TC

Total No. of Questions : 6 **Max Marks: 100**
No.of Pages : 3 **Time Allowed: 3 Hours**

Question No.1 Compulsory
Answer any four questions from the rest

1. (a) Briefly describe the different methods of Transfer Pricing (5 Marks)

(b) Write short note on pricing by service sector (5 Marks)

(c) Pollard Manufacturing has developed value-added standards for its activities including material usage, purchasing, and inspecting. The value added output levels for each of the activities, their actual levels achieved, and the standard prices are as follows:

Activity	**Activity Driver**	**SQ Rs.**	**AQ Rs.**	**SP Rs.**
Using lumber	Board feet	24,000	30,000	Rs 10
Purchasing	Purchase orders	800	1,000	Rs 50
Inspecting	Inspection hours	0	4,000	Rs 12

Assume that material usage and purchasing costs correspond to flexible resources (acquired as needed) and that inspection uses resources that are acquired in blocks or steps of 2,000 hours. The actual prices paid for the inputs equal the standard prices.

Required:

1. Assume that continuous improvement efforts reduce that demand for inspection by 30 percent during the year (actual activity usage drop by 30 percent). Calculate the volume and unused capacity variances for the inspection activity. Explain their meaning. Also, explain why there is no volume or unused capacity variance for other two activities.

2. Prepare a cost report that details value and nonvalue-added costs.

3. Suppose that the company wants to reduce all nonvalue-added costs by 30% in the coming year. Prepare Kaizen standards that can be used to evaluate the company's progress towards this goal. How much will these measures save in resource spending?

(10 Marks)

2. (a)'Relevant Cost analysis helps in drawing the attention of managers to those elements of cost which are relevant for the decision' comment. (5 Marks)

(b) Universe Ltd manufactures 20,000 units of 'X' in a year at its normal production capacity. The unit cost as to variable costs and fixed costs at this level are Rs 13 and Rs 4 respectively. Due to trade depression, it is expected that only 2,000 units of 'X' can be sold during the next year. The management plans to shut-down the plant. The fixed costs for the next year then is expected to be reduced to Rs 33,000. Additional costs of plant shut-down are expected at Rs 12,000. Should the plant be shut-down? What is the shut-down point? (5 Marks)

(c) "Because a single budget system is normally used to serve several purposes, there is a danger that they may conflict with each other". Do you agree? Discuss. (5 Marks)

(d) Define the 'Opportunity Cost' (5 Marks)

(3) (a) Tyson Lam Company is noted for its full line of quality lamps. The company operates one of its plants in Green Bay, Wisconsin. That plant produces two types of lamps: classical and modern. Jane Martinez, the president of the company, recently decided to change from a unit-based, traditional costing system to an activity-based costing system. Before making the change companywide, she wanted to assess the effect on the product costs of the Green Bay plant. This plant was chosen because it produces only two types of lamps; most other plants produce at least a dozen.

To assess the effect of the change, the following data have been gathered (for simplicity, assume one process)

Lamp	Quantity	Prime costs	Machine Hours	Material Moves	Setups
Classical	4,00,000	Rs 8,00,000	1,00,000	2,00,000	100
Modern	1,00,000	Rs 1,50,000	25,000	1,00,000	50
Value (Rs)	--	5,95,000	5,00,00*	8,50,000	6,50,000

*the cost of operating the production equipment.

Under the current system, the costs of operating equipment, materials handling, and setups are assigned to the lamps on the basis of machine hours. Lamps are produced and moved in batches.

Required:

(i) Compute the unit cost of each lamp using the current unit-based approach.

(ii) Compute the unit cost of each lamp using an activity-based costing approach.

(10 Marks)

(b) Describe three distinct groups of variances that arise in standard costing (10 Marks)

4 (a): Despite the increase in the sales price of its sole product to the extent of 20%, a company finds that it has incurred a loss during the year 2007-08 to the extent of Rs 4 lacs are against a profit of Rs 5 lacs made in 2006-07. This adverse situation is attributed mainly to the increase in prices of materials and overheads, the increase over the previous year being, on the average, 15% and 10% respectively.

The following figures are extracted from the books of the company:

	31-3-2007	31-3-2008
	Rs	Rs
Sales	1,20,00,000	1,29,60,000
Cost of Sales:		
Materials	80,00,000	91,10,000
Variable Overhead	20,00,000	24,00,000
Fixed Overhead	15,00,000	18,50,000

Required:

Analyse the variance over the year in order to bring out the reasons for the fall in profit.

(10 Marks)

(b) State the need for emergence of activity based costing (5 Marks)

(c) How does Total Quality Management (TQM) facilitate value addition in an organization?

(5 Marks)

5 (a) A company manufacture two products A and B, involving three departments Machining, Fabrication and Assembly. The process time, profit / unit and total capacity of each department is given in the following table.

	Machining (Hours)	Fabrication (Hours)	Assembly (Hours)	Profit Rs
A	1	5	3	80
B	2	4	1	100
Capacity	720	1800	900	

Set up Linear Programming problem to maximize profit. What will be the product Mix at Maximum profit level?

(10 Marks)

(b) Discuss the methods of finding initial feasible solution of a transportation problem and state the advantages, disadvantages and two areas of application for each of them.

(10 Marks)

6 (a) The Secretary of a school is taking bids on the City's four school bus routes. Four companies have made the bids as detailed in the following table:

	Bids (in Rs)			
	Route 1	Route 2	Route 3	Route 4
Company 1	4,000	5,000	--	--
Company 2	--	4,000	--	4,000
Company 3	3,000	--	2,000	--
Company 4	--	--	4,000	5,000

Suppose each bidder can be assigned only one route. Use the assignment model to minimize the school's cost of running the four bus routes.

(10 Marks)

(b) One of the activities in a PERT project has an expected duration of 12 weeks with a standard deviation of 2 weeks. The most likely time estimate of this activity is 12 weeks, Calculate the optimistic and pessimistic time estimates for this activity.

(5 Marks)

(c) What are Pseudo-random numbers? (5 Marks)

PRIME ACADAMY

27 -Session Final

COST MANAGEMENT

Suggested Answers

1(a) The methods of pricing usually employed in industry when goods or services are transferred from one unit to the other can be broadly classified under the following three categories:

(i) Pricing at cost or variants of cost e.g. manufacturing cost; standard cost; full cost and full cost plus mark up.

(ii) Pricing at market price.

(iii) Pricing at bargained or negotiated price.

1(b) The service has no physical existence and it must be priced and billed to customers. Most service organizations use a form of time and material pricing to arrive at the price of a service. Service companies such as appliance repair shops, automobile repair business arrives at prices by using two computations, one for labour and other for material and parts. If material and parts are not part of service being performed, then only direct labour costs are used as basis for determining price.

For professionals such as accountants and consultants a factor representing all overhead costs is applied to the base labour costs to establish a price for the service, which are generally worked out on the basis of rate per man hour.

1(c) (1)

SP x SQ	SP x AQ	SP x AU
Rs 12 x 0	Rs 12 x 4,000	Rs 12 x 2,800
Rs 0	Rs 48,000	Rs 33,600

Volume Variance Rs 48,000 (U)

Unused Capacity Variance Rs 14,400 (F)

The activity volume variance is the nonvalue-added cost. The unused capacity variance measures the cost of the unused activity capacity. The other two activities have no volume variance or capacity variance because they use only flexible resource. No activity capacity is acquired in advance of usage; thus, there cannot be an unused capacity variance or a volume variance.

(2)

	cost		
	Value-Added	Nonvalue-Added	Total
Using Lumber	Rs 2,40,000	Rs 60,000	Rs 3,00,000
Purchasing	Rs 40,000	Rs 10,000	Rs 50,000
Inspecting	Rs 0	Rs 48,000	Rs 48,000
Total	Rs 2,80,000	Rs 1,18,000	Rs 3,98,000

(3)

	Kaizen Standard	
	Quantity	Cost
Using Lumber	28,200	Rs2,82,000
Purchasing	940	Rs 47,000
Inspecting	2,800	Rs 33,600

If the standards are met, then the savings are as follows

Using lumber	= Rs 10 x 1,800	= Rs 18,000
Purchasing	= Rs 50 x 60	= Rs 3,000
	Saving	= Rs 21,000

There is no reduction in resource spending for inspecting because it must be purchased in increments of 2,000 and only 1,200 hours were saved – another 800 hours must be reduced before any reduction in resource spending is possible. The unused capacity variance must reach Rs 24,000 before resource spending can be reduced.

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

Relevant costs are those expected future costs which are essential to a decision. The two key aspects of these costs are as follows:

(i) They must be expected future costs
(ii) They must be different among the alternative courses of action.

For example, in a decision relating to the replacement of an old machine, the written down of the existing machine is not relevant but its sale price is relevant.

2(b) Let assume selling price is Rs 20

Statement of cost for taking a decision about shut-down of plant

	Plant is operated Rs	Plant is shut down Rs
Variable cost	26,000 (2,000 U x Rs 13)	--
Fixed cost	80,000 (20,000 U x Rs 4)	33,000 (inescapable cost)
Additional shut-down cost	---	12,000
Total Cost	1,06,000	45,000
State of loss:		
Sales	40,000 (2,000 U x Rs 20)	--
Less Total Cost	(1,06,000)	(45,000)
Loss	(66,000)	(45,000)

Recommendation: A comparison of loss figures indicated as above points out, that, loss is reduced if the plant is shut-down. In fact by doing so the concern's loss would be reduced by Rs 21,000.

Calculation of shut down point3

$$\text{Shout down Point} = \frac{\text{Total Fixed Cost} - \text{Shut down cost}}{\text{Contribution per unit}}$$

$$= \frac{80{,}000 - 45{,}000}{\text{Rs } 20 - \text{Rs}13}$$

$$= 5{,}000 \text{ units}$$

2(c) A single budget system may be conflicting in planning and motivation, and planning and performance evaluation roles as below:

- **(i)** **Planning and motivation roles:-** Demanding budgets that may not be achieved may be appropriate to motivate maximum performance but they are unsuitable for planning purposes. For these, a budget should be a set based on easier targets that are expected to be met.
- **(ii)** **Planning and performance evaluation roles:-** For planning purposes budgets are set in advance of the budget period based on an anticipated set of circumstances or

environment. Performance evaluation should be based on a comparison on of active performance with an adjusted budget to reflect the circumstance under which managers actually operated.

2(d) Opportunity cost is primarily an economic concept. In Economics, the opportunity cost of designated alternatives is the greatest net benefit lost by selecting an alternative. It is the benefit given by rejecting one alternative and selecting another. Accounting takes the same view and defines it as the benefits foregone by rejecting the second best alternative in favour of the best. Opportunity costs represent the measurable value of opportunity bypassed by rejecting and alternative use – the profit that is lost by the diversion of an input factor from one use to another. It is defined as the maximum contribution that is foregone using limited resources for a particular purpose.

3(a) I***n this problem total Prime cost is wrongly printed as Rs 5,95,000 instead of Rs 9,50,000.***

1. Total overhead is Rs 2,00,000. The plant wide rate is Rs 16 per machine hour (Rs 20,00,000 / 1,25,000). Overhead is assigned as follows:

   Classical lamps : Rs 16 x 1,00,000 = Rs 16,00,000
   Modern lamps : Rs 16 x 25,000 = Rs 4,00,000

   The unit costs for the two products are as follows:

   Classical lamps (Rs 8,00,000 + 1,60,000) / 4,00,000 = Rs 6.00
   Modern lamps (Rs 1,50,000 + 4,00,000) / 1,00,000 = Rs 5.50

2. In the activity-based approach, the consumption ratios are the same for materials handing and setups, so a batch-level pool can be formed. The machine pool is a unit- level pool. (machining is performed each time a lamp is produced). Thus, two overhead pools are formed, and rates for each of these pools are as follows:

Machining pool: Rs 5,00,000 / 1,25,000 = Rs 4.00 per machine hour

Materials handling	= Rs 8,50,000
Setups	= Rs 6,50,000
Total	= Rs 15,00,000

Number of setup = Rs 15,00,000 / 150 = Rate Rs 10,000 per setup

Overhead is assigned as follows:

Classical lamps = Rs 4 x 1,00,000 = Rs 4,00,000
Rs 10,000 x 100 = Rs 10,00,000
Total = Rs 14,00,000

Modern lamps = Rs 4 x 25,000	= Rs 1,00,000
Rs 10,000 x 50	= Rs 5,00,000
Total	= Rs 6,00,000

This produces the following unit costs:

Classical Lamps:

Prime costs	= Rs 8,00,000
Overhead costs	= Rs 14,00,000
Total costs	= Rs 22,00,000
Units produced	= Rs 22,00,000 / 4,00,000
Units cost	= Rs 5.50

Modern Lamps:

Prime Cost	= Rs 1,50,000
Overhead costs	= Rs 6,00,000
Total costs	= Rs 7,50,000
Units produced	= Rs 7,50,000 / 1,00,000
Unit cost	= Rs 7.50

3(b) The three distinct groups of variances that arise in standard costing are:

(i) Variances of efficiency: These are the variances, which arise due to efficiency or inefficiency in use of material, labour etc.

(ii) Variances of prices and rates: These are the variances, which arise due to changes in procurement price and standard price.

(iii) Variances due to volume: These represent the effect of difference between actual activity and standard level of activity.

4(a) Statement showing figures extracted from the books of the company

(figures in lacs of Rs)

	2006-07	2007-08 (based on 2006-07 Prices)	Difference
	Rs	Rs	Rs
(a)	(b)	(c)	(b) – (c)
Sales (see Working Note 1)	120	108.00	12
Cost of sales			
Material (see Working Note 2)	80	79.22	
Variable overhead (see Working Note 3)	20	21.82	
Fixed overhead (see Working Note 4)	15	16.82	

Decrease in sales = Rs 120 less 108 = Rs 12 lacs or 10% of 2006-07 sales figure at 2006-07 rate

Contribution to sales ratio during 2006-07 $= \dfrac{\text{Sales – Variable cost}}{\text{Sales}}$

$= \dfrac{\text{Rs 120 – Rs 100}}{\text{Rs 120}}$

= 16.67% or 1/6

Loss of contribution during 2007-08 on the sale of 12 lacs = Rs 12 lacs x 1-6 = Rs 2 lacs

Computation of Variances:

Sales price variance = Actual sales – Standard sales
= Rs 129.60 – Rs 108 = Rs 21.60 lacs (Favourable)

Material price variance = standard cost of actual quantity – actual cost
= Rs 79.22 – Rs 91.10 = 11.88 lacs (Adverse)

Variable overhead
Expenditure variance = (Budgeted variable overhead for actual hours – Actual variable overhead)

Variable overhead
Efficiency variance = (standard variable overhead for standard hours – Standard variable overhead for actual hours)
= Rs 18 – Rs 21.62 = Rs 3.62 lacs (Adverse)

Note: Variable overhead in 2006-07 was Rs 20 lacs. Since there was a decrease in sales in 2007-08 to the extent of 10% of 2006-07 sales figure (based on 2006 – 07). Therefore, the standard variable overhead for standard hours at this reduced sales in 2007-08 would be equal to (Rs 20 lacs minus 10% of 20 lacs) ie (Rs 20 lacs – Rs 2 lacs) = Rs 18 lacs.

Fixed overhead expenditure variance = (Budgeted fixed overhead – Actual fixed Overhead)
= Rs 16.82 – Rs 18.50 = Rs 1.68 lacs (adver.)

Fixed overhead Volume Variance = (Standard fixed overhead for actual output – Standard fixed overhead for budget output)

= Rs 16.82 – 15 = Rs 1.82 lacs (Adv.)

Reconciliation Statement

	Rs	Rs
Profit during 2006-07		5,00,000
Add: Net increase in profit due to the sales of 2007-08 (see working note 5)		19,60,000
Total		24,60,000

Less: usage or efficiency variance		
Material	7,22,000	
Variable overhead	3,82,000	
Fixed overhead volume variance	1,82,000	
	------------	12,86,000
Less: Price variances		
Material price variance	11,88,000	
Variable overhead expenditure variance	2,18,000	
Fixed overhead expenditure variance	1,68,000	
	-------------	15,74,000
Loss during 2007-08		4,00,000

Conclusion:

The reasons for the decrease in the total profit figure of the year 2007-08 (inspite of the increase in sales price) are due to adverse (i) usage or efficiency variance to the extent of Rs 12, 86,000 and (ii) price variance to the extent of Rs 15,74,000.

Working note

(1) Sales during 2007-08 at 2006-07 price level= (129.60 /120) x 100 = Rs 108 lacs
(2) Material cost of 2007-08 at 2006-07 price level = (91.10 / 115) x 100 = Rs 79.22 lacs
(3) Variance overhead of 2007-08 at 2006-07 price level = (24/110) x 100 = Rs 21.82 lacs
(4) Fixed overhead of 2007-08 at 2006-07 price level = (18.50 /110) x 100 = Rs 16.82 lacs
(5) Net increase in profit due to rise of 20% of S. P = (Rs129.60 lacs – Rs 108 lacs – Rs 2 lacs) = Rs 19.60 lacs reduction in sales.

4(b) Need for emergence of activity based costing:

i. Traditional product costing systems were designed when most companies manufactured a narrow range of products.
ii. Direct material and direct labour were the dominant factors of production then.
iii. Companies were in sellers market
iv. Overheads were relatively small and distortions due to inappropriate treatment were not significant
v. Cost processing information was high.
vi. Today companies produce a wide range of products.
vii. Simple methods of appointing overheads on direct labour or machine hours basis are not justified.
viii. Non volume related activities like material handling, set up etc. are important and their costs cannot be apportioned on volume basis.

4(c) Total Quality Management is defined as a set of concepts and Tools for getting all employees focused on continuous improvements in the eyes of the customers. Since the TQM focuses the attention of an organization on quality, thus it helps to provide the customer with much higher quality prudent expenditure on cost of preventing errors can often lead to larger reduction in cost of failure and consequently will lead to reduce the total cost. The organizations constantly strive for improvement so that and more value can be added through improved quality at lower cost.

5(a) Maximize $z = 80x + 100y$ subject to

$$x + 2y \le 720$$
$$5x + 4y \le 1800$$
$$3x + y \le 900$$
$$x \ge 0 \quad y \ge 0$$

where x = No. of units of A

y = No. of units of B

By the addition of slack variables s1, s2 and s3 the inequalities can be converted into equations. The problem thus become

$z = 80x + 100y$ subject to

$$x + 2y + s1 = 720$$
$$5x + 4y + s2 = 1800$$
$$3x + y + s3 = 900$$

and $x \ge 0, \quad y \ge 0, \quad s1 \ge 0, s2 \ge 0, s3 \ge 0$

Table I

			80	100	0	0	0	
	Profit/unit	Qty.	X	Y	S1	S2	S3	
S1	0	720	I	2	1	0	0	$\frac{720}{2} = 360$
S2	0	1800	5	4	0	1	0	1800/4 = 450
S3	0	900	3	I	0	0	1	900/1 = 900
Net evaluation row			80	100	0	0	0	

$1800 - 720 \times 4/2 = 360$ $\qquad$ $900 - 720 \times 1/2 = 540$

$5 - I \times 2 = 3$ $\qquad$ $3 - 1 \times ½ = 5/2$

$4 - 2 \times 2 = 0$ $\qquad$ $I - 2 \times 1/2 = 0$

$0 - I \times 2 = -2$ $\qquad$ $0 - I \times 1/2 = -1/2$

I - 0×2 = I	0 – 0 ×1/2 = 0
0 - 0×2 = 0	I- 0×1/2 = I

Table 2:

			80	100	0	0	0	
Program	Profit/unit	Qty.	X	Y	S1	S2	S3	
Y	100	360	½	I	½	0	0	360÷1/2=720
S2	0	360	3	0	–2	1	0	360÷3=120
S3	0	540	5/2	0	–1/2	0	I	540÷5/2=216
Net evaluation row			30	0	–50	0	0	

360 – 360 × 1/6 = 300	540 – 360 × 5/6 = 240
½ - 3 ×1/6 = 0	5/2 –3 × 5/6 = 0
1- 0× 1/6=1	0 – 0 × 5/6 = 0
½ - -2 × 1/6 = 5/6	-1/2 - -2 ×5/6 = 7/6
0 – 1 ×1/6 = - 1/6	0 – 1 × 5/6 = -5/6
0 – 0 ×1/6 = 0	1-0 × 5/6 = 1

Table 3:

			80	100	0	0	0
Program	Profit/unit	Qty.	X	Y	S1	S2	S3
Y	100	300	0	I	5/6	-1/6	0
X	80	120	I	0	–2/3	1/3	0
S3	0	240	0	0	7/6	-5/6	I
Net evaluation row			0	0	-500/6 +160/3 $= \frac{180}{6}$	+100/6 -80/3 $= -\frac{60}{6}$	0

All the values of the net evaluation row of Table 3 are either zero or negative, the optimal program has been obtained.

Here X = 120, y = 300 and the maximum profit

$= 80\times120 + 100\times 300 = 9600 + 30{,}000$

= Rs. 39,600.

5(b) Various methods of finding initial feasible solution of a transportation problem are enumerated below:

1. North West Corner Rule:

(i) According to this rule, the first allocation is made to the cell occupying the upper left hand corner of the matrix. Further this allocation is of such a magnitude that either the origin capacity of the first row is exhausted, or the destination requirement of the first column is satisfied or both.

(ii) If the origin capacity of the row 1 is exhausted first, we move down the first column and make another allocation which either exhausts the origin capacity or row 2 or satisfies the remaining destination requirement of column 1

(iii) If the first allocation completely satisfies the destination requirements of column 1, we move to the right is row 1 and make a second allocation which either exhausts the remaining capacity of row 1.

(iv) The above procedure is repeated until all the rim requirements are satisfied.

Advantages:

(a) it is very simple and reliable method

(b) it is easy to compute, understand and interpret

Disadvantages:

(a) It ignores the relative cost of the different routes while making the first assignment and hence it does not give a feasible solution close enough to an optimum solution.

Area of Application:

(i) it is used in case of transportation within the campus of an organization as costs are not significant

(ii) it is used for transportation to satisfy such obligations where cost is not the criteria. For example in case of food corporation of India Ltd.

2. Vogel's Approximation Method:

(i) For each row of the transportation matrix, calculate difference between the smallest and the next smallest elements. Similary for each column of the matrix, compute the difference of the smallest and next smallest element of the column

(ii) Identify the row of column with largest difference. If a tie occurs, use that row or column which has least cost. In case there is a tie in cost cell also, choice may be made for a row or column by which maximum requirement is exhausted.

(iii) Allocate the maximum feasible quantity in the box corresponding to the smallest cost in the row or column

(iv) Eliminate the row or column where an allocation is made

(v) Re-compute row and column where an allocation is made

(vi) Re-compute row and column differences for the reduced transportation table. The above procedure is repeated until all the rim requirements are satisfied.

Advantages:

(a) This technique is simple and later on considerably reduces the number of iteration required to arrive at the optimal solution.

(b) It gives an initial feasible solution which is very close to the optimal solution

Disadvantages:

(i) it takes more time to compute the initial solution compared to north west corner rule.

(ii) It does not guarantee minimum cost solution.

Area of Application:

(i) it is used to compute transportation routes in such a way as to minimize transportation cost for finding out locations of warehouses.

(ii) It is used to find out locations of transportation corporations depots where insignificant total cost difference may not matter.

6(a) Since some of the companies have not made bids for certain routes, let us assign very high bid M for all such routes, the assignment model becomes as given below:

Bids

	Route 1	Route 2	Route 3	Route 4
Company 1	4000	5000	M	M
Company 2	M	4000	M	4000
Company 3	3000	M	2000	M
Company 4	M	M	4000	5000

Apply assignment algorithm to the above mentioned problem.
The optimum solution is

Bids

	Route 1	Route 2	Route 3	Route 4
Company 1	0	0	M	M
Company 2	M	0	M	0
Company 3	1000	M	0	M
Company 4	M	M	0	0

The assignment is as given below:

Company 1	----------- Route 1	4000
Company 2	----------- Route 2	4000
Company 3	----------- Route 3	2000
Company 4	----------- Route 4	5000

		15,000

Thus, the minimum cost of running the four bus routes is Rs 15,000.

6(b) Most likely time estimate = t_m = 12 weeks.

$$\text{Expected duration} = t_E = \frac{t_o + 4t_m + t_p}{6} = 12 \text{ weeks}$$

Subtracting the value of tm in the above equation, we get = 24

$$t_p + t_o = 24$$

$$\text{we are also given that standard deviation} = \frac{t_p - t_o}{6} = 2 \text{ weeks}$$

By substituting the above t_p = 18

t_o = 6

thus, optimistic time for the activity is 6 weeks and the pessimistic time estimate is 18 weeks.

6(c) The methods commonly used to generate random numbers are not random processes. Random numbers are called pseudo-random numbers when they are generated by some deterministic process but they qualify the predetermined statistical test for randomness. The sequence of numbers generated by such process is completely determined by the input data or the first random number used for the method.

MS

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

<u>Question No.1 is compulsory</u>
<u>Answer any 4 from the rest</u>

1. (a) Explain the factors which determine the information requirements of executives (10 Marks)
   (b) Explain the components of client server architecture. (10 Marks)

2. (a) Describe the various feasibility studies carried out as part of preliminary investigation. What are the various costs identified during feasibility study ?. (10 Marks)
   (b) Briefly explain the prototyping approach (5 Marks)
   (c) Briefly describe the concept of Codes (5 Marks)

3 (a) What are the factors to be considered while designing data communication systems (10 Marks)
  (b) Discuss the advantage of using pre-written application packages. (10 Marks)

4 (a) Discuss the meaning, advantages and disadvantages of various conversion strategies ? (10 Marks)
  (b) Discuss the system interfaces, inputs, output reports and files for an accounts payable system (10 Marks)

5 (a) All businesses should assess the adequacy of the controls to protect their information systems assets against fraud (10 Marks)
  (b) Explain disk imaging and analysis as a fraud detection forensic tool (10 Marks)

6 (a) Explain how audit trails can be used to support security objectives (10 Marks)
  (b) How are electronic records authenticated using digital signature (10 Marks)

7. Write Short Notes on the following (4 x 5 Marks = 20 Marks)
   a. Run-to-run controls and operator intervention controls
   b. Concurrent audit techniques
   c. Core Principles of Information Security
   d. Individual and Group Decision

PRIME ACADAMY
27 -Session Final

MANAGEMENT INFORMATION AND CONTROL SYSTEMS

Suggested Answers

1(a). Information requirement of executives depends on:

Operational functions

Type of decision making
- Programmed decisions.
- Non- programmed decisions

Levels of Mgmt. Activities
- Strategic level
- Tactical level
- Supervisory Level

1. Operational functions:

- **Meaning**: grouping of several functional units based on the related activities into sub-units is termed as operational function (similar to departments).
- **Ex:** Marketing, finance, personnel are the different operational functions in a business
- Information requirement depends on operational function
- Information for different operational function vary in :

a.	Content	:	Depends on activities performed in an operational function. **Ex** : Marketing Department may require only consumers, new product information, while HR Department may require information on OT hours and pay rates
b.	Characteristics	:	**Ex** : Levels of accuracy, Rate of transmission

2. Type of decision making:

In any organisation decisions fall under two broad categories:

Programmed decisions | Non- programmed decisions

i. Programmed decisions:

- **Meaning**: Refer to decisions which are made on problems and situations by referring to predetermined set of precedents, procedures, techniques and rules.
- **Characteristic:** Well-structured in advance and time-tested for validity, consistent over situations and time.
- When a problem/issue requires decision making, the relevant pre-determined rule/ procedure applied and hence decision arrived at.
- Such decisions are made in respect of familiar, routine, recurring problems which are amenable to structured solutions by applying well-known operating procedures.
- Organisations create a repository/collection of such rules and procedures based on manager’s previous experience and familiarity.

Note: Structured/ programmed decision does not necessarily mean simple problems. Organisations can also solve complex problems through structured decisions.

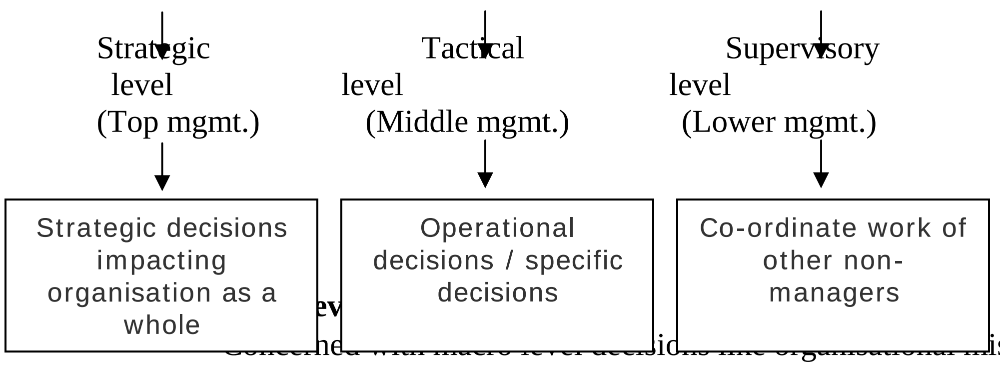
ii. Non- programmed decisions:

- **Meaning**: Decisions made on situations and problems which are novel and non-repetitive and about which not much information is available.
- They are non-programmed implying that they are not made by applying any standard procedures, rules or guidelines.
- They are solved by using the managerial intelligence, experience and judgment
- No single best solution may be available as the decision environment is uncertain. The solutions and decisions may be unique or unusual.

Note: In real business situations most of the decisions share a feature of programmed and non- programmed decisions

3. *Levels of management activity:*

Different levels of management in planning and control hierarchy are:



- Concerned with macro level decisions like organisational mission, objectives and strategies. Such decisions are critical to the success of the organisation and are hence called strategic decisions.
- Much analysis and judgment are required to make strategic decisions. They can be compared to non-programmed decisions which are made under conditions of partial knowledge.

B. *Tactical level*

- Refers to the middle management. They plan, organise, control and lead the activities of the other managers.
- Decisions made at this level are called tactical or operational decisions. These are required to implement the strategic decisions.
- Tactical decisions are short, structured and break strategic decisions to implement packages. They are made in an environment where there is less uncertainty.

C. *Supervisory level*

- Refers to the lowest level in the management hierarchy
- Managers at this level co-ordinate the work of others who are not managers. They ensure that specific tasks are carried out effectively. (**Ex:** Floor supervisor in a factory)

1(b). C/S has the following components

- a. Client
  - Thin Client
  - Fat Client
- b. Server
- c. Middleware
- d. Network

a. Client:

❖ Users of the services offered by the servers

❖ They may be either non-GUI based like ATMs and cell-phones

❖ They may be GUI clients like Windows 3.1 which are human interaction models with icons/menus

❖ They may be object-oriented user interface (OOUI) clients like Windows 95.

b. Server:

❖ Accepts requests from clients

❖ Regulates access to the shared resources (like email facility, shared printers)

❖ Some types of servers are:

File servers: Help to share files across a network by maintaining a shared library of documents, data and images.
Database servers: Help users to access stored data through SQL request from the clients.
Web servers: Allow users of the internet and the website hosting servers to communicate with a standardised language called http.
Back-up servers: They provide for back up of data in organisations like banks, insurance companies and hospitals.
Mail servers: They provide facilities for corporates to provide mail access to their employees.

c. Middleware:

- It refers to the distributed software which allows clients and servers to interact.
- It may also be looked as the network system implemented within the C/S technology.
- It allows for communication, directory service, queuing and distributed file sharing.
- It is usually made up of four layers- service, back-end processing, network operating system and transport stacks.

d. Network:

- It refers to the physical cabling, communication cords and network devices (like hubs, switches, routers) which help in physical connection between the client and the server.

Concept of Thin Client/ Thick Client

- Based on the extent of processing carried out at the clients end it can be classified as either thin client or thick client.

- **Thick client:** If the majority of the processing is carried out at the clients end the client is called as a thick client (which implies that the server is a **thin server**).
  (This architecture is called as **two- tier architecture)**
- **Thin client**: If majority of the processing is carried out at the server **and** only minimum processing is done by the client it is called as thin client (which implies that the server is a **thick server).**
  (This architecture is called as **three- tier architecture)**

2(a). Testing project's feasibility (Technical, Operational, Economical etc.)

Purpose: To determine whether the proposed project would be beneficial to the organisation.

How is it done? By testing the project for technical, operational and economical feasibility.

First technical feasibility studied ➔ then impact on social systems/employees (operational feasibility) ➔ if both are found to be ok, then economical feasibility study done.

Technical feasibility study

Meaning: To study the impact of the proposed system on the hardware and software- both existing and expected(compatibility, interoperability).

What questions are posed to judge technical feasibility?

- Can user requirements be met by the existing technology and can the organisation acquire the technology?
  Ex: A university may want to put all the results in the internet. It has to see whether there is any software to securely put it on the web and whether it can buy it .

- Has the proposed system the technical capability to hold the data required by the new system?
  Ex: The organisation decides to centralise its corporate mail facility. The server proposed should have the capability to handle such high volumes of data.

- Will the system provide adequate response to inquires for multiple users from multiple location?

This is a case of a number of users trying to access the same system from various locations.

Ex: A bank with a centralised server should have the capability to respond to various internet banking users who access their accounts from various locations.

- Will the system have facility for expansion?
  This pertains to scalability of the system to meet future needs of business.
- Are there technical guarantees of accuracy, reliability, ease of access and data security?

Economical feasibility

Meaning: Involves judging the incremental costs /benefits (cost saving or increased revenue) on account of implementing a new system.

What are the questions that need to be answered?

- Cost of conducting a full systems investigation
- Cost of new hardware and software for the proposed system
- Benefits in terms of reduced operating costs or lesser costly errors.

Ex : Cost of introducing a billing software to ensure that no items are omitted to be billed.

- Cost of maintaining status-quo- that is if we continue with the existing system what would be cost or opportunity that we would be missing.

Operational feasibility

Meaning: Ascertaining the views of employees, managers and suppliers. about the system

Importance: The support or lack of support given by the employees is very critical to the success of the system. A system feasible in all other aspects but not supported by employees is likely to create HR problems and will fail.

Ex: An ERP package may be technically advanced and economically feasible, but if users are not comfortable with the usage, the system might fail.

What are the questions to be answered?

- Do the management and staff support the system
- Are the current systems well used and users satisfied that they may resist change to a new system?
- Do users find some problem with the current systems- in which case they may support a new system?

- Has there been user participation in the planning and development of new system- if so acceptance is likely to be high with little or no resistance and projects would be successful.
- Will the proposed system
  - Cause harm /loss of control in any area
  - Produce poorer results
  - Reduce/hinder accessibility of information
  - Affect adversely individual performance
  - Slow down performance of any department.

Some other feasibility studies to be undertaken

Schedule feasibility

Meaning: Involves the estimation by the design team of the time involved for making the new system functional/operational and communicating this to the steering committee.

Purpose of schedule feasibility: This is a tool by which the management can decide whether to go-ahead with the development of the project or look for alternates like buying a off-the shelf product.

Ex: A bank decides that it needs to implement a centralized banking software.

The design team estimates that it would take at least 3 years to develop and implement the system. This is communicated to the steering committee.

The steering committee may decide that it would be better to buy an off-the shelf centralised-banking solution and customise it since it would take lesser time than development.

Legal feasibility

Meaning: The proposed system should not conflict with the legal/statutory obligations of the organisation. It should help the organisation confirm with the state and central legislations.

Ex: A hospital wants to buy/develop a hospital management system to store the patient records in the system. Since the hospital is bound legally to maintain confidentiality about patient information, the software should support this through access controls and encryption.

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). Why coding ?

- Information system projects are developed with an intention to save on time, cost and space
- Hence codes are developed to :
  - Reduce input and control errors
  - Speed up the entire process
- Descriptions are not suitable for computer applications as they may consume computer application time. Hence coding is used.
- With use of codes , fewer inputs but no loss of information.

Meaning of code

- A code is a brief number, title or symbol used to replace a lengthy or a ambiguous/unclear description

  Ex: Factory number 2, Block B, Room number 345 may be coded as F2B345

Characteristics of a good coding system

(FOR 5 Marks question a few lines about each characteristic would be sufficient-for a detailed question complete explanation would be required)

i. Individuality

- Code must identify each object uniquely i.e. same code for different objects will cause confusion
- Same code should be used uniquely throughout the organisation. This implies that for the same product two different departments should not give two different codes.

ii. Space

- Code number must be briefer/concise than the description.

iii. Convenience

- Codes should be such that it is easy for people to use. This implies that they should be short, simple and should avoid special symbols.

iv. Expandability

- Coding should also provide for future growth in number of objects
- This may be done by adopting longer digits which may not be useful at present but with growth in volume in future may be required.
  Ex: While deciding on the employee number coding in a large organisation first two places may be reserved for representing department and next 4 or 5 places may be reserved for employee number. PR0010 implies employee number 10 of purchase department. It can accommodate upto maximum 9999 employees. Though at present there may not be that many employees, it provides for future expansion.
- Related items/objects should have similar codes.
  Ex: All electrical stores items should start with "ET**"** to indicate that they are items belonging to Electrical stores.

v. Suggestiveness

- The logic behind the coding scheme used should be readily understood by the users.
  Ex: All users of stores items should be told that coding is such that first two places identify the product category, next two places represent the rack where kept and last four places identify the item itself. Hence if this logic is understood, users would be able to make sense of the various codes.

- Codes should not be too long as they defeat the very purpose of having a code (to shorten the description).

vi. Permanence :

- With changing circumstances, codes schemes should not become obsolete/invalidated. If at all any changes are made, they should be minimum.

(If coding schemes keep changing frequently, it will cause confusion in the minds of the users in understanding it and they would make mistakes)

3a. Systems analyst is responsible for

- Selecting the correct communication equipment
- Steps to be taken to design the application and specifying ways by which the application would be connected to the communication network
- Selecting the most useful and cost effective communication service.

He should know what communication components are needed by the new system and how they will interact with the components existing in the present system.

Requirements of data communication system

Systems analyst has to select the following :

COMMUNICATION CHANNELS
↓
These are lines of communication selected based on the rate of transmission, up-time etc.
(Ex: Leased line, Dial-up lines, ISDN)

COMMUNICATION CONTROL DEVICES
↓
Include devices like modems switches, multiplexers etc.

In on-line/real-time systems the analyst must provide for user and transaction authorisation , protect against illegal/unexpected processing requests and audit trail for reliability and integrity.

3(b). ADVANTAGE OF BUYING THE APPLICATION SOFTWARE FROM THE VENDOR ("OFF-THE-SHELF" PRODUCT)

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 going to get at what price.	Long development time- leads to uncertainty as regards 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.

4(a)

Conversion method	***Meaning***	***Advantages***	***Disadvantages***
1. Direct change over method	On a specified date old system is	Users straight away use the	1. Risky

(also called Plunge Method)	dropped and new system is put to use Can be adopted only if extensive testing done beforehand	new system- adaptation easy.	2. Long delays if errors occur since this the only system available to do the processing 3. Users resent/resist since unfamiliar system 4. Cannot compare results with the old system(since old system has been discarded)
2. Parallel conversion	Running the old system and the new system in parallel at the same time Results of the new system compared with that of the old system and if reliable over a period of time, old system is stopped and new system put to use.	1. Since data available from both old and new systems, any errors in new system can be corrected. 2. Users feel secure as they are not faced with abrupt change	1. Cost of running both systems (old and new) is very high. 2. Employees work load increases during conversion. 3. Unless new system is replacing old manual system, output comparison difficult. 4. If new system is an improvement over existing system, outputs would differ and hence difficult to compare. 5. Users familiar with old system and will continue to use only that.
3. Gradual conversion	Attempts to combine the good features of parallel and direct changeover	Users can use the new system gradually and there is a possibility of	1.Time consuming as it may take a long time to put the new system in use.

	method. Volume of transaction gradually increased ➔ new system is phased in.	detecting and correcting errors without much system downtime.	2. Not the best method for small, simple systems.
4. Modular prototype conversion	Involves building of modular, operational prototypes to change from old to new system. Each module is modified, accepted and put to use gradually.	1. Thorough testing of modules before being put to use. 2. User familiarity before model put to use.	1. Too many prototypes and hence may not be feasible. 2. Interfacing of the various modules (so that they work as a system) may be a problem.
5. Distributed conversion (Also called as PILOT run)	Involves full implementation of the system in one branch of the organization (say a bank branch) using any of the above four methods. If successful then carried out at other branches.	Problems if any can be identified and controlled in one location rather than affecting all locations.	Each branch/site may have its own problem that needs to be handled separately. Hence success in one site does not necessarily mean success in other sites.

4(b). A. Accounts payable

This software is used to keep track of the various vendor bills which are pending payment. The need arises as organisations make purchases on credit and prompt payment may entail some discount. Similarly late payment may attract some penal interest. The accounts payable system helps organisation to decide on the time of payment as part of working capital management. It should also help in vendor evaluation to decide the best source of supply.

Input for the Accounts payable system

The basic document for entry into this system take the form of vendor invoices which give details of goods supplied along with terms of payment. As different vendors may give invoices in different forms, there may be no standardization. Hence prior to data entry it may be advisable to record the important information from each invoice in a standard disbursement voucher.

The unit value charged by the vendor should be compared with the purchase order or other pre-accepted rates negotiated with the vendor. The goods returned are evidenced by a credit note. The various invoices are batched along with the disbursement vouchers. Then a batch control/transmittal sheet is prepared which carries the control totals like sum total of all invoices in the particular batch. These control totals are compared with system totals to ensure that there are no input errors.

Files involved in the accounts payable system include the vendor master file and the accumulated accounts payable file. (Sundry Creditors Ledger)

The processing logic is as follows:

1. The purchase department on receipt of various vendor invoices, does a preliminary check, prepares a disbursement voucher for each invoice, affixes vendor codes and numbers them serially.

2. The invoices and disbursement slips are grouped into various batches

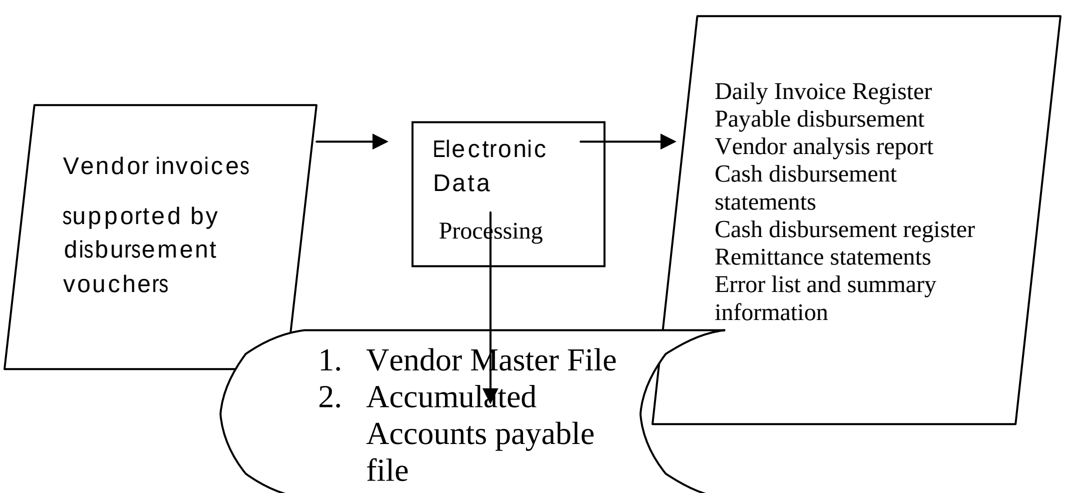
3. Manual batch control totals like record count, financial total of all invoices and hash values like vendor account number total, bill number total are prepared

4. The batch along with the transmittal sheet is forwarded to the data entry section which prepares a record of all vouchers received on the system.

5. The data entry section then enters the batch into the system as a transaction file, carries out the various control checks and updates vendor file

6. Erroneous transactions are listed as part of error listing. These erroneous transactions are investigated in the purchasing department. They would be resubmitted after rectification.

7. The various outputs obtained are statement of remittances, summary of remittances, vendor analysis report and updated vendor accounts.



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). EXAMPLE OF FRAUD DETECTION METHOD USING DISK IMAGING AND ANALYSIS TECHNIQUE

- Computer frauds can be detected using forensic tools which help in gathering evidence.
- Disk imaging and analysis is one such tool. It involves discovering of evidences left behind in computers which the fraudster did not know about or thought had destroyed/could not be recovered.

Ex: It could be a MS Word file / temporary internet file etc- giving an idea of how the fraud was committed – may contain some confidential information which may help the investigation process.

How does this tool work ?

Three stages are involved in this process:

1. **Taking a copy of the hard disk:** This is **done without the suspect being alerted .** The original disk is kept intact. This can be achieved by **attaching an imaging hardware to the computer and running an imaging software without using the computer's O/S.** Image so captured is copied on to a disc and used for investigation.
2. **Processing the copied image – recovery procedure:** When a file is created in a computer, references are stored in a computer's file allocation table.(FAT)(very similar to contents page/index of a book)
   When files are deleted in a system, **file information is not physically removed; what gets deleted is the reference in the file allocation table** thereby freeing the space occupied by the file to be overwritten by other data.
   Hence by using imaging technique, a number of files **deleted but not overwritten** may be recovered. These provide useful clues to the investigator.
3. **Analysis of processed image:**
   - This is done by **search software** which can be programmed to find references to suspect transactions. It searches all files including those which seems to have been deleted.
   - Searches can be single word searches, phrase searches, word searches etc.
   - Outside the area where normal live files are stored, information can be recovered from:

     1. **Free Space:** Refers to area of a file system which has not been allotted for file storage. These may have been used before & may contain deleted data- which has not been overwritten.
     2. **Lost chains:** These refer to areas allocated for storage which are currently disconnected from the file system.

3. **Slack space:** Files are allocated several 100/1000 bytes in allocation blocs. However they rarely use complete space. The unused space may contain data which has not been overwritten.
4. **Deleted files:** Files that have been undeleted by the processing software → available for interrogation.
5. **Contents of Windows SWAP Files:** Refers to disk cache created by windows each time it is run. These are storage area where all kinds of data are kept. The files are large, hidden, rarely deleted and may contain entire documents, database information which are extremely useful to investigator.
6. **Internet cache files/temporary internet files :** Each time we browse the net, web pages looked up are copied into user computer in folder called as temporary internet files. These are rarely used , seldom deleted and provide important clues to investigator to map internet access.

6(a). Meaning: They are the logs that are used to capture the activity (sequence/trail) at the system, application or user level.

Ex: If a cashier initiates a cash withdrawal transaction and an officer authorises it, the audit trail will contain the user-id of the cashier, user-id of the officer, the time of initiation/authorisation, the general ledger to which it has been credited/debited, balance before this transaction and balance after this transaction.

Purpose of audit trails: They provide a **means of detective control** and hence help in achieving security policy objectives.

How to enable audit trails ?: An organisation has to decide the level of auditing to be provided by the system. This means a selection of the events which would be linked to the audit trail and hence organistions can capture only significant/critical events on the log.

(This is important since audit logs occupy substantial memory space and may lead to performance degradation of the system. Hence it is important that we choose only critical activities to be linked to an audit trail. A poorly designed audit trail would be self defeating)

Objectives of audit trail:

1. **Detecting of unauthorised access:** this can be achieved in two ways :

REAL TIME DETECTION	AFTER THE FACT DETECTION
Objective is to protect the system against security breaches It can detect changes in performance levels indicating some virus like activities May occupy lot of memory Space - degrade operational Performance	Refer to logs stored electronically - reviewed periodically / when needed Can be used to detect if unauthorised access was accomplished / attempted / or failed. Ex : On review of user IDs it may be found that one ID has been used 3 times with wrong

PA

2. Reconstructing events:

- Audit trails provide vital information for reconstructing/ tracing back events which lead to systems failure, security breaches or application errors.
- They contain information of the condition that existed at the time of system failure (before image). This provides basis for fixing responsibility and helps prevent such events from occurring in future.
- Audit trails provide basis for accounting control by maintaining details of all account balances and the changes effected to them. This can be used to reconstruct files if they get corrupted/data loss happens.
  (**Ex:** In a bank day end balance of one day + transactions of subsequent days can be used to build up files if data is lost)

3. Personal accountability:

- Audit trails used to monitor activity of individuals to the lowest detail. This can be looked upon as a preventive control that can be used to influence behaviour.
- Users may not violate organisation's security policy if they are aware that their actions and activities are being logged (they know that through audit logs, responsibility can be easily fixed).

Advantages of enabling audit trail:

a. Information in audit logs provide details as to measure the potential damage/financial loss caused due to application errors, abuse/misuse of power, unauthorised intrusion.

They also provide information on adequacy of controls in place & also identify areas of control weakness

6(b). Chapter II of the IT Act consisting of S.3, deals with the authentication of electronic records using Digital Signature.

Suppose "A" wants to send a message digitally signed to "B", he has to follow the following steps.

Events happening at the sender's place (A's Place) :

Step 1.: Run a **one way hashing function** on the message text to get the **message digest .** Hashing function refers to a computer program that creates a **unique message digest (Let us call it Message Digest 1)** for every message. Even if a small change is made to the message, the message digest would be altered- throwing out the modifications made.
(At the end of Step 1, "A" has the original message + a message digest)
Step 2 : Encrypt the message digest using "A's" Private Key.
(At the end of Step 2, "A" has the original message + encrypted message digest called as digital signature/digitally signed message)

Step 3 : "A" **sends the ORIGINAL MESSAGE + ENCRYPTED MESSAGE DIGEST TO "B"**

EVENTS HAPPENING AT THE SENDER'S PLACE

SENDER "A"

CLEAR MESSAGE / PLAIN TEXT ⇒ Run a Hashing Function ⇒ Obtain a Message Digest (Say Mssg. Dgst.1)

⇓

Encrypt the message Digest **using A's Private key** (Obtain encrypted message Digest called as digital sign.)

⇓

Send the clear text message AND Encrypted Message Digest

EVENTS HAPPENING AT THE RECEIVER'S PLACE (B'S PLACE) :

"B" receives the ORIGINAL MESSAGE + ENCRYPTED MESSAGE DIGEST sent by "A"

Step 1: "B" runs a hashing function on the original message and gets locally a message digest (Called as Message Digest 2)

Step 2 : "B" decrypts the Encrypted message digest sent by "A" using A's public key – gets back the Message Digest 1.

Step 3 : "B" compares MD 1 with MD 2

If MD1 & MD2 are same	If MD1 & MD 2 are different
⇓	⇓
Evidence that message has not been tampered/changed in transmission	Evidence that message has been tampered/changed in transmission

If B is able to decrypt the encrypted message digest using A's Public key, it implies that the original message has been sent by A, since he alone has access to his private key. Hence the sender is authenticated.

7a. Run-to-run controls and operator intervention controls

Run-to-run controls:

- Refer to using batch figures /control totals to monitor a batch as it moves from one program module /procedure /run to another.
- Ensures that with each run, the system processes the batch completely and correctly.

S. No.	Type of run-to-run control	Meaning
i.	Re-calculate Control totals	• After each process/ run, batch control totals, hash-totals, record counts re-calculated and compared with control records • Will expose issues like unprocessed records , duplicate records etc.
ii.	Transaction codes	• Refers to comparison of transaction codes of each record with that of the codes in the control

		record. This ensures that only correct type of transactions are being processed.
iii.	Sequence checks	• This check compares the sequence of each record in the batch with that of the previous record to ensure that proper sorting has taken place. • This is important since the order of record in the batch is critical for correct and complete processing.

2. *Operator intervention controls:*

- 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(b). Concurrent auditing 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 : ITF, SCARF, CIS, Snapshots**

7c. EIGHT CORE PRINCIPLES OF INFORMATION SECURITY

1. Accountability
2. Awareness
3. Multidisciplinary
4. Cost Effectiveness
5. Integration
6. Reassessment
7. Timeliness
8. Societal Factors

(A few lines explaining each of the principles)

7d. Individual decisions:

- Decisions made by individual managers, who take full responsibility of the consequence of the decision.(may even be critical decisions)
- Such managers are vested with the required authority to carry out their jobs.
- In the process they may get the reports, information from sub-ordinates. However the final onus lies on manager to make the decision.

Group decisions:

- Such decisions are made by more than one manager joining together for this purpose; especially those which have inter-departmental effect.
  Ex: Decision to increase the price of a product may be taken by a group constituted by the sales manager, purchase manager and finance manager.
  Ex: Board of directors, planning committee

SD

Total No. of Questions: 10 **Max Marks: 100**
No. of Pages : 4 **Time Allowed: 3 Hours**

Answer all Questions

1. Discuss the provisions relating to set off and carry forward and set off of losses u/s.72A in case of amalgamation, demerger or conversion of a proprietary concern or partnership firm into a company.

(8 Marks)

2. Anushka & Co was a firm of three partners which was dissolved by mutual consent on 31.03.2007 and the block of assets, inter alia, was divided in specie among them. In the case of Mr.Alankrit (one of the partners), the value at which the block of assets was transferred and the written down value of these assets in the books of the firm at the time of dissolution are given below:

Description	WDV as on 31.03.08 Rs.	Value at which asset was transferred Rs.
Machinery & Plant	50,000	1,00,000
Furniture	20,000	25,000
Building	1,00,000	8,00,000

In his personal assessment for the A.Y.2008-09, Mr.Alankrit claimed depreciation on the values at which he had taken over the block of assets from the erstwhile firm. The Assessing Officer, however, restricted the claim by allowing depreciation on the written down value of the assets as on 31.03.2008. Is such restriction justified?

(5 Marks)

3.

(a) What are the conditions to be satisfied for claiming deduction for a housing project u/s.80-IB

(4 Marks)

(b) An automobile manufacturing company made a provision of Rs.8,52,925/- towards warranty claims and free service charges in respect of cars sold by it during the period 01.04.2007 to 31.03.2008. This provision was based upon the number of cars sold and the actual disbursements under these two heads in the earlier three years. The company claimed the same as deduction from its total income. Is the claim justified?

(4 Marks)

(c) The assessee trust was created on 12.01.2005. The trust however did not apply for registration to the Commissioner of Income Tax until 15.02.2008. The Commissioner is of the view that since the application has been made belatedly, the registration cannot be granted. Is the Commissioner of Income Tax justified? If the Commissioner of Income Tax is to grant registration, from which date will the registration be valid?

(4 Marks)

4.

(a) An employee encashed his leave at the time of his resignation. The assessing officer is of the view that since section 10(10AA) provides for an exemption only on retirement whether on superannuation or otherwise, the benefit of the exemption cannot be availed of. Comment.

(4 Marks)

(b) An individual has transferred his house property for inadequate consideration to his spouse in connection with an agreement to live apart. The Assessing Officer is of the view that since there is a transfer to the spouse of an asset for inadequate consideration, the income arising there from is to be clubbed in the hands of the transferor. Discuss

(4 Marks)

(c) An assessing officer in the course of assessment did not initiate penalty proceedings under section 271(1)(c) though certain additions were made in the course of assessment. The Commissioner of Income Tax is of the view that this has caused prejudice to the interest of the revenue and therefore wants to exercise his power of revision under section 263 and set aside the assessment for the assessing officer to redo the same, also imposing the penalty under section 271(1)(c). Is this view of the Commissioner justified?

(4 Marks)

5. If an assessee were to pay any sum to a non-resident net of tax, discuss how the tax deduction provisions will apply.

(4 Marks)

6. Write short notes on the following:
   a. Interest payable to an assessee
   b. Liability of a liquidator of a company
   c. Provisional attachment to protect the interest of revenue

(3 x 3 = 9 Marks)

7.

(a) The Managing Director of a company had unauthorisedly used a car belonging to the company for his private purposes. The Managing Director was not empowered to do the same. The Assessing Officer wants to disallow the expenses incurred on the use of the car by the Managing Director unauthorisedly in computing the income of the company. Is the Assessing Officer justified?

(4 Marks)

(b) An employee was entrusted with money for disbursement of wages. The money so entrusted to the employee was lost due to the carelessness of the employee. Can this sum be claimed as a deduction by the employer?

(4 Marks)

(c) Ashmita was a shareholder in Zenus Steels Ltd. Zenus Steels Ltd went in for a reduction of its share capital reducing the face value of the shares. What will be the tax implication of such deduction in the hands of Ashmita?

(4 Marks)

(d) The assessee was an underwriter of shares and underwrote to the public issue of shares of a company. The shares were not fully subscribed to and therefore had to be taken by way of purchase by the underwriter in compliance of its obligations. The commission on underwriting was Rs.8 lakhs while the shares that had to be purchased by the assessee was of the value of Rs.80 lakhs. The assessee claimed that 72 lakhs should be shown as investment in shares and that Rs.8 lakhs need not be offered as income. Comment.

(4 Marks)

8.

(a) The assessee company had claimed a deduction in respect of expenditure incurred, which in another case was held by the Tribunal to be not allowable. This issue was in the course of assessment u/s.143(3) considered and allowed in the case of the assessee company. Subsequently the Assessing Officer came to know of the decision of the Tribunal where it was held that the expenditure was not allowable. On coming to know of the same the Assessing Officer wants to reopen the assessment. Can this be done?

(4 Marks)

(b) The Assessing Officer in order to collect a demand wants to attach the deposits held by the assessee in default by way of fixed deposits with banks. The Assessing Officer also wants to encash the deposits before their maturity. Can this be done? Will it be possible to do this when the Assessing Officer does not have the deposit receipt?

(4 Marks)

(c) The assessee had paid corporation tax in an earlier year that was allowed as a deduction in computing income from house property. The said tax was refunded in the previous year 2005-06 as a result of an appellate order under the local laws. The assessing officer wants to assess this refund in the assessment year 2006-07 as either an income from house property or as an income under the head income from other sources. Is the assessing officer justified?

(4 Marks)

(d) Is tax required to be deducted at source in the following cases and if so at what rate and under which section:

(i) a non refundable deposit given by a tenant
(ii) payments made to the electronic or print media

(2 x 2 = 4 Marks)

9.

(a) Where tax has been deducted at source but where the payer has not remitted the tax so deducted into the account of the Government, would the Assessing Officer be justified in requiring the payee to pay the tax so deducted but not remitted by refusing to give credit for the TDS in the hands of the payee in his assessment.

(4 Marks)

(b) When shall an appeal lie before the High Court under the Income Tax Act?

(4 Marks)

10.

(a) Compute the net wealth of Samarajit, a resident individual, as on March 31, 2004 from the following particulars furnished:

i. He has a house property at Kolkata, valued at Rs.12,00,000 which is occupied by a firm in which he is a partner for its business purposes. Another house at Bangalore, valued at Rs.8,00,000 is being used for his own business

ii. Vehicles for personal use

	Market Value in Rs.
Motor Car	4,40,000
Motor Van	2,20,000
Jeep	2,16,000

iii. Cash in Hand 2,10,000

iv. Jewellery 8,40,000

v. Samarajit has gifted to a trust a commercial establishment situated at Chennai purchased 5 years back for Rs.10,00,000 for the benefit of the smaller Hindu undivided family consisting of himself and his wife

vi. Samarajit has transferred an urban house plot measuring 450 Sq. Mt. in February, 1991 in favour of his niece which was not revocable during her lifetime. This niece died on March 14, 2008. Samarajit could get the title to the plot retransferred to his name only on April 15, 2008 despite sincere and honest efforts. The market value of the house as on March 31, 2008 is Rs.9,40,000

vii. Samarajit is the holder of an impartible estate which owns urban agricultural lands of the value of Rs.4,30,000 as on March 31, 2008.

(7 Marks)

(b) An assessee agreed to sell a property and received a part of the consideration in advance and gave possession of the property. The title however remained in the name of the assessee and therefore the same was to be included in computing the wealth of the assessee. Can the advance received be treated as a liability and reduced in computing the net wealth of the assessee?

(3 Marks)

PRIME ACADAMY
27 -Session Final
DIRECT TAXES
Suggested Answers

1. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such loss or depreciation shall be set off or carried forward for a period of 8 assessment years or for an indefinite period respectively by the amalgamated company. The amalgamating company shall be engaged in any of the following activities:

   i. Owning an industrial undertaking or a ship or a hotel with any another company

   ii. A public sector company engaged in the business of operation of aircraft with another public sector company engaged in the same business.

   iii. A banking company with specified bank

   The conditions to be fulfilled by the amalgamating and amalgamated company in order to avail the carry forward and setoff benefit are as enlisted here below:

   1. Conditions to be satisfied by the amalgamating company:

      a. The amalgamating company has been engaged in the business in which the accumulated loss occurred or depreciation remains unabsorbed for three or more years;

      b. The amalgamating company has held continuously as on the date of amalgamation atleast $3/4^{th}$ of the book value of fixed assets held by it two years prior to the date of amalgamation.

   2. Conditions to be satisfied by the amalgamated company :

      a. The amalgamated company holds continuously for a minimum period of 5 years from the date of amalgamation at least $3/4^{ths}$ of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;

      b. The business of the amalgamating company should be continued by the amalgamated company for a minimum period of 5 years from the date of amalgamation:

      c. The amalgamated company fulfills the following additional conditions prescribed under Rule 9C to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose:

         i. The amalgamated company shall achieve the level of production of at least 50% of the installed capacity (capacity as on the date of amalgamation) of the said undertaking before the end of 4 years from the date of amalgamation and continue to maintain the said minimum level of production till the end of 5 years from the date of amalgamation. Central Government has the power to modify this requirement on an application made by the amalgamated company.

         ii. The amalgamated company shall furnish to the assessing officer a certificate in Form No.62 verified by a Chartered Accountant in this regard.

In a case where any of the above conditions are not complied with, the set off of loss or depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

The benefit conferred under the Income Tax Law for amalgamation will apply to a banking company only in case the amalgamation is effected with a specified bank.

“Specified Bank” has been defined to mean the State Bank of India or its subsidiary or a corresponding new bank.

In the case of a demerger, the accumulated loss and unabsorbed depreciation of the demerged company shall be allowed to be carried forward and set off in the hands of the resulting company. Where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, it shall be apportioned between the demerged company and the resulting company. The basis for such apportionment shall be in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company. The Central Government may notify conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

The accumulated loss and the unabsorbed depreciation of the predecessor firm or the proprietary concern, as the case may be, shall be deemed to be the loss or depreciation of the successor company. The other provisions relating to set off and carry forward of loss and depreciation shall apply. Accordingly, such loss or depreciation shall be deemed as the loss or depreciation of the successor company for the previous year in which business reorganization is effected. The successor company will be able to claim the benefit of carry forward of business loss for a fresh period of 8 years commencing from the end of the year of such business reorganization. However, unabsorbed depreciation can be carry forward or set off for an indefinite period

If the conditions stipulated by the Central Government are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor company shall be deemed to be the income of the company chargeable to tax in the year in which such conditions are not complied with.

The term “Accumulated Loss” means so much of the loss of the predecessor firm or proprietary concern or the amalgamating company or the demerged company, as the case may be, under the head ‘profits and gains of business or profession’ (other than the speculation loss) which would have been allowed to be carried forward and set off under the provisions of section 72 if the reorganization of business or amalgamation or demerger had not taken place

The term “Unabsorbed Depreciation” means the depreciation of the predecessor firm or proprietary concern or the amalgamating company or the demerged company, as the case may be which remains to be allowed and which would have been allowed to the predecessor firm or proprietary concern or the amalgamating company or the demerged company, as the case may be, if the reorganization of business or amalgamation or demerger had not taken place

“Industrial undertaking” means any undertaking which is engaged in –

i. The manufacture or processing of goods; or
ii. The manufacture of computer software; or
iii. The business of generation or distribution of electricity or any other form of power; or
iv. The business of providing telecommunication services, whether basic or cellular including radio paging, domestic satellite service, network of trunking, broad band network and internet services; or
v. Mining; or
vi. The construction of ships, aircrafts or rail systems;

2. In the given case the partnership firm is dissolved and the partners have got assets distributed. Partner Mr.Alankrit has obtained block of assets at a value which is higher than the written down value in the books of the firm. In his individual assessment, Mr.Alankrit has claimed the depreciation on the values at which he had taken over the block of assets from the firm. The written down value of assets acquired during the previous year by an assessee shall be the cost at which it is acquired. Therefore u/s.43(6) Mr.Alankrit should be able to claim depreciation on the values at which he acquired the assets. However, explanation 3 to section 43(1) enables an Assessing Officer to determine, with the previous approval of Joint Commissioner, the actual cost to the assessee for the purpose of allowing depreciation if the following conditions are satisfied:

(i) Before the date of acquisition by the assessee, the assets were at any time used by any other person for the purposes of his business or profession; and

(ii) The Assessing Officer is satisfied that the main purpose of the transfer of such asset, directly or indirectly to the assessee, is the reduction of income tax liability

If the above conditions are not satisfied then the action of the assessing officer is not justified. Refer *Ashwin Vanaspati Industries v CIT [2002] 255 ITR 26 (Guj)* and *Nagammal Cotton Mills (P) Ltd v CIT [2002] 258 ITR 390 (Mad)*

3.a. Conditions to be satisfied in case of construction and development of housing projects - [section 80-IB(10)]

- The housing project should be approved before 31st March 2007 by a local authority
- The size of the plot of land should be minimum of 1 acre.
- However this condition is not applicable to a housing project carried out in accordance with a scheme framed by the Central Government or a State Government for reconstruction or re-development of existing buildings and such scheme is notified by the Board in this behalf.
- Maximum built up area:
  (i) Mumbai or Delhi or within 25 km of the municipal limits of these cities – 1,000 Sq. Ft.
  (ii) Any other place – 1,500 Sq. Ft.

  "Built up area" means the inner measurements of the residential unit at the floor level, including the projection and balconies, as increased by the thickness of the walls but does not include the common areas shared with other residential units.

  The built up area of the shops and other commercial establishments included in the housing project should not exceed 5% of the aggregate built up area of the housing project or 2000 sq. ft. whichever is less.

- The development and construction of the housing project should commence on or after 1st October 1998
- Where housing projects has been approved by the local authority before 1st April 2004, it should be completed on or before 31st March 2008
- Where housing project has been approved by a local authority on or after 1st April 2004 but on or before 31st March 2008, it should be completed within 4 years from the end of the financial year in which the housing project is approved by the local authority. Where

approval in respect of a housing project is obtained more than once, such housing project is deemed to have been approved on the date on which the building plan of such housing project is first approved by the local authority.

- The date of completion of a housing project is taken to be the date on which the completion certificate in respect of such housing project is issued by the local authority.

3.b. In the case study given, the assessee company has made the claim for deduction of warranty claims and free service charges in respect of the cars sold during the previous year which has been calculated on the basis of the actual figures available for the earlier 3 years. Therefore, the deduction claim is not an adhoc amount nor it can be said to be wholly contingent in nature. The sale price accounted for during the year includes the sum collected to meet the expenses to be incurred in the future on the basis of warranty claims and free service commitment. On the principle of matching costs and revenue, a well recognized accounting and commercial principle, the claim of the assessee company is justified. This view has been affirmed by the Supreme Court in the case of *Investments Ltd v CIT [1970] 77 ITR 533 (SC)* and *Anup Engineering Ltd v CIT 247 ITR 457 (Guj)*.

3.c. Every trust or institution shall submit an application for registration in the prescribed form (Form 10A) as required u/s.12A to the Commissioner of Income Tax before the expiry of a period of one year from the date of creation of the trust or the establishment of the institution

Provided that –

(i) the above provision of this clause shall not apply in relation to any application made on or after the 1st day of June 2007

(ii) where any application has been made on or after the 1st day of June 2007, the provisions of sections 11 and 12 shall apply in relation to the income of such trust or institution from the assessment year immediately following the financial year in which such application is made.

On receipt of the application, according to the provisions of section 12AA, which prescribe the procedure for registration, the Commissioner shall call for such documents or information as considered necessary in order to satisfy about the genuineness of activities of the trust or institution. Inquiries can also be made as deemed necessary. After being satisfied about the objects and the genuineness of activities an order shall be passed in writing, registering the trust or institution. If not so satisfied, an order shall be passed in writing, refusing to register. Copy of any such order shall be sent to the applicant. Before an order is passed refusing registration, reasonable opportunity of being heard should be given. The time limit for passing an order u/s.12AA is six months from the end of the month in which the application is received.

In the instant case the Commissioner of Income Tax cannot refuse to grant registration only for the reason that the application is filed belatedly. However he can refuse to grant registration if the other conditions are not satisfied. Further the Commissioner of Income Tax can grant registration only from the 1st day of April 2007 since the application is made only on 15.02.2008.

4.a. Leave salary encashed at the time of retirement on superannuation or otherwise is exempt up to a specified limit under section 10(10AA). Exemption was denied in a case of resignation on the ground that it would not amount to retirement. The Madras High Court in *CIT v R.J.Shahney [1986] 159 ITR 160 (Mad)* had found that the interpretation placed by the Revenue was too narrow. It found that the words “or otherwise’ following the word “superannuation” would clearly indicate that resignation has to be treated as voluntary retirement and that no question of law would arise on this finding of the Tribunal. The word ‘whether” was added before the word “superannuation” by the Taxation Laws (Amendment) Act, 1984, with retrospective effect from April 1, 1978, the date on which the provision itself was brought on the statute. The Bombay High Court in *CIT v D.P.Malhotra [1988] 229 ITR 394 (Bom)* points out that the purport of this amendment is to cover the contingency of even resignation.

4.b. Section 64(1)(iv) specifically provides that where there is the transfer of an asset directly or indirectly to the spouse by an individual otherwise than for adequate consideration or in connection with an agreement to live apart, the income arising there from is to be included in the hands of the transferor spouse. In the instant case, since the transfer of the house property is in connection with an agreement to live apart, the income arising there from is not to be included in the hands of the transferor but will have to be assessed in the hands of the transferee.

4.c. Section 263 enables the Commissioner to correct any order passed by any officer subordinate to him, where such order is prejudicial to the interests of the Revenue. The issue of whether non-initiation of penalty proceedings in a case, where it ought to have been initiated justify jurisdiction under section 263 is one, which had arisen in *CIT v C.R.K.Swamy [2002] 254 ITR 158 (Mad)*. It was held that the exercise was beyond the purview of reversionary power following *Addl. CIT v Sudershan Talkies [1993] 200 ITR 153 (Delhi)*. Such a view has been taken in a number of cases by different High Courts, where the assessment is set aside merely for initiation of penalty proceedings. The decision of the Delhi High Court in *Addl CIT v J.K.D'Costa [1982] 133 ITR 7 (Delhi)* taking the same view favorable to the taxpayer became the subject matter of a special leave petition, which was dismissed by the Supreme Court in *[1984] 147 ITR (St.) 1*. The same view has also been taken by the Rajasthan High Court in *CIT v Keshrimal Parasmal [1986] 157 ITR 484 (Raj)*, the Gauhati High Court in *Surendra Prasad Singh v CIT [1988] 173 ITR 510 (Gau)* and the Calcutta High Court in *CIT v Linotype and Machinery Ltd. [1991] 192 ITR 337 (Cal)*.

5. (a) Where, under any agreement or other arrangement, the tax chargeable on any income referred to in the above provisions is to be borne by the person by whom the income is payable, then for the purposes of deduction of tax, under those provisions such income shall be increased to such amount as would after deduction of tax be equal to the net amount payable under such agreement or arrangement. (Section 195A)

(b) In a case where tax is borne by the Indian company by grossing up principle, one significant issue that arises is about issuing the certificate for deduction of tax at source to the payee to enable the payee to avail appropriate credit in the home country subject to the law prevalent in that country. Since the tax is borne by the Indian company, a doubt arises about the entitlement.

6.a. Interest payable to an assessee

(a) Interest on excess payment of advance tax, tax deducted or collected at source and other tax or penalty becoming refundable will be paid u/s.244A at the rate of 1/2% for every month or part of a month

(b) The period for which the interest is payable will be:

  (i) For advance tax and tax deducted or collected at source, from 1st April of the relevant assessment year to the date on which the refund is granted. However, no interest will be payable, if the amount of refund is less than 10% of the tax determined u/s.143(1) or on regular assessment; and

  (ii) For all other taxes / penalties, from the date of payment of tax / penalty to the date on which the refund is granted

(c) Delay in granting refund, if any, attributable to the assessee will be excluded from the period for which interest is payable

(d) If the amount on which interest was payable is increased or reduced due to regular assessment order, reassessment, rectification, appeals, revision or Settlement Commission's orders, interest also will be increased or reduced

(e) It may be noted that interest allowed u/s.244A is to be treated as income of the previous year in which it is allowed and is, therefore, required to be declared in the return of income for the corresponding assessment year.

6.b. Liability of a liquidator of a company

(i) Every person who is a liquidator of any company which is being wound up or who has been appointed the receiver of any assets of a company shall within 30 days of such appointment give notice of his appointment to the Assessing Officer

(ii) The Assessing Officer after making enquiries and calling for information shall notify to the liquidator within 3 months from the date of receipt of such notice, the amount which in his opinion would be sufficient to provide for any tax which is likely to be payable by the company

(iii) The liquidator shall not part with any of the assets of the company until so notified without the permission of the Chief Commissioner or Commissioner of Income Tax. On being so notified the liquidator shall set aside an amount equal to the amount notified before parting with any asset of the company. However, he can part with the assets for the purpose of : (a) payment of tax (b) payment of secured creditors having priority over debts due to Government and (c) meeting such priority costs and expenses of winding up as may be reasonable in the opinion of the Chief Commissioner or Commissioner of Income tax

(iv) If the liquidator fails to give notice or parts with any assets of the company without permission from the Chief Commissioner or Commissioner or without setting apart the notified amount, he shall be personally liable. If the Assessing Officer has notified any amount the personal liability shall be restricted to such amount

(v) Where there is more than one liquidator the obligations and liabilities shall be attached to all the liquidators jointly and severally

6.c. Provisional attachment to protect the interest of revenue

Where, during the pendency of any proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment, the Assessing Officer is of the opinion that for the purpose of protecting the interests of the revenue it is necessary so to do, he may, with the previous approval of the Chief Commissioner or Commissioner, Director General or Director by order in writing, attach provisionally any property belonging to the assessee in the manner provided in the second schedule.

The attachment will be for a period of 6 months unless it is extended by an order of the Chief Commissioner or Commissioner, Director General or Director for reasons to be recorded in writing. The maximum period for which such an attachment is made cannot exceed 2 years.

Second schedule to the Income Tax Act lays down the procedure for recovery of tax from