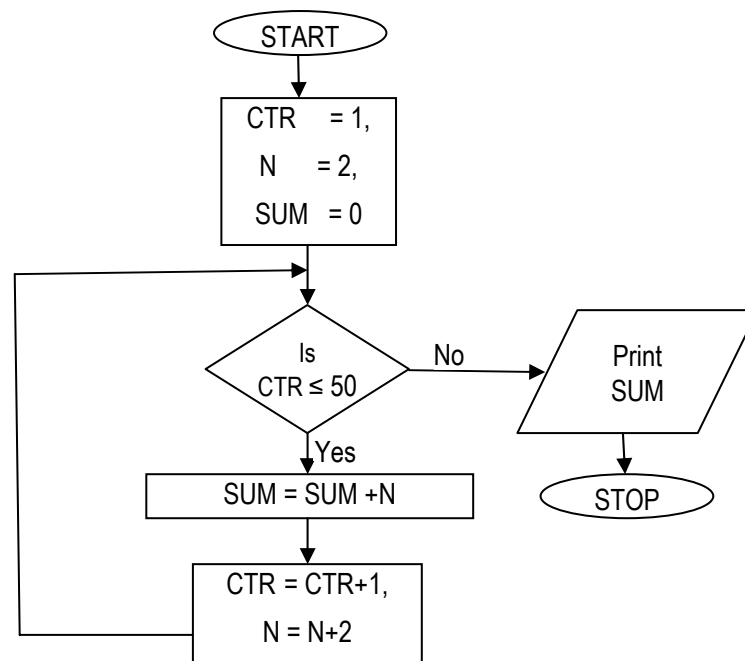
The areas to be focused upon for review are given below:

- (a) **Prioritization:** All applications are inventoried and critical ones identified. Each of the critical applications is reviewed to assess its impact on the organization, in case a disaster occurs. Subsequently, appropriate recovery plans are developed.
- (b) **Identifying critical applications:** Amongst the applications currently being processed the critical applications are identified. Further analysis is done to determine specific jobs in the applications which may be more critical. Even though the critical value would be determined based on its present value, future changes should not be ignored.
- (c) **Assessing their impact on the organization:** Business continuity planning should not concentrate only on business disruption but should also take into account other organizational functions which may be affected. The areas to be considered include:
 - Legal liabilities;
 - Interruptions of customer services;
 - Possible losses; and
 - Likelihood of fraud and recovery procedures.
- (d) **Determining recovery time-frame:** Critical recovery time period is the period of time in which business processing must be resumed before the organization incurs severe losses. This critical time depends upon the nature of operations. It is essential to involve the end users in the identification of critical functions and critical recovery time period.
- (e) **Assess Insurance coverage:** The information system insurance policy should be a multiperil policy, designed to provide various types of coverage. Depending on the individual organization and the extent of coverage required, suitable modifications may be made to the comprehensive list, which include various items namely, hardware facilities, software reconstruction, extra expenses, business interruption, valuable paper and records, Errors and omissions, fidelity coverage, and media transportation.
- (f) **Identification of exposures and implications:** It is not possible to accurately predict as to when and how a disaster would occur. So, it is necessary to estimate the probability and frequency of disaster.
- (g) **Development of recovery plan:** The plan should be designed to provide for recovery from total destruction of a site.
- (b) (i) **Project Manager :** A project manager is normally responsible for more than one project and liaisons with the client or the affected functions. S/he is responsible for

delivery of the project within the time and budget and periodically reviewing the progress of the project with the project leader and his/her team.

- (ii) **Systems Analyst:** The systems/business analysts' main responsibility is to conduct interviews with users and understand their requirements. S/he is a link between the users and the programmers to convert the users requirements in the system requirements and plays a pivotal role in the Requirements analysis and Design phase.
- (iii) **Database Administrator (DBA) :** The data in a database environment has to be maintained by a specialist in database administration so as to support the application program. The DBA handles multiple projects; ensures the integrity and security of information stored in the database and also helps the application development team in database performance issues. Inclusion of new data elements has to be done only with the approval of the database administrator.
- (iv) **IS Auditor :** As a member of the team, IS Auditor ensures that the application development also focuses on the control perspective. He should be involved at the Design Phase and the final Testing Phase to ensure the existence and the operations of the Controls in the new software.

(c)



Question 4

(a) Explain the various general components of Disaster Recovery Plan.'

(6 Marks)

- (b) *What is Data Privacy? Explain the major techniques that are used to address Privacy Protection for IT Systems.* (6 Marks)
- (c) *In what ways, an audit trails is used to support security objectives? Describe each one of them.* (4 Marks)

Answer

(a) The general components of a disaster recovery plan are given as follows:

- The conditions for activating the plans, which describe the process to be followed before each plan, are activated.
- Emergency procedures, which describe the actions to be taken following an incident which jeopardizes business operations and/or human life. This should include arrangements for public relations management and for effective liaison with appropriate public authorities e.g. police, fire, services and local government.
- Fallback procedures, which describe the actions to be taken to move essential business activities or support services to alternate temporary locations, to bring business process back into operation in the required time-scale.
- Resumption procedures, which describe the actions to be taken to return to normal business operations.
- A maintenance schedule, which specifies how and when the plan will be tested, and the process for maintaining the plan.
- Awareness and education activities, which are designed to create an understanding of the business continuity, process and ensure that the business continues to be effective.
- The responsibilities of individuals describing who is responsible for executing which component of the plan. Alternatives should be nominated as required.
- Contingency plan document distribution list.
- Detailed description of the purpose and scope of the plan.
- Contingency plan testing and recovery procedure.
- List of vendors doing business with the organization, their contact numbers and address for emergency purposes.
- Checklist for inventory taking and updating the contingency plan on a regular basis.
- List of phone numbers of employees in the event of an emergency.
- Emergency phone list for fire, police, hardware, software, suppliers, customers, back-up location, etc.
- Medical procedure to be followed in case of injury.
- Back-up location contractual agreement, correspondences.
- Insurance papers and claim forms.

- Primary computer centre hardware, software, peripheral equipment and software configuration.
- Location of data and program files, data dictionary, documentation manuals, source and object codes and back-up media.
- Alternate manual procedures to be followed such as preparation of invoices.
- Names of employees trained for emergency situation, first aid and life saving techniques.
- Details of airlines, hotels and transport arrangements.

The answer stated above described general components of a Disaster Recovery Plan(DRP). However, these components can be categorized under the four heads namely, Emergency Plan, Recovery Plan, Backup Plan and Test Plan. The solution to the question can also be presented as follows:

The general components of the disaster recovery plan which is described as the contingency measures that organizations have adopted at key computing sites to recover from, or to prevent any monumentally bad event or disaster are as follows:

- **Emergency Plan:** This part of the Disaster Recovery Plan (DRP) outlines the actions to be undertaken immediately after a disaster occurs. It identifies the personnel to be notified immediately, for example, fire service, police, management, insurance company etc. It provides guidelines on shutting down the equipment, termination of power supply, removal of storage files and disks, if any. It sets out evacuation procedures like sounding the alarm bell, activating fire extinguishers, evacuation of personnel. It also provides return procedures as soon as the primary facility is ready for operation like backing up data files at offsite, deleting data from disk drives at third party's site, relocation of proper versions of backup files, etc.
- **Recovery Plan:** This part of the DRP sets out how the full capabilities will be restored. A recovery committee is constituted. Preparing specifications of recovery like setting out priorities for recovery of application systems, hardware replacement etc. will be the responsibility of the Recovery Committee. The following steps may be carried out under this plan:
 - (i) An inventory of the hardware, application systems, system software, documentation etc. must be taken.
 - (ii) Criticality of application systems to the organization and the importance of their loss must be evaluated. An indication must be given of the efforts and cost involved in restoring the various application systems.
 - (iii) An application systems hierarchy must be spelt out.
 - (iv) Selection of a disaster recovery site must be made. A reciprocal agreement with another organization having compatible hardware and software could be made.

- (v) A formal back agreement with another company must be made. This should cover the periodical exchange of information between the two sites regarding changes to hardware/software, the time and duration of systems availability, modalities of testing the plan etc.
 - **Backup Plan:** Organizations no matter how physically secure, their systems are always vulnerable to the disaster. Therefore, an effective safeguard is to have a backup of anything that could be destroyed, be it hardware or software. As regards hardware, stand by must be kept with regard to the needs of particular computer environments. So far as the software is concerned, it is necessary to make copies of important programs, data files, operating systems and test programs etc. The backup copies must be kept in a place, which is not susceptible to the same hazards as the originals.
 - **Test Plan:** To provide assurance that the disaster recovery plan is complete, it should be tested, several times. A disaster recovery test plan contains information for simulating various levels of disasters and recording an organization's ability to cover. Any needed recovery actions that are not specified in the plan should be added.
- (b) **Data Privacy:** This refers to the evolving relationship between technology and the legal right to, or public expectation of privacy in the collection and sharing of data. Privacy problems exist wherever uniquely identifiable data relating to a person or persons are collected and stored, in digital form or otherwise. Improper or non-existent disclosure control can be the root cause for privacy issues. The most common sources of data that are affected by data privacy issues are:
- Health information,
 - Criminal justice,
 - Financial information,
 - Genetic information, and
 - Location information.

Privacy protection for IT systems: Increasingly, as heterogeneous information systems with different privacy rules are interconnected, technical control and logging mechanisms (policy appliances) will be required to reconcile, enforce and monitor privacy policy rules (and laws) as information is shared across systems and to ensure accountability for information use. There are several technologies to address privacy protection in enterprise IT systems. These falls into two categories: communication and enforcement.

(i) **Policy Communication**

- **P3P** – This is the Platform for Privacy Preferences. P3P is a standard for communicating privacy practices and comparing them to the preferences of individuals.

(ii) Policy Enforcement

- XACML - The extensible Access Control Markup Language (XACML) together with its Privacy Profile is a standard for expressing privacy policies in a machine readable language which a software system can use to enforce the policy in enterprise IT systems.
- EPAL - The Enterprise Privacy Authorization Language (EPAL) is very similar to XACML, but is not yet a standard.
- WS-Privacy - "Web Service Privacy" will be a specification for communicating privacy policy in web services. For example, it may specify how privacy policy information can be embedded in the SOAP envelope of a web service message.

(c) Audit trails can be used to support security objectives in three ways:

- Detecting unauthorized access to the system,
- Facilitating the reconstruction of events, and
- Promoting personal accountability.

A brief discussion on each of them is given as follows:

- (i) Detecting Unauthorized Access:** Detecting unauthorized access can occur in real time or after the fact. The primary objective of real-time detection is to protect the system from outsiders who are attempting to breach system controls. A real-time audit trail can also be used to report on changes in system performance that may indicate infestation by a virus or worm. After-the-fact detection logs can be stored electronically and reviewed periodically or as needed. When properly designed, they can be used to determine if unauthorized access was accomplished, or attempted and failed.
- (ii) Reconstructing Events:** Audit analysis can be used to reconstruct the steps that led to events such as system failures, security violations by individuals, or application processing errors. Knowledge of the conditions that existed at the time of a system failure can be used to assign responsibility and to avoid similar situations in the future.
- (iii) Personal Accountability:** Audit trails can be used to monitor user activity at the lowest level of detail. This capability is a preventive control that can be used to influence behavior. Individual accountability will normally increase because their actions will be recorded in an audit log.

Question 5

- (a) As a system auditor, what control measures will you check to minimize threats, risks and exposures to a computerized system?* (8 Marks)
- (b) Describe the advantage and disadvantage of Continuous Auditing Techniques in brief.* (4 Marks)

- (c) *What are commonly used techniques to assess and evaluate risks? Explain each one of them.* (4 Marks)

Answer

- (a) Various control measures that will be checked by the system auditor to minimize threats, risks and exposures in a computerized system are discussed below:
- (i) **Lack of integrity:** Control measures to ensure integrity include implementation of security policies, procedures and standards, use of encryption techniques and digital signatures, inclusion of data validation, editing, and reconciliation techniques for inputs, processes and outputs, updated antivirus software, division of job and layered control to prevent impersonation, use of disk repair utility, implementation of user identification, authentication and access control techniques, backup of system and data, security awareness programs and training of employees, installation of audit trails, and audit of adequacy of data integrity etc.
 - (ii) **Lack of confidentiality:** Control measures to ensure confidentiality include use of encryption techniques and digital signatures, implementation of a system of accountability by logging and journaling system activity, development of a security policy, procedures and standards, employee awareness and training, requiring employees to sign a non-disclosure undertaking, implementation of physical and logical access controls, use of passwords and other authentication techniques, establishment of a documentation and distribution schedule, secure storage of important media and data files, installation of audit trails, and audit of confidentiality of data.
 - (iii) **Lack of system availability:** Control measures to ensure availability include implementation of software configuration controls, a fault tolerant hardware and software for continuous usage and an asset management software to control inventory of hardware and software, insurance coverage, system backup procedure to be implemented, implementation of physical and logical access controls, use of passwords and other authentication techniques, incident logging and report procedure, backup power supply, updated antivirus software, security awareness programs and training of employees, installation of audit trails, audit of adequacy of availability safeguards.
 - (iv) **Unauthorized users attempt to gain access to the system and system resources:** Control measures to stop unauthorized users to gain access to system and system resources include identification and authentication mechanism such as passwords, biometric recognition devices, tokens, logical and physical access controls, smart cards, disallowing the sharing of passwords, use of encryption and checksum, display of warning messages and regular audit programs. Data transmitted over a public or shared network may be intercepted by an unauthorized user, security breaches may occur due to improper use or bypass of available security features, strong identification and authentication mechanisms such as

biometric, tokens, layered system access controls, documentation procedures, quality assurance controls and auditing.

- (v) **Hostile software e.g. virus, worm, Trojan horses, etc.:** Establishment of policies regarding sharing and external software usage, updated anti-virus software with detection, identification and removal tools, use of diskless PCs and workstations, installation of intrusion detection and prevention tools and network filter tools such as firewalls, use of checksums, cryptographic checksums and error detection tools for sensitive data, installation of change detection tools, protection with permissions required for the 'write' function.
 - (vi) **Disgruntled employees:** Control measures to include installation of physical and logical access controls, logging and notification of unsuccessful logins, use of disconnect feature on multiple unsuccessful logins, protection of modem and network devices, installation of one time use only passwords, security awareness programs and training of employees, application of motivation theories, job enrichment and job rotation.
 - (vii) **Hackers and computer crimes:** Control measures to include installation of firewall and intrusion detection systems, change of passwords frequently, installation of one time use passwords, discontinuance of use of installed and vendor installed passwords, use of encryption techniques while storage and transmission of data, use of digital signatures, security of modem lines with dial back modems, use of message authentication code mechanisms, installation of programs that control change procedures, and prevent unauthorized changes to programs, installation of logging feature and audit trails for sensitive information.
 - (viii) **Terrorism and industrial espionage:** Control measures to include usage of traffic padding and flooding techniques to confuse intruders, use of encryption during program and data storage, use of network configuration controls, implementation of security labels on sensitive files, usage of real-time user identification to detect masquerading, installation of intrusion detection programs.
- (b) **Continuous Auditing Technique:** Continuous auditing enables auditors to shift their focus from the traditional 'transaction' audit to the 'system and operations' audit.

Advantages: Some of the advantages of continuous audit techniques are as under:

- *Timely, comprehensive and detailed auditing:* Evidence would be available more timely and in a comprehensive manner. The entire processing can be evaluated and analyzed rather than examining the inputs and the outputs only.
- *Surprise test capability:* As evidences are collected from the system itself by using continuous audit techniques, auditors can gather evidence without the systems staff and application system users being aware that evidence is being collected at that particular moment. This brings in the surprise test advantages.

- *Information to system staff on meeting of objectives:* Continuous audit techniques provides information to systems staff regarding the testing to be used in evaluating whether an application system meets the objectives of asset safeguarding, data integrity, effectiveness, and efficiency.
- *Training for new users:* Using the ITFs, new users can submit data to the application system, and obtain feedback on any mistakes they make via the system's error reports.

Disadvantages: The following are some of the disadvantages and limitations of the continuous audit system:

- Auditors should be able to obtain resources required from the organization to support development, implementation, operation, and maintenance of continuous audit techniques.
- Continuous audit techniques are more likely to be used if auditors are involved in the development work associated with a new application system.
- Auditors need the knowledge and experience of working with computer systems to be able to use continuous audit techniques effectively and efficiently.
- Continuous auditing techniques are more likely to be used where the audit trail is less visible and the costs of errors and irregularities are high.
- Continuous audit techniques are unlikely to be effective unless they are implemented in an application system that is relatively stable.

(c) Following are the most commonly used techniques to access and evaluate risks:

- Judgment and intuition,
- The Delphi Approach,
- Scoring,
- Quantitative Techniques, and
- Qualitative Techniques.

A brief discussion on each of them is given as follows:

- (i) **Judgment and intuition:** In many situations, the auditors have to use their judgment and intuition for risk assessment. This mainly depends on the personal and professional experience of the auditors and their understanding of the system and its environment. Together with it, systematic education and ongoing professional updating is also required.
- (ii) **The Delphi Approach:** This technique is used for obtaining a consensus opinion. A panel of experts is engaged and each expert is asked to give his opinion in a written and independent method. They enlist the estimate of the cost benefits and the reasons why a particular system is to be chosen, the risks and exposures of the system. These estimates are then compiled together. The estimates falling within a

pre-decided acceptable range are taken. The process may be repeated four times for revising estimates falling beyond the range. Then a curve is drawn taking all the estimates as points on the graphs. The median is drawn and this is the consensus opinion.

- (iii) **The Scoring Approach:** In this approach, the risks in the system and their respective exposures are listed. Weights are then assigned to the risks and to the exposures depending on the severity, impact of occurrence and costs involved. The product of the risk weight with the exposure weight of every characteristic gives the weighted score. The sum of these weighted score gives the risk and exposure score of the system. System risks and exposures are then ranked according to the scores.
- (iv) **Quantitative Techniques:** Quantitative techniques involve the calculating of an annual loss exposure value based on the probability of the event and the exposure in terms of estimated costs. This helps the organization to select cost effective solutions. It is the assessment of potential damage in the event of occurrence of unfavorable events, keeping in mind how often such an event may occur.
- (v) **Qualitative Techniques:** These are by far the most widely used approach to risk analysis. Probability data is not required and only estimated potential loss is used. Most qualitative risk analysis methodologies make use of a number of interrelated elements, namely, threats, vulnerabilities, and controls.

Question 6

- (a) *What is the significance of a Business Impact Analysis? Enumerate the tasks to be undertaken in this analysis. In what ways the information can be obtained for this analysis?* (8 Marks)
- (b) *Give the hierarchy of Information Security Policies and discuss each one of them.* (4 Marks)
- (c) *Describe the composition and powers of Cyber Regulatory Appellate Tribunal.* (4 Marks)

Answer

- (a) **Business Impact Analysis:** Business Impact Analysis (BIA) is essentially a means of systematically assessing the potential impacts resulting from various events or incidents. It enables the business continuity team to identify critical systems, processes and functions, assess the economic impact of incidents and disasters that result in a denial of access to the system, services and facilities, and assess the "pain threshold," that is, the length of time business units can survive without access to the system, services and facilities.

The business impact analysis is intended to help and understand the degree of potential loss (and various other unwanted effects), which could occur. This will cover not just direct financial loss, but other issues, such as reputation damage, regulatory effects, etc.

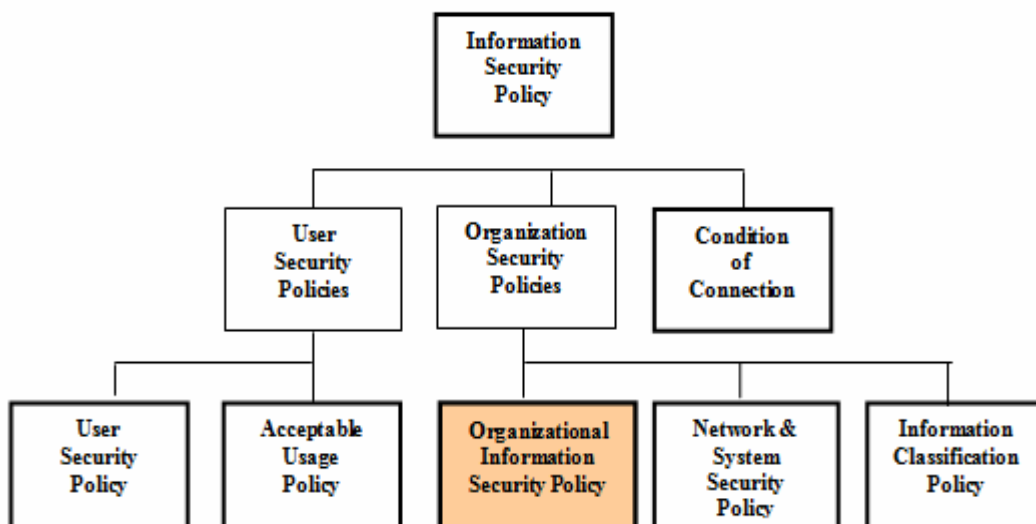
A number of tasks are to be undertaken in this phase as enumerated under:

- (i) Identify organizational risks - This includes single point of failure and infrastructure risks. The objective is to identify risks and opportunities and to minimize potential threats that may lead to a disaster.
- (ii) Identify critical business processes.
- (iii) Identify and quantify threats/ risks to critical business processes both in terms of outage and financial impact.
- (iv) Identify dependencies and interdependencies of critical business processes and the order in which they must be restored.
- (v) Determine the maximum allowable downtime for each business process.
- (vi) Identify the type and the quantity of resources required for recovery e.g. tables, chairs, faxes, photocopies, safes, desktops, printers, etc.
- (vii) Determine the impact to the organization in the event of a disaster, e.g. financial reputation, etc.

There are a number of ways to obtain this information:

- Questionnaires,
- Workshops,
- Interviews, and
- Examination of documents.

- (b) The hierarchy of various Information Security Policies is shown in the following figure:



Each of the Information Security Policy given in the above figure is briefly discussed below:

- **Information Security Policy** – This policy provides a definition of Information Security, its overall objective and the importance that applies to all users.
 - **User Security Policy** – This policy sets out the responsibilities and requirements for all IT system users. It provides security terms of reference for Users, Line Managers and System Owners.
 - **Acceptable Usage Policy** – This sets out the policy for acceptable use of email and Internet services.
 - **Organizational Information Security Policy** – This policy sets out the Group policy for the security of its information assets and the Information Technology (IT) systems processing this information. Though it is positioned at the bottom of the hierarchy, it is the main IT security policy document.
 - **Network & System Security Policy** – This policy sets out detailed policy for system and network security and applies to IT department users
 - **Information Classification Policy** - This policy sets out the policy for the classification of information
 - **Conditions of Connection** – This policy sets out the Group policy for connecting to their network. It applies to all organizations connecting to the Group, and relates to the conditions that apply to different suppliers' systems.
- (c) **Cyber Regulatory Appellate Tribunal:** As per Information Technology (Amendment) Act, 2008, the cyber regulation appellate tribunal shall consist of one person only called the Presiding Officer of the Tribunal who shall be appointed by the Central Government. The person must be qualified to be a Judge of a High Court or is or has been a member of Indian Legal Services in the post in Grade I of that service for at least three years. The Presiding Officer shall hold the office for a term of five years or upto a maximum age limit of 65 years, whichever is earlier.

Some of the powers specified are given as follows:

- (i) Summoning and enforcing the attendance of any person and examining him on oath;
- (ii) Requiring the discovery and production of documents or other electronic records;
- (iii) Receiving evidence on affidavits;
- (iv) Issuing commissions for examination of witnesses or documents;
- (v) Reviewing the decisions;
- (vi) Dismissing an application for default or deciding its ex party;
- (vii) Any other matter which may be prescribed.

Question 7

Write Short Notes on any **FOUR** of the following:

- (a) *Objectives of an Operating System* (4 Marks)
- (b) *Information System Maintenance* (4 Marks)
- (c) *Client/ Server Technology* (4 Marks)
- (d) *Locks on Doors with respect to Physical Access Control* (4 Marks)
- (e) *HIPAA* (4 Marks)

Answer

- (a) **Objectives of an Operating System** : An operating system (OS) is a program that controls the execution of an application program and acts as an interface between the user of a computer and computer hardware. The purpose of an OS is to provide an environment in which a user can execute programs in a convenient and efficient manner. An operating system is an important part of almost every computer system. It is considered to be the backbone of a computer, managing both software and hardware resources. Operating systems are responsible for everything from the control and allocation of memory to recognizing input from external devices and transmitting output to computer displays. They also manage files on computer hard drives and control peripherals, like printers and scanners.

Major objectives/functions of an operating system are given as follows:

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

devices. Such information is usually maintained for the purpose of charging users' departments for their use of the organization's computing resources.

- (b) **Information System Maintenance** : Maintaining the system is an important aspect of SDLC. As key personnel change positions in the organization, new changes will be implemented, which will require system updates. 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 organizational requirements.

Maintenance can be categorized in the following ways:

- *Scheduled maintenance*: Scheduled maintenance is anticipated and can be planned for. For example, the implementation of a new inventory coding scheme can be planned in advance.
- *Rescue maintenance*: 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.
- *Corrective maintenance*: Corrective maintenance deals with fixing bugs in the code or defects found. A defect can result from design errors, logic errors; coding errors, data processing and system performance errors. The need for corrective maintenance is usually initiated by bug reports drawn up by the end users. Examples of corrective maintenance include correcting a failure to test for all possible conditions or a failure to process the last record in a file.
- *Adaptive maintenance*: Adaptive maintenance consists of adapting software to changes in the environment, such as the hardware or the operating system. The term environment in this context refers to the totality of all conditions and influences which act from outside upon the system, for example, business rule, government policies, work patterns, software and hardware operating platforms. The need for adaptive maintenance can only be recognized by monitoring the environment.
- *Perfective maintenance*: Perfective maintenance mainly deals with accommodating to new or changed user requirements and concerns functional enhancements to the system and activities to increase the system's performance or to enhance its user interface.
- *Preventive maintenance*: Preventive maintenance concerns activities aimed at increasing the system's maintainability, such as updating documentation, adding comments, and improving the modular structure of the system. The long-term effect of corrective, adaptive and perfective changes increases the system's complexity. As a large program is continuously changed, its complexity, which reflects deteriorating structure, increases unless work is done to maintain or reduce it. This work is known as preventive change.

- (c) **Client/Server Technology** : Client/Server (C/S) technology refers to computing technologies in which the hardware and software components (i.e., clients and servers) are distributed across a network. The client/server software architecture is a versatile, message-based and modular infrastructure that is intended to improve usability, flexibility, interoperability, and scalability as compared to centralized, mainframe, time sharing computing. This technology includes both the traditional database-oriented C/S technology, as well as more recent general distributed computing technologies. The use of LANs has made the client/server model even more attractive to organizations.

Client/server is described as a 'cost-reduction' technology. Some of the Implementation examples of client / server technology are: Online banking application, internal call centre application, Applications for end-users that are stored in the server etc. Major characteristics that reflect the key features of a client / server system are given as follows:

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

- (d) **Locks on Doors with respect to physical access control:** Different types of locks on doors for physical security are discussed below:

- **Cipher Locks (combination Door Locks):** The Cipher Lock consists of a pushbutton panel that is mounted near the door outside of a secured area. There are ten numbered buttons on the panel. To enter, a person presses a four digit number sequence, and the door will unlock for a predetermined period of time, usually ten to thirty seconds.

Cipher Locks are used in low security situations or when a large number of entrances and exits must be usable all the time. More sophisticated and expensive cipher locks can be computer coded with a person's handprint. A matching handprint unlocks the door.

- **Bolting Door Locks:** A special metal key is used to gain entry when the lock is a bolting door lock. To avoid illegal entry the keys should not be duplicated.
 - **Electronic Door Locks:** A magnetic or embedded chip based plastics card key or token may be entered into a sensor reader to gain access in these systems. The sensor device upon reading the special code that is internally stored within the card activates the door locking mechanism.
 - **Biometric Door Locks:** These locks are extremely secure where an individual's unique body features, such as voice, retina, fingerprint or signature, activate these locks. This system is used in instances when extremely sensitive facilities must be protected, such as in the military.
- (e) **HIPAA :** Health Insurance Portability and Accountability Act (HIPAA) was enacted by the U.S. Congress in 1996. Major points are given as follows:
- Title I of HIPAA protects health insurance coverage for workers and their families when they change or lose their jobs.
 - Title II of HIPAA, the Administrative Simplification (AS) provisions, requires the establishment of national standards for electronic health care transactions and national identifiers for providers, health insurance plans, and employers. The AS provisions also address the security and privacy of health data. The standards are meant to improve the efficiency and effectiveness of the nation's health care system by encouraging the widespread use of electronic data interchange in the US health care system. What is of interest here is the Security Rule issued under the Act.

PAPER – 7 : DIRECT TAX LAWS

Working notes should form part of the answer.

Question No.1 is compulsory.

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

Question 1

- (a) Jyoti Education Centre, a charitable institution registered under section 12AA of the Income-tax Act, 1961 runs schools for primary and secondary education. The following particulars pertaining to the previous year 2010-11 are furnished to you by the institution:

		₹ in lakhs
(i)	Gross Receipts from students towards admission fees, tuition fees, development fees, laboratory fees etc.	152.75
(ii)	Dividend received on units of mutual funds specified in section 10(23D)	16.00
(iii)	Donations received (including anonymous donation ₹ 2.50 lakh)	10.50
(iv)	Grant from State Government	7.25
(v)	Amount applied for purposes of schools	90.60
(vi)	Purchase of computers and laboratory equipments	21.40
(vii)	Included in (v) above, a sum of ₹ 3.50 lakh, being the amount applied for the benefit of the founder of the institution	
(viii)	The institution had accumulated ₹ 20 lakh under section 11(2) in the previous year 2007-08 for a period of two years for acquiring and developing a plot of land for construction of a new school. Land was purchased for ₹ 15 lakh and development was made at a cost of ₹ 2 lakh in the previous year 2010-11	
(ix)	Excess of expenditure over income in the previous year 2009-10.	35.00

Compute total income of the institution and tax payable by it for the Assessment Year 2011-12. (10 Marks)

- (b) A Limited engaged in manufacturing activity has the following immovable properties as on 31st March, 2011. State, with reasons, whether the assets are chargeable to wealth tax on the valuation date 31st March, 2011.
- (i) A plot of agricultural land in Chennai acquired on 1st January, 2009 for conversion into non-agricultural land to be used for opening a new factory. The approval of the Tamil Nadu State Government for conversion into industrial land was obtained on 1st November, 2010. The development activity for conversion was in progress on 31st March, 2011.

The Suggested Answers for Paper 7: Direct Tax Laws are based on the provisions applicable for A.Y. 2011-12, which is the assessment year relevant for November 2011 examination.

- (ii) A building is under construction at Coimbatore. The said building after construction will be used partly for accommodating senior executives each having annual salary exceeding ₹ 5 lakh and partly as guest house. (4 Marks)
- (c) Madhav, a child artist acting in laughter shows, accumulated income of ₹ 25 lakh over a short span of time. The same was put into securities by his mother, who is also the guardian. The securities were sold in the P.Y. 2010-11 resulting in capital gain of ₹ 10 lakh, which was invested in a plot of land in urban area. The Assessing Officer proposes to include the value of the land in computation of net wealth of the mother under section 4(1) on the valuation date. Is the proposition of the Assessing Officer justified in law? (3 Marks)
- (d) "The rules laid down in Schedule III to the Wealth-tax Act, 1957 are not binding on the Valuation Officer." Examine the correctness of the statement. (3 Marks)

Answer**(a) Computation of total income of Jyoti Education Centre for the P.Y.2010-11**

Particulars	₹	₹
Gross receipts from students towards admission fees, tuition fees, development fees, lab fees etc.	1,52,75,000	
Less: Amount applied for purposes of schools assumed as revenue expenditure incurred for earning income (Note 1)	87,10,000	
	65,65,000	
Donations (other than anonymous donations) (Note 4)	8,00,000	
	73,65,000	
Less: 15% eligible for exemption	11,04,750	
	62,60,250	
Less: Application for the purposes of the institution		
Purchase of computers and lab equipments (Note 6)	21,40,000	
Excess of expenditure over income in the P.Y.2009-10 (Note 7)	35,00,000	
		6,20,250
Add: Application for the benefit of founder chargeable u/s 12(2) (Note 8)		3,50,000
Amount accumulated for construction of a school but not spent deemed to be income under section 11(3) (₹ 20 lakh – ₹ 15 lakh – ₹ 2 lakh) (Note 9)		3,00,000
Anonymous donations taxable@30% under section 115BBC		2,50,000
Total Income		15,20,250

Computation of tax liability for A.Y.2011-12		
Particulars	₹	₹
Tax on anonymous donations of ₹ 1,50,000@30% (Note 5)		45,000
Tax on amount of ₹ 3,50,000 applied for the benefit of founder @30% (Note 8)		1,05,000
Tax on other income of ₹ 9,20,250 at normal rates		
Upto ₹ 1,60,000 Nil	Nil	
₹ 1,60,001 – ₹ 5,00,000 10%	34,000	
₹ 5,00,001 – ₹ 8,00,000 20%	60,000	
₹ 8,00,001 – ₹ 9,20,250 30%	<u>36,075</u>	<u>1,30,075</u>
		2,80,075
Add: Education cess@2%		5,602
Secondary and higher education cess@1%		<u>2,801</u>
		<u>2,88,478</u>

Notes:

- (1) The information relating to “gross receipts” is given in the problem, but there is no information relating to expenditure incurred. Therefore, the problem has been solved by taking the amount applied for the purposes of the schools (i.e., ₹ 87,10,000, being ₹ 90,60,000 – ₹ 3,50,000, applied for the benefit of the founder of the institution) as the expenditure incurred.

Note – The problem can also be solved taking the amount of ₹ 87,10,000 as application for the purposes of the schools.

- (2) Dividend received on units of mutual funds specified in section 10(23D) is exempt under section 10(35). Therefore, it need not be applied for charitable purposes.

Note – There is an alternate view that since the income as envisaged by section 11 is not “total income” computed in accordance with the provisions of the Income-tax Act, 1961, but income as understood in commercial sense, the charitable institution is required to apply such income also for charitable purposes in India.

- (3) Grant from State Government is assumed to be capital in nature (for acquisition of capital assets).

Note – The purpose of the grant would determine the nature of the grant, i.e., whether it is revenue or capital in nature. Since the purpose of the grant has not been given in the question, it is also possible to assume that the grant is revenue in nature and solve the problem accordingly.

- (4) It is assumed that donations are not corpus donations. Hence, they have to be considered as income. Section 13(7) provides that the exemption provisions contained in section 11 or section 12 shall not be applicable in respect of any

anonymous donations referred to in section 115BBC on which tax is payable in accordance with the provisions of that section.

- (5) Only the anonymous donations in excess of the exemption limit specified below would be subject to tax@30% under section 115BBC.

The exemption limit is the higher of the following –

- (1) 5% of the total donations received by the assessee [i.e., ₹ 52,500 (5% x 10,50,000)]; or
- (2) ₹ 1 lakh.

Therefore, in this case, the exemption would be ₹ 1 lakh.

The total tax payable by such institution would be –

- (i) tax@30% on the anonymous donations exceeding the exemption limit as calculated above [i.e., tax @30% on ₹ 1,50,000 (being ₹ 2,50,000 – ₹ 1,00,000)]; and
 - (ii) tax on the balance income i.e., total income as reduced by the aggregate of anonymous donations received.
- (6) The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Purchase of computers and laboratory equipments is a capital expenditure incurred for promoting the objects of the institution and hence, eligible for deduction. The adjustment for depreciation has not been provided for since in the absence of separate values of computer and laboratory equipment, it is not possible to compute depreciation.

Note – *The alternate view is that when capital expenditure is fully allowed as application of income, depreciation in respect of the same is not permissible.*

- (7) ₹ 35 lakhs, being excess of expenditure over income in the P.Y.2009-10 can be treated as application of income of the current year.
- (8) ₹ 3,50,000 applied for the benefit of the founder of the institution is taxable under section 12(2) read with section 13(6). This amount is taxable at the maximum marginal rate of 30%.
- (9) Section 11(3) provides that if the income accumulated for certain purpose is not utilized for the said purpose within the period (not exceeding 5 years) for which it was accumulated, or in the year immediately following the expiry thereof, then the unutilised amount is deemed to be the income of the charitable institution for the previous year immediately following the expiry of the period of accumulation. In the instant case, the institution accumulated ₹ 20,00,000 in the previous year 2007-08 for acquiring and developing a land for construction of a new school for a period of 2

years. Period of accumulation thus expired on 31.3.2010. The assessee has spent ₹ 17,00,000 [out of accumulated sum of ₹ 20,00,000] in the P.Y. 2010-11. Therefore, the unutilised amount of ₹ 3,00,000 is deemed to be income of the previous year 2010-11 (A.Y. 2011-12).

Note – *This problem has been solved on the basis of certain assumptions/views as mentioned under the respective adjustments. Alternate assumptions/views are possible, and accordingly, the computation of total income and tax liability would vary in each case, depending upon the assumption made for each item of adjustment.*

- (b) (i) A plot of agricultural land in Chennai is chargeable to wealth-tax on valuation date 31.3.2011, since it is an urban land within the definition of 'asset' under section 2(ea) of the Wealth-tax Act, 1957. Although unused land held for industrial purposes for a period of two years is not included in the definition of urban land, this exception does not apply in this case since as on the valuation date 31.3.2011, the land in Chennai has been held for more than two years from the date of its acquisition (i.e. 1.1.2009). It may be noted that the time period of two years has to be reckoned from the date of acquisition and not date of approval for conversion. Therefore, the plot of land in Chennai is an asset on the valuation date 31.3.2011.
- (ii) Building under construction is an incomplete building which neither falls within the meaning of 'building' nor within the purview of urban land under section 2(ea), and hence, is not an asset chargeable to wealth-tax on the valuation date 31.3.2011. It was so held by the Punjab & Haryana High Court in *CIT v. Smt. Neena Jain (2011) 330 ITR 157*.

Under section 2(ea), a building used for residential or commercial purposes or for the purpose of maintaining a guest house is an asset. However, an incomplete building cannot be used for residential or commercial purposes or for the purpose of maintaining a guest house and is hence, not an asset under section 2(ea). Therefore, the word "building" has to be interpreted to mean a completely built structure having a roof, dwelling place, walls, doors, windows, electric and sanitary fittings etc.

In this case, the building is under construction as on the valuation date and the purposes for which it will be used after its completion is not relevant for determining the issue.

The said building will also not fall within the definition of "urban land", since Explanation 1(b) under section 2(ea) defining "urban land" for levy of wealth-tax, specifically excludes from its scope, the land occupied by any building which has been constructed with the approval of the appropriate authority. Therefore, the incomplete building of the assessee neither falls within the meaning of a "building" nor within the purview of "urban land" under section 2(ea). Consequently, the incomplete building is not an asset chargeable to wealth-tax.

Note – There is an alternate view that only an urban land, on which a completed building stood, is eligible for exemption. According to this view, the urban land, on which building was under construction, is taxable. This was the view of the Karnataka High Court in *CWT v. Giridhar G. Yadalam* (2010) 325 ITR 223.

- (c) The value of asset held by a minor child on the valuation date is includible in the net wealth of the parent under section 4(1)(ii). However, assets acquired by the minor child out of income from activity involving, *inter alia*, appreciation of his talent, being income referred to in the proviso to section 64(1A), would be taxable in the hands of minor and not included in the hands of the parent.

In this case, however, the above exception to the clubbing provision under section 4(1)(ii) does not apply to the plot of land in urban area, since the same has been purchased out of capital gains of ₹ 10 lakhs from sale of the original asset, namely, securities. It is only the securities which were purchased out of income earned from application of talent of the minor child.

Therefore, the value of urban land, which is an asset under section 2(ea), is includible in the net wealth of the mother as on valuation date. The proposition of the Assessing Officer is justified in law.

Note: It has been assumed that Madhav is a minor child, not suffering from any disability of the nature specified in section 80U. It is also assumed that net wealth of mother (excluding minor's wealth) is higher than the net wealth of father or that she is the only living parent or in case the parents are separated, it is the mother who maintains the child.

- (d) The statement is not correct.

As per section 2(r) of the Wealth-tax Act, 1957, "Valuation Officer" means a person appointed as a Valuation Officer under section 12A. The Valuation Officer is, therefore, a creation of the Statute. He is, therefore, bound by the provisions of the Statute and the rules made thereunder unless there is something in the Act or in the Rules to indicate otherwise.

As per section 16A(1), for the purpose of making an assessment under the Wealth-tax Act, 1957, where under the provisions of section 7 read with rules made under the Act or, as the case may be, the rules in Schedule III, the market value of any asset is to be taken into account in such assessment, the Assessing Officer may refer the valuation of any asset to a Valuation Officer.

Therefore, the Valuation Officer is bound to follow the rules of valuation under Schedule III.

Note: The Supreme Court has held that the rules of valuation are binding on the Valuation Officer in *Bharat Hari Singhania v. CWT* (1994) 207 ITR 001, on the basis of the above reasoning.

Question 2

XYZ Private Limited is engaged in manufacturing and selling ceramic tiles. The net profit of the company as per its profit and loss account for the year ended 31st March, 2011 is ₹ 150 lakh after debiting or crediting the following items:

- (i) One-time license fee of ₹ 20 lakh paid to a foreign company for obtaining franchise on 1st June, 2010.
- (ii) ₹ 29,000 paid to A & Co., a goods transport operator, in cash on 31st January, 2011 for distribution of the company's products to its warehouse.
- (iii) Rent of ₹ 6 lakh received from letting out a part of its office premises. Municipal tax in respect of the said part of the building amounting to ₹ 15,000 remains unpaid.
- (iv) ₹ 2 lakh, being contribution to a University approved and notified under section 35(1)(ii).
- (v) ₹ 3 lakh, being loss due to destruction of a machinery caused by a fire due to short circuit. The Insurance Company did not admit the claim of the company.
- (iv) ₹ 4 lakh and ₹ 1 lakh, being amounts waived by a bank out of principal and arrear interest, respectively, in an one-time settlement. The loan was obtained for meeting working capital requirement four years back.
- (vii) ₹ 1 lakh, being amount payable to a contractor (who does not have Permanent Account Number) for repair work at the company's factory. Tax of ₹ 2,000 was deducted and paid in time.
- (viii) Dividend of ₹ 0.10 lakh from P. Limited on 1000 equity shares of ₹ 10 each purchased at ₹ 100 per share on 10th October, 2010. The rate of dividend declared is 100%, the record date being 1st December, 2010. The shares were sold on 1st March, 2011 at ₹ 80 per share. Loss of ₹ 0.20 lakh has been debited to Profit & Loss Account.
- (ix) Depreciation on tangible fixed assets ₹ 1 lakh.

Additional Information:

- (i) Depreciation on tangible fixed assets as per Income-tax Rules ₹ 1.75 lakh.
- (ii) The company has obtained a loan of ₹ 2 lakh from ABC Private Limited in which it holds 16% voting rights. The accumulated profits of ABC Private Limited on the date of receipt of loan was ₹ 0.50 lakh.

Compute total income of XYZ Private Limited for the Assessment Year 2011-12 indicating reasons for treatment of each item. Ignore the provisions relating to minimum alternate tax.

(16 Marks)

Answer**Computation of total income of XYZ Private Ltd. for the A.Y. 2011-12**

Particulars	₹	₹
Income from House Property (Note 1)		
Gross Annual Value (GAV) (Rental income has been taken as GAV in the absence of other information)	6,00,000	
Less: Municipal Taxes (not deductible since it has not been paid)	<u>Nil</u>	
Net Annual Value (NAV)	6,00,000	
Less: Deduction under section 24 (30% of NAV)	<u>1,80,000</u>	4,20,000
Profits and gains of business or profession		
Net profit as per profit and loss account	1,50,00,000	
Add: Licence fee for obtaining franchise (Note 2)	20,00,000	
Municipal taxes in respect of let-out part of office premises (Note 1)	15,000	
Contribution to approved and notified university (treated separately) (Note 4)	2,00,000	
Loss due to destruction of machinery by fire (Note 5)	3,00,000	
Amount payable to contractor not having PAN (Note 6)	1,00,000	
Short-term capital loss on sale of shares of P. Ltd. (Note 7)	20,000	
Depreciation on tangible fixed assets (Note 8)	<u>1,00,000</u>	
	1,77,35,000	
Less: <u>Depreciation under section 32 (Note 8)</u>		
:		
Tangible fixed assets (Note 8)	1,75,000	
Intangible asset (Franchise)		
25% of ₹ 20,00,000 (Note 2)	<u>5,00,000</u>	6,75,000
<u>Weighted deduction under section 35(1)(ii) (Note 4)</u>		
2,00,000 x 175% (Contribution of University)	3,50,000	
Rental income to be taxed under "Income from house property" (Note 1)	6,00,000	
Dividend credited to profit and loss account to be excluded (Note 7)	10,000	
Waiver of interest on bank loan credited to profit and loss account but not taxable (Note 9)	<u>1,00,000</u>	
		1,60,00,000

Capital Gains (Note 7)		
Short-term capital loss (₹ 20 x 1000 shares)	20,000	
Less: Dividend exempt under section 10(34)	<u>10,000</u>	
Short-term capital loss to be carried forward to A.Y. 2012-13	<u>10,000</u>	
Income from Other Sources (Note 10)		
Deemed dividend under section 2(22)(e)		<u>50,000</u>
Total Income		<u>1,64,70,000</u>

Notes:

- (1) Rental income from letting out a part of the office premises is taxable under “Income from house property”. Therefore, it has to be deducted while calculating business income, since the income has been credited to profit and loss account. Likewise, municipal taxes due in respect of such property, debited to profit and loss account has to be added back to compute business income

Note - There is an alternate view that rental income from letting out part of the excess premises by an assessee who is engaged in business is only exploitation of the commercial asset by an assessee who is engaged in business and hence, the same constitutes business income only. In such a case also, municipal taxes is not allowable as deduction since the same has not been paid on or before the due date of filing of return of income as required under section 43B.

- (2) Franchise is an intangible asset eligible for depreciation @ 25%. Since one-time licence fees of ₹ 20 lakh paid to a foreign company for obtaining franchise has been debited to profit and loss account, the same has to be added back. Depreciation @ 25% has to be provided in respect of the intangible asset since it has been used for more than 180 days during the year.
- (3) ₹ 29,000 paid to A & Co., a goods transport operator in cash is deductible while computing business income, since the limit above which disallowance under section 40A(3) would be attracted in case of payment to a transport contractor engaged in the business of plying, leasing goods carriages is ₹ 35,000.
- (4) Contribution to a university approved and notified under section 35(1)(ii) is eligible for a weighted deduction of 175%. Therefore, the contribution of ₹ 2,00,000 debited to profit and loss account has been added back and ₹ 3,50,000 (being 175% of ₹ 2,00,000) has been deducted while computing business income.
- (5) Loss of ₹ 3 lakh due to destruction of machinery caused by fire is not deductible since it is capital in nature.
- (6) Non-furnishing of PAN to deductor results in attracting provisions of section 206AA, which require tax to be deducted at a higher rate of 20%. Since the company has deducted tax @ 2% and not @20% as per the requirement under section 206AA,

disallowance under section 40(a)(ia) would be attracted in respect of payment of ₹ 1 lakh made to contractor.

Note - There is a possibility of alternate views regarding the tax treatment of disallowance under section 40(a)(ia) for short-deduction of tax. It is possible to take a view that only proportional disallowance under section 40(a)(ia) would be attracted in such a case. Another view is that disallowance under section 40(a)(ia) is only for non-deduction of tax at source and not short-deduction of tax and therefore, no disallowance should be made in case of short-deduction of tax. The computation of total income would, accordingly, change.

- (7) As per section 94(7), where any person buys any shares within 3 months prior to the record date and sells such shares within 3 months after such date and the dividend received on such shares is exempt, then the loss arising out of such purchase and sale of shares shall be ignored to the extent of dividend income.

	₹
Loss on purchase and sale of shares (₹ 100 - ₹ 80) x 1000 shares	20,000
Less: Dividend exempt under section 10(34)	<u>10,000</u>
Short-term capital loss	<u>10,000</u>

Since short term capital loss can be set-off only against income under the head "Capital Gains", the short-term capital loss of ₹ 10,000 has to be carried forward to the next year. Dividend of ₹ 10,000 credited to profit and loss account has to be deducted and short-term capital loss of ₹ 20,000 debited to profit and loss account has to be added back.

- (8) Depreciation as per Income-tax Rules, 1962, is deductible while calculating business income. Therefore, ₹ 1.75 lakh depreciation on tangible fixed assets and ₹ 5 lakh on intangible assets is deducted. The amount of ₹ 1 lakh depreciation debited to profit and loss account has been added back.
- (9) Waiver of principal amount of loan taken for trading activity is a benefit in respect of a trading-liability by way of remission or cessation thereof and is, hence, taxable under section 41(1). It has been so held in *Solid Containers v. DCIT (2009) 308 ITR 417 (Bom.)*. Since the loan waiver has already been credited to profit and loss account, no adjustment is required.

Since the loan is for meeting working capital requirement, it is logical to assume that is taken for trading activity.

However, the treatment is different in respect of interest of loan. Since interest on such loan would have not been allowed as deduction in the earlier years as per section 43B due to non-payment of such interest, waiver of interest will not be taxable. Since ₹ 1,00,000 representing interest waiver has already been credited to profit and loss account, the same has to be deducted for computing business income.

- (10) As per section 2(22)(e), any payment by a company in which the public are not substantially interested by way of loan to a shareholder, who is the beneficial owner of shares holding not less than 10% of voting power, is deemed as dividend to the extent to which the company possesses accumulated profits. Accordingly, in this case, ₹ 50,000 would be deemed as dividend under section 2(22)(e).

Question 3

- (a) A partnership firm consisting of three partners X, Y and Z is engaged in the business of manufacturing and selling toys.

Turnover of the business for the year ended 31st March, 2011 amounts to ₹ 55 lakh. Bad debts written off in the books are ₹ 75,000. Interest at 12% is provided to partner Z on his capital of ₹ 6 lakh as authorized by the partnership deed.

The firm had business loss of ₹ 50,000 and unabsorbed depreciation of ₹ 1,50,000 carried forward from Assessment Year 2010-11. The firm did not pay tax under presumptive tax system in assessment year 2010-11. The firm opts for presumptive taxation under section 44AD for Assessment Year 2011-12.

- (i) Compute the income of the firm chargeable under the head "Profits and gains of business or profession."
 - (ii) What would be the liability for interest under section 234B and 234C, if the firm has not paid any advance tax? (7 Marks)
- (b) Mr. X transferred his residential house to Y for ₹ 10 lakh on 1st April, 2010. The value of the said house as per Stamp Valuation Authority was ₹ 16 lakh. Mr. Y is a childhood friend of Mr. X.
- Mr. X gifted a plot of land (purchased by him on 1st August, 2007) to Mr. Y on 1st July, 2010. The value as per Stamp Valuation Authority is ₹ 8 lakh. Mr. Y sold the land on 1st March, 2011 at ₹ 14 lakh.
- Cost Inflation Index - 2007-08:551; 2010-11:711.
- Compute the income of Mr. Y chargeable under the heads "Capital Gains" and "Income from other sources" for Assessment Year 2011-12. (5 Marks)
- (c) JJ Limited, a company incorporated in Australia has entered into an agreement with KK Limited, an Indian company for rendering technical services to the latter for setting up a fertilizer plant in Orissa. As per the agreement, JJ Limited rendered both off-shore services and on-shore services to KK Limited at fee of ₹ 1 crore and ₹ 1.5 crore, respectively. JJ Limited is of the view that it is not liable to tax in India in respect of fee of ₹ 1 crore as it is for rendering services outside India. Discuss the correctness of the view of JJ Limited. (4 Marks)

Answer

- (a) (i) **Computation of income of the firm chargeable under the head “Profits and Gains of business or profession”**

Particulars	₹
Presumptive income under section 44AD (8% of ₹ 55 lakh) [See Note 1]	4,40,000
Less: Interest @ 12% to Z (12% of ₹ 6 lakh) [See Note 3]	<u>72,000</u>
	3,68,000
Less: Brought forward business loss under section 72 [See Note 4]	<u>50,000</u>
	<u>3,18,000</u>

Notes: -

- (1) A partnership firm falls within the definition of “eligible assessee” under section 44AD. The threshold limit of turnover for applicability of presumptive taxation scheme under section 44AD is ₹ 60 lakh. In this case, since the turnover of the business of the firm is ₹ 55 lakh, it falls within the definition of “eligible business” and therefore, the firm is eligible to opt for presumptive taxation under section 44AD. 8% of the total turnover would be deemed to be the business income of the firm.
 - (2) As per section 44AD(2), all deductions allowable under sections 30 to 38 shall be deemed to have been allowed in full and no further deduction shall be allowed.
Accordingly, no deduction shall be allowed for bad debts since the same is deductible under section 36(1)(vii) and unabsorbed depreciation since the same is deductible under section 32(2).
 - (3) However, where the “eligible assessee” is a firm, salary and interest would be allowed as deduction subject to the conditions and limits prescribed under section 40(b). Therefore, interest@12% to partner Z, which is authorized by the partnership deed, is allowable as deduction.
 - (4) Further, business loss of previous year 2009-10 can be set-off against current year business income as per section 72.
- (ii) As per section 44AD(4), the provisions of Chapter XVII-C would not apply to an eligible assessee in so far as they relate to the eligible business. Therefore, an assessee opting for presumptive taxation scheme under section 44AD is relieved from the requirement of advance tax payments. It would be sufficient compliance if they pay their tax while filing their return of income before the due date.
- Therefore, in this case, the firm is not required to make advance tax payments. Accordingly, there would be no liability for interest under sections 234B and 234C.

(b) **Computation of income of Mr. Y chargeable under the heads “Capital Gains” and “Income from other sources” for A.Y. 2011-12**

Particulars	₹
Income chargeable under the head “Capital Gains”	
Sale consideration	14,00,000
Less: Cost of acquisition (deemed to be the stamp value charged to tax under section 56(2)(vii) as per section 49(4) (See Note 3))	<u>8,00,000</u>
Short-term capital gains (See Note 4)	<u>6,00,000</u>
Income from other sources	
Stamp duty value of plot of land received without consideration (taxable under section 56(2)(vii) (See Note 2))	8,00,000

Notes:-

- (1) Transfer of immovable property for inadequate consideration is outside the scope of section 56(2)(vii). Therefore, the provisions of section 56(2)(vii) are not attracted in respect of transfer of residential house by Mr. X to Mr. Y for inadequate consideration.
 - (2) The provisions of section 56(2)(vii) are, however, attracted in respect of transfer of immovable property without consideration, if the stamp duty value of such property exceeds ₹ 50,000. In this case, since Mr. Y has received a plot of land from Mr. X, a non-relative, without consideration and the stamp duty value of ₹ 8 lakh exceeds ₹ 50,000, the entire stamp duty value of ₹ 8 lakh is chargeable to tax under section 56(2)(vii).
 - (3) Section 49(4) provides that where the capital gain arises from the transfer of such property which has been subject to tax under section 56(2)(vii), the cost of acquisition shall be deemed to be the value taken into account for the purpose of section 56(2)(vii). Therefore, ₹ 8 lakh would be the cost of acquisition in this case.
 - (4) The resultant capital gains will be short-term capital gains since for calculating the period of holding, in a case where cost is computed under section 49(4), the period of holding of the previous owner is not to be included. As per section 2(42A), the period of holding will include the period of holding of the previous owner only in the case of a capital asset which becomes the property of the assessee in the circumstances mentioned in section 49(1) [i.e., where cost to previous owner would be deemed as the cost of acquisition].
- (c) *Explanation* below section 9(2) has been substituted with retrospective effect from 1st June, 1976 to clarify that income by way of, *inter alia*, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, JJ Ltd., were for setting up a fertilizer plant in Orissa. Therefore, the services were utilized in India. Consequently, as per section 9(2), the fee of ₹ 2.5 crore for technical services rendered by JJ Ltd. (both off-shore and on-shore services) to KK Ltd. is deemed to accrue or arise in India and includible in the total income of JJ Ltd.

Therefore, the view of JJ Ltd. that it is not liable to tax in India in respect of fee of ₹ 1 crore (as it is for rendering services outside India) is not correct.

Question 4

Attempt any **four** questions out of the following questions:

- (a) *Rajesh regularly files his return of income electronically. While he was trying to upload his return of income for assessment year 2010-11 on 31st July, 2010, last date for filing the same, he found it extremely difficult to do the same due to network problems and ultimately he became successful in making e-filing of his return only at 1 A.M. on 1st August, 2010. The return contained a claim for carry forward of business loss of 1 lakh. This circumstance was recorded in a letter delivered to the office of the Deputy Commissioner of Income Tax on 1st August, 2010 during normal office hours. Rajesh made a request to the CBDT for condonation of delay in filing the return of income.*

Discuss whether the CBDT has the power to condone the delay in filing the return of income and permit carry forward of loss in the given circumstance.

- (b) *PQR Limited has written off certain debts as bad debts in the books of account and claimed deduction under section 36(1)(vii) in the return of income filed for Assessment Year 2011-12. The Assessing Officer made disallowance for deduction of bad debts on the ground that the debts have not been established to have become irrecoverable and bad in the previous year 2010-11.*

Examine the correctness of the action of the Assessing Officer.

- (c) *MNO Limited is engaged in manufacturing activities. It received liquidated damages of ₹ 10 lakh from supplier of machinery due to delay in supply of machinery. State, with reasons, whether or not the income by way of liquidated damages is assessable as income from business.*
- (d) *ABC JET Limited, an airline company, pays landing and parking charges to the Airports Authority of India. Discuss whether the company is required to deduct tax at source from such payment.*
- (e) *ABC Limited has claimed exemption on the income from long-term capital gains under section 54EC by investing in bonds of National Highway Authority of India within the prescribed time. In the computation of "book profit" under section 115JB, the company claimed exclusion of long-term capital gains because of exemption available on it by virtue of section 54EC. The Assessing Officer reckoned the book profit including long-*

term capital gains for the purpose of levy of minimum alternate tax payable under section 115JB.

Is the action of the Assessing Officer justified in law?

(4 × 4 = 16 Marks)

Answer

- (a) Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or **any other relief under the Act** after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of late filing of a return is relatable to a claim arising under the category of “any other relief available under the Act”. Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.

The facts of the case are similar to the case of *Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441*, where the Delhi High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown justifiable reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the assessee. Therefore, the Court held that the delay of one day in filing of the return had to be condoned.

Applying the rationale of the above court ruling to the case on hand, the CBDT has the power to condone the delay in filing the return of income of Mr. Rajesh and permit carry forward of business loss of ₹ 1 lakh, since the delay of one hour was due to a genuine and justifiable reason i.e., network problem while e-filing the return.

- (b) As per section 36(1)(vii), the amount of any bad debts or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable as deduction, subject to the provisions of section 36(2).

Section 36(2), *inter alia*, provides that such debt should have been taken into account in computing the income of the assessee for the previous year in which it was written off or any earlier previous year or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee.

Therefore, there is no requirement under section 36(1)(vii) to establish that the debt has become irrecoverable or bad. It is enough if the bad debts is written off as irrecoverable in the accounts of the assessee during the relevant previous year. It was so held by the Apex Court in the case of *T.R. F. Ltd. v. CIT (2010) 323 ITR 397*.

Applying the provisions of section 36(1)(vii), section 36(2) and the rationale of the Supreme Court decision, the action of the Assessing Officer in this case is incorrect, assuming PQR Ltd. had taken into account such debt in computing its income of this previous year or any earlier previous year.

- (c) The issue under consideration in this case is whether the liquidated damages received by a company from the supplier of machinery for delay in supply of machinery is revenue in nature i.e., whether the same can be assessed as business income.

On this issue, the Apex Court, in the case of *CIT v. Saurashtra Cement Ltd.* (2010) 325 ITR 422, held that such liquidated damages were directly and intimately linked with the procurement of a capital asset which lead to delay in coming into existence of the profit-making apparatus. It was not a receipt in the course of profit earning process. Therefore, the amount received by the assessee towards compensation for sterilization of the profit earning source, not in the ordinary course of business, is a capital receipt in the hands of the assessee.

Applying the rationale of the above Apex Court ruling in this case, the income by way of liquidated damages of ₹ 10 lakh received by MNO Ltd. from the supplier of machinery is a capital receipt and hence, not assessable as income from business.

- (d) This issue as to whether landing and parking charges could be deemed as rent to attract the provisions of section 194-I came up before the High Court in the cases of *CIT v. Japan Airlines Co. Ltd.* (2010) 325 ITR 298 and *United Airlines v. CIT* (2006) 287 ITR 281.

The Court observed that rent as defined in section 194-I had a wider meaning than “rent” in common parlance. It included any payment under any agreement or arrangement for use of, *inter alia*, land. When the wheels of the aircraft coming into an airport touch the surface of the airfield, use of the land of the airport immediately begins. Similarly, for parking the aircraft in that airport, again, there is use of the land. Therefore, the landing and parking fee were “rent” within the meaning of the provisions of section 194-I as they were payments for the use of the land of the airport.

Applying the rationale of the above ruling to the case on hand, the payment of landing and parking charges by ABC JET Ltd., an airline company, to the Airports Authority of India is in the nature of rent, and accordingly, the provisions of tax deduction at source under section 194-I would be attracted, if the aggregate rental income during the year is ₹ 1,80,000 or more.

- (e) The issue under consideration in this case is whether long-term capital gain exempted by virtue of section 54EC can be included in the book profit computed under section 115JB for levy of minimum alternate tax.

It may be noted that minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18% of book profit. Chapter XII-B is a self-contained code for computation of book profit. The net profit as per the profit and loss account for the relevant previous year prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956, as increased/reduced by the specified adjustments provided for in *Explanation 1* to section 115JB would be the book profit for levy of MAT under section 115JB.

Therefore, if an assessee has claimed exemption under section 54EC by investing in bonds of National Highways Authority of India within the prescribed time, the long term capital gains so exempt would still be taken into account for computing book profit under section 115JB for levy of MAT, since *Explanation 1* to section 115JB does not provide for such deduction.

As long as long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956, capital gains cannot be excluded unless provided under *Explanation 1* to section 115JB. It was so held by the Kerala High Court in *N. J. Jose and Co. (P.) Ltd. v. ACIT (2010) 321 ITR 0132*.

Therefore, the action of the Assessing Officer is justified in law.

Question 5

- (a) Explain the term "Bilateral Relief" in the context of Double Taxation Avoidance Agreement. (4 Marks)
- (b) Ajay, a non-resident Indian, has the following sources of income in India during the previous year 2010-11:

	Particulars	₹	₹
(i)	Income from house property located in India (computed)		1,80,000
(ii)	Dividend from Indian Companies		75,000
(iii)	Interest on debentures of Indian company (Subscribed in convertible foreign exchange)	1,00,000	
	Less: Interest on loan taken for purchase of debentures	<u>20,000</u>	80,000
(iv)	Long-term capital gains on sale of debentures subscribed in US \$:		
	Cost in 2002-03	4,00,000	
	Sale in 2010-11	<u>6,00,000</u>	
		2,00,000	
	Less: Commission to brokers	<u>6,000</u>	1,94,000
	Cost Inflation Index: F.Y. 2002-03 - 447; F.Y.2010-11 – 711.		

Compute the tax payable by Ajay for Assessment Year 2011-12, if he opts for the provisions of Chapter XII-A of the Income-tax Act, 1961. (6 Marks)

- (c) State the consequences that would follow if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment? (6 Marks)

Answer

- (a) Where a tax payer is resident in one country but has a source of income in another country, it gives rise to possible double taxation. The Governments of two countries can enter into a mutual agreement to provide relief to the tax payer against double taxation of the income by working out the basis on which the relief is to be granted. This is called bilateral relief.

Bilateral Relief may be granted by way of the following methods:

- (a) **Exemption method** :- Under this method, the relief is provided to the assessee by taxing a particular income in only one of the two countries, which would otherwise have been taxed in both the countries
- (b) **Tax relief method** :- Under this method, the income of the assessee is taxable in both countries in accordance with their respective tax laws/DTAAs. However, the country of which the tax payer is a resident, allows him credit for the tax charged on the doubly taxed income in the other country.

Note - In India, double taxation relief is provided for in sections 90 and 90A, either by way of granting relief in respect of income-tax paid in India and the other country or specified territory or by way of avoidance of double taxation of income in India and the other country or specified territory.

- (b) **Computation of tax liability of Mr. Ajay for the A.Y. 2011-12 as per provisions of Chapter XII-A**

Particulars	₹	₹
Tax on long term capital gain ($\text{₹ } 1,94,000 \times 10\%$) [See Notes 1 & 2]	19,400	
Tax on interest on debentures being investment income ($\text{₹ } 1,00,000 \times 20\%$) [See Notes 1 & 3]	20,000	
Tax on balance income of ₹ 1,80,000		
Upto ₹ 1,60,000	Nil	
₹ 1,60,000 – ₹ 1,80,000 @ 10%	<u>2,000</u>	41,400
Add: Education cess @ 2%		828
Add: Secondary and higher education cess @ 1%		414
Total tax liability		42,642
Total tax liability (rounded off)		42,640

Notes:

- (1) **Computation of total income of Mr. Ajay for the A.Y. 2011-12 as per provisions of Chapter XII-A**

Particulars	₹	₹
Income from house property (computed)		1,80,000
Capital Gains on sale of debentures		
Sale consideration	6,00,000	
Less: Commission to brokers	<u>6,000</u>	
Net sale consideration	5,94,000	
Cost of acquisition (Refer Note 2)	<u>4,00,000</u>	
Long term capital gain		1,94,000
Dividend income received from Indian companies [exempt under section 10(34)]		Nil
Interest on debentures of Indian company (Refer Note 3)		1,00,000
Total Income		4,74,000

- (2) As per section 115D, the indexation benefit would not be available for calculating cost of acquisition for computing long term capital gains under Chapter XII-A.
- (3) No expenditure is allowed to be deducted from the interest on debentures being the investment income as per the provisions of section 115D. Therefore, interest on loan taken for purchase of debentures is not deductible.
- (4) As per the provisions of section 115E, the tax rate applicable on investment income is 20% and on the long term capital gain the tax rate applicable shall be 10%. The balance income shall be chargeable to tax as per the normal tax rates.
- (5) It has been assumed that the debentures referred to in the question are issued by an Indian company which is not a private company and are hence, specified assets. Since the specified assets have been subscribed in convertible foreign exchange, they are foreign exchange assets.

Note - If a non-resident purchases shares in, or debentures of, an Indian company by utilising foreign currency, capital gain shall be calculated under first proviso to section 48 in the same foreign currency which was initially utilised in purchase of shares and debentures. Capital gains so computed in foreign currency shall be reconverted into Indian currency. Since the telegraphic transfer buying rates and telegraphic transfer selling rates of US \$ on the date of acquisition, date of sale and 31st March, 2011 are not given in the question, effect has not been given to the first proviso to section 48 in the above solution.

(c) In case the Assessing Officer makes adjustment to Arm's Length Price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow:-

- (1) No deduction under section 10A, section 10AA, section 10B or Chapter VI-A shall be allowed from the income so increased.
- (2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

- (1) In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.
- (2) In any other case, he can file an appeal under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.
- (3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 6

- (a) *The Assessing Officer within his jurisdiction surveyed a popular Cyber Café at 12 o'clock in night for the purpose of collecting information which may be useful for the purposes of the Income-tax Act, 1961. The Cyber Café is kept open for business every day between 2 P.M. and 2 A.M. The owner of the Cyber Café claims that the Assessing Officer could not enter the café in late night. The Assessing Officer wanted to take away with him the books of account kept at the Cyber Café. Examine the validity of the claim made by the owner and the proposed action of the Assessing Officer.* (4 Marks)
- (b) *The Assessing Officer issued a notice under section 142(1) on the assessee on 24th December, 2010 calling upon him to file return of income for Assessment Year 2010-11. In response to the said notice, the assessee furnished a return of loss and claimed carry forward of business loss and unabsorbed depreciation. State whether the assessee would be entitled to carry forward as claimed in the return.* (4 Marks)

- (c) *The regular assessment of MNO Ltd. for the Assessment Year 2009-10 was completed under section 143(3) on 13th March, 2011. There was an audit objection by the Revenue Audit team that interest on loan should be disallowed partly as there was diversion of borrowed fund to sister concern without charge of interest.*

Based on the above facts:

- (i) *State, with reasons, whether the Assessing Officer can issue notice under section 148 on the basis of audit objection of the Revenue Audit team.*
 - (ii) *If the action stated in (i) above is not permitted, what is the option open to the Revenue Department to deal with the said audit objection? (5 Marks)*
- (d) *Discuss the correctness or otherwise of the following statements with reference to the provisions of the Income-tax Act, 1961:*
- (i) *An appeal before Income-tax Appellate Tribunal cannot be decided in the event of difference of opinion between the Judicial Member and the Accountant Member on a particular ground.*
 - (ii) *A High Court does not have an inherent power to review an earlier order passed by it on merits. (3 Marks)*

Answer

- (a) The Assessing Officer can exercise his power of survey under section 133A only after obtaining the approval of the Joint Commissioner or Joint Director, as the case may be. Assuming that he has obtained such approval in this case, he is empowered under section 133A to enter any place of business of the assessee within his jurisdiction only during the hours at which such place is open for the conduct of business.

In the case given, the cyber cafe is open from 2.00 p.m. to 2.00 a.m. for the conduct of business. The Assessing Officer entered the cyber cafe at 12 o'clock in the night which falls within the working hours of the cyber cafe. Therefore, the claim made by the owner to the effect that the Assessing Officer could not enter the cyber cafe at late night is not in accordance with law.

Further, as per section 133A(3)(ia), the Assessing Officer may, impound and retain in his custody for such period as he thinks fit, any books of account or other documents inspected by him. However, he shall not impound any books of account or other documents except after recording his reasons for doing so. He shall not retain in his custody any such books of account or other documents for a period exceeding ten days (exclusive of holidays) without obtaining the approval of the Chief Commissioner or Director General therefor, as the case may be.

- (b) As per the provisions of section 139(3), any person who has sustained loss under the head 'Profit and gains of business or profession' is allowed to carry forward such a loss under section 72(1) or section 73(2), only if he has filed the return of loss within the time allowed under section 139(1). Also, the provisions of section 80 specify that a loss which has not been determined as per the return filed under section 139(3) shall not be allowed to be carried

forward and set-off under, *inter alia*, section 72(1) (relating to business loss) or section 73(2) (losses in speculation business) or section 74(1) (loss under the head "Capital gains") or section 74A(3) (loss from the activity of owning and maintaining race horses). However, if the loss relates to a "specified business" to be carried forward under section 73A, no such condition is imposed either under section 139(3) or under section 80. Further, there is no such condition for carry forward of unabsorbed depreciation under section 32.

In the given case, the assessee has filed its return of loss in response to notice under section 142(1). As per the provisions stated above, the return filed by the assessee in response to notice under section 142(1) is a belated return and therefore, the benefit of carry forward of business loss under section 72(1) or section 73(2) shall not be available. However, if the loss relates to a "specified business" to be carried forward under section 73A, the same can be carried forward. The assessee shall also be entitled to carry forward the unabsorbed depreciation as per provisions of section 32(2).

- (c) (i) Section 147 states that, *inter alia*, if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section.

The basic requirements are as follows:

- (1) The Assessing Officer should have reason to believe that income chargeable to tax has escaped assessment. The belief should be that of the Assessing Officer and not the audit party.
- (2) It is further well established that audit party cannot express opinion on legal issues or issues involving provisions of law [*Indian & Eastern Newspaper Society v. CIT (1979) 119 ITR 996 (SC)*]. Such opinion cannot be the basis upon which the Assessing Officer can initiate reassessment proceedings.
- (3) The Income-tax Act, 1961 does not confer jurisdiction on change of opinion on the interpretation of a particular provision earlier adopted by the assessing authority. It is assumed that this issue had already been considered earlier during the course of scrutiny assessment and the Assessing Officer had come to a conclusion that no disallowance of interest paid by the assessee is required, even though loans had been given to sister concern without any interest. Therefore, the same issue cannot be the basis of reassessment, merely because the revenue audit team takes a different view.

Therefore, the Assessing Officer cannot issue notice under section 148 on the basis of audit objection of the Revenue Audit team.

- (ii) The option open to the Revenue is initiation of proceedings under 263, by the jurisdictional Commissioner. He has the power to call for and examine the records,

if he is of the opinion that the order passed by the Assessing Officer under section 143(3) is erroneous in so far as it is prejudicial to the interests of the Revenue.

However, where the Assessing Officer has considered the issue in the original assessment and come to a conclusion that no disallowance of interest is called for, the Commissioner cannot initiate revisionary proceedings, merely because he holds a different view. Only where the view taken by the Assessing Officer is unsustainable in law, the Commissioner will be justified in initiating the revisionary proceedings under section 263. In *CIT v. Sohana Woollen Mills (2008) 296 ITR 238*, it has been held that mere audit objection and merely because a different view can be taken, are not enough to say that the order of the Assessing Officer is erroneous or prejudicial to the interest of revenue.

- (d) (i) The statement given is not correct. As per the provisions of section 255, in the event of difference in opinion between the members of the Bench of the Income-tax Appellate Tribunal, the matter shall be decided on the basis of the opinion of the majority of the members. In case the members are equally divided, they shall state the point or points of difference and the case shall be referred by the President of the Tribunal for hearing on such points by one or more of the other members of the Tribunal. Such point or points shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who had first heard it.
- (ii) The statement given is correct. As per the decision given by the High Court in the case of *Deepak Kumar Garg v. CIT (2010) 327 ITR 448*, the power to review the order passed is not an inherent power but need to be expressly provided in the statute by way of specific provisions or by way implication. It was observed that, by virtue of section 260A(7), the power of re-admission or restoration of the appeal is always enjoyed by the High Court. However, such power cannot be treated to be a power to review its earlier order on merits as it is not expressly provided for in the law.

Question 7

- (a) Ms. Madhvi, a resident individual and self-employed industrial designer, furnished the following particulars for the year ended 31-03-2011:

	Particulars	₹
i.	Gross total income	5,00,000
ii.	Housing loan principal repayment. The property is under construction at Jaipur as on 31-03-2011.	1,10,000
iii.	Principal repayment of housing loan from a relative. This property is self-occupied situated at Jodhpur.	50,000
iv.	Contribution to Public Provident Fund in the name of her mother.	70,000
v.	She deposited ₹ 5,000 per month in her account under a pension scheme notified by the Central Government.	

Compute total income of Ms. Madhvi for Assessment Year 2011-12 stating reasons for the deduction eligible under appropriate provisions of Chapter VI-A. (5 Marks)

- (b) A sum of ₹ 60,000 was paid to Mr. Dastur, an advocate, on 1st July, 2010 towards fees for his professional services without deducting tax at source. Later on, a further sum of ₹ 70,000 was due to him on 27th February, 2011 from which tax of ₹ 13,000 was deducted at source. The tax so deducted was deposited on 25th June, 2011. Compute interest payable by the deductor under section 201(1A). (5 Marks)
- (c) Explain whether there is conflict between accounting standards and provisions of the Income-tax Act, 1961 in respect of the following:
- Effect of fluctuation in foreign currency rates where a capital asset is imported by a company.
 - Permanent fall in value of long-term investments held by a company. (3×2=6 Marks)

Answer

- (a) **Computation of total income of Ms. Madhvi for the A.Y. 2011-12**

Particulars	₹	₹
Gross Total Income		5,00,000
Less: Deductions under Chapter VI-A		
<u>Section 80C</u>		
Principal repayment for housing loan taken for house property at Jaipur [See Note 1]	Nil	
Principal repayment for housing loan taken for house property at Jodhpur [See Note 2]	Nil	
Contribution to public provident fund in the name of mother [See Note 3]	Nil	
<u>Section 80CCD</u>		
Contribution to pension scheme notified by the Central Government [See Note 4]	50,000	50,000
Total income		4,50,000

Notes :

- As per the provisions of section 80C, the deduction for principal repayment of housing loan is provided only in respect of a house property whose income is chargeable to tax under the head 'Income from house property'. As the house property at Jaipur is still under construction, no income is chargeable to tax under the head "Income from house property". Hence, no deduction would be available under section 80C for principal repayment of the housing loan for property under construction at Jaipur.
- The deduction for principal repayment of housing loan under section 80C is provided only in respect of the loan taken from the institutions mentioned under

section 80C (like banks, Life Insurance Corporation of India, National Housing Bank, specified employer etc.) However, loan from a relative does not qualify for deduction under section 80C. Since, in the present case, the loan is taken from a relative, no deduction would be available under section 80C for the repayment of the principal in respect of self-occupied property at Jodhpur.

- (3) The contribution to public provident fund is allowed as deduction only if it is in the name of specified persons mentioned in section 80C, namely, self, spouse or any child of such individual. Since mother of the individual is not a specified person as per section 80C, no deduction would be available for the contribution to public provident fund in the name of the mother.
 - (4) The deduction under section 80CCD shall be an amount not exceeding 10% of the gross total income of in case of a self-employed individual. Therefore, the deduction in respect of deposit by Ms. Madhvi to the pension scheme notified by the Central Government ₹ 60,000 shall be limited to ₹ 50,000, being 10% of ₹ 5,00,000.
- (b) In this case, tax is deductible@10% under section 194J in respect of fees for professional services. Since there has been a delay in deduction and deposit of tax, interest under section 201(1A) is attracted.

As per the provisions of section 201(1A), if a person who is liable to deduct tax at source fails to deduct tax at source or after deducting such tax, fails to pay the tax as required by the Act, then he is liable to pay interest as follows -

- (i) 1% for every month or part of month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually deducted.
- (ii) 1½% for every month or part of month on the amount of such tax from the date on which such tax was deducted to the date on which tax is actually paid.

Therefore, in the given case, interest under section 201(1A) would be computed as follows –

	₹
1% on tax deductible but not deducted i.e., 1% on ₹ 6,000 for 8 months	480
1½% on tax deducted but not deposited i.e. 1½% on ₹ 13,000 for 4 months	780
Total interest payable under section 201(1A)	1,260

- (c) (i) As per AS-11 on “Accounting for the effects of changes in foreign exchange rates”, exchange differences relating to a liability incurred (i.e. loan taken to repaid in installments) for acquiring fixed assets, which are carried in terms of historical cost, cannot be adjusted in the carrying amount of the said fixed assets. The effect of fluctuation in foreign currency has to be charged to profit and loss account at the end of each year.

However, the provisions of section 43A of the Income-tax Act, 1961 requires such exchange differences to be adjusted against the actual cost of the imported asset in the year in which the actual payment is made irrespective of the method of accounting followed by the assessee.

Therefore, there is a difference regarding the treatment of the effect of fluctuation in foreign currency rates (where a loan is taken for purchase of capital asset imported by a company) as per the accounting standards and as per the provisions of the Income-tax Act, 1961.

Note - *It may be noted that in the case of companies, the exchange difference relating to acquisition of a depreciable capital asset can be adjusted against the cost of the asset at the end of each year, at the option of the enterprise. This treatment can be done in respect of accounting periods between 7th December, 2006 and 31st March, 2012.*

- (ii) As per AS-13 on "Accounting for Investments", long-term investments should be carried at cost and provision should be made to recognize a permanent decline in the value of long-term investments. Such reduction should be determined and made for each investment individually.

However, under the Income-tax Act, 1961 there is no provision to recognize any decline in the value of investments, whether permanent or temporary. Only if the investments are disposed of, the profit/loss on account of the same is recognized.

Therefore, there is a difference in the treatment of the permanent decline in the value of the long term investments held by a company under the accounting standards and the provisions of the Income-tax Act, 1961.

PAPER – 8: INDIRECT TAX LAWS

Question No. 1 is compulsory

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

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

Question 1.

- (a) MNO Ltd. is in the manufacture of both excisable and non-excisable goods in their factory building rented by them from October 1, 2010 and have been occupying the same as a tenant. From the following particulars for the period October 1, 2010 to March 31, 2011, state briefly with suitable explanations, whether MNO Ltd. could claim the benefit of exemption in terms of Notification No. 8/2003-CE dated 1-3-2003 for the financial year 2011-12.

		₹ (in lakhs)
(i)	Clearances of branded goods	60
(ii)	Export Sales to Nepal	80
(iii)	Export Sales to USA and Canada	120
(iv)	Clearances of goods (duty paid based on Annual capacity of production under section 3A of the Central Excise Act, 1944)	70
(v)	Clearances of goods subject to valuation based on retail sale price under section 4A of the Central Excise Act, 1944(said goods are eligible for 30% abatement)	200
(vi)	Job work under Notification No. 214/86-CE dated 25-3-86	60

During the period April 1, 2010 to Sept 30, 2010 the previous tenant of the building presently occupied by MNO Ltd. had cleared excisable goods of the aggregate value of ₹ 120 lakhs.

(5 Marks)

- (b) The following information is provided in respect of manufacture of a product "X" for the purpose of captive consumption in the same factory. You are required to determine the value for purpose of duty of excise in terms of Rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000:

	₹
Cost of direct materials (includes central excise duty ₹ 1,545)	16,545
Cost of direct employees	12,300
Works overheads	8,400

The suggested answers for Indirect Tax Laws (Paper 8) are based on the provisions as amended by the Finance Act, 2010 and notifications/circulars issued up to 30.04.2011 which are relevant for November 2011 examinations.

Quality control cost	4,300
Research & development cost	2,700
Administrative cost:	
Production related	3,000
Others	1,500
Selling and distribution cost	3,600
Scrap value realized	1,500

Make assumptions if required and provide suitable explanations. (5 Marks)

- (c) Raj & Co. provide the following details in respect of the services provided and the payments thereagainst received by them for the month of March 2011. Compute the value of taxable service under 'Business Auxiliary Service' falling under section 65(105) (zzb) of the Finance Act, 1994 and the service tax payable thereon:

		₹ Lakhs
(i)	Commission for procurement of services for their client M/s Shraddha & Co.	10
(ii)	Commission on distribution of UTI Mutual Fund products	16
(iii)	Customer care service provided on behalf of M/s Sweta & Co. Ltd	8
(iv)	Commission on purchase and sale of food grains	20
(v)	Commission on procurement of advertisements for publications company (No other service is provided)	4
(vi)	Charges for processing parts and accessories in the manufacture of cycles for use by the client (client has supplied inputs valued at ₹ 2 lakhs)	10

Make assumptions where required and provide suitable explanations. (5 Marks)

- (d) From the following information provided by M/s RA Ltd., registered under the VAT law in the State of Gujarat as dealer in consumer goods, compute the amount of VAT payable for the month of July 2011:

Purchase of raw material (within the State)

Item	Amount (₹)	Rate of VAT
Goods 'X'	7,50,000	Exempt
Goods 'Y'	25,00,000	1%
Goods 'Z'	35,00,000	12.5%

Sales

Particulars of finished goods sold	State in which goods are sold	Value ₹	VAT/CST Rate %
(i) Produced from goods 'X'	Gujarat:	5,00,000	12.5% VAT
	Interstate sales to Maharashtra:	6,00,000	2% CST
(ii) Produced from goods 'Y'	Gujarat:	30,00,000	Exempt
(iii) Produced from goods 'Z'	Gujarat:	40,00,000	4% VAT

Raw materials valued at ₹ 5 lakhs of goods 'Z' have been transferred to the branch in Madhya Pradesh during the month. Assume 2% reduction in input credit on account of such transfer.

Make assumptions where required and provide suitable explanations (5 Marks)

- (e) Determine the assessable value for the purpose of Customs Act, 1962 from the following information in respect of import of a machine from UK:

(i)	FOB Value	£ 6,000
(ii)	Air Freight	£1,500
(iii)	Design and development charges paid in UK	£500
(iv)	Design and development charges paid in India	₹10,000
(v)	Commission paid to local agents 1% of FOB Value	
(vi)	Date of Bill of Entry 10-4-2011 (Exchange rate notified by CBEC £ 1 = ₹ 70)	
(vii)	Date of Entry Inward 20-4-2011 (Exchange rate notified by CBEC £ 1 = ₹ 65)	

Insurance charges are not ascertainable

Make assumptions where required and provide suitable explanations. (5 Marks)

Answer

- (a) Computation of value of clearances for home consumption in the financial year 2010-11

S.No.	Particulars	₹ (in lakh)
(i)	Clearances of branded goods (Note-1)	Nil
(ii)	Export sales to Nepal (Note-1)	80
(iii)	Export sales to USA and Canada (Note-1)	Nil
(iv)	Clearances of goods on which duty has been paid under section 3A of the Central Excise Act	70

(v)	Clearances of goods subject to valuation under section 4A of the Central Excise Act (Note-2)	140
(vi)	Job work under Notification No. 214/86-CE (Note-1)	Nil
(vii)	Clearances of previous tenant of the building occupied by MNO Ltd. (Note- 3)	<u>120</u>
	Total	<u>410</u>

Notes:

1. In order to claim the benefit of exemption under *Notification No. 8/2003 C.E. dated 01.03.2003* in a financial year, the total turnover of a unit should not exceed ₹ 400 lakh in the preceding financial year. *Notification No. 8/2003 C.E. dated 01.03.2003* provides that for the purpose of computing the turnover of ₹ 400 lakh,:-
 - (a) clearances bearing the brand name or trade name of another person are excluded. It has been assumed that the branded goods are excisable goods and they bear the brand name of another person and not the brand name of MNO Ltd.
 - (b) export turnover is excluded. However, exports to Nepal and Bhutan are not excluded as these are treated as "clearance for home consumption". It has been assumed that goods exported by MNO Ltd. to Nepal are excisable goods.
 - (c) clearances under specified job work notifications are excluded and *Notification No. 214/86 CE dated 25.03.86* is one of the specified notification.
2. In case of the goods subject to valuation under section 4A of the Central Excise act, 1944, value for the purpose of the SSI exemption would mean value fixed under section 4A i.e., retail sale price less abatement. Hence, value of such clearances would be ₹ 200 lakh × 70% = ₹ 140 lakh.
3. For the purpose of computing the turnover of ₹ 400 lakh, all the clearances made by different manufacturers from the same factory are to be clubbed together. Hence, clearances, worth ₹ 120 lakh of previous tenant of the building occupied by MNO Ltd. have been added.

Conclusion: Since the value of clearances for home consumption exceeds ₹ 400 lakh in the financial year 2010-11, MNO Ltd. is not eligible to claim the benefit of exemption under *Notification No. 8/2003 – C.E. dated 01.03.2003* in the financial year 2011-12.

- (b) As per rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, the value of the excisable goods used for captive consumption is 110% of the cost of production of such goods. The cost of production has to be computed as per the Cost Accounting Standard (CAS)-4.

Computation of cost of production as per CAS-4 and value of the excisable goods:-

Particulars	₹
Cost of direct materials ₹ 16,545	
Less: Central excise duty ₹ <u>1,545</u>	15,000
Cost of direct employees	12,300
Work overheads	8,400
Quality control cost	4,300
Research and development cost	2,700
Administrative cost (production related)	<u>3,000</u>
Total	45,700
Less: Scrap value realized	<u>1,500</u>
Cost of production as per CAS-4	<u>44,200</u>
Value of excisable goods [₹ 44,200× 110%]	48,620

Notes:

1. It has been assumed that CENVAT credit is available on central excise duty paid on direct materials and hence, it has been deducted from the cost of direct materials in accordance with Cost Accounting Standard-4.
2. Administrative overheads in relation to activities other than manufacturing activities have not been included in cost of production [CAS-4].
3. Selling and distribution cost have been excluded from the cost of production as they are not in relation to production activity [CAS-4].

(c) Computation of value of taxable 'business auxiliary service' of Raj & Co. and service tax payable:-

S.No.	Particulars	₹ (in lakh)
(i)	Commission for procurement of services for their client M/s Shraddha & Co. (Note-1)	10.00
(ii)	Commission on distribution of UTI Mutual Fund products (Note-2)	Nil
(iii)	Customer care services provided on behalf of M/s Sweta & Co. Ltd. (Note-1)	8.00
(iv)	Commission on purchase and sale of food grains (Note-3)	Nil
(v)	Commission on procurement of advertisements for publication company (Note-4)	4.00
(vi)	Charges for processing parts and accessories in the manufacture of cycles for use by the client [₹ 10 lakh× 70%] (Note -5)	<u>7.00</u>
	Value of taxable services	<u>29.00</u>

Service tax @10% [₹ 29 lakh× 10%]	2.90
Education cess @ 2% [₹ 2.9 lakh× 2%]	0.058
Secondary and higher education cess @ 1% [₹ 2.9 lakh× 1%]	<u>0.029</u>
Service tax payable	<u>2.987</u>

Notes:

- Any service provided in relation to:-
 - any customer care service provided on behalf of the client
 - procurement of goods or services, which are inputs for the client
 is a business auxiliary service [Section 65(19)].
- Although distribution of mutual funds is taxable under business auxiliary services, service tax is payable by the mutual fund or asset management company, as the case may be, receiving such service [Rule 2(1)(d) of the Service Tax Rules, 1994].
- Commission on purchase and sale of food grains is exempt from service tax [Notification No. 13/2003 ST dated 20.06.2003].
- Merely procurement of advertisements for publication company is liable to service tax under business auxiliary service [Circular No. 96/7/2007 ST dated 23.08.2007].
- In case of processing of parts & accessories used in the manufacture of cycles for client, an abatement of 30% is granted from the gross amount charged subject to the fulfillment of the specified conditions [Notification No. 1/2006 ST dated 01.03.2006]. It has been assumed that all such conditions have been fulfilled by Raj & Co. The abatement is available when the gross amount charged is inclusive of the cost of inputs, whether or not supplied by the client. It has been assumed that inputs supplied by the client worth ₹ 2 lakh are included in ₹ 10 lakh charged for the said services.
- It has been assumed that Raj & Co. is not entitled for the exemption available to small service providers vide Notification No. 6/2005 ST dated 01.03.2005.

(d) Computation of VAT payable by M/s. RA Ltd. for the month of July, 2011

	Particulars	₹
(A)	Output VAT payable	
	(i) On sale of finished goods produced from Goods 'X' within Gujarat (₹ 5,00,000 × 12.5%)	62,500
	(ii) On sale of finished goods produced from Goods 'Z' within Gujarat (₹ 40,00,000 × 4 %)	<u>1,60,000</u>
	Total (A)	<u>2,22,500</u>

(B)	Input tax credit available	
	(i) Goods 'X' (Exempt)	Nil
	(ii) Goods 'Y' (Note-2)	Nil
	(iii) Goods 'Z' transferred to branch (₹ 5,00,000×10.5%)	52,500
	(iv) Remaining Goods 'Z' after transfer to the branch [₹ (35,00,000- 5,00,000)×12.5%]	<u>3,75,000</u>
	Total (B)	<u>4,27,500</u>
	Net VAT payable = (A)-(B)	(2,05,000)
	CST payable (₹ 6,00,000×2% = (₹ 12,000)on inter-state sale of goods produced from Goods 'X' would be paid from the balance of credit of ₹ 2,05,000.(Note-3)	<u>12,000</u>
	Balance input credit carried forward to next month	<u>1,93,000</u>

Notes:

1. It is assumed that there is no opening and closing inventory. Hence, entire purchases of the raw materials have been used to manufacture the respective finished goods.
2. Goods utilized in the manufacture of exempted goods are not eligible for input tax credit. Hence, no input tax credit is available in respect of VAT paid on purchase of Goods 'Y' as they have been used to produce goods which are exempt from VAT.
3. Input tax credit can be used to set off the central sales tax payable on the inter-state sales.

(e) Computation of assessable value of machine:-

Particulars	£	₹
FOB Value	6,000.00	
Add: Air Freight [since the goods are imported by air, the freight would be restricted to 20% of FOB value as per rule 10(2) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 – hereinafter referred to as Customs Valuation Rules]	1,200.00	
Insurance charges [since they are not ascertainable, they have been taken at 1.125% of FOB value as per rule 10(2) of the Customs Valuation Rules]	67.50	
Design charges paid in UK [included on the presumption that the same have been paid for design & development work under taken in UK –Rule 10(1)(b) of the Customs Valuation Rules]	<u>500.00</u>	
	7,767.50	
Value in Indian Rupees = £ 7,767.50 × ₹ 70		5,43,725.00

[Exchange Rate of ₹ 70 notified by the CBEC on the date of presentation of bill of entry has been considered for currency conversion purposes as per section 14 of the Customs Act, 1962]		
Commission paid to local agents [included as per rule 10(1) of the Customs Valuation Rules-1% of (6,000 × 70)]		<u>4,200.00</u>
CIF Value		5,47,925.00
Landing charges [1% of CIF Value as per Rule 10(2) of the Customs Valuation Rules]		<u>5,479.25</u>
Assessable Value		<u>5,53,404.25</u>
Assessable Value (rounded off)		5,53,404.00

Note: Design & development charges paid in India have not been considered on the presumption that the same have been paid for design & development work undertaken in India. Rule 10(1)(b) of the Customs Valuation Rules provides for inclusion of only those design & development charges which have been paid for design & development work undertaken elsewhere than in India.

Question 2

- (a) Discuss with a brief note the validity of the following statements with reference to the Cenvat Credit rules, 2004.
- Credit of input services used in the repairs or renovation of factory or office is not available.
 - Credit of capital goods can be availed where such capital goods are exclusively used in the manufacture of dutiable goods with respect to which benefit under Notification No. 1/2011-CE dated 1-3-2011 is availed.
 - Cenvat Credit of duty paid on capital goods used outside the factory of manufacturer for generation of electricity for captive use within the factory is allowed. (3 × 2 = 6 Marks)
- (b) With reference to the provisions of the Finance Act, 1994 relating to service tax, write a brief note on the following:
- Vacant land given on lease or license for construction of a building or temporary structure at later stage to be used for furtherance of business or commerce
 - Activities relating to promotion of a brand of goods, events, business entity.
 - Air transport of crew members on board the air craft. (3 × 2 = 6 Marks)
- (c) Write a brief note with reference to the provisions of the customs Act, 1962 on the assessment of "Packaged Software" where affixation of Retail Sale Price (RSP) is : (i) mandatory and (ii) not required under the Standards of Weights and Measures Act, 1976. (3 Marks)

Answer

- (a) (i) The given statement is **not valid** as the definition of input service under rule 2(l) of the CENVAT Credit Rules, 2004 specifically includes services used in relation to renovation or repairs of a factory or an office relating to such factory. Thus, credit on such services is available.
- (ii) The said statement is **not valid**. No credit can be availed on capital goods which are used exclusively in manufacture of exempted goods or in providing exempted service. Since, goods in respect of which the benefit of an exemption under *Notification No. 1/2011-CE dated the 01.03.2011* is availed are exempted goods (as per the amended definition of exempted goods), credit of capital goods used exclusively in manufacture of such goods is not allowed [*Circular No. 943/04/2011-CX dated 29.04.2011*].
- (iii) The said statement is **valid**. Capital goods used outside the factory of manufacturer for generation of electricity for captive use within the factory are capital goods eligible for CENVAT credit. Such capital goods have been specifically included in the amended definition of capital goods as provided under rule 2(a) of the CENVAT Credit Rules, 2004.
- (b) (i) Renting of a vacant land which is given on lease or licence for construction of building or temporary structure at a later stage to be used for furtherance of business or commerce has been made liable to service tax by the Finance Act, 2010 under the category of renting of immovable property service under section 65(105)(zzzz) of the Finance Act, 1994. Explanation 1 to section 65(105)(zzzz) of the Finance Act, 1994 defining immovable property has been amended to include such land.
- (ii) Services provided under a contract for promotion or marketing of a brand of goods, service or event or endorsement of name, trade name, logo or house mark of a business entity by appearing in advertisement and promotional event have been brought under the service tax net vide the Finance Act, 2010 vide section 65(105)(zzzzq) of the Finance Act, 1994. Carrying out any promotional activity for such goods, service or event will also attract service tax. The services can be provided to any person by any other person either through a business entity or otherwise.
- (iii) The definition of passenger under section (77c) of the Finance Act, 1994 was amended by the Finance Act, 2010 to the effect that air transport of crew members on board the aircraft became taxable. However, simultaneously, *Notification No. 25/2010 ST dated 22.06.2010* was issued to exempt the air travel of the crew members on board the aircraft.
- (c) (i) Where the affixation of retail sale price on packaged software is mandatory, (i.e. the software is covered under the provisions of section 4A of the Central Excise Act, 1944), the assessable value for the purpose of charging additional duty of customs leviable under section 3(1) of the Customs Tariff Act, 1975 is deemed to be the

retail sale price declared on such packaged software less the amount of abatement, if any, granted by the Central Government under section 4A of the Central Excise Act, 1944.

- (ii) Where the affixation of retail sale price on packaged software is not required under the Standards of Weights and Measures Act, 1976, the assessable value for the purpose of charging additional duty of customs leviable under section 3(1) of the Customs Tariff Act, 1975 is the value computed as per the provisions of section 14 of the Customs Act, 1962 less the value representing consideration for transfer of right to use such packaged software.

The affixation of retail sale price will not make any difference in respect of assessment of other duties of customs.

Question 3

- (a) *M/s XYZ Co. Ltd is engaged in the manufacture and sale of machine parts for sugar machinery. The goods were sold at certain prices on the basis of which excise duty was paid at the time to removal from the factory. Following certain negotiations with the customers the price of goods already cleared were retrospectively revised upward. Consequently M/s XYZ Co. Ltd issued supplementary invoices to its customers and realized the differential price as per the said invoices. Differential excise duty consequent upon the said revision in prices was also calculated and remitted to the Government account. A show cause notice has been issued on M/s XYZ Co. Ltd by the excise department demanding interest on delayed payment of duty under section 11AB of the Central Excise Act, 1944. Discuss with a brief note whether the stand taken by the central excise department is correct in law. You may refer to decided case law if any in support of your answer.* (6 Marks)

- (b) *"Efficient Collections" (EC) entered into a license agreement with the Airport authority in terms of which EC were granted the right to collect entrance fee from visitors to the airport. The central excise department has issued a showcase notice on EC claiming service tax on the collections made by EC on the ground that these are services provided to a customer in the Airport and hence taxable under the Finance Act, 1994.*

Discuss with reference to decided case law if any whether the stand taken by the central excise department is correct in law. (6 Marks)

- (c) *PQR Ltd. imported certain machine parts and filed a Bill of Entry in the usual course. The said machine parts are entitled for concessional rate in terms of a notification. The assessee PQR Ltd. omitted to claim the benefit of the aforesaid notification at the time of filing and assessment of the Bill of Entry. Later when PQR Ltd., discovered about the benefit under the notification as aforesaid they filed a refund claim for the excess amount paid as customs duty under section 27 of the Customs Act, 1962. There was no assessment order since the duty was paid on the basis of the Bill of Entry filed in the usual course. The refund claim was rejected on the ground that section 27 of the Customs Act, 1962 could be invoked only if an assessment order has been passed and*

duty payment made pursuant thereto. Discuss with a brief note and decided case law if any whether the stand of the department is correct in law. (3 Marks)

Answer

- (a) As per section 11A(2B) of the Central Excise Act, 1944, the assessee in default is not served with the demand notice under section 11A(1) of the Act if he makes payment of the unpaid duty **on the basis of his own ascertainment** or as ascertained by a Central Excise Officer. Further, Explanation 2 to this sub-section provides that such payment is not exempt from interest chargeable under section 11AB. Section 11AB which deals with interest on delayed payment of duty also reiterates the same position.

In the given case, the assessee has paid the enhanced duty on the increased prices of the goods on account of negotiations with the customers, on his own ascertainment. Therefore, in view of the above provisions, interest would be leviable on the differential duty paid by the assessee.

The Supreme Court has also conformed to the above position in the case of *CCE v. International Auto Ltd.* 2010 (250) E.L.T. 3 (S.C.) wherein it has held that it becomes clear from the scheme of section 11A(2B) and section 11AB of the Act that interest is levied for loss of revenue caused on any count. In this case also, the price, on the date of removal/clearance of the goods, was not correct i.e., it was understated. The enhanced duty was leviable on the corrected value of the goods on the date of removal. When the differential duty was paid after the date of clearance, it indicated short-payment/short-levy on the date of removal, hence, interest which was for loss of revenue, became leviable under section 11AB of the Act.

In view of the above discussion, the stand taken by the Central Excise Department is correct in law.

- (b) Yes, the stand taken by the Central Excise Department that the services provided by the Efficient Collections (EC) are taxable under Finance Act, 1994 and that EC is liable to pay service tax thereon are correct in law. As per amended section 65(105)(zzm) of the Finance Act, 1994, **any service** provided to any person, by airports authority **or by any other person**, in any airport is liable to service tax and all such services would be classified under the category of 'airport service'. In view of the amended definition, the services provided by EC would be liable to service tax under 'airport services'.

Further, the High Court in the case of *CCE v. P. C. Paulose* 2010 (19) STR 487 (Ker.) has held that even though the respondent was not providing the service in the Airport which was done by the Airport Authority, once the licence was given by the Airport Authority to the respondent to permit entry and allow enjoyment of the services provided there to the customers, respondent, in fact, became the service provider, though he was only acting as an agent under the licence agreement with the Airport Authority. Therefore, the High Court held that respondent being the service provider was liable to pay the service tax.

Note: It may be mentioned that the finding of the High Court has been confirmed by the Supreme Court in *P. C. Paulose v. CCE* 2011 (21) STR 353.

- (c) Section 27(1) of the Customs Act, 1962, *inter alia* provides that any person claiming refund of any duty and interest:

- (i) paid by him in pursuance of an order of assessment; **or**
- (ii) borne by him,

may make an application for refund of such duty and interest.

Since clauses (i) and (ii) of sub-section (1) of section 27 have the expression 'or' in between them, it is clear that application for refund cannot only be made in pursuance of an assessment order but also when the duty is borne by the applicant. In fact, section 27(1)(ii) aims to cover those very cases where the duty is paid by a person without an order of assessment.

The above conclusion has also been confirmed by the High Court in the case of *Aman Medical Products v. CCus. 2010 (250) E.L.T. 30 (Del.)* wherein the High Court has held that it is not necessary that a refund can be claimed only when the duty paid by the importer is in pursuance to an order of assessment. The refund can also be claimed when the duty paid by the importer is 'borne by him'.

In view of the above discussion, the stand taken by the Department is not correct in law.

Note: This case has been appealed to Supreme Court and appeal is pending in 2010(256)ELT A57(Supreme Court).

Question 4

- (a) *The assessee M/s T & Co. Ltd were engaged in the manufacture of 'tarpaulin made ups'. This was nothing but tarpaulin cloth prepared by making a solution of wax, aluminum stearate and pigments that were mixed. The solution was heated in a vessel and was transferred to a tank. Grey cotton canvas fabric was then dipped into the solution and passed through two rollers, whereafter the canvas was dried by exposure to sun. The tarpaulin made ups were prepared by cutting the cloth into various sizes and stitched and eyelets were fitted. The central excise department has issued a show cause notice to M/s T & Co. Ltd. that the tarpaulin made ups prepared by means of cutting, stitching and fixing eyelets amounts to manufacture under the Central Excise Act, 1944. Write a brief note with reference to decided case law if any whether the department's view in the matter is legally sustainable. (6 Marks)*
- (b) *M/s Sure Shot are in the business of providing photography services. These services involved besides shooting photographs activities such as developing and printing the exposed films. M/s Sure Shot availed the benefit of Notification No 12/2003-ST dated 20-6-2003 which provides exemption for materials that are sold by the service provider to the extent of the value of such materials from the value of taxable services. The department has issued a show cause notice that the value of materials actually consumed during the processing of exposed films cannot be excluded from the gross value of the services. M/s Sure shot had paid VAT on the materials consumed in providing the photography services to its customers. Discuss with a brief note and*

decided case law if any whether the stand taken by the department is correct in law for purposes of levy of service tax in terms of the Finance Act, 1994. (6 Marks)

- (c) *M/s SRT Ltd. had imported certain goods and got them cleared for home consumption. Later the customs department found that the goods have been improperly imported and are liable for confiscation under section 111 of the Customs Act, 1962 even though the same are cleared and not available for the seizure. Consequently the goods were confiscated under section 111(d) of the Customs Act, 1962 and a penalty under section 112(a) was levied. The authority has also imposed redemption fine under section 125 of the Customs Act, 1962. Discuss with a brief note whether the penal action and redemption fine can be legally upheld in the facts of the case. (3 Marks)*

Answer

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

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

- (b) The facts of the given case are similar to the case of *CCE v. Vahoo Colour Lab*. 2010 (18) S.T.R. 548 (P & H). In the instant case, the High Court, following the judgment of *Bharat Sanchar Nigam Ltd. v. Union of India*, 2006 (2) S.T.R. 161 (S.C.) has observed that processing of photography cannot be completed without the developing and printing process.

The photography films, printing papers, chemicals and envelopes are the integral and essential ingredients to complete the process of photography and thus, the components of sale of photography, developing and printing etc. are clearly distinct and discernible than that of photography service. The High Court has, therefore, held that photography is in the nature of works contract involving the elements of both sale and service and thus service tax would not be leviable on the sale portion.

However, rule 5(1) of the Service Tax (Determination of Value) Rules, 2006 (referred to as Rules hereafter) (applicable from 18.04.2006) provides that the expenditure or costs incurred by the service provider in the course of providing taxable service forms integral part of the taxable value of the service provided and therefore, should be included in the value of the taxable service. Such expenditure or costs would be included even if they are separately indicated in the invoice or bill issued by the service provider to his client. Such expenditures or costs can be excluded from the value of the taxable services only if the same are incurred by the service provider as a 'pure agent' of the service receiver.

- (c) The intent of the question is to check the students' knowledge regarding imposition of redemption fine and levy of penalty when goods are not available for confiscation. Hence, the following answer has been given in reference of the same.

The High Court in the case of *CCus. (Imports) v. Finesse Creation Inc. 2009 (248) ELT 122 (Bom.)* has held that redemption fine can only be imposed when the goods are available and can be redeemed. The High Court has explained that if the goods are not available, they cannot be confiscated and consequently cannot be redeemed. Once goods cannot be redeemed, redemption fine cannot be imposed.

Therefore, the imposition of redemption fine is not legally correct in the instant case.

Penalty under section 112 can be imposed *inter alia* when a person omits to do any act which would render such goods **liable for confiscation** under section 111. Therefore, penalty can be imposed in the given case.

Notes: This ruling of the High Court has been maintained by the Supreme Court in *Commissioner v. Finesse Creation Inc. 2010 (255) E.L.T. A120 (SC)*.

Question 5

- (i) Write a brief note on who could be considered as a 'related person' under section 4(3)(b) of the Central Excise Act, 1944.
- (ii) Briefly explain the following expression under the Central Excise Act, 1944:- "Place of removal". (2 × 3 = 6 Marks)
- (b) (i) State briefly the provision regarding rejection of value and determination of value by central excise officer under Rule 4 of the Service Tax (Determination of Value) Rules, 2006.
- (ii) Explain briefly the invoice method for computation of VAT. (2 × 3 = 6 Marks)
- (c) Explain with a brief note with reference to the Customs Act, 1962 how duty ought to be determined where the imported goods consist of articles liable to different rates of duty and imported as a "set of articles" (3 Marks)

Answer

- (a) (i) As per section 4(3)(b) of the Central Excise Act, 1944, persons are deemed to be "related", if:-
- (i) they are inter-connected undertakings
 - (ii) they are relatives
 - (iii) amongst them the buyer is a relative and a distributor of the assessee or a sub distributor of such distributor, or
 - (iv) they are so associated that they have interest, directly or indirectly, in the business of each other.

- (ii) As per section 4(3)(c) of the Central Excise Act, 1944, “place of removal” means –
- (i) a factory or any other place or premises where excisable goods are being produced or manufactured
 - (ii) a warehouse or any other place or premises wherein the excisable goods have been permitted to be deposited without payment of duty
 - (iii) a depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearance from the factory
- (b) (i) The provisions of rule 4 of the Service Tax (Determination of Value) Rules, 2006 are as under:-
- (i) The Central Excise Officer is empowered to satisfy himself as to the accuracy of any information or document furnished for valuation. The provisions of rule 3 do not restrict or put to question such power of the Central Excise Officer.
 - (ii) The Central Excise Officer can reject the value determined by the service provider and issue a show cause notice to him, if he is of the opinion that the value determined by such service provider is not in accordance with the provisions of the Finance Act, 1994 or these rules. The service provider would then be required to show cause why the value of taxable service should not be fixed at the amount specified in such notice.
 - (iii) The Central Excise Officer, after giving such service provider an opportunity of being heard, will determine the value of such taxable service in accordance with the provisions of the Finance Act, 1994 and these rules.
- (ii) Under invoice method, at each stage of sales, VAT is imposed on the full sales value and VAT paid at the earlier stage is allowed as set off. Hence, at every stage the difference between the VAT payable at the time of sales and VAT paid at the time of purchases is required to be paid.
- Under this method, at each stage, VAT is charged separately in the invoice. It is the most common and popular method of computing VAT. In India also this method is followed for computation of State-Level VAT and CENVAT. It is also known as the 'Tax Credit Method' or 'Voucher Method'.
- (c) The provisions relating to calculation of duty in case of goods imported as ‘set of articles’ are contained in section 19 of the Customs Act, 1962. As per section 19, if the articles in the set are liable to duty at different rates, duty will be charged at the highest rate. Even articles not liable to duty would be chargeable to such highest rate.
- However, if the importer is able to produce evidence regarding the value of any of the articles liable to different rates of duty, the article would be charged to duty separately at the rate applicable to it. Further, if accessories/spare parts/maintenance and repairing implements of any article are compulsorily supplied with the article and if no separate charge is made for such supply, they would be chargeable at the same rate of duty as that of the article.

Question 6

- (a) Write a brief note with reference to the Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001 on the provisions relating to the following cases:
- (i) Consequence of goods not being used for intended purposes.
 - (ii) Defective, damaged, unsuitable, surplus goods returned to manufacturer.
 - (iii) Goods lost or destroyed by natural causes or unavoidable accident and not used for intended purpose. (6 Marks)

OR

- (a) (i) Write a brief note under the Central Excise Act, 1944 in the context of provisions relating to 'payment of duty under protest'.
- (ii) Briefly state the provisions under the Central Excise Rules, 2002 with respect to filing of 'Annual Installed Capacity Statement'. (2 × 3 = 6 Marks)
- (b) (i) Briefly explain whether the provisions of 'deemed registration' under rule 4(5) of the Service Tax Rules, 1994 are applicable in case of centralized registration.
- (ii) What are the circumstances under which VAT registration could be cancelled? Write a brief note. (2 × 3 = 6 Marks)
- (c) Explain briefly the powers of review to the Commissioner of Customs under section 129D(2) of the Customs Act, 1962 in respect of decisions taken by adjudicating authority subordinate to him. (3 Marks)

Answer

- (a) The provisions of the Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001 in relation to the following cases are explained as under:
- (i) Consequence of goods not being used for intended purpose:-
If the material received at concessional rate of duty is not used for intended purpose, the manufacturer is liable to pay the amount equal to the difference between the duty leviable on such goods without the concession available under these rules and that already paid, if any, at the time of removal from the factory of the manufacturer of the subject goods, along with interest.
The provisions of section 11A and section 11AB of the Central Excise Act, 1944 apply *mutatis mutandis* for effecting such recoveries.
 - (ii) Defective, damaged, unsuitable, surplus goods returned to manufacturer:-
If the manufacturer on receiving the subject goods finds them to be defective or damaged or unsuitable or surplus to his needs, he may return the subject goods to the original manufacturer of the goods.

Such returned goods are added to the non duty paid stock of the manufacturer of the subject goods and dealt with accordingly.

- (iii) Goods lost or destroyed by natural causes or by unavoidable accident and not used for intended purpose:-

If the goods are lost or destroyed by natural causes or by unavoidable accident during transport from

- the place of procurement to the manufacturer's premises or
- from the manufacturer's premises to the place of procurement or
- during handling or storage in the manufacturer's premises,

the manufacturer is liable to pay the amount equal to the difference between the duty leviable on such goods without the concession available under these rules and that already paid, if any, at the time of removal from the factory of the manufacturer of the subject goods, along with interest.

The provisions of section 11A and section 11AB apply *mutatis mutandis* for effecting such recoveries also.

- (a) (i) If the assessee does not agree to the classification or assessable value of goods determined by the excise authorities, he can file an appeal and till the time the appeal is decided, can pay the duty under protest if no stay is obtained from Appellate Authorities. However, if the appeal is not decided in his favour and the appellate remedy is exhausted, the assessee will lose the right to pay duty under protest. The time limit of one year for claiming refund of excise duty does not apply if duty is paid under protest.

The assessee will inform the Superintendent/Inspector of Central Excise that he is paying duty under protest in writing. He will mark invoices or monthly/quarterly returns indicating the goods on which duty is paid as 'under protest'. In case of lump-sum duty payment of past demand, he may record the fact of duty payment under protest in the PLA, CENVAT account or Daily Stock Account.

- (ii) Every assessee has to submit to the Superintendent of Central Excise an Annual Installed Capacity Statement declaring the annual production capacity of the factory for the financial year to which the statement relates by 30th April of the succeeding financial year in Form ER-7 [Rule 12(2A)].

However the assessee's manufacturing biris, matches, reinforced cement concrete pipes under prescribed conditions are exempt from the submission of Annual Installed Capacity Statement.

- (b) (i) An application for service tax registration is made to the Superintendent of Central Excise under rule 4(1) of the Service Tax Rules, 1994. As per rule 4(5), registration certificate is to be granted by the Superintendent of Central Excise within seven days from the date of receipt of application and that the certificate is deemed to be granted if the same is not issued by the Department within the said seven days.

However, centralized registration is granted by the jurisdictional Commissioner of Central Excise under rule 4(2) of the Service Tax Rules, 1994 and no time-limit for the grant of the same has been prescribed for such a case.

Thus, it can be inferred that the provisions of deemed registration under rule 4(5) are attracted only in case where the registration is applied under rule 4(1) to the Superintendent of Central Excise and not in case of centralized registration applied under rule 4(2) to the jurisdictional Commissioner of Central Excise. The High Court in the case of *Karamchand Thapar & Bros. (Coal Sales) Ltd. v. UOI 2010 (20) S.T.R. 3 (Cal.)* has also conformed to the above view.

(ii) VAT registration can be cancelled in following circumstances:

- (i) discontinuance of business; or
- (ii) disposal of business; or
- (iii) transfer of business to a new location; or
- (iv) annual turnover of a manufacturer or a trader dealing in designated goods falls below the specified amount.

(c) Section 129D(2) empowers the Commissioner of Customs to review any decision taken by the adjudicating authority subordinate to him. The Commissioner may on its own, call for and examine the record of any proceeding in which an adjudicating authority subordinate to him has passed any order to satisfy himself as to the legality or propriety of the order.

Thereafter, the Commissioner may direct such authority or any officer of customs subordinate to him to apply to the Commissioner (Appeals) to determine such points as may be specified by him.

Such an order has to be made within a period of 3 months from the date of communication of the decision or order of the adjudicating authority.

Question 7

(a) (i) *Write a brief note on the classification of incomplete/unfinished articles with reference to Rule 2(a) of the Interpretative Rules to the First Schedule of the Central Excise Tariff.*

(ii) *Write a brief note on the matters with respect to which an appeal does not lie before the Customs Excise Service Tax Appellate Tribunal against any order passed by Commissioner (Appeals), under section 35B of the Central Excise Act, 1944*

(2 × 3 = 6 Marks)

(b) (i) *Briefly state the charges/services that are specifically excluded from the category of special services provided by builder to the prospective buyer of a residential/commercial complex under section 65(105)(zzzu) (sic.) section 65(105)(zzzzu) of the Finance Act, 1994.*

- (ii) *State briefly the key principles adopted by the States under the VAT laws with regard to incentive schemes.* (2 × 3 = 6 Marks)
- (c) *Explain briefly how the terms 'warehouse', 'warehoused goods' and 'warehousing station' are defined in the Customs Act, 1962.* (3 Marks)

Answer

- (a) (i) As per rule 2(a)(i) of the Interpretative Rules to First Schedule of the Central Excise Tariff, if any particular heading refers to a finished/complete article, the incomplete/unfinished form of that article would also be classified under the same heading provided the incomplete/unfinished goods have the essential characteristics of the finished goods.
- (ii) As per section 35B of the Central Excise Act, 1944, the matters in respect of which an appeal does not lie before the Customs Excise Service Tax Appellate Tribunal against any order passed by Commissioner (Appeals) are as follows:-
- case of loss of goods during transit or during their processing in a warehouse or in storage in a factory or a warehouse
 - rebate of excise duty on export goods or on excisable materials used in the manufacture of export goods or goods exported without payment of duty (except exports to Nepal or Bhutan);
 - CENVAT credit which is utilized for payment of excise duty on final products
- (b) (i) Special services provided by a builder to the prospective buyer of a residential/commercial complex under section 65(105)(zzzzu) of the Finance Act, 1994 do not include the following service/charges:-
- Management, maintenance or repair services
 - Commercial or industrial construction and construction of complex
 - Services in relation to parking place
- (ii) The key principles adopted by the States while framing various incentive schemes under the VAT laws are as under:
- VAT chain should not be disturbed.
 - There should not be any further revenue loss to the States.
 - The Department should be able to track the transactions and should ensure that there is no evasion/avoidance of tax due to the policy.
- Further, the States who have continued the old incentive schemes in the form of exemption/deferment considered the following additional issues:
- the units enjoying exemption under the old law should not be put to disadvantageous position under the VAT system.
 - the units purchasing inputs without payment of any tax should be allowed to enjoy the benefit under the new system also.

- (c) As per section 2(43) of the Customs Act, 1962, 'warehouse' means a public warehouse appointed under section 57 or a private warehouse licensed under section 58.

Section 2(44) of the Customs Act, 1962 defines 'warehoused goods' to mean goods deposited in a warehouse.

As per section 2(45) of the Customs Act, 1962, 'warehousing station' means a place declared as a warehousing station under section 9.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF CANDIDATES

PAPER – 5 : ADVANCED MANAGEMENT ACCOUNTING

Question 1.(a) When and Whether to manufacture : The students were required to decide on the range of market demand for which fully manufacture or sub contract or no production at all was recommended. A few students did this right. Some did the BEP for the 2 products. Many worked out the indifference point for preference of one option over the other, but did not do the BEP part and many did the BEP for only one product. Most students failed to conclude properly. They had a set of figures in front of them, but were unable to conclude. Even when some concluded, they gave one conclusion contradicting their own earlier conclusion. Application of concept was found lacking.

(b) Process further or not- Incremental Cost Approach: A very few students used the incremental cost approach. Most tried to work out the total costs under each option. Some concluded wrongly.

(c) Limitations on assumptions of PERT and CPM: Students were not prepared at all for this though this is a repeatedly asked question from the study material. Most students converted the question into differentiating between PERT and CPM and wasted time on lengthy answers. Generally, performance was poor.

(d) Classification of Quality Costs: This was a new type of question, which tested the application of the concept of quality costs. Performance was moderate on the whole.

Question 2.(a) Standard Costing – Sales Margin Variances: Many students lacked understanding of the concept of eliminating cost variances from the margin variances by taking the budgeted cost for both actual and budgeted margins. This fundamental mistake has been committed earlier also. Most students identified that the variances were favourable or adverse, but a few of them interchanged the favourable and adverse tags. Some were confused whether to take the margins and compute or just the selling price. Many did not know the mix variance calculation. Some had price, volume and mix variances interchanged.

(b) Assignment – (Operations Research): Many students lacked understanding of the concept of the topic. They did not use the information of the part answer given in the question. They laboured out fully from the start. Many had fruitfully used the information and proceeded from that point to finish it quickly. Some students could not interpret the solution for finding the discount figure.

Question 3.(a) ABC Costing: This was an analytical question. Students applying their minds on a basic cost-benefit analysis would have attempted reasonably. Very few got this fully right. Normally, students perform very well on ABC system of costing, by using their calculator and routinely distributing overheads among products. This question sought to test their fundamentals on appreciating ABC system and its suitability. They had no grasp of the

concept. But a good number did justice to the second part. Even those who reasonably analysed were not able to report effectively. Performance was poor.

(b) Transfer Pricing: This question was a test on the entire topic of transfer pricing. The question had an error on the transferring division. But most students took it correctly and stated the assumption. Many were able to appreciate only the usual variable cost or market price transfers. Most were able to do part (vi) by adding specific transfer costs to the price. Performance was average.

Question 4.(a) Performance Budget: Most students fared very well. Calculations were simple. A few missed out marks for not classifying into the fixed and variable parts. A very few students did badly.

(b) Marginal Costing with step costs: Many students ignored the step fixed costs concept. They calculated these as variable costs.

Question 5.(a) Relevant Costs for decision making: Most students fared very badly. Though they normally get good marks when a theory is asked on relevant costs, they exhibited complete lack of knowledge. The problem had very minor calculations. A few students got the answer, presented a clear solution and got full marks. Performance was poor on the whole.

(b) Simplex – Linear Program (Operations Research): Most of the students got the first part of formulating the inequations. Many tried to complete the table. But the question gave a portion of the table and required interpretation of the numbers. Students are probably used to memorising the steps and therefore had no understanding of what the contents of the table are. Student have not read the study material, where the meanings of these figures are well discussed.

Question 6.(a) – Network – (Operations Research): Many students did not even draw the network properly. There was a mistake in the problem on the float of a particular activity. But students did not even reach there. This was a reverse question. Given the floats and the ESTs, they had to find the paths and their durations. Actually, the problem could have been solved very simply by subtracting the floats of each path from the total duration. **Very few** students understood this concept and submitted a neat and effortless answer.

(b) Pricing Strategy: Many students had not read through this portion clearly, though this is a repeatedly asked topic.

(c) P/V ratio- Product performance: Most students got this right. Some cared to give an example. But many wrote precisely and got the marks.

Question 7.(a) Steps in Simulation Process – (Operations Research): Though the general simulation process was asked, many students wrote about Monte Carlo simulation and explained the problem solving process. Many students had not prepared well enough from the study material, though this is an often repeated question. Some secured full marks, some got zero, and some got one or two. Performance in general was average.

(b) Learning curve theory – (Operations Research): This is a repeated question. Some students lost marks as they tried to explain the same point as many. Performance was average.

(c) Life cycle of a product: Performance was mostly good as this was an easy and repeated question.

(d) Pareto analysis: Most students had prepared well. Performance was good.

(e) Just -in -time concept: Many students only discussed the raw material aspect and missed the marks. This is also a repeated question. Performance was average.

PAPER – 6: INFORMATION SYSTEMS CONTROL AND AUDIT

Question 1. It was a simple case study based question comprising four sub parts.

(a) For the first part, most of the candidates were able to identify the areas, which are required to be studied in order to know about the present system. In second part, problems faced by ABC Udyog were also covered fairly well by quite a few students. However, some candidates could not link the questions with the case study but they answered theoretically correct. Performance was average for this question.

(b) Most of the candidates mentioned the reasons for selecting ERP solution with a detailed description. Hence, the performance was very good for this part.

(c) Only a few candidates mentioned about the trainings to various stakeholders for effective utilization of the proposed new system and standards. Overall performance was below average for this question.

(d) Most of the candidates explained different backup techniques with their proper explanation. However, some of them had difficulty to differentiate between differential and incremental backup; accordingly for recommending one backup technique for the given case. Hence, performance was average for this part.

Question 2.(a) 'Information' and its important attributes were discussed by the candidates well. Accordingly, very good performance was observed for this part.

(b) Only a few candidates wrote the correct answer. Some of the candidates have not been specific to the System Requirements Specification (SRS) and therefore, they could not write the content precisely. Overall performance was average for this question.

(c) In many cases, discussion was focused both on generalized view and technicalities and not on the core significance of Post Implementation Review. Overall performance was average for this question.

Question 3.(a) Though the concept of 'Risk Assessment' was clear to most of the candidates but quite a few candidates could not write about its various areas that needed to be focused. Accordingly, an average performance was observed for this part.

(b) Most of the candidates wrote the appropriate answer. However, some of the candidates gave a generic answer and they have not been specific to various roles involved in the SDLC, as asked in the question. But, overall performance was good.

(c) Flowchart to find the sum of first 50 even numbers, starting from 2 was not drawn correctly by most of the candidates; very poor understanding of the logic was observed in most of the cases. Overall performance was below average for this part.

Question 4.(a) This part dealing with various General Components of a Disaster Recovery Plan was answered well by the candidates. Hence, performance was good for this part.

(b) Most of the candidates did not attempt the question in the desired way by explaining Data Privacy, Policy Communication-P3P and Policy Enforcement- XACML, EPAL and WS-Privacy. Hence, the performance was poor.

(c) Very few candidates wrote about the significance of audit trail to support security objectives. Hence, overall performance was average for this part.

Question 5.(a) In this question, many candidates listed threats with a generic description; many wrote about the categories of controls without explaining 'what control works for what threat'. But, overall performance was average.

(b) Most of the candidates attempted the question well by explaining major advantages and disadvantages of Continuous Auditing Techniques. Hence, performance was good.

(c) The question based on the commonly known techniques to assess and evaluate risk was well attempted by the candidates. However, a few candidates did not understand the question and wrote irrelevant techniques. Overall performance was good.

Question 6.(a) For the first part, candidates explained the significance of Business Impact Analysis up to a satisfactory level. But, most of the candidates were not able to enumerate the tasks to be undertaken in BIA. Very few candidates could write the ways by which information can be obtained for this analysis. Overall performance was average for this question.

(b) Many of the candidates discussed the information security policies well but some of them could not show the hierarchy of these policies by chart/diagram. Overall performance was average.

(c) First part based on the Composition of Cyber Regulatory Appellate Tribunal was not properly answered by many candidates; however, most of the candidates wrote the powers of the Tribunal, correctly in the second part. As a result of this, average performance was observed for this part.

Question 7. Question was based on the short notes.

(a) General description of Operating System was given by most of the candidates instead of giving some of its fundamental objectives. Hence, overall performance was average for this part.

(b) Most of the candidates could not answer this question properly by explaining Information systems maintenance and its various types; rather, it was interpreted in terms of AMC by many candidates. Hence, overall performance was below average for this part.

(c) Meaning of the Client/Server Technology was explained well by most of the candidates but further explanation about the same was not given by many candidates. Performance was average for this part.

(d) The question was based on the 'Locks on Doors with respect to Physical Access Control'. The candidates, who understood the question, attempted well; otherwise many candidates could not write the answer appropriately. Overall performance was below average for this part.

(e) Most of the candidates had fairly clear understanding of HIPAA while security rule was not clear to many candidates. An average performance was observed for this part.

PAPER – 7 : DIRECT TAX LAWS

General Comments

- (1) The presentation of the answers were poor.
- (2) Precise legal terminology were used by very few candidates.
- (3) Communication skills were poor.
- (4) For questions 1(a) and 2, most of the students could not adduce proper reasons for the tax treatment of the concerned items. The brief nature of the item as appearing in the question paper and the amount were reproduced by many of them.
- (5) Few students could correctly state the provisions involved in solving the answers for the impugned questions.
- (6) Even students who appear to know the answers, simply mentioned correctly the case law involved and the conclusion. Students should understand that they must also clearly state the rationale involved in their answer.

Specific Comments

Question 1.(a) Most of the students did not know the concept involved in income to be applied by a charitable trust as per the provisions of section 11 of the Income-tax Act, 1961. Very few students could solve this problem in satisfactory manner.

(b) These two sub-divisions were answered satisfactorily by several students. However, the precise treatment as regards building under construction was meted out by few students only.

(c) Though the clubbing provisions in wealth-tax relating to a minor child were known to most of the students, some of them did not understand that assets acquired out of capital gains arising from sale of an asset, is liable for clubbing.

(d) This sub-division was the most poorly answered one amongst all the sub-divisions in the question paper. Most of the students wrongly opined that the rules enshrined in Schedule III of the Wealth-tax Act, 1957 are not binding on Valuation Officers.

Question 2. Proper treatment of various issues in this question [i.e., waiver of bank loan principal and interest, disallowance of payment made to contractor without TDS and depreciation on intangible asset (franchise fee)] was not known to many students.

Question 3.(a) Many students did not know the proper treatment of unabsorbed depreciation. Certain students were not aware of the concept involved in the computation of presumptive income and computed the deductions from the total turnover of ₹ 55 Lakhs and arrived at the total income.

(b) Several students wrongly concluded that the resultant capital gain was long term in nature and hence went wrong in the entire computation, thus losing valuable marks.

(c) This sub-division evoked a satisfactory response, though precision was lacking.

Question 4.(a) Though most of the students stated that the CBDT had the power to condone the delay, only a few of them could state the provisions of section 119(2)(b).

(b) This sub-division was answered in a satisfactory manner by several students.

(c) Several students simply stated that the liquidated damages received was a capital receipt and hence not taxable. They could not elaborate the reasons as to why the said receipt had to be treated as a capital receipt.

(d) Though most of the students could decipher that TDS provisions under section 194-I were involved, they did not adduce reasons as to why the landing and parking charges paid by the airlines constituted "rent".

(e) By and large, this sub-division met with a satisfactory response. The underlying reasons could however, be precisely pinpointed by few students only.

Question 5.(a) Vague and general answers were given for this sub-division.

(b) Several students were not aware of the correct interpretation of the provisions of chapter XII-A of the Income-tax Act, 1961.

(c) This sub-division was also one of the poorly answered questions. Neither the precise consequence, nor the remedies available, were known to several students.

Question 6.(a) The general aspects of survey as per the provisions of section 133A were known to many students. However, the power to impound books was not known to several students.

(b) Though the conclusions could be correctly drawn in a satisfactory number of cases, several students did not explain the provision of sections 80 and 139(3) of the Income-tax Act, 1961.

(c) The validity of the reassessment proceeding was properly explained by few candidates only. Very few amongst them were aware of the option available to the Department in this regard.

(d) Most of the students did not give satisfactory answers for both the sub-divisions.

Question 7(a) Few students could correctly compute the deductions available under Chapter VIA.

(b) Provisions relating to interest chargeable under section 201(1A) were known to few students only.

(c) Vague and general answers were given by most students. Even the portion relating to tax treatment of both the items were satisfactorily explained by few students only.

PAPER – 8 : INDIRECT TAX LAWS

General Comments

The overall performance of the students was “above average” and many candidates were able to answer the numerical questions representing 25% of the total marks of the paper quite well. Moreover, a good performance in case law based questions particularly on Central excise and service tax enabled the candidates to score high marks. The students were well aware about the latest amendments also, which was reflected in the answers written by them for question no. 2. However, in most cases, the theoretical part was not attempted adequately owing to lack of preparation and the concepts not being understood properly by the students.

Question 1. This is a compulsory question with sub-parts (a) to (e) involving numerical problems to be solved based on application of law in Central excise, customs, service tax and VAT. Most of the students were able to attempt this part quite satisfactorily.

(a) Many candidates did not consider turnover of previous tenant and some candidates wrongly treated the turnover/clearance of branded goods.

(b) While computing cost of production, many candidates included ‘administration cost not related to production’ also.

(c) Very few candidates provided proper reasoning for not including commission on distribution of UTI mutual fund & on procurement of advertisements. The abatement of 30% for services of processing parts & accessories of cycles was also not clear to the most of the candidates.

(d) Set off of input tax credit of goods ‘Y’ and ‘Z’ and branch transfer was wrongly treated by most of the candidates.

(e) Many candidates got confused in rate of exchange. Some candidates added design and development charges in UK to find FOB and few candidates added design/development charges paid in India also while arriving at the assessable value.

Question 2. The performance was generally satisfactory as the questions were based on the recent amendments. However, in sub-part (a), some candidates wrongly concluded that no CENVAT credit is available for services used in repair/renovation of factory/office. In sub-part (b), the category of service in which the services were taxable and reasoning thereof were not provided correctly.

Question 3 and 4. The performance with respect to the case law based problems on Central excise was satisfactory in general while the problems relating to customs and service tax revealed that candidates had not fully understood the application of the legal concepts involved in the same. The analysis of the cases was not up to the mark. In sub-part (c), only few candidates arrived at the correct conclusion that penalty under section 112(a) can be imposed.

Question 5. The question on "Basic Concepts" in Central excise was answered well while in the case of customs and service tax, the answers showed that the candidates had not prepared adequately. In sub-part (c), most of the candidates only mentioned the point that imported goods would be valued at highest rate. They did not provide comprehensive answer elaborating the provisions of section 19 of the Custom Act.

Question 6. This question with a sectional choice is mainly on procedural parts and the performance was below average since it appears that the candidates had not particularly focused on the procedural aspects as part of their preparation. In sub-part (a)(ii) of the alternative question, only few candidates mentioned the exemptions from filing the Annual Installed Capacity Statement. In sub-part (b), some candidates wrongly opined that deemed registration is same as centralized registration under service tax.

Question 7. This question is a mix of procedure and substantive law and the performance was far from satisfactory since the candidates were not well equipped to deal with this portion. However, this question was least attempted.