No. of Questions: 6 **CM** **Total Marks: 100**
No. of Pages Printed: 4 **Time Allowed: 3 Hours**

Question No.1 is compulsory. Answer any FOUR from the rest.
All Working notes should form part of your Answer

1A. X Ltd. specializes in the distribution of pharmaceutical products. X Ltd. buys from pharmaceutical companies and resells to each of three different markets – P, Q & R. Given below is the data for the three markets, for the month of August 2007:

	P	Q	R
Average revenue per delivery	Rs. 30,900	Rs. 10,500	Rs. 1,980
Average cost of goods sold per delivery	Rs. 30,000	Rs. 10,000	Rs. 1,800
Number of deliveries	120	300	1,000

X Ltd. uses Gross margin percentage [(Revenue – Cost of goods sold) ÷ Revenue] to evaluate the relative profitability of its different distribution outlets. X Ltd. decides to consider using Activity Based Costing. The August 2007 operating costs (other than cost of goods sold) and the costs of each area along with the key activity areas and the details of cost drivers are as follows:

Other data for August 2007 are:

Particulars	P	Q	R
Total number of orders	140	360	1,500
Average number of line items per order	14	12	10
Total number of store deliveries	120	300	1,000
Average number of cartons shipped per store delivery	300	80	16
Average number of hours of shelf stacking per store delivery	3.0	0.6	0.1

Activity Area	Total Costs in August 2007 (Rs.)
1. Order processing	80,000
2. Line item ordering	63,840
3. Store deliveries	71,000
4. Carton deliveries	76,000
5. Shelf stacking	10,240
Total costs	3,01,080

Each order consists of one or more line items. A line item represents a single product. Each store delivery entails delivery of 1 or more cartons of products. Each product is delivered in 1 or more separate cartons. X Ltd. delivery staff stack cartons directly onto display shelves in a store. Currently there is no charge for this service and not all customers use X Ltd. for this activity.

Required:

1. Compute the August 2007 gross-margin percentages for its three distribution markets.
2. What is the operating income of X Ltd.?
3. Compute the operating income of each distribution market in August 2007 using the activity-based costing information. Comment on the results. What new insights are available with the activity-based information?
4. Describe four challenging problems X Ltd. would face in assigning the total August 2007 operating costs of Rs. 3,01,080 to the five activity areas.

(12 Marks)

1B. The following data pertains to a network. It is desired to compress the project to the least possible duration day and estimate the extra cost. Indirect Costs per day is Rs.600/-.

Activity	**Tn**	**Tc**	**Cost slope**
1-2	5	3	300
2-3	4	2	200
3-4	6	3	400
3-5	4	1	300
4-5	3	1	600

(8 Marks)

1C. List down the advantages of Balanced Score Card. **(4 Marks)**

2A. V Ltd. manufactures four products A, B, C & D and has set the following budget for 2008:

	A	B	C	D
Production (Units)	40,000	10,000	50,000	30,000
Selling Price per Unit (Rs.)	30.00	50.00	60.00	80.00
Cost per Unit				
Direct Materials (Rs.)	6.00	13.50	10.50	24.00
Direct Labour (Rs.)	7.50	10.00	18.00	24.00
Variable Overheads (Rs.)	4.50	10.00	12.00	13.00
Fixed Overheads (Rs.)	7.50	10.00	18.00	24.00
Profit / (Loss) (Rs.)	4.50	6.50	1.50	(5.00)

When the budget was placed before the Budget Committee, the Marketing Manager puts up a proposal to increase the sales by 20,000 additional units for which capacity existed. The additional 20,000 units could be one product or any combination of products. The proposal was accepted by the committee.
The committee also decided that the production capacity for the next year, namely 2009 would be set in such a way that there would be a further increase in the output by 50,000 units over and above the increase of 20,000 units envisaged for 2008. The additional production of 50,000 units would be of Product B only for which a new plant would be acquired. The additional fixed expenses of the new plant were estimated at Rs. 70,000 per annum during 2009, the material and labour costs were expected to increase by 10% but the other costs and selling prices would remain the same.

Required:
- (i) Set a budget for 2008 in such a way that the additional capacity of 20,000 units is utilized to maximise the profits.
- (ii) Set a budget for 2009.
- (iii) Assuming that the increased output may not fully materialize, calculate the number of units of Product B required to be sold in 2009 at the given price in order to ensure that profitability at least at 2008 level is maintained.

(14 Marks)

2B. What are the general rules for dealing with an order at lower than normal prices? **(5 Marks)**

3A. A bakery keeps stock of popular brand of bread. Previous experience indicates the daily demand as given below:

Daily Demand	10	20	30	40
Probability:	0.20	0.15	0.50	0.15

Using the following sequence of random numbers, simulate the demand for the next 10 days.
Random Numbers: 48, 78, 19, 51, 56, 87, 15, 14, 68, 8

(i) Find out the stock situation if the owner of the bakery decides to make 30 breads every day.
(ii) Estimate the daily average demand for the bread on the basis of simulated data. **(9 Marks)**

3B. The standard weight of a special purpose brick is 5 kg and it contains two basic ingredients B1 and B2. B1 costs Rs. 5 per kg and B2 costs Rs. 8 per kg. Strength considerations state that the brick contains not more than 4 kg of B1 and minimum of 2 kg of B2. Since the demand for the product is likely to be related to the price of the brick, find out graphically minimum cost of the brick satisfying the above conditions.

(7 Marks)

3C. Write a short note on Dummy Activity. **(3 Marks)**

4A. X Ltd. produces a chemical compound by processing two raw materials through a single stage process. Standard costs for processing 100 gallons of finished output have been calculated as follows:

	Rs.
Input of material X (55 gallons at Rs. 2)	110
Input of material Y (55 gallons at Rs. 1)	55
Direct Wages (2 hours)	60
Variable Overheads	80
Selling price (per 100 gallons)	370

Fixed overheads are budgeted at Rs. 30,000 per month. Normal wastage is 10 gallons per 110 gallons of input. Budgeted output is 60,000 gallons per month.

The following details relate to a recent month:

	Rs.
Material X (input 24,000 gallons)	53,000
Material Y (input 28,000 gallons)	26,000
Direct wage (900 hours)	31,000
Variable Overheads	35,000
Fixed Overheads	29,000

Output during the month was 50,000 gallons. Sales were 40,000 gallons with a total sales value of Rs. 1,46,000. You are required to compute all the variances which arose in the period.

(14 Marks)

4B. What is Benchmarking? What are its advantages? **(5 Marks)**

5A. Company Q has three divisions: B. S and L. It also deals with two other companies; X and Y. Division B can buy a widget from division S or from company X, which will meet S's market price of Rs.200 per unit. If B buys from X, X in turn buys a component from division L for Rs.40 per unit: the outlay costs to division L of supplying this component are Rs.20 per unit. In filling B's order, S would incur outlay costs of Rs.165 per unit. Assume that division S is working at full capacity and can provide the widget to an outside buyer (i.e company Y) at the same market price of Rs.200 per unit and with the same outlay costs of Rs.165 per unit.

What alternative would be best for Company Q as a whole – B buying from company X or division S? Show supporting calculations.

What transfer price should be used to guide the mangers of division B and S so as to maximise overall company net inflow (cash inflow)?

Suppose that division S has sufficient extra capacity to supply the widget to both division B and the outside buyer at the same time. How would this change your answers in parts (a) and (b)? Show supporting calculations.

(10 Marks)

5B. An unexpected order has been received for a product for which the labour and machine time is available and which requires three types of materials – A, B and C.

Material A – This material is used regularly within the firm for various products. The new order will require 1500 kgs. The present stock is 21,000 kgs purchased at Rs. 250 per kg. The current replenishment price is Rs. 265 per kg and it is estimated that if 1500 kgs is used on the new order, the normal stock replenishment order for A will have to be brought forward 3 weeks at which time it is estimated that the replenishment price will be Rs. 270 per kg.

Material B – 1000 kgs of this material are in stock purchased at Rs. 85 per kg and the new order requires 800 kgs. The current replacement price is Rs. 95 per kg. This material is used on no other product and recent enquiries revealed that the material in stock could be sold at Rs. 55 per kg.

Material C – 5000 kgs are required for the order and large quantities are in stock purchased at Rs.18 per kg. Because of heavy usage, the material is purchased weekly and the current price is Rs. 21 per kg.

What is relevant cost for decision making purposes of each of the three materials? **(6 Marks)**

5C. List down the three circumstances wherein Penetration Pricing can be adopted. **(3 Marks)**

6A. The Bombay Transport Company has trucks available at four different sites in the following numbers:

Site / Customer	W	X	Y	Supply
A	7	3	6	5
B	4	6	8	10
C	5	8	4	7
D	8	4	3	3
Demand	5	8	10	

Solve the above transportation problem. **(8 Marks)**

6B. Define Budget. What are the benefits and problems associated with budgeting? **(8 Marks)**

6C. List down any three practical Application of Assignment Model. **(3 Marks)**

PRIME ACADAMY
26TH SESSION MODEL EXAM
FINAL – COST MANAGEMENT AND QUNTITATIVE TECHNIQUES

1A.

1. Gross margin percentage of X Ltd.'s distribution markets:

S No	Particulars	P (RS)	Q (RS)	R (RS)	Total (RS)
1	Average Revenue per delivery	30,900	10,500	1,980	-
2	Average cost of goods sold per delivery	30,000	10,000	1,800	-
3	Average Gross profit per delivery (1 – 2)	900	500	180	-
4	Number of deliveries	120	300	1,000	1,420
5	Gross Profit for Aug 2007 (3 x 4)	108,000	150,000	180,000	438,000
6	Total Revenue	3,708,000	3,150,000	1,980,000	8,838,000
7	Gross profit percentage for Aug 07	2.91%	4.76%	9.09%	4.96%

2. Operating income of X Ltd:

Particulars	Amount (Rs.)
Gross Profit (as computed above)	438,000
Less: Total Operating costs	301,080
Operating Income for the month	1,36,920

3. Activity Based Costs for each distribution market: (Amounts in Rs.)

Sl. No.	Activity Area	Cost driver	Total cost in Aug 07	Basis of cost allocation based on the cost driver (P:Q:R)	Markets P	Markets Q	Markets R
1	Order processing	Number of orders	80,000	140 : 360 : 1500	5,600	14,400	60,000
2	Line item ordering	Number of line items delivered	63,840	1960 : 4320 : 15000 (1 x 2)	5,880	12,960	45,000
3	Store deliveries	Number of store deliveries	71,000	120 : 300 : 1000	6,000	15,000	50,000
4	Carton deliveries	Number of cartons delivered	76,000	36000 : 24000 : 16000 (3 x 4)	36,000	24,000	16,000
5	Shelf stacking	number of hours of shelf stacking	10,240	360 : 180 : 100 (3 x 5)	5,760	2,880	1,600
		Total	**301,080**		**59,240**	**69,240**	**172,600**

Profitability analysis of markets:

S No	Particulars	P	Q	R	Total
1	Traditional system followed by X Ltd.:				
a	Gross Profit percentage as per current system in X Ltd.	2.91%	4.76%	9.09%	4.96%
b	Rank under the traditional system	**3**	**2**	**1**	
2	Activity Based Costing:	**(Rs)**	**(Rs)**	**(Rs)**	**(Rs)**
a	Total Gross Profit	108,000	150,000	180,000	438,000
b	Less: Total operating costs under Activity based costing	(59,240)	(69,240)	(172,600)	(301,080)
c	Net Profit under ABC	48,760	80,760	7,400	136,920
d	Revenue	3,708,000	3,150,000	1,980,000	8,838,000
e	Net Profit percentage (c / d)%	1.31%	2.56%	0.37%	1.55%
f	Rank on the basis of Profitability	**2**	**1**	**3**	

It is noted that the market R was the most profitable market on the basis of Gross-margin percentage analysis. However, under Activity Based Costing it is the least profitable distribution market with 0.37% of net profit percentage. The distribution market Q has the highest profitability, followed by the market P.

4. Problems likely to be faced in assigning the total operating costs to the activities areas:

(i) Choosing the appropriate cost drivers for each area: It is likely that over time, further refinements occur in cost drivers. For example, not all store deliveries are equally easy to make depending on parking availability, accessibility of the storage / shelf space to the delivery point, etc. Similarly not all cartons are equally easy to deliver – their weight, size or likely breakage component are factors that can vary across carton types.

(ii) Developing a reliable data base on the chosen cost drivers: For some items, such as the numbers of orders and the number of line items, this information likely would be available in machine readable form at a high level of accuracy. Unless the delivery personnel have hand-held computers that they use in a systematic way, estimates of shelf-stacking time are likely to be unreliable. Advances in information technology likely will reduce problems in this area over time.

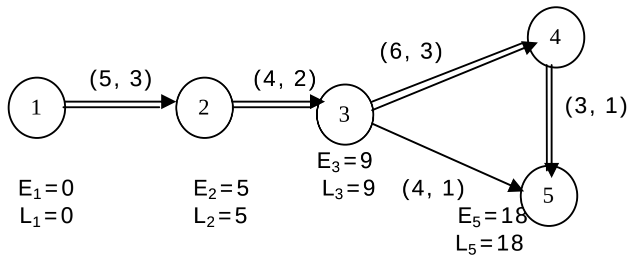
(iii) Deciding how to handle costs that may be common across several activities: For example, (3) store delivery and (4) cartons shipped to stores have the common cost of the same trip. Some organizations may treat (3) as the primary activity and attribute to (4) only incremental costs. Similarly, (1) order processing and (2) line item ordering may have common costs.

(iv) Choice of the time period to compute cost rates per cost driver: Here, the cost driver rates are calculated on a monthly basis. The organization may also want to consider using longer time periods that may be less affected by seasonal or random variations in demand.

(v) Behavioural factors are likely to be a challenge: The sales people have to be made aware that they have been less profitable than previously thought.

1B.

$E_4=15$, $L_4=15$



There are two paths namely 1-2-3-4-5 and 1-2-3-5 with a normal duration of 18 days and 13 days respectively. The Critical Path is 1-2-3-4-5. In order to determine the least cost schedule, the duration is compressed by crashing step by step the activities having the least cost slope in the critical path and the same is carried out till such time crashing is no longer possible. Analyzing and comparing the least cost slope, the order of the activities selected is 2-3, 1-2, 3-4 and 4-5. Activities 2-3 and 1-2 are reduced by 2 days each which brings down the critical duration to 14 days. Since these activities are common to the two paths, the duration of the other path is also affected by the reduction and hence 1-2-3-4-5 remains still as the critical path. Activities 3-4 and 4-5 are further reduced by 3 days and 2 days respectively. This brings the duration of both the paths equal; i.e. 1-2-3-4-5 and 1-2-3-5 each having duration of 9 days. At this stage, in order to reduce further the duration, activities which are common to either the paths (or) combination of activities must be selected. The activities that are common are 1-2 and 2-3 which cannot be reduced further. The combination of activities can either be 3-4 and 3-5 or 3-5 and 4-5. Since neither 3-4 nor 4-5 could be crashed further, the least cost duration will be 9 days. Following is the table with the cost analysis with a day-by-day reduction:

Step	Critical path	Duration	Activity with least cost slope	Reduction in days	Crash cost	Cumulative crash cost (Rs.)	Indirect costs (Rs.)	Total cost (Rs.)
1	1-2-3-4-5	18			0	0	10800	10800
2	1-2-3-4-5	17	2-3	1	200	200	10200	10400
3	1-2-3-4-5	16	2-3	1	200	400	9600	10000
4	1-2-3-4-5	15	1-2	1	300	700	9000	9700
5	1-2-3-4-5	14	1-2	1	300	1000	8400	9400
6	1-2-3-4-5	13	3-4	1	400	1400	7800	9200
7	1-2-3-4-5	12	3-4	1	400	1800	7200	9000
8	1-2-3-4-5	11	3-4	1	400	2200	6600	8800
9	1-2-3-4-5	10	4-5	1	600	2800	6000	8800
10	1-2-3-4-5	9	4-5	1	600	3400	5400	8800

Note: The total cost remains the same for 11 days as well as the subsequent days since the crash cost equals the indirect costs.

1C. Advantages of Balanced Score Card:

1. It brings strategy and vision as the center of management focus.
2. It brings together in a single management report, many of the seemingly desperate elements like customer oriented, shortening response time, improving quality etc. of a competitive agenda.
3. Balanced Score Card provides management with a comprehensive picture of business operations.
4. The methodology of balanced score card facilitate communication and understanding of business goals and strategies at all levels of an organization.
5. The Balanced Score Card provides strategic feedback and learning. The Balance Score card guards against subordination. It emphasis an integrated combination of traditional and non-traditional performance measures. It helps senior managers to consider all important performance measures together and lets them

to see whether an improvement in one area may have been achieved at the expense of another.

2A. Computation of Contribution per unit for each product: (Amounts in Rs.)

	Particulars	2008				2009			
		A	**B**	**C**	**D**	**A**	**B**	**C**	**D**
a	Selling price per unit	30.00	50.00	60.00	80.00	30.00	50.00	60.00	80.00
b	Variable cost per unit								
	- Direct materials	(6.00)	(13.50)	(10.50)	(24.00)	(6.60)	(14.85)	(11.55)	(26.40)
	- Direct labour	(7.50)	(10.00)	(18.00)	(24.00)	(8.25)	(11.00)	(19.80)	(26.40)
	- Variable Overheads	(4.50)	(10.00)	(12.00)	(13.00)	(4.50)	(10.00)	(12.00)	(13.00)
		(18.00)	(33.50)	(40.50)	(61.00)	(19.35)	(35.85)	(43.35)	(65.80)
c	Contribution p. u	12.00	16.50	19.50	19.00	10.65	14.15	16.65	14.20

(i) & (ii). Budget for the years 2008 & 2009:

Particulars	2008			2009		
	Volume (Units)	Contribution per unit (Rs.)	Total (Rs.)	Volume (units)	Contribution per unit (Rs.)	Total (Rs.)
Product A	40,000	12.00	480,000	40,000	10.65	426,000
Product B	10,000	16.50	165,000	60,000	14.15	849,000
Product C *	70,000*	19.50	1,365,000	70,000	16.65	1,165,500
Product D	30,000	19.00	570,000	30,000	14.20	426,000
Total contribution			2,580,000			2,866,500
Less: Fixed overheads			(2,020,000)			(2,090,000)
Profit / (Loss)			**560,000**			**776,500**

* The additional units of 20,000 for the year 2008 have been added to the production of Product C since it yields the maximum contribution per unit.

(iii) No. of units of B to be sold in 2009 to maintain the profitability of 2008:

	Particulars	Amt (Rs.)
a	Total contribution before increase of output by 50,000 units of B (4,26,000+1,41,500+11,65,500+4,26,000)	21,59,000
b	less: Fixed cost before increase of output	(20,20,000)
c	Profit for 2009 before increase of output	1,39,000
d	Profit for 2008	5,60,000
e	Additional profit required in 2009 over 2008	4,21,000
f	Additional fixed expenses of the new plan in 2009	(70,000)
g	Total profit required to earn the same level of profit of 2008	4,91,000
h	Contribution per unit of Product B	14.15
i	Minimum No. of units of B to be sold in 2009 (g / h)	**34,700**

2B. General Rules for dealing with an order at lower than normal prices:

1. If the new order brings in more contribution resulting in increased net profit, the order would be acceptable purely on the cost figures.
2. However, there are several other factors which would need to be considered before a final decision is taken.
    a. Will the acceptance of one order at a lower price lead other customers demand lower prices as well?
    b. Is this special order the most profitable way of using the spare capacity?

c. Will the special order lock up capacity which could be used for future full price business?

d. Is it absolutely certain that fixed costs will not alter?

3A.

Demand simulation:

Demand	Probability	Cumulative Probability	Class Interval
10	0.20	0.20	0 - 19
20	0.15	0.35	20 - 34
30	0.50	0.85	35 - 84
10	0.15	1.00	85 - 99

Day	Random No.	Demand (no. of breads)
1	48	30
2	78	30
3	19	10
4	51	30
5	56	30
6	87	40
7	15	10
8	14	10
9	68	30
10	8	10
Total demand		230
Average demand per day		23

(i) Stock situation of the bakery if 30 breads are made every day:

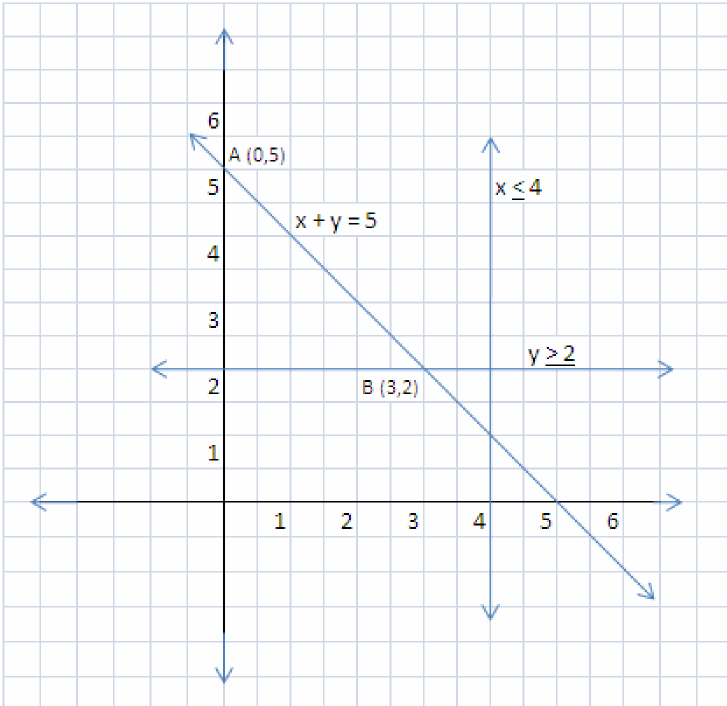
Particulars	Day 1	Day 2	Day 3	Day 4	Day 5	Day 6	Day 7	Day 8	Day 9	Day 10
Opening stock	-	-	-	20	20	20	10	30	50	50
Fresh make	30	30	30	30	30	30	30	30	30	30
less : No. of breads sold	(30)	(30)	(10)	(30)	(30)	(40)	(10)	(10)	(30)	(10)
Closing stock	-	-	20	20	20	10	30	50	50	70

(ii) Average demand per day (as computed above) is 23 breads.

3B. Let x & y be the weight in Kgs. of the ingredients B1 and B2 respectively, of the brick. Formulation of the given problem is:

Objective: Minimise $Z = 5x + 8y$ (Cost of the brick)

Constraints: $x + y = 5$; $0 < x \leq 4$; $y \geq 2$.



The feasible region has two corner points A (0,5) and B (3,2) and the minimum value of z (cost) is found at B (3,2).

Vertices	A (0, 5)	B (3, 2)
Cost of the brick	40	31

Hence, the optimum product mix is to have 3 Kgs of ingredient B1 and 2 Kgs of ingredient B2 in order to achieve the minimum cost of Rs.31.

3C. Dummy Activity:

It is a hypothetical activity which consumes no resource and time. It is represented by dotted lines and is inserted in the network to clarify activity pattern under the following situations:

(i) It is created to make activities with common starting and finishing events distinguishable.

(ii) To identify and maintain the proper precedence relationship between activities which are not connected by events.

(iii) To bring all "loose ends" to a single initial and a single terminal event in each network using dummies, if necessary.

4A. 1) Material variances:

Material	**SP. SQ**	**SP. RSQ**	**SP.AQ**	**AQ.AP**
X	2 x 50 x 550 / 27500	2 x 26000	2 x 24000	53000
Y	1 x 50 x 550 / 27500	1 x 26000	1 x 28000	26000
X	55000	52000	48000	53000
Y	27500	26000	28000	26000
Total	82500	78000	76000	79000

Variance	Yield	Mix	Usage	Price	Cost
X	3000 F	4000 F	7000 F	5000 A	2000 F
Y	1500 F	2000 A	500 A	2000 F	1500 F
Total	**4500 F**	**2000 F**	**6500 F**	**3000 A**	**3500 F**

2) Variable Overhead variances:

	SR. SH	SR. AH	AOH
=	40 x 1000	40 x 900	35000
=	40000	36000	35000

Variable OH Efficiency variance = 4000 F
Variable OH Expenditure variance = 1000 F
Variable OH Cost variance = 5000 F

3) Labour variances

	SR. SH	SR. AH	AH. AR
=	30 x 1000	30 x 900	31000
=	30000	27000	31000

Labour Efficiency variance = 3000 F
Labour Rate variance = 4000 A
Labour Cost variance = 1000 A

4) Fixed Overhead variance:

	SR. SH	SR. AH	SR. BH	AOH
=	2.5 x 1000	2.5 x 900	2.5 x 1200	29000
=	25000	22500	30000	29000

Fixed OH Efficiency variance = 2500 F
Fixed OH Capacity variance = 7500 A
Fixed OH Volume variance = 5000 A
Fixed OH Expenditure variance = 1000 F
Fixed OH Cost variance = 4000 A

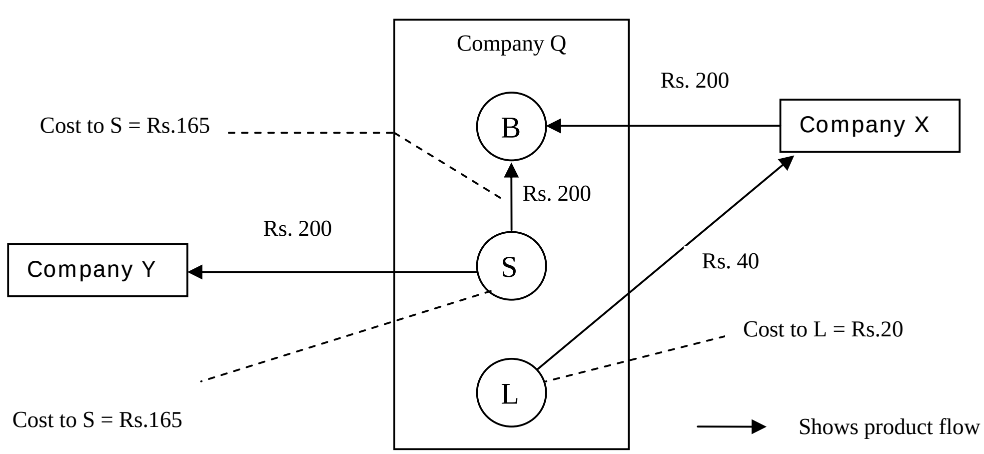
Where, SQ = Standard qty. SP = Standard price, RSQ= Revised Standard qty, AQ = Actual quantity, AP = Actual Price, SR = Standard rate, AOH = Actual overhead, BH = Budgeted hours, SH = standard hours, AR = Actual rate.

5) Sales Price variance – AQ x (AP – SP) = 40,000x (3.65 – 3.70) = 2000 A.
Note: There will not be any sales volume variance since standard volume is not specified. However, if the budgeted volume of output is considered, sales margin variances can be computed. In that case, there could be sales margin volume variance.

4B. Benchmarking and its advantages:

Benchmarking is a technique for continuous improvement in performance. It involves comparing a firm's products, services or activities against other best performing organizations, either internal or external to the firm. The objective is to find out how the product, service or activity such as customer order processing needs to be improved and finding a non-rival organization that is considered to represent world class best practice and studying how it performs the activity. It is a performance measure that provides the driving force to establish high performance and means to accomplish these goals. It is thus a component of a wider improvement process such as business process reengineering or quality improvement. It is a powerful tool for continuous improvement in performance.

5A.



a) Evaluation of alternatives:

S No	Particulars	Alternative 1 Buy from X	Alternative 2 Buy from S
1	Outflow to the company as a whole	(200)	(165)
2	Cash inflows		

	To Division L (Rs.40 – Rs.20)	20	-
	To Division S (Rs.200 – Rs.165)	35	-
	Net cash outflow to the company as a whole	**(145)**	**(165)**

Alternative 1 – Buying the widget from company X is the better option since it involves lesser cost. Hence, division B should buy from company X.
b) Transfer Price = variable costs + Opportunity costs
= Rs. 165 + Rs.20 + Rs. 35 = Rs.220 per unit.
Suppose division S has sufficient extra capacity to supply the widget to both division B and the outside buyer, the answer would be as follows:

S No	Particulars	Alternative 1 Buy from X	Alternative 2 Buy from S
1	Outflow to the company as a whole	(200)	(165)
2	Cash inflows	-	35
	To Division L (Rs.40 – Rs.20	20	-
	To Division S (Rs.200 – Rs.165)	35	-
	Net cash outflow to the company as a whole	**(145)**	**(130)**

The alternative 2 – Buying the widget from division S is the better option with lesser cost per unit, for the company as a whole. The transfer price, in this case should be: Transfer Price = Variable costs + Opportunity costs = Rs.165 + Rs.20 = Rs.185/-.

5B. Relevant cost for the order:

Material	Relevant cost	Reason
A	270 per kg	The original purchase price is irrelevant and, as it is not intended to purchase immediately, so is the current replenishment price. The relevant cost is the replenishment cost at the expected purchase time.
B	55 per kg	The historical purchase price is not relevant and as there is adequate in stock for current needs there is no question of replenishment. The only alternative use for the material is sale at Rs. 55 per kg.
C	21 per kg	As the material will be replenished within a week, the current replenishment price is the relevant cost.

5C. The three circumstances wherein Penetration Pricing can be adopted:

(i) When demand of the product is elastic to price. In other words, the demand of the product increases when price is low.

(ii) When there are substantial savings on large scale production. Here increase in demand is sustained by the adoption of low pricing policy.

(iii) When there is threat of competition. The prices fixed at a low level act as an entry barrier to the prospective competitors.

6A. *Initial Basic Feasible solution:*

	W	X	Y	Z	Supply	Cost Differences I	II	III	IV	V
A	7	$\boxed{5}$ 3	6	0	5 / 0	3	**<u>3</u>**	-	-	-
B	$\boxed{5}$ 4	$\boxed{3}$ 6	8	$\boxed{2}$ 0	10 / 8/ 3/0	**<u>4</u>**	2	**<u>2</u>**	2	2
C	5	8	$\boxed{7}$ 4	0	7/ 0	4	1	1	**<u>4</u>**	-

D	8	$\boxed{e}$ 4	$\boxed{3}$ 3	0	3 / 0	3 1 1 1 1
	5 / 0	8 / 3/ 0	10 / 3/ 0	2/0	25	

Cost differences

I	1	1	1	0
II	1	1	1	-
III	1	2	1	-
IV	-	2	1	-
V	-	2	**5**	-

No. of allocations = 6; n + m – 1 = 7
no. of allocations < (n+m-1)
Hence, there is a degeneracy. A dummy allocation is made in the least cost unallocated cell.

Optimality test for the Initial Basic Feasible solution:

Ui / vj	4	6	5	0	
-3	***6*** 7	$\boxed{5}$ 3	**1** 6	***3*** 0	5 / 0
0	$\boxed{5}$ 4	$\boxed{3}$ 6	**3** 8	$\boxed{2}$ 0	10 / 5 / 2
-1	***2*** 5	***3*** 8	$\boxed{7}$ 4	**1** 0	7/5 / 0
-2	***6*** 8	$\boxed{e}$ 4	$\boxed{3}$ 3	***2*** 0	3 / 0
	5 / 0	8 / 3/ 0	10 / 5 /2	2/0	25

All the entries in Net Evaluation Table are non-negative and hence, the Initial Basic Feasible solution is unique and optimal.

Site (to) Customer	Trucks	Costs involved
B to W	5	20
A to X	5	15
B to X	3	18
C to Y	7	28
D to Y	3	9
Total minimum cost →	23	**90**

6B. Budget: A financial and / or quantitative statement prepared and approved prior to a defined period of time of the policy to be pursued during that period for the purpose of attaining a given objective. It may include income, expenditure and employment of capital (as defined by The Chartered Institute of Management Accountants of England and Wales).

Benefits of budgeting:

1. It encourages self-study in all aspects of a company's operations.
2. It brings in co-operation among the teams operating in the company, towards achieving clearly defined objectives.

3. It defines and crystallizes the company's policies and aims.
4. It increases the effectiveness with which the people and capital are employed.
5. It discloses the areas of potential improvement in the company's operations.
6. It stimulates study of relationship of the company to its external economic environment for improving the effectiveness of its direction.
7. Management's time can be saved and attention directed to areas of most concern by the 'exception principle' which is at the heart of the budgetary control.
8. It is an important medium of communication for organizational plans and objectives and of the progress towards meeting those objectives.

Problems associated with budgeting:

1. There may be too much reliance on the technique as a substitute for good management.
2. The budgetary system, perhaps because of undue pressure or poor human relations, may cause antagonism and decrease motivation.
3. Variances are just as frequently due to changing circumstances, poor forecasting or general uncertainties as due to managerial performance.
4. Budgets are developed round existing organizational structures and departments which may be inappropriate for current conditions and may not reflect the underlying economic realities.
5. The very existence of well documented plans and budgets may cause inertia and lack of flexibility in adapting to change.
6. There is a major problem in setting the levels of attainment to be included in budgets and standards. Although much research has been done in this area, knowledge is still incomplete. There are many factors to be considered including: the aspiration level of individuals, group pressures, the extent of participation, past performances and so on. This is an unresolved problem which I present in every budgetary and standard costing system.
7. The inherent lags and delays in the system. For example, the actual results for June are typically available mid to late July and would be comp0ared with June's budget which itself would be based on estimates and forecasts which were made up to12 months previously. The resulting variances may then be used to guide management's actions for August. Because of these delays and lags, there is the real possibility that the budgets and resulting variances are of little value as a guide to current operations.

6C. Practical Applications of Assignment Model:

1. assignment of Sales personnel to Sales territories (maximization of Sales)
2. assignment of Auditors to Client accounts (minimization of cost / time)
3. Assignment of Instructors to specialized learning situations.
4. Flight scheduling (minimization of total time involved for jobs)

No. of Questions: 7 **MX** **Total Marks: 100**
No. of Page Printed: 1 **Time Allowed: 3 Hours**

Question No.1 is compulsory. Answer any FOUR from the rest.

1. (a) MIS is fraught with myths/misconceptions- explain **(10 Marks)**

(b) "The benefits of client server technology are many but there are related risks associated with C/S technology"- Explain **(10 Marks)**

2. (a) Explain the concepts of systems approach to problem solving. Detail the steps involved in such approach. **(10 Marks)**

(b) Briefly explain the prototyping approach **(5 Marks)**

(c) Distinguish between Batch processing and Direct Processing and Transaction file and master file **(5 Marks)**

3. (a) What are the factors to be considered while designing system input **(10 Marks)**

(b) Why is personnel training important for the successful implementation of information system ? What type of training should be imparted to (i) Systems operator and (ii) end users **(10 Marks)**

4. (a) What are the special characteristics of personal computers which give rise to new risks? What are the resultant new risks? What security measures need to be followed to protect against these risks? **(10 Marks)**

(b) Information to be useful bears certain characteristics - Explain **(5 Marks)**

(c) Explain the terms: Asymmetric crypto systems, Key pair, Digital signature as per the IT Act ,2000 **(5 Marks)**

5. (a) All businesses should assess the adequacy of the controls to protect their information systems assets against fraud **(10 Marks)**

(b) Prepare an audit framework for program development and acquisition **(10 Marks)**

6. (a) Explain the steps to be taken by organisations for establishing better information protection **(10 Marks)**

(b) Under what situations can a Certifying authority revoke a digital signature Certificate **(5 Marks)**

(c) Discuss in brief the advantages of pre-written application software **(5 Marks)**

7. Write Short Notes on the following **(4 x 5 = 20 Marks)**

a. Concurrent Audit Techniques
b. Business process re-engineering
c. Operator intervention controls
d. Program debugging

PRIME ACADAMY

26TH SESSION MODEL EXAM

FINAL – MANAGEMENT INFORMATION AND CONTROL SYSTEMS

1(a)

S.No.	**Myths about MIS**	**Facts/truths about MIS**
1.	Study of MIS is about use of computers	• MIS may or may not be computer based • Computer is only a tool
2.	More data (quantity) means more information to managers	• Quantity does not matter, relevance of data to decision making is what is important • Form & presentation is important- unorganised data creates confusion
3.	Accuracy of reporting is of vital importance	• True at operational level (**Ex:** Temperature in chemical storage) • Higher levels of accuracy- higher is the cost of obtaining the data • Decision making at higher levels of management are macro decisions where a fairly correct presentation of relevant data is adequate (**Ex:** Project outlay is around 300 to 320 crores)

1(b) Operating in a C/S environment pose the following risks:

Kind of risk	***Meaning***	***Solution to mitigate risk***
Technological risk	• Will the C/S model work (short run) • Will the C/S model become obsolete (long run)	Company & IT department should understand the standards and market trends while deciding on what system to incorporate

Kind of risk	***Meaning***	***Solution to mitigate risk***
Operational risk	• Will it achieve the performance level required(short run) • Will it meet the future	Sound planning and factoring future issues is the solution

	requirements (long run)	
Economic risk	• In short run hidden costs of C/S i.e. costs will rise as both C/S and old system may run parallely for some time • In long run concern about support / maintenance cost	An economic feasibility study should be carried out before implementing C/S technology.
Political risk (Implies risk associated with user acceptance)	• In short range the risk involved in transition i.e. whether end users and management will be satisfied • In long range whether all the departments can be moved from mainframe to C/S model-else some dept. operating in mainframe may have increased cost of processing and may create political problems.	The organisation and the IT department should work towards a smooth transition from mainframes to C/S environment. Also timetable should be drawn to migrate all the systems over a period of time from the mainframes to the C/S environment so as to bring down over all cost of processing and avoid political problems.

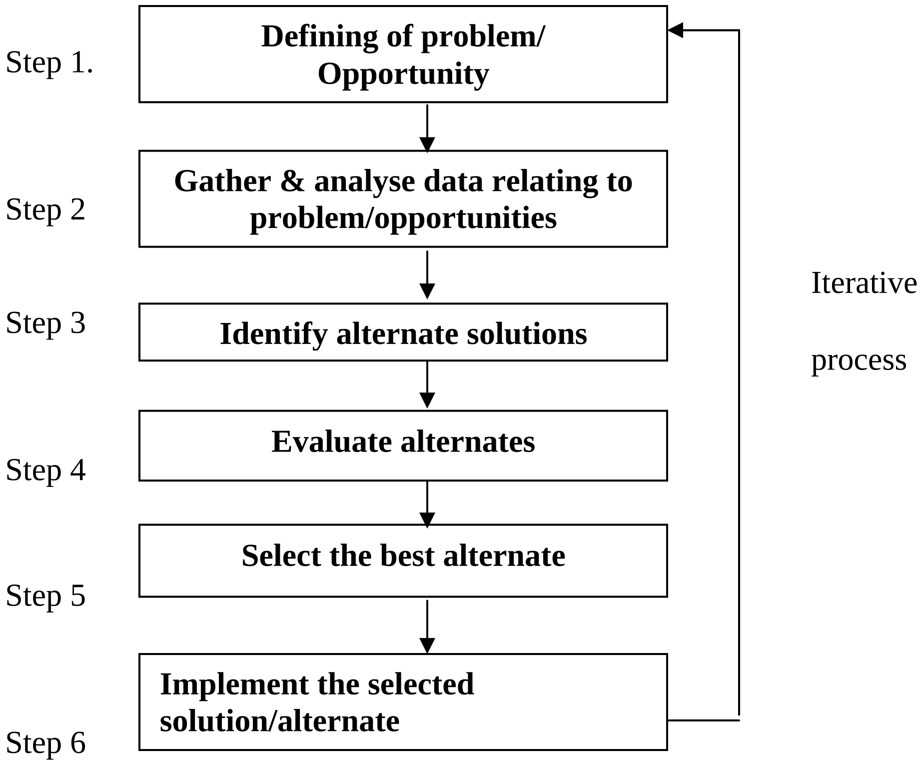
Some additional problems in C/S environment:

- Security and management tools in C/S are not as mature as in mainframes.
- Users take time to adapt to the tools
- IS department may not like giving up centralised control as existing in mainframe environment to a decentralised C/S environment.

2(a) Meaning of the term systems approach to management:

- It refers to a way of thinking about management problems.
- It considers organisation as a group of interacting and interdependent parts.
- Action in one part will impact the other part(s). Hence at the time of decision making the manager has to consider the problem in its entirety bearing in mind the way the overall system would react to changes in the parts.
- In other words the decision-making effort should not consider a part in isolation. The overall impact on the system as a whole should be considered.
- Managers should anticipate the intended as well as unintended impacts of their decisions.

Steps involved in the system approach to problem solving.



2(b)

- **Meaning of prototype**: It is a usable system or a system component that is built quickly at a lesser cost and with the intention of being modified or replaced with a full scale or fully operational system.

- Using traditional approach may take years to complete. Hence for smaller systems the organisations build prototype/pilot versions.

- The users are allowed to work with the prototype, their suggestions are incorporated into the prototype and a revised prototype is developed. This process goes on till a prototype is reached which incorporates all user requirements.

- The final prototype can either be :

  1. Refined/turned into the real system (**or)**

  2. Scrapped and the knowledge used to build the real system.

  Steps in prototyping

  a. Identify information systems requirements
  b. Develop the initial prototype
  c. Test and revise

d. Obtain user signoff of the approved prototype

2(c) Computer processing

Batch processing	Direct processing
Transactions accumulated subsequently	Individual transactions in batches and posted to ledger directly posted in ledger
Ex : Manual accounting	**Ex :** Tally Software - immediate posting

Transaction file : Collection of transactions for inputs and only of temporary interest to management. It is important for audit trail

Master File: Relatively permanent and of interest to the management

3(a) **Meaning of input design**

Consists of developing specifications and procedures for basic data preparation and entry into the computer system.

Where to begin?

Review the information collected at the requirement analysis phase to understand as to **what** data are entered**, who** enters them, **where** are they captured/entered, **when** are they captured in the current system.

The above process helps to identify the weakness in the present systems which need to be addressed by the new system.

Important factors to be considered in design of input

Six important factors to be given importance while designing user inputs :

CONTENT TIMELINESS MEDIA FORMAT INPUT VOLUME

1. **Content**

- Analyst has to decide on the types of data that need to be collected to get the desired output
- New systems require new information from new data source and hence use new documents for collecting information.

2. **Timeliness**

- Timely outputs require timely inputs
- Plan of action need to be drawn as to when various inputs will enter the system. This is critical when people giving the inputs and people requiring the outputs are different.

  Ex: An organisation may have a procedure wherein the HR department should give its inputs on leave, overtime hours to payroll department by the 25^{th} of every month, payroll department will process salary and give inputs to accounts department by 28^{th} of every month so as to enable accounts department to generate bank advice letters by the 30^{th} of every month. Even a day's delay in one department will affect the processing of subsequent department.

3. **Media**

- An important consideration is the choice of the input media and the devices used to input data. (**Ex**: magnetic tapes, key-boards, OCR/OMR etc.)
- Medium selection should be based on the application to be computerised.

4. **Format**

- Refers to specifying record formats like length of data fields, special characters to be used etc.
- Formats can be generated using application generators and sometimes may require the assistance of professional programmers/ DBAs

5. **Input volume**

- Refers to the amount of data to be entered in the computer system at one time.
- In real-time systems input volume is less (since each entry is posted immediately) while in batch processing systems the inputs are accumulated and then entered and hence input volume is heavy.

3(b) Importance of training

- A system can succeed or fail depending on how it is operated or used. Hence quality of training received by various personnel (systems operators and other users) decides the success or failure of the implementation effort.

(**Ex:** An ERP package's success depends on how well the end users are trained in its usage and maintenance)

How is training imparted? : Training is imparted through classes and through hands-on learning techniques for both hardware and software.

Who are the people to be trained ?: Training should be imparted to :

↓ ↓

SYSTEMS OPERATORS END USERS

Training of systems operators

- System operators are responsible for keeping equipment running + providing support services.

- Training should cover all types of operations ; both routine and extra-ordinary.

- Areas of training should include :
  - How to switch on a new equipment
  - What are the normal operations of the new system
  - What are the common malfunctioning/problems that might arise, how to recognise them and what action is to be taken **(trouble shooting).**
  - Who are the contact persons in case of unusual problems, how to get in touch with them (**Ex:** Vendor help desk number etc.)

Training of users

- It may involve **use of equipment** i.e. how to operate the system.
- They may be trained in **trouble-shooting.** This involves identification as to whether a problem is caused due to software or is it a hardware problem.
- They are also trained in **data handling.** This includes data editing, data coding, designing queries and deleting records.
- Users are trained in **system maintenance activities** like preparing disks, loading papers in printers and changing printer cartridges/ribbons.

4 (a) Some risks / problems associated with personal computers

1. **Weak access controls:**

   Security software provides log-on procedures but will work only if computer is booted from the hard disk.

   How is this circumvented? Hackers/ criminals force the system to boot from floppy drives (A:>), hence uncontrolled O/S loaded into the computer . Thus O/S security is by-passed and the hacker has access to data and programs (can do damage).

   Preventive/protective methods- Installing disk locks can prevent unauthorised individuals from accessing the floppy drives.

   Types of disk locks are :

Memory resident disk locks	Physical disk locks
This lock will prevent the floppy drives from being used to boot the computer and to copy files into/from the hard disk.	This device fits into the A:> drive like a floppy disk to prevent its use and secure it with a lock and key
It can be password controlled so that it can be disabled when required by the authorised user	It was introduced to overcome the disadvantage associated with memory resident disk locks.
Disadvantage: in the event of hard-disk failure, users cannot use the A:> to boot or to take back-up copies since it has been disabled.	

2. **Multilevel password controls:**

   - This method uses the access control list /authorisation table to restrict access to specific functions like read-only, view only, data input only.
   - Thus with the same set of files ,different users can be given different rights using the multilevel password controls.
   - **Ex:** Both the cashier and the manager may have access to the same files. While cashier's password would allow him access to only enter transactions, the officer's password would allow him to modify/authorise/delete transactions.

3. **Inadequate back-up procedures:**

   Need for back-ups

- Disk failure is the major cause of data loss in a computerised environment. If hard-disk fails , it may become impossible to recover data and hence we need to have back-up for data and critical programs to reduce this risk.

Who is responsible for back-ups ?

In a networking / server environment

Back-up is automated by the operating system, manual intervention may not be required. Uses specialised hardware and softwares

In a stand alone / PC environment

The end user is responsible

for back-ups. They are

usually not trained in this

The various types of back-up are :

S. No.	Type of back-up	Meaning
1	Floppy disk back-up	• Files can be regularly/periodically backed up in floppy disks → stored away from computer → in the event of failure data can be reconstructed from the disks • Requires a conscious effort on part of the users – failure to back-up even for a single day can lead to data loss
2.	Dual internal hard drives	• It involves using two internal hard-disks – one for storing live/production data (called as data disk) and other for back-up files • An automated program can be run at the beginning and end of the data processing activity to take back-up into the back-up disk. • Useful since large files cannot be stored onto a floppy- if one internal hard disk fails data would be restored from another hard disk.
3	External hard drives	• It refers to a external hard drive with removable disk cartridges • Can store data even greater than 1 gigabyte per cartridge • If one cartridge is consumed- can use another • Simple and effective mechanism of back-up
4.	Tape back-up devices	• It refers to magnetic tapes – internal or External • Provide for efficient and effective back-up • In normal mode can store upto 1.6 gigabytes of data, in

		compressed mode can store upto 3.2 gigabytes of data

4(b))

1. ***Timeliness*** : Available when required
2. ***Purpose*** : Must have a purpose at the time of transmission
3. ***Mode & format*** : Mode- visual, verbal or written Format- so designed to assist decision making (**Ex:** Classified/ tabulated/ exceptions only)
4. ***Redundancy*** : Excess information per unit of data
5. ***Rate*** : Number of numeric characters /minute – for humans

   Number of bits/second – for machines
6. ***Frequency*** : Periodicity of information flow
7. ***Completeness*** : As complete/comprehensive as possible
8. ***Reliability*** : Source from which information originates should be reliable/ confidence level high
9. ***Cost benefit analysis*** : Benefits derived from using the information should justify cost of procuring the information
10. ***Validity*** : Information should close to the purpose it purports
11. ***Quality*** : Correctness (**Ex:** Without any personal bias)

4(c)

a. **Asymmetric Crypto Systems :** According to S.2 (f) of the Information Technology Act, 2000, "asymmetric crypto system" means a system of a secure key pair consisting of a **private key for creating a digital signature** and **a public key to verify the digital signature**

b. **Key Pair :** “Key pair", in an asymmetric crypto system, means a private key and its mathematically related public key, which are so related that the public key can verify a digital signature created by the private key

c. **Digital Signature :** As per S.2 (p) of the IT Act, 2000 “digital signature" means **authentication of any electronic record by a subscriber by means of an electronic method or procedure** in accordance with the provisions of section 3.

5 (a)

- Companies are becoming increasingly dependent on computers either stand alone or networked.

- Companies have started subscribing to **electronic payment systems.** **Ex**: ECS, Credit card payments etc.

- With the growth of E-Commerce, more systems on the internet and hence a higher risks of hacking

How are computer frauds different from other conventional frauds?

1. **Easily hidden & Hard to find:** Unlike conventional frauds, there may be no recognizable audit trail & frauds are hidden in enormous volumes of data.

2. **Evidence hard to find / difficult to legally prove:** In computer frauds, evidence are hard to find and difficult to prove as per relevant statutes .

3. **Easily committed and may not be obvious:** It involves manipulation of invisible data. Just a few key strokes may be needed, with remote access this problem is increased (as we cannot physically see a person committing fraud).

Also with increase in media capacity, huge amounts of data can be written within a short time. This increases the speed of fraud.

5(b) ***Program development and acquisition***

Errors in program development/acquisition

↓ ↓

Inadvertent program errors	Unauthorised program errors
Due to misunderstanding system Specifications or careless program.	Deliberate insertions into the programs

Both the above problems can controlled by requiring management and user authorisation, approval through testing and proper documentation

Role of IS auditor in systems development:

- Should be restricted to independent review of the systems development activities. He should not be involved in developing the system (to maintain his independence)

- During review, the auditor should gain understanding of the development procedures and **discuss the same with** management, users and IS department. He should also **review the** policies , procedures and documentation etc.

- **To test development controls :**
    - ❖ Interview managers and users
    - ❖ Examine the development approvals
    - ❖ Review minutes of development team meetings
    - ❖ Review thoroughly the **test documents** to ensure that all changes were tested before implementation
    - ❖ Review of test data and test results to see how problems were sorted out.

- Sometimes strong processing controls can compensate for inadequate development controls.(called as **compensating controls)**

If compensating processing controls relied on:

- Auditor should **carry out compliance tests** like independent processing of test data.
- If this evidence cannot be obtained, auditor has to conclude that material weakness in internal control exists and risks of errors and frauds are unacceptably high.

6(a) Points to be considered for better information protection

S. No.	***Points to be considered***	***Meaning***
1.	Not all data have same value	• Organisation must determine **value of different data (relative importance)** and then decide on the type of protection. • **Ex:** Payroll data more sensitive than petty cash expenses data & hence varied degree of protection needs to be applied.
2.	Know where critical data resides	• Refers to company's **information systems infrastructure.** Each piece of information requires different levels of protection. Identifying information's location helps establish an **integrated security solution.** • This approach provides **significant cost benefits** so as to ensure that cost of protection need not exceed the value of data.
3.	Develop an access control methodology	• Information loss can happen by mere copying or disclosure of data and need not have to be removed to cause damage. • This can be addressed by providing for **adequate access control methods** like user-IDs and passwords .
4.	Protect information on stored media	• Data loss/theft can occur if employees have facility to copy data into removable media- floppies, CDs - hence need to be controlled.

		• **Magnetic media** like hard discs should be controlled to protect programs and data. • **During migration/change-over** from one system to another, all discs and data should be controlled(to prevent loss, duplication, exposure).
5.	Review hard copy outputs	• Refers to review of hardcopy output of employee's daily work – like drafts, working papers, papers kept in recycle or trash containers(may be valuable. If falls in wrong hands may be misused)

6(b) As per S.38 Certifying Authority may revoke a Digital Signature Certificate issued by it under the following circumstances :

(1) Where the **subscriber or any other person authorised by him makes a request** to that effect

(2) Upon the **death of the subscriber**

(3) Upon the **dissolution of the firm or winding up of the subscriber's company**

(4) A **material fact represented in the Digital Signature Certificate is false or has been concealed**

(5) A requirement for issuance of the Digital Signature Certificate was not satisfied;

(6) The **Certifying Authority's private key or security system was compromised** in a manner materially affecting the Digital Signature Certificate's reliability;

(7) The subscriber has been **declared insolvent or dead or where a subscriber is a firm or a company, which has been dissolved, wound-up or otherwise ceased to exist**.

6(c)

S.No.	***Points for consideration***	***Advantage if we buy the software***	***Disadvantage if it is developed in-house***
1.	**Implementation**	Rapid implementation	May take months or years to implement
2.	**Risk**	Low risk- product already available- organisation aware of the features it is	Long development time- leads to uncertainty as regards

		going to get at what price.	quality and cost of development.
3.	**Quality**	Vendors dealing in application software- retain specialists who have lot of experience. Hence product quality good.	In-house programmers have to work on a wide range of applications and may not have expertise.
4.	**Cost**	Software vendors sell products to various customers and hence cost per customer may be low.	There may be some hidden costs.

Further vendors may provide complete set of documentation and user training along with the software which is an added advantage.

7(a) Concurrent Audit Techniques

- On-line systems processing heavy volume of data leave very little audit trails. In such cases **evidence gathered** after data processing is **insufficient for audit purpose**

- Also it may be **difficult to stop the system in order to perform the audit tests**

- Hence the need to use **concurrent audit techniques i.e.** continual monitoring of the system to collect audit evidence **even while data are being processed in live area.**

Working methodology

They use **embedded audit modules** which are program codes performing audit functions.

They **report test results and store evidence for auditor's review.**

They may be **time-consuming and difficult to use.** However, it would be very **effective if embedded when programs are developed.**

Examples of concurrent audit techniques are : Integrated Test Facility, Snapshot technique, System Controlled Audit Review File, Audit Hooks, Continuous and Intermittent Simulation.

7(b)

- Every company wanting to implement an ERP has to reengineer its processes (activities) in order to suit to the ERP.

- It is a fundamental **rethinking, radical redesign of processes/activities to achieve dramatic improvements in performance like quality and cost saving.**

- Fundamental rethinking: refers to asking questions like "why do we do a process – what value does it add?". If a process does not add any value, it may better be dropped rather than simplifying/automating it.

- Radical redesign: refers to reinventing processes and not just enhancing or improving. It uses methods like "clean slate approach" (similar to zero based budgeting (ZBB))

- Dramatic improvements: Aims to achieve 80% to 90% reduction in costs. It is possible only through major improvements/breakthroughs and not through small incremental changes.

7(c)

- System may sometimes require operator intervention to initiate some actions like :
  - Entering control totals for a batch of records
  - Providing parameter values
  - Activating program from a different point (other than from start point) while re-entering semi-processed error records.

- Operator intervention increases chances of human errors. Hence systems with limited operator's intervention are less prone to processing error.

- Operator intervention cannot be eliminated. However they can be reduced by logical derivation of parameter values, program start points etc.

7(d) **Meaning:** Correcting the syntax errors in programming language and also the diagnostic errors.

Purpose: It is carried out so that the program compiles without any problem (called as "clean compile") and can be successfully converted from source code into machine code.

Debugging consists of the following steps :

Inputting the source program into the compiler

↓

Compiler finds out the errors in programming

↓

Correct the errors thrown out

↓

Re-submit the source program to the compiler

DS

No. of Questions: 6 **Total Marks: 100**

No. of Pages Printed: 4 **Time Allowed: 3 Hrs**

Answer all Questions

Notes should form of your answers

1. a) What are the provisions of Wealth-tax Act relating to the valuation of assets of a business?

b) From the following data furnished by Ravi, determine the value of house property built on leasehold land as at the valuation date 31st March 2008:-

	Rs.
Annual Value as per Municipal valuation	70,000
Rent received from tenant	54,000
Municipal tax paid by tenant	5,000
Repairs on property borne by tenant	4,000
Refundable deposit collected from tenant as security deposit which does not carry any interest	1, 00,000

The difference between unbuilt area and specified area over aggregate area is 9.5%.

C**)** Vimal, Karta of HUF, from out of the HUF funds gifted to his nephew and niecean amount of Rs.1, 00,000 each on 1st November, 2007. The coparceners of the HUF challenged the gifts and as a consequence gifts were held to be void. Discuss whether the amount of Rs.2,00,000 is taxable as wealth of Vimal HUF for the valuation date 31st March 2008.

3x5 = 15 Marks

2. Vidur was in the service of Citizen Ltd. since 1st January, 1984 as a medical officer. He died on 1st February, 2007. The following information is available:
Basic salary Rs.20,000 per month; dearness allowance Rs.6000 per month (40% of which is included for the purpose of determining retirement benefits); transport allowance Rs.3800 per month (out of which only Rs.600 was used for the journey between office and residence, the remaining amount was not spent); and entertainment allowance Rs.1000 per month. He used to contribute 15% of basic pay towards recognized provident fund and citizen ltd. also made a matching contribution. Interest was credited at the rate of 9.5%. After the death was Vidur, his wife got the following payments from Citizen Ltd:

a) Salary for the month of January, 2008.
b) Family pension Rs.10,000 per month.
c) Encashment of leave standing to the credit Vidur on 31st January, 2007 Rs.2, 40,000 (as per service rules, Vidur was entitled for 45 days leave for year of service).
d) Provident Fund balance Rs.3, 90,000.
e) Gratuity Rs.2, 60,000 (Vidur was neither covered by the payment of gratuity act, 1972 nor was there any agreement with the employer to receive gratuity

Vidur was also running a small clinic near his residence which was discontinued after his death. His income from the clinic for the period from 1st April, 2006 to 31st January, 2007 was Rs.49,000.

After the discontinuation of the clinic, Mrs. Vidur recovered Rs.76,000 by 31st March, 2007 against outstanding bills issued by Vidur, Mrs.Vidur did not have any other income. On 30th March, 2007, Mrs.Vidur withdrew Rs.1,40,000, being the balance in account of Vidur in National Saving Scheme, 1987.

Assuming that salary, allowances and pension become due on the last day of the month, compute the taxable income and tax liability thereon of Mr.and Mrs. Vidur for the A.Y. 2007-08.

2 a) Assessing Officer omitted to grant to the assessee interest under section 244A on refund found to be payable in an order passed pursuant to appellate order; assessee is seeking grant of interest. Discuss?

2 (b) Ram voluntarily files his return of income for the assessment year 2004-05 on 15-9-2007 showing income below taxable limit and claiming a refund of Rs.75,000. Hoe will the assessing officer deal with the case?

17 Marks

3 Dalal was the holder of a membership card Bombay Stock Exchange acquired in 1977 for Rs.10 lakhs. He transferred the card to a company, Dalal & Co. (Pvt.) Ltd. in September, 1998 and was allotted 25,000 shares of the value of Rs.100 each in the company in consideration of the transfer. Due to ill health, he sold these shares at Rs.130 per share in May 2007. Discuss the consequences of these transfers. To avoid arithmetical calculations you are told to assume the indexed cost of the membership card in September, 1998 at Rs.20 lakhs.

17 Marks

4 (a) X has taken a loan under registered mortgage deed dated 16.07.2001 against the house, which was purchased by him on 26.03.1981 for Rs.5 Lakhs. The said property was inherited by his sin 'A' under 'will' in December 2005. For obtaining a clear title paid the outstanding amount of loan of Rs.15 lakhs on 12.02.2008. The said house property was sold by 'A' on 16.03.2008 for Rs.50 lakhs. State with reasons the amount chargeable to capital gains for A.Y.2008-09.

4 (b) Ms. Rupali furnishes the following details for the AY 2008-09:

PARTICULARS	AMOUNT Rs.
Net Agricultural Income in India	4,800
Net agricultural income from land in Sri Lanka	10,000
Profit on sale of agricultural land situated in Mangalore City	25,00,000
Vacant land-ground rent received	12,000
Rent received on sub-letting house	37,500
Rent payable for house sub let	15,000
Maintenance expenses on house sublet	1,200
Directors setting fees	3,600
Interest on deposits with nationalization bank	1,000
Interest on postal savings bank account	1,200
Interest credited to PPF account	6,000
Interest accrued but not received on NSC VIII Issue	1,050
Interest received under post office monthly income scheme	12,000
Interest on deposits with HDFC	900
Interest on securities [gross]	5,000
Dividends received from Indian Companies	12,000
Bank charges for collection of above dividend	100
Dividend received from foreign companies	1,100
Interest paid on amount borrowed to invest in shares of foreign co.	8,600
Gift received from a charitable institution registered u/s.12AA	55,000
Gift from a friend in foreign currency	50,001
Gift from another friend in Indian currency	500
Winning from lottery [Net of tax of Rs.30,600]	69,400
Cost of Lottery tickets purchased during the year	5,300
Debenture Interest on 10% debentures of ABC Ltd. of Face Value of Rs.1,00,000(due half yearly on 30.9 and 31.3.) but received on 15.4.2008	

Compute the taxable income from other sources of Ms.Rupali, who is following mercantile system of accounting.

17 Marks

5 (a) Ramalingam, a resident Indian, has derived the following incomes for the previous year relevant to the assessment year 2008-09.

	Particulars	Rs.
(1)	Income from profession	94,000
(2)	Share income from a partnership firm in Country X (Tax paid in country X for this income in equivalent Indian rupees Rs.8,000)	40,000
(3)	Commission income from concern in Country Y (Tax paid in country Y at 20%) converted in Indian rupees	30,000
(4)	Interest from scheduled banks	18,000

Ramalingam wishes to know whether he is eligible to any double taxation relief and if so, its quantum. India does not have any Double Taxation Avoidance Agreement with Countries X and Y.

5 (b) Mr. Gavaskar sought voluntary retirement from Government of India Undertaking and received compensation of Rs.40 lakhs on 31st January, 2008. He is planning to use the money as capital for a business of dealership in electronic goods. The manufacturer of the product requires a security deposit of Rs.15 lakh, which would carry interest at 8% p.a. Gavaskar's wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of Rs.3 lakhs. Mr. Gavaskar would like to draw a monthly remuneration of Rs.40,000 and also interest @10% p.a. on his capital in the business. Mr. Gavaskar has approached you for a tax efficient structure of the business.

Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required.

17 Marks

6 (a) The total income of non-resident Indian includes:

Particulars	Rs.
Investment income (net)	50,000
Long-term capital gains	25,000
Other income	75,000
Total Income	**1,50,000**

What will be the tax payable by him in respect of assessment year, 2008-09 on the above income under Chapter XIIA of the Income Tax Act? In what manner can the tax liability be reduced in this case?

6 (b) Varinder Charitable Trust, a charitable trust registered u/s.12A of the Income-tax Act, 1961 has sold the plot acquired two years back. The purchase price was Rs.2,00,000. The sale consideration was Rs.3,60,000. A sum of Rs.10,000 was incurred in connection with the

sale. The trust acquired English mortgage (worth Rs.3,10,000) of an immovable property utilising the sale proceeds. Is the trust entitled to exemption u/s.11(1A)?

17 Marks

PRIME ACADAMY
26TH SESSION MODEL EXAM
FINAL – DIRECT TAXES

1a) (a) Where the assessee is carrying on business for which accounts are maintained by him regularly, the net value of the assets of the business as a whole, having regard to the balance sheet of such business on the valuation date, shall be taken for wealth tax purposes. For this purpose of valuation, the value of any asset as disclosed in the balance sheet shall be taken to be as follows:

i) Depreciable asset (eg. Motor Car) : WDV value

ii) Non depreciable asset (eg. Urban Land) : Book value

iii) Closing stock (eg. Urban Land held as stock-in-trade beyond 10 years after purchase) : Value adopted for IT purpose.

However, if the value of any of these assets determined in accordance with the relevant Rule of Schedule III which is applicable to that asset and if no Rule is applicable, the fair market value determined in accordance with Rule 20, exceeds the above value by more than 20%, then the higher value shall be taken to be the value of that asset.

The above provision is summarized as follows:

Steps	Particulars	Amount
I	Value of assets as per Balance Sheet 1. Depreciable Assets – WDV 2. Non-Depreciable Assets – Book Value 3. Closing Stock – Value as per I.T Act	Step I value
II	Add 20% to the value determined in step I	Step II value
III	Value as per Schedule 13 Rules 1.House Property - Rule 3 2.Life Interest – Rule 17 3.Jewellery – Rule 18 & 19 4.Other Assets – Rule 20 & 21	Step III value
IV	Compare Step III with Step II 1.If Step III > Step II 2.If Step II > Step III	 Value as per Step III Value as per Step I.

b) The value of an asset not disclosed in the balance sheet shall be taken to be the value determined in accordance with the provisions of Schedule III as applicable to that asset.

c) The value of the following assets, which are disclosed in the balance sheet, shall not be taken into account:

i) Advance tax paid;

ii) Bad debt allowed as a deduction under Income-tax Act;

iii) Assets on which wealth-tax is not payable;

iv) Debit balance of profit and loss account;

v) Any asset not relating to the business.

d) The following amounts shown as liabilities in the balance sheet shall not be taken into account:

i) Capital employed other than borrowed fund

ii) Reserves

iii) Any provision for meeting future or contingent liability

iv) Liability not pertaining to the business

v) Liability to the extent it is utilised for acquiring an asset exempt from wealth-tax.

1b) Computation of value of house property of Mr. Ravi as on the valuation date 31.3.2008.

	Rs.	**Rs.**
Gross Maintainable Rent (GMR)		
As per working note		80,000
Less: i) 15 % of GMR	12,000	
ii) Municipal tax levied -	5,000	17,000
Net Maintainable Rent Rs.		**63,000**
Capitalising the Net Maintainable Rent, assuming the lease period is more than 50 years (63,000 x 10)		6,30,000
Add: Adjustment to capitalised value at 20% for the difference between unbuilt area and specified area (6,30,000x 20%)		1,26,000
Value of house property		**7,56,000**
Working note: Gross Maintainable Rent		
Actual rent received		54,000
Add: a) 1/9th of actual rent, since the tenant bears the repairs	6,000	
b) Municipal tax paid by tenant	5,000	
c) Interest on security deposit @ 15% p.a.	15,000	26,000
Annual Rent		80,000
Annual value - Municipal valuation		**70,000**

Annual value or annual rent, whichever is higher, shall be adopted as gross maintainable rent for computation of the value of immovable property. Thus, in this case Rs.80,000 shall be adopted as Gross Maintainable Rent.

1c) Once the amount of Rs.2 lakhs has been gifted by the HUF, as on the valuation date the amount has ceased to be the asset of the HUF. The legal ownership has passed on to the donee. Merely because the gift is challenged and held to be void, the amount does not come back to the HUF. Further, the transfer of the asset is not under revocable transfer and therefore HUF cannot be deemed to own the amount gifted as on the valuation date u/s.4. Therefore, Vimal HUF is not chargeable to tax for the sum of Rs.2 lakhs.

2 Computation of total income of Vidur for the A.Y. 2007-08

Particulars	Working	Details	Amount	Amount
<u>Salaries</u>				
Basic	20,000*10			20,000
<u>Allowance</u>				
Dearness Allowance	6000*10		60,000	
Entertainment Allowance	1000*10		10,000	
Transport Allowance	3800*10	38000		
Less: Exempted	800*10	8000	30,000	1,00,000
Employer contributions to RPF		30,000		
Less: Exempted	12% of salary1	26,880	3120	
Interest on RPF			Nil	3120
Taxable Salary				3,03,120
<u>Profit & gains of business or</u>				

profession				
Income from clinic				49000
Gross Total Income				3,52,120
Less: Deduction u/s 80C	Contribution to RPF			30,000
Total Income				3,22,120

Salary for the purpose of RPF

Basic Rs.2,00,000

DA (to the extent of 40%) Rs.24000

Rs.2,24,000

Computation of tax liability of Vidur for A.Y.2007-08

Particulars	Amount
Taxable Income	3,22,120
Tax liability before surcharge [(1,00,000*Nil) + (50,000*10%) + (1,00,000*20%) + (72,120*30%]	46,636
Add: Surcharges	Nil
Tax liability after surcharge	46,636
Add: Education cess @2%	933
Tax liability (Rounded off u/s 288B)	47,570

Computation of total income of Mrs. Vidur for the A.Y.2007-08

Particulars	Working	Details	Amount	Amount
Profits & gains of business or profession				
Income from clinic (Note 3)				76000
Income from other sources				
Gratuity	Note 2		Nil	
Leave encashment	Note 2(b)		Nil	
Lump sum from provident fund	Not taxable		Nil	
Pension	Rs.10,000*2	20,000		
Less: Standard deduction u/s 57(iia)	1/3rd of 20,000 or Rs.15,000 (lower)	6667	13,333	
Withdrawal from NSS	Note 4		Nil	13,333
Gross Total Income				89,333
Less: Deduction under chapter VIA				Nil
Total Income (Rounded off u/s 288A)				89,330
Tax on above				Nil

2(a) According to Sec.240, the Assessing Officer is expected to grant refund becoming due to an assessee in pursuance of any order passed in appeal without any need for a claim from the assessee. When any such refund is due, Sec.244A provides for payment of simple interest at the rate of 0.50% per month or part of a month. If the Assessing Officer has not granted such interest which the assessee is entitled to it as per law, then interest can be granted by passing an order u/s.154 as it is a mistake apparent on record.

2(b) A return of income is valid only if it is filed within the time prescribed u/s.139(1) or in response to notice issued u/s.142(1). A belated return can be filed at any time within a period of one year from the end of the relevant assessment year or before completion of assessment, whichever is earlier. A claim for refund can also be made in Form No.30 u/s.239 provided it is made within one year from the end of the assessment year. In the given case the assessee has filed the return showing income below the taxable limit and claiming a refund of Rs.75,000. The return, though filed voluntarily, is beyond the specified time limit. The recourse to the assessee will be to approach the Central Board of Direct Taxes u/s.119 and seek condonation of the delay in claim of refund.

3 The provisions of Sec.47(xi) says that transfer of a capital asset being membership of a recognized stock exchange to a company in exchange of shares allotted to the transferor is not chargeable to tax. However, the transfer must be made on or before 31.12.1998. In this case the transfer was made in September 1998 hence there is no tax liability on the transfer.

However, there is a restriction in Sec.47A(2) that the shares acquired as consideration for the transfer of membership card should not be transferred within a period of 3 years from the date of the original transfer. If this restriction is not adhered to, the capital gain exempted in respect of the original transfer shall be chargeable to tax in the year in which the shares are transferred. In the given case, shares acquired in consideration for sale of membership card are sold after a period of 3 years. Therefore, the exempted capital gain will not be liable to tax by invoking Sec.47A (2).

However, sale of shares would result in long term capital gain. The entire capital gain is exempt u/s.10(38) if the transaction of sale is subject to securities transaction tax. Only where the sale of listed security or unit or zero coupon bond when not subjected to securities transaction tax, section 112 and the proviso to the section would be applicable.

The amount of capital gains would be Rs. 1250000 (Being Sale consideration 32.50 lakhs less Rs 20 lakhs as Indexed cost of acquisition)

4(a) Computation of capital gains in the hands of Mr.A for A.Y. 2008-09

		Rs. in Lakhs
Sale consideration		50.00
Less: Indexed cost of acquisition:		
FMV as at 01.04.1981		
Indexed cost thereof: (5.00 x 551 / 497)	5.54	

Amount paid towards discharge of mortgage	15.00	20.54
Long term capital gain		**29.46**

The contrary view would be that the benefit of indexation can be availed from the first year in which the previous owner acquired the property is also arguable. In such cases, the capital gains would be as computed here below:

		Rs. in Lakhs
Sale consideration received on 16.03.2008		50.00
Less: Indexed cost of acquisition:		
FMV as at 01.04.1981 – Rs 5.00 Lakhs		
	27.55	
Indexed cost thereof: (5.00 x 551 / 100)		
Amount paid towards discharge of mortgage	15.00	42.55
Long term capital gain		
		7.45

Note: Any amount paid towards discharge of mortgage in respect of inherited property shall be allowed as a deduction. (*RM. Arunachalam* – (1998) 227 ITR 222(SC). It needs mention that the repayment of self-created mortgage is not eligible for deduction (*Attili Narayana Rao* – (2001) 252 ITR 880(SC) – Refer to case law under the caption section 55- cost of improvement). As the discharge of mortgage was in the same year of transfer, the question of claiming indexation benefit thereof does not arise.

4(b) Computation of income from other sources of Ms.Rupali AY 2008-09

Particulars	**Refer Note**	**Rs.**	**Rs.**
Net Agricultural Income in India	1		Nil
Net agricultural income from land in Sri Lanka	2		10,000
Profit from sale of agricultural land situated in Mangalore City	3		N.A.
Vacant land -ground rent received	4		12,000
Rent received on sub-letting house		37,500	
Less: Rent payable for house sub let		15,000	
Maintenance expenses on house sublet		1,200	21,300
Directors sitting fees			3,600
Interest on Deposits with nationalized bank			1,000
Interest on Postal savings bank account	5		Nil
Interest credited to PPF account	6		Nil

Interest accrued but not received on NSC VIII Issue			1,050
Interest received under Post Office Monthly Income Scheme			12,000
Interest on deposits with HDFC			900
Interest on securities (gross)			5,000
Dividends received from Indian Companies	7		Nil
Dividend received from foreign companies	8	1100	
Less Interest paid on amount borrowed		8600	(7,500)
Gift received from a Charitable Institution registered under section 12AA – Exempt Sec.56(2)(vi)	9	Nil	
Gift from a friend in foreign currency		50,001	50,501
Gift in Indian currency		500	
Winnings from Lottery (gross)	10		1,00,000
Debenture Interest on 10% debentures of ABC Ltd. of Face Value of Rs.1 lakh.	11		10,000
Taxable income from other sources			**2,19,851**

Notes :

1. Agricultural income derived from land situated in India is exempt from income-tax u/s.10(1).
2. Agricultural income from land situated outside India is not covered by exemption u/s.10(1) and therefore, Rs.10,000 agricultural income from Sri Lanka is taxable.
3. Agricultural income derived in India is exempt. However, sale of agricultural land in a specified area is covered by definition of capital asset u/s.2(14). Therefore, such gains shall be subject to tax under the head "capital gains". As it is not taxable under the head "income from other sources" it is not included in the computation.
4. Rent received from letting out of land and sub-lease is not chargeable to tax under the head "Income from House Property". However, it is taxable under income from other sources. Accordingly, expenses in connection with earning this income have been claimed as deduction u/s.57.
5. Interest on postal saving bank account is exempt u/s.10(15)(i) – Notification number S.O.607(E), dt.09.06.1989.
6. Any amount received from public provident fund is exempt u/s.10(11). Accordingly, interest of Rs.6,000 is claimed as exemption.
7. Dividend received from companies which are subject to dividend distribution tax are exempt u/s.10(34). Therefore, Rs.12,000 claimed as exemption. However, expenses incurred in connection with any income, which are exempt from tax, are not

deductible by virtue of Sec.14A. Hence, Rs.100, relating to collection charges cannot be claimed as deduction.

8. Dividend from foreign companies are subject to tax as these are not liable to dividend distribution tax u/s.115-O. The related expenditure are allowable as deduction u/s.57.
9. Gift received from charitable institutions/associations which are covered by exemption u/s.10(23C) or Sec.11, are exempt – Sec.56(2)(vi).

   Gift received from non-relatives aggregate of which does not exceed Rs.50,000 are not chargeable to tax. In the given case, the amount of gift received is Rs.50,501. Therefore, the whole of such gift is chargeable without any exemption.
10. Any expenditure incurred in relation to lottery winnings are not allowable as deduction u/s.58. Therefore, Rs.5,300 is not allowable as a deduction.

Interest accrued and due on NSC and debentures are taxable even though assessee has not received such interest, since she is following mercantile system of accounting.

5(a) Computation of Total income of Mr. Ramalingam – A.Y. 2008-09

Particulars	Rs.
Income from Profession	94,000
Share income from firm in country X	40,000
Commission income from country Y	30,000
Interest from scheduled banks	18,000
Gross total income c/f.	1,82,000
Gross total income b/f.	1,82,000
Less: Deduction under chapter VI A	Nil
Taxable Income	**1,82,000**
Tax on Rs.1,82,000	10,400
Add: Education Cess @ 3%	312
	10,712
Effective tax rate 10,712/ 1,82,000x 100 = 5.89%	
Less: Relief u/s.91 in respect of doubly taxed	
income 70,000 x 5.89% (20% or 5.89% whichever is lower)	4,123
Total Tax payable	**6,589**
Tax rounded off to nearest multiple of rupees 10	**6,590**

5(b) Mr.Gavaskar has received Rs.40 lakhs as VRS payment for which he is eligible for exemption under section 10(10C) and also relief under section 89 of the Income-tax Act.

He is planning to introduce Rs.15 lakhs as security deposit with the company for obtaining dealership of its electronic goods. The question is silent as regards how much Mr.Gavaskar wants to invest in business out of the VRS compensation of Rs.40 lakhs. It may be advised that he may keep at least 25% of the VRS compensation in other investments other than business to act as a reservoir for any other contingency.

His income from security deposit would be Rs.1.20 lakhs. He is planning to take a remuneration of Rs.40,000 per month and interest at 10% on the capital invested. Mrs.Gavaskar wants an annual income of Rs.3 lakhs for acting as an employee, contributing to the business of her husband. Accordingly, the total amount is withdrawal of Mr. & Mrs.Gavaskar from the business would be Rs.7.80 lakhs plus interest on capital at 10%.

In the light of the above facts, following three types of entities are contemplated:

1. ***Sole proprietorship:***

Mr. Gavaskar may commence the business as a proprietary concern and income derived there from will be taxed in the status of an individual. Accordingly, he enjoys the basic exemption limit and the maximum rate charged would be only 30.9% in case of taxable income not exceeding Rs.10 lacs and 33.99 % in case of income exceeding Rs.10 lacs. Since his wife is a knowledgeable and experienced person, she can be paid a salary of Rs.3,00,000/- p.a in the proprietory firm. This will not be subject to clubbing/disallowance in the hands of Mr.Gavaskar and therefore, she is also assessed in the status of an individual in respect of the salary received by her. By drafting a suitable terms and conditions of employment comprising of perquisites and allowances, she would be entitled to claim these perquisites, allowances and standard deduction while computing her taxable salary income. However, interest on capital and monthly remuneration of Rs.40,000 are not eligible for deduction as they constitutes drawings made by proprietor.

2. ***Partnership:***

On the other hand, Mr.Gavaskar can enter into partnership with his wife to carry on the business. The firm will be assessed to tax at the effective rate of 30.90%. The remuneration and the interest on capital can be claimed as an expense by the firm, subject to limits prescribed u/s.40(b). These shall be taxed in the hands of the partners as per the rates applicable to individuals. However, the share of profit from the firm is exempt u/s 10(2A).

3. ***Private Limited Company:***

Mr.Gavaskar may form a private limited company and enter into a separate employment agreement for the purpose of his salary, subdivided in the form of various perks so that his taxable income from remuneration would be substantially reduced. Similarly, salary package of Mrs.Gavaskar may be designed in such a manner that the available exempt allowances as are actually intended, may be paid so that her taxable income will also be reduced to the optimal figure.

The interest on capital cannot be taken, but Mr.Gavaskar may contribute his capital as equity shares and declare dividend, which may result in payment of dividend distribution tax to the exchequer in addition to the normal tax payable by the company. However, this dividend would be exempt u/s 10(34) in the hands of Mr.Gavaskar.

On the other hand, instead of contributing entire amount by way of investment in shares, Mr. Gavaskar may invest some portion by way of loan to the company as per the rate of interest prevailing in the market. As per this device of planning, the company is entitled to claim the interest on loan as an expenditure and save tax to the extent of 30.9%. Though Mr.Gavaskar is liable to tax irrespect of such interest receipts the effective rate of taxation would be only 30.9%.

The following table summarizes the important aspects of all the 3 options discussed above.

SL No	Head of expenditure	Sole proprietor	Partnership	Private Limited Co
1	Salary to Self	Not Allowed	Allowed	Allowed
2	Salary to Spouse	Allowed	Allowed	Allowed
3	Interest on Investment	Not Allowed	Allowed	Not Allowed
4	Interest on Loan	Not Allowed	Allowed	Allowed
5	Balance Income taxed at	30.9% or 33.99%	30.9%*	30.9%*
6	Dividend distribution tax	N.A.	N.A.	14.025%

* If the total income exceeds Rs.1 crore then surcharge at 10% to be added to the income.

Therefore, out of the three options it is better to commence as a proprietary concern instead of a partnership firm or a company mode.

6(a) Under chapter XII-A, section 115E prescribes tax rate of 20% plus surcharge for investment income and 10% for long term capital gains. In respect of the other income, normal rates of tax shall apply. Therefore, the tax payable in the case of the non-resident Indian on the basis of information furnished shall be as follows:

i) Investment income Rs.50,000 at 20% = Rs.10,000.

ii) Long term capital gains Rs.25,000 at 10% = Rs.2,500

iii) Other income Rs.75,000 which is below basic exemption limit = Rs.Nil.

The aggregate of the above Rs.12,500 is the tax liability. Also, education cess and secondary and higher education cess @ 3% being Rs.375 is payable on Rs.12,500.

The tax liability in respect of long term capital gains can be reduced or avoided u/s.115F if the non-resident Indian invests the net consideration in any of the specified assets or the savings certificates referred to in Sec.10(4B). If the entire net consideration is not invested, proportionate exemption can be availed.

Chapter XII-A is an optional scheme and a non-resident Indian may elect not to be governed by the provisions of this chapter for any assessment year by furnishing is return of income for that assessment year under section 139 and making a declaration for non application of chapter XII-A.

If the non-resident Indian decides not to avail chapter XII-A benefit for the assessment year 2008-09 his total income of Rs.1,50,000 would be chargeable to tax in the normal manner and his tax liability would be Rs.6,500 (on long term capital gains @ 20% Rs.5,000 and other incomes at regular rates Rs.1500).

The assessee hence should opt for normal provisions of Income-tax Act and declare that chapter XII-A provisions be not applied in his case.

6(b) Sale consideration as reduced by expenses resulting in a net consideration of Rs.3,50,000 is required to be invested to avail exemption in respect of the entire capital gains of Rs.1,50,000 (Rs.3,50,000 – 2,00,000 cost). Acquiring of English mortgage by a trust is treated as reinvestment of the proceeds arising on transfer of a capital asset in another capital asset. It has been so held in the case of *Bafna Charitable Trust vs. CIT* (1997) 230 ITR 864 (Bom). However, since the amount of mortgage acquired is Rs.3,10,000, the capital gain shall be exempt only to the extent of Rs.1,10,000, being the amount invested in excess of the original cost of the transferred asset (Rs.3,10,000 less 2,00,000). In view of this, Rs.40,000 shall be included in the taxable income of the trust and Rs.1,10,000 shall be eligible for deduction u/s.11(1A).

Students may note that section 11(1A) deals with taxability of capital gain in the case of charitable trusts and it does not make any distinction between short term capital asset vis a vis long term capital asset. Therefore, even proceeds from sale of short term capital asset when reinvested in fresh acquisition, it is eligible for deduction subject to satisfaction of the conditions contained in section 11(1A).

IE

No of Questions: 9
Total Marks: 100

No of Pages Printed: 4 **Time allowed: 3Hrs**

Question No.1, 6, & 9 are Compulsory. Answer any Two from Part A and One from Part B

1(a) Briefly explain any **two** of the following with reference to the provisions of theCENVAT Credit Rules, 2004:

(i) Job work
(ii) Principal inputs
(iii)Deemed Cenvat Credit **(2 x 2 = 4 Marks)**

b) With reference to Cenvat Credit Rules, 2004, discuss giving reason whether the following statements are True or False:

(i) Credit of duties of excise on inputs will not be available if inputs are used in intermediate product, which is exempt from duty, even though the final product is dutiable
(ii) A manufacturer can sell the inputs on which Cenvat has already been availed of, as they are, provided he pays the amount equal to the credit availed.
(iii) A manufacturer is eligible for Cenvat Credit in the cases stated below:
(1) Inputs used in trial runs
(2) Materials used for maintaining factory building

(6 Marks)

c) ABC, an assessee availing the SSI exemption scheme paid Central Excise duty of Rs.10,000 for the goods cleared in the month of March, 2005 on April 15, 2005. Discuss whether any interest will be charged from ABC for late payment of duty. If yes, what will be the interest liability?

(4 Marks)

(i) Discuss briefly with reference to the provisions of the Central Excise Act, 1944 whether the following process would amount to 'manufacture'. XYZ Corporation is engaged in the process of mixing aluminium paste, metal lacquer and thinner resulting in the production of aluminium paint having a shelf life of 8-10 hours.

(ii) Explain briefly whether duty liability under the Central Excise Act, 1944 will be attracted in the following case: MN & Co. engaged in the manufacture of Vanaspati oil used activated clay for deodoring, bleaching and decolouring of oil. As a result of this processing, the activated clay was transformed into "spent earth" which was nothing but the residue of activated clay. The activated clay residue had lost its absorbent character during the course of refining and bleaching of oil. Excise Department sought to classify the "spent earth" under Central Excise tariff chapter Heading No. 1507, which reads as: residues resulting from treatment of fatty substances or animal or vegetable waxes."

(6 Marks)

2 (a) Explain the provision regarding maintenance of daily stock account of stored goods under rule 10(1) of Central Excise Rules.

(b) Write a short note on the procedure in respect of exported goods subsequently re-imported and returned to factory

(c) **Comment on the following:**

(i) Excise department cannot challenge the responsibility of MRP printed on the package

(ii) If any excisable goods are exempted from duty of excise absolutely, the manufacturer of such goods will be bound to avail of the exemption

(iii) SSI units whose turnover exceeds Rupees 90 lakhs per annum have to give a declaration in the prescribed form

(iv) Annual Financial Information Statement (ER-4) is required to be submitted by the assesses paying duty of Rs. 4 crores or above per annum through PLA

(d) What is CT-1 certificate?

[4+5+4+2 = 15 Marks]

3 (a) Explain briefly with reference to the provisions of the Central Excise Act the term Deemed Manufacture".

(b) Discuss the provisions of the Central Excise Act relating to collection of amount by a person from his buyer in Excess of the Duty assessed or determined and paid on any excisable goods.

(c) When a person shall be deemed to be related person for the purpose of valuation under the Central Excise Act.

(d) Describe Power to Summon persons under the Central Excise Act (**3+4+4+4=15 Marks).**

4 (a) Noble Plastics manufactures plastic trays on job work basis at its factory situated at Pune by using the ingredients supplied by another company, Bright Industries. Noble Plastics has received a Show Cause Notice from the Central Excise Department demanding duty on the sale price of Bright Industries. Noble Plastics contends that it is only a job worker for Bright Industries and it is not the owner of the ingredients and therefore not liable to pay duty on the price at which plastic trays are sold by Bright Industries. Discuss, with the help of decided case law, if any, whether the contention of Noble Plastics is justified

(5 Marks)

(b) Maharaja, a manufacturer of dutiable as well as exempted goods, furnishes the following information for the month of Mar. 2008

(i) Assessable Value of dutiable goods Rs.250 lakhs (rate of duty 14%)

(ii) Price of exempted goods cleared from factory Rs 200 lakhs

(iii) Cenvat Credit of Input X (used only in the manufacture of exempted goods) Rs.10 lakhs

(iv) Cenvat Credit of Input Y (used only in the manufacture of dutiable goods) Rs.15 lakhs

(v) Cenvat Credit of Input Z (used commonly in manufacture of exempted as well as dutiable goods but no separate accounts are maintained in respect of input Z) Rs.20 lakhs; and

(vi) Cenvat Credit of Capital Goods (used partly for manufacture of exempted goods also) Rs.25 lakhs (total amount of duty)

Compute the amount of excise duty and any other amount payable by Maharaja for the month of Mar. 2008

(6 Marks)

(c) What are the circumstances under which the manufacturer can claim refund of Cenvat Credit in cash? **(4 Marks)**

5 **(a)** Write short notes on the following:

(i) Place of Removal

(ii) Interest u/s 11AB

(b) What is Personal Ledger Account or PLA? How is it maintained?

(c) Briefly explain the procedure for removal of goods by a unit which is an 100% EOU for Domestic Tariff Area

(6+5+4 = 15 Marks)

Part B

6 **(a)** Explain briefly with reference to the provisions of the Customs Act, 1962 any two of the following:
(i) *Ad hoc* exemptions
(ii) Entry outward
(iii) Warehousing stations

(b) A person makes an unauthorized import of goods liable to confiscation. After adjudication, Assistant Commissioner provides an option to the importer to pay fine in lieu of confiscation. It is proposed to impose a fine (in lieu of confiscation) equal to 50% of margin of profit. From the following particulars calculate the maximum amount of fine that can be imposed : Assessable value – Rs 50,000, Total duty payable – Rs 20,000, Market value – 1,00,000. Also calculate the amount of fine and the total payment to be made by the importer to clear the consignment

(c) State in brief the provisions of the Customs Act, 1962 relating to filing of "Import Manifest/Report".

(d) Explain briefly with respect to the provisions of the Customs Act, 1962:
(i) Denaturing/Mutilation of imported goods
(ii) Declaration by owner of Baggage

[4+6+5+5 = 20 Marks]

7(a) When the ship on its arrival from Dubai was searched by the Customs Officer, they found 2,000 biscuits of Gold kept concealed in the ceiling of one of the unoccupied Cabin. The Chief cook of the ship admitted the concealing of the Gold. The Captain of the ship deposed in his statement that he along with Chief Engineer and Chief Officer had inspected the vessel for contraband and inspection did not reveal anything. No Evidence was also found that captain was involved in the smuggling of Gold. Discuss whether the ship is liable to confiscation under the Customs Act.

(b) M/s. XYZ, a 100% export oriented undertaking (100% EOU in short) imported DG sets and furnace oil duty free for setting up captive power plant for its power requirements for export production. They used the power so generated for export production but sold surplus power in domestic tariff area. Is customs department justified in demanding duty on DG sets and furnace oil as surplus power has been sold in Domestic Tariff Area?

(c) Mention the circumstances under which goods are considered to have been removed improperly from a warehouse under the Customs Act **(5+5+5 = 15 Marks)**

8. (a) Write a brief note on any **two** of the following with reference to the Customs Act, 1962 :

(i) Fine and Penalty

(ii) Rules and Regulations

(iii) Power to search persons under section 100 and section 101 **(3 x 2 = 6 Marks).**

(b) Explain briefly if the Authority for Advance Ruling could entertain applications from residents with specific reference to section 28E(C) of the Customs Act, 1962 **(3 Marks).**

(c) Write a brief note on "remission of duty in case of volatile goods" under section 70 of the Customs Act, 1962 **(3 Marks).**

(d) Briefly explain " Standard unit of Quantity" with reference to the first schedule to the Customs Tariff Act 1975 (3 Marks)

Part C

9 (a) **State whether the following services attract Service Tax**

(i) **Service provided in the State of Andhra Pradesh by a person having place of Business in the state of Jammu & Kashmir**

(ii) Service provided in the State of Jammu and Kashmir by a person having place of business in Mumbai

(iii) Service rendered to a foreign citizen in India

(iv) Service rendered abroad by an Indian Company

(v) Service received in India which is provided by a person outside India

(5 x 2 = 10 Marks)

(b) **Star Limited has received a sum of Rs.25, 000 as hire charges for letting out open land owned by it for organizing a social function. The department has demanded service tax on hire charges under the category of mandap keepers. Star Limited has contended that it has not let out any hall and therefore not liable to service tax. Is the contention of Star Limited tenable in law** (3 Marks)

(c) State whether the following is true or false giving reason for your answer

(i) Service Tax is payable on the amount actually received and not on the amount of invoice

(2 Marks)

PRIME ACADEMY

26th SESSION MODEL EXAM

FINAL– INDIRECT TAXES

Part -A

1(a)

(i) Job work

Job work involves the processing of goods by contract labour or any other enterprises, which is a part of the process of manufacture of goods. When a manufacturer as part of the manufacturing process provide raw material, in put capital goods to another person to undertake part of the manufacturing process the same is referred to as job work.

Example: A company provides material to house hold for manufacturing agar pathies, dhups which is sent back to the company after processing by the house hold

(ii) Principle input

Principle input refer to the goods or services that are used by a manufacturer or services provided in or in relation to manufacture of final product or rendering output service.

Example: Company X purchase picture tubes from company Y for manufacture of television.

(iii) Deemed Cenvat Credit

As per rule 16 when a manufacturer or supplier of goods gets back the product due to some defect or any other reason when we can claim credit as if he receives any input

If he carryout any activities on the product which amount to manufacture then he is liable to charge excise duty on the value of the goods as per rules. If the process does not amount to manufacture while removing the goods he has to pay the amount of duty he has taken as credit.

1(b) (i) False. Since the final product is dutiable, CENVAT credit is available irrespective of the fact that the intermediate goods are exempt. This is due to the fact that in put are utilized in manufacture of final product which is excisable.

(ii) True. Rule 3(5) of CENVAT Credit rules 2004 inter alia products that a manufacturer of the final products can remove inputs on which CENVAT Credit has been taken as such from the factory if he pays an amount equal to credit availed in respect of such goods.

(iii) Any input used in or in relation to manufacture of final product is eligible for credit.

(i) Trial runs are an integral part of manufacturing process. Credit can be claimed.

(ii) To materials used for maintaining factory building are not used by the manufacturer directly or indirectly. For manufacturer credit is not available.

1(c) For goods cleared in March duty is to be remitted by 31 march

An Assessee availing SSI exemption can clear goods upto Rs 1.5 Crore without payment of duty subject to exemption. If Rs 10000 falls within Rs 1.5 Crore limit , no duty is payable and consequently no interest is payable If Rs 10000 is beyond the 1.5 Crore limits ABC is liable to interest under section 11 AB. At the rate of 13% per annum from the 1st day of the Month succeeding the month which interest is due that is from 1st April on words.

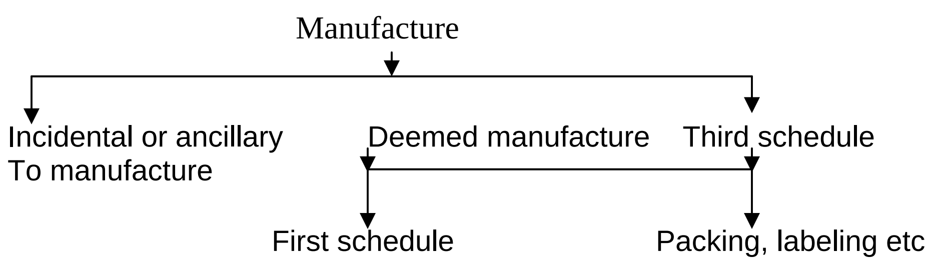
1 **(i)** Manufacture = Movable + Marketable

For an activity to constitute Manufacture a transformation must take place and a new product must emerge distinct from the input product.

XYZ mixes aluminum paint metal lacquer and thinner to product aluminum paint thus a new product emerges. Transformation has occurred

The product has a sheep life of 8 to 10 hours. It is marketable Therefore manufacture has taken place Judicial preceded are available for the said facts where in the department product evidence of a similar product being sold in the market. The contention of the assessee that the product had self life of more 8 – 10 hours was quashed by the Supreme Court, which held that the process amounted to manufacture

(ii)



The product finds place in first schedule to central excise Tariff Act. Therefore it would be deemed to be manufacture. However courts have held that just because tariff heading is available for the said product does not mean it amounts to manufacture

The resulting product is not marketable moreover it is a more by product of the manufacturing process

Therefore the process is not manufacture and spent earth produced by MN & co is not excisable.

2(a) Daily Stock account has to be maintained in respect of excisable good stored under Rule 10 (1) of Central Excise Rules. Format of the Daily stock account has not been prescribed by the rules. But it should contain the following:

1. Description of the goods
2. Quality of the goods
3. Opening Stock
4. Details of Removal of the goods
5. Closing Stock
6. It should be verified and signed by an authorized person.

2 (b) Exported goods subsequently re-imported and returned to factory has to be treated as deemed imported goods and appropriate import duty leviable on such imported goods have to be paid in respect of such goods also. Refund for export duty paid can be claimed on such goods if goods are exported after payment of export duty on the said goods.

2 (c)

(i) The statement is true.

MRP is based on the standards of Weights and Measures Act. Goods which are dutiable on the basis of MRP based on valuation have to be charged to duty at a specified expectancy on the MRP. Excise department can verify only the correctness of the duty liability and not the MRP printed on the package

(ii) This statement is true

If any excisable goods are exempted from the duty of excise absolutely the manufacturer will be bound to avail the exemption and he has no option. This is according to exemption notification issued U/S 5A of the Central Excise Act.

(iii) The statement is true

a) **SSI limits whose turnover exceeds Rs.90 lakhs per annum have to give a declaration in the prescribed form to the excess authorities regarding attainment of the prescribed level of turnover.**

(iv) The statement is False:

a) **Annual financial information statement (ER -4) is requested to be submitted by the assesses paying duty of Rs. 1 crore or above per annum through PLA.**

2(d) CT – 1 Certificate:

a) **It is a certificate issued by a merchant exporter to the manufacturer of export goods in order to procure goods without payment of excise duty. The merchant exporter issues the CT – 1 certificate to the manufacturer stating the value of goods and the duty leviable thereon.**

b) **On the basis of this CT – 1 Certificate the manufacturer removes excisable goods for export without payment of duty.**

3(a) **Deemed Manufacture:**

Deemed manufacture is of two types:

a) **CETA specifies some processes as 'amounting to manufacture.' If any of these procedures are carried out, goods will be said to be manufactured, even if as per Court's decisions, the process may not amount to 'manufacture' (Sec.2 (f) (ii)).**

b) **In respect of goods specified in Third Schedule to Central Excise Act, repacking, relabelling, putting or altering retail sale price etc. will be 'manufactured'. The goods included in Third Schedule of Central Excise Act are some of those on which excise duty is payable u/s.4A on basis of MRP printed on the package (Sec.2(f)(iii) with effect from 14.5.2003)**

3(b) Provisions of the Central Excise Act relating to collection of amount by a person from his buyer in Excess of the Duty assessed or determined and paid on any excisable goods:

Every person, who is liable to pay duty under Central Excise Act and Rules and has collected from buyer any amount in excess of the duty assessed or determined and paid on any excisable goods under CE Act or rules, representing as duty of excise, must pay the amount immediate to the credit of Central Government. This is governed by Sec.11D (1) of CEA '44.

Thus, a person who charges an amount in the invoice representing as excise duty, must deposit the same with the Central Government whether or not the duty was legally payable.

After assessment is completed, if some amount is found to be refundable, the amount will be credited to Consumer Welfare Fund or refunded to the person who has borne the duty incidence as per Sec.11B.

3(c) <u>'Deemed Related Person' for Valuation purposes under Central Excise Act :'</u>

Sec.4 (3) (b) of Central Excise Act deals with 'Deemed Related Person'. As per the said Section, the following persons are 'deemed to be related person' for valuation purposes, if

a) They are Inter Connected Undertakings
b) They are relatives
c) Amongst them, buyer is a relative and a distributor of assessee or a sub-distributor of such distributor or
d) They are so associated that they interest, directly or indirectly in the business of each other

3(d) <u>Power to Summon Persons under Central Excise Act :</u>

Sec.14(1) of CEA provides that any Central Excise Officer empowered by the Central Government to issue summons to any person for any inquiry which such excise officer is making under Excise Act. As per Sec.14 (1), the empowered excise officer can require a person to produce any document or any other thing relevant to enquiry. The excise officer can examine a person.

The term 'summons' means asking a person to appear before the named authority and to give evidence and produce documents or other things. A person summoned is bound to attend and state the truth upon any subject respecting which they are examined. (Sec.14 (2)).

Excise Officers of Superintendent or above rank are empowered to issue summons – Notification No.9/99-CE (NT) dated 10.2.99

4(a) As per Rule 4(5)(a) of Cenvat Credit Rules, the inputs / capital goods can be removed as such or after partial processing to job worker for further processing, testing, repairs or reconditioning or for manufacture of intermediate goods necessary for manufacture of final products or any other purpose. As per Rule 2(n) of Cenvat Credit Rules, Job Work means processing or working upon raw materials or semi-finished goods supplied to job worker so as to complete a whole of the process resulting in manufacture or finishing of an operation which is essential for aforesaid process and the expression 'job worker' shall be construed accordingly. After carrying out the required operation, the goods should be returned to factory or premises of service provider within 180 days. If these are not received back within 180 days of their being sent out, manufacturer should pay an 'amount' equivalent to Cenvat Credit attributable to them, which can be made through PLA/Cenvat. If the inputs/capital goods received back in 180 days, the manufacturer can take Cenvat Credit of duty paid by him. Further, normally, though the duty liability is of the actual manufacturer and not the raw material supplier, under Cenvat Rules, duty liability is of the manufacturer who is sending his inputs for Job Work. Therefore, the contention of Noble Plastics is right in as much as they are only the job worker of Bright Industries and they need not have to pay duty on the sale price of the Bright Industries. In fact, Noble Plastics is not required to pay duty provided the goods are sent under Rule 57F (4). Bright Industries would have cleared the raw materials without duty payment and Noble Plastics after doing further processing at their end can clear the Plastic Trays to Bright Industries within 180 days, which Bright Industries will clear their final product viz., Plastic Trays on their sale price. There are number of Tribunal decisions available on the point that job worker is not required to pay duty in respect of goods received under Rule 57F(4). They are: - Trico Process vs. CCE 2005 (189) ELT 126 (CESTAT); Akash Fashion vs. CCE 2006 (200) ELT 509 (CESTAT). While this is so, the rules have been amended from 1st of April 07, whereby, where a job worker manufactures a final product on behalf a manufacturer and clear the final product directly to the depot of the manufacturer then value will be the price at which the goods are sold by the principal manufacturer and not the job worker. In this context, it may be mentioned that the contention of the dept is right and the stand of Noble plastics may not be sustainable in law.

4(b)

Computation of Excise Duty and other amount payable by Maharaja for the month of Mar. 2008:

(In Rupees)

S.No.	Description	Duty Amount @ 14%	Edn.Cess @ 2%	SHE Cess @ 1%
1.	Assessable Value of Dutiable Goods – Rs.250 lakhs	35,00,000	5,00,000	2,50,000
2.	Price of Exempted Goods cleared from the Factory – Rs.200 lakhs – 10% of the Price of the Goods – since Credit availed	20.00.000	Nil	Nil
3.	Cenvat Credit of Input X (used only in the manufacture of Exempted Goods – Rs.10 lakhs)	(10,00,000)	Nil	Nil
4.	Cenvat Credit of Input Y (used only in the manufacture of dutiable goods) – Rs.15 lakhs	(15,00,000)	Nil	Nil
5.	Cenvat Credit of Input Z (used commonly in manufacture of dutiable as well as	(20,00,000)	Nil	Nil

	exempted goods, but no separate accounts are maintained for Z) – Rs.20,00,000			
6.	Cenvat Credit of Capital Goods (used partly in manufacture of exempted goods also) – Rs.25, 00,000 – (only 50% can be availed in the 1st year and balance only in the next year) and since final product is dutiable it can be used in manufacture exempted goods also. But, the Capital Goods Credit can be utilized for making the payment only after full utilization (Rs.12,50,000 credit cannot be utilised now)	Nil	Nil	Nil

Total Duty payable by M/s.Maharaja is Rs.62,50,000 (Rs.35,00,000 + Rs.5,00,000 + Rs.2, 50,000 + Rs.20, 00,000)

Cenvat Credit that can be utilised is Rs.(45, 00,000)

PLA (cash payment) to be made is Rs. 17, 50,000

Otherwise,
If no Cenvat Credit is availed on Input X and Input Z, then in that case, duty payable will only be
- Rs.42, 50,000 (Rs.35L+Rs.5L+Rs.2.5L)
(as no duty need to be paid on Exempted Goods)

Cenvat Credit that can be utilised is only from Input Y - Rs.(15, 00,000)

PLA (cash payment) to be made is - Rs.27, 50,000

Therefore, it is advantageous to go for the first option.

4(c) In some cases, it may happen that duty paid on inputs may be more than duty payable on final products. In such cases, though the Cenvat Credit will be available to the manufacture, he cannot use the same and the same will lapse. There is no provision for refund of excess Cenvat Credit. However, only exception is available in case of exports where duty paid on inputs used for exported goods is refundable. Other exception is when Cenvat Credit could not be availed due to fault / wrong action of the department. In such cases, Tribunal has ordered cash refund / credit in PLA in many cases. However, if assessee is in a position to avail Cenvat Credit, refund should be given only by way of Cenvat Credit if duty was paid through Cenvat Credit. However, in many cases it has been held that duty paid through Cenvat can be refunded in cash when assessee cannot avail Cenvat Credit for variety of reasons (e.g. factory closed, product exempted etc. or where department did not allow utilisation of Cenvat Credit).

5(a)

(i) Place of Renewal:

Place of Renewal refers to any place from when the excisable goods are renewed for home consumption. It include a depot, premises of a consignment agent and such other place from when excisable goods are renewed on payment of excise duty.

(ii) Interest U/S II AB:

If the duty not levied / short levied, duty not paid on erroneously refunded is not paid within the relevant date then interest U/S 11 AB is leviable on such short / levy / not levy or erroneous refund @ 13% per annum.

Relevant date means:

I. If returns are regularly filed then the date when returns is filed.
II. If returns are not filed last date on which return had to be filed.
III. In any other case, if duty is paid the date of payment of duty.
IV. In the case of erroneous refund the date of refund.

5 (b) Personal Ledger Account:

It is an account maintained by the manufacturer with the Central Excise Department where by amount is credited to such account and the duty payable in excess of the Cenvat credit availed is paid by debit to the PLA account.

Hence when excise duty is excess of the Cenvat credit availed is to be paid is paid through the PLA account.

5 (c) Renewal of goods by a 100% EOU to Domestic Tariff area:

(i) When goods are renewed by a 100% EOU to domestic tariff area they are deemed as imports.
(ii) Such goods shall be renewed under the cover of an invoice under central excise rule 11.
(iii) Appropriate excise duty has to be paid by the 100% EOU

Part - B

6 (a)

(i) Ad hoc exemptions :

The central government has the power to issue a general / specific order granting exemptions in respect of certain category of goods. The same is done through notification in the official Gazettee.The exemption may prescribe a lower rate / Nil rate for imports and / or a different method of valuation.

(ii) Entry Outward

Entry outward refers to the permission given by the proper officer of customs to master of the Vessel to depart from the custom station after loading the export goods on board the vessel.

(iii) Warehousing Station:

Warehousing station refers to places which are licensed by the customs authorised warehousing station to store the imported goods pending clearance for home consumption.

6 (b) Computation of the amount of fine and total payment to be made by the importer to clean the consignment.

(i) Assessable Value = 50,000
Total duty payable = 20,000

70,000

Margin of Budget = Market value – cost to importer

= Rs 1, 00,000 - Rs 70,000

= Rs 30,000

Amount of fine = Margin of Budget x 50%

= Rs 30,000 x 50%

= Rs 15,000

(ii) Total payment to be made by the importer to clear the consignment

= Total duty payable + fine

= Rs 20,000 + Rs 15,000

= Rs 35,000

Answers:

(i) Amount of fine = Rs 15,000

(ii) Total payment to be made by importer to clear the consignment = Rs 35,000

6 (c) **<u>Import Manifest / Report:</u>**

Import manifest / report is filed by the importer in the land custom station when goods are imported by vehicle.

It contains the description of imported goods like:
(i) Nature of goods / description of the goods
(ii) No. of packages
(iii) Quantity of the goods
(iv) Quality of the goods
(v) Value of the goods
(vi) Details of the exporter and place from where it is exported

On the basis of import manifest/report filed by the importer the customs officer assesses the imported goods for the purpose of levying customs duty.

6 (d) (i) Denaturing / Mutilation of imported goods:

Some imported goods are capable of multiple uses. Such goods are denatured / Mutilated at the custom station so that they can be used only for the intended purpose and not for other purposes. Such goods are deemed to be imported in their denatured / Mutilated form and import duty is leviable on the denatured / Mutilated value of the goods.

(iii) Declaration by owner of baggage:

U/S 77 of the custom act, the owner of the imported baggage have to give a declaration regarding contents of the baggage and their value thereof. Based on the baggage declaration made by the owner of the baggage, customs duty is ascertained on the imported baggage.

7 (a) According to the provisions of the customs act, if any officer of customs has reason to believe that any vessel, vehicle on aircraft contains goods which are enable to confiscation, then they have power to step such vessel / vehicle / aircraft and confiscate / seize the contraband goods.

In this case, ship is enable to be confiscated since it contains contraband goods. Even if captain is not involved in smuggling of gold and inspection by chief engineer and chief officer had not revealed the smuggled goods.

7 (b) Inputs and capital goods imported by a 100% EOU for export product is exempt from custom duty. In this case, power has generated using imported DG sets and furnace oil and surplus power was sold to Domestic Tariff Area. The custom department is not justified in demanding duty on DG sets and furnace oil since it is primarily used for export production and only the surplus was sold to domestic tariff area as surplus power cannot be stored and it had to be consumed in one way on the other. Only the surplus power of the meeting the export requirements was sold to domestic Tariff area. Hence the contention of the department is not tenable in law.

7 (c) Circumstances under which goods are considered to have been removed improperly from a warehouse under customs act:

(i) If goods are removed without payment of the appropriate customs duty leviable on the imported goods.
(ii) If goods have been lost from the warehouse where they are stored.
(iii) Theft of the warehoused goods.

8(a) (i) **Fine and Penalty:**

Fine: Sec.125 (1) of Customs Act provides that wherever confiscating of goods is ordered, the adjudicating officer may give option to the owner of goods to pay 'fine' in lieu of confiscation if the importation or exportation of goods was prohibited. However, if importation or exportation was not prohibited, the option to pay redemption fine shall be given to the owner of goods which is called redemption fine.

Penalty: Penalty is levied if violation is intentional. However, in many penal provisions in taxation laws, the liability is absolute, i.e., penalty is leviable irrespective of intention. Penalty is leviable for violation of rules – it does not matter whether it is a genuine mistake, lack of knowledge, negligence or intentional violation of rules. This can be considered only while deciding the quantum of penalty leviable.

(ii) **Rules:**

Under Sec.156 of Customs Act, 1962 Central Government has been empowered to make rules, consistent with the provisions of the Act, to carry out for the purposes of the Act. Various rules have been framed under these powers

Regulations:

Under Sec.157 of Customs Act, 1962, Central Board of Excise & Customs has been empowered to make regulations, consistent with provisions of the Act, to carry out the purposes of the act various regulations have been framed under these powers.

(iii) **Powers to search Persons under Sec.100 & Sec.101:**

The powers of search under Sec.100 are in respect of people in customs area or people entering or leaving India only. However, as per Sec.101 of Customs Act, an Officer of Customs is empowered by special order of Commissioner of Customs can search any person (anywhere in India), if he has reason to believe that such person is carrying gold, diamond, manufacture of gold and diamonds or watches or any other class of goods as may be notified by Central Government which are liable for confiscation.

8(b) As per Sec.28E(c) of Customs Act, application for Advance Ruling can be by any of the following with specific reference to resident. That is;-

(i) A resident setting up a joint venture in India in collaboration with a non-resident;
(ii) A resident falling in any class or category as may be specified by Central Government by issuing a notification.

Therefore in both the cases, an application from a resident can be entertained u/s.28E(c).

8(c) Remission of duty in case of Volatile Goods:
Under Sec.70 of the Act, Central Government can prescribe goods for which allowance for deficiency in quantity due to natural loss can be permitted by Assistant Commissioner. Duty on such deficiency can be remitted by Assistant Commissioner. Goods specified under Customs Notification No.122-Cus dated 11.5.63 for this purpose are:- a) Petroleum Products like aviation fuel, motor spirit, kerosene, diesel oil (b) Ethylene dichloride kept in tanks (c) Liquid helium gas in containers; (d) Wine, spirit or beer kept in casks. Duty can be remitted only if there is natural loss. Loss due to pilferage or theft cannot be permitted.

8(d) Standard Unit of Quantity with reference to First Schedule to Customs Tariff Act, 1975:
Under Customs Tariff Act, 1975 Standard Unit of Quantity is specified for each item to facilitate – collection, comparison and analysis of Trade Statistics. Some of them are:-

Amps - Ampere(s); CIF – Cost, Freight & Insurance; ; cc – Cubic Centimeter; cm – centimeter; t – tonne; tu – thousand in number; Rs. – Rupees; US$ - US Dollar etc.

Part – C

9(a) (i) Yes – it attracts service tax. Service is provided in the state of Andhra Pradesh but the person has place of business in the state of Jammu & Kashmir.

The state of Jammu & Kashmir is exempt from the levy of service tax. But in this case senior service is provided in Andhra Pradesh and not Jammu & Kashmir, it attracts service tax. Andhra Pradesh is included in the service tax net.

(ii) No – Service tax is not attracted in this case.

The state of Jammu & Kashmir is excluded from the service tax net. In this case, since service is provided in the state of Jammu & Kashmir by a person having place of business in Mumbai, it attracts service tax.

(iii) Yes – Service tax is attracted in this case.

All taxable services provided in India attract service tax irrespective of whether it is provided to an Indian citizen or a foreign citizen.

(iv) No – Service tax is not attracted in this case.

Service tax is not attracted if services are rendered abroad by an Indian company since only services rendered within India are taxable in India.

(v) Yes – Service received in India which is provided by a person outside India is taxable in India.
It is taxable in the hands of the recipient as though taxable services was provided by him

9(b) Service of maiden keepers includes letting out open land for organizing a social function. Here the sum of Rs. 25000 on hire charges recovered by Star Limited for letting out open land is taxable as maiden keepers service. Maiden keepers service does not include letting out halls alone, it also include letting out open land owned by it for hire. Hence the department is right into contention and the assese's contention is not taxable in law.

9(c) (i) True.
Service tax is payable on the gross amount actually received by the service provider including any advance received in respect of taxable service to be provided in future.

Service tax is not payable on the amount of invoice.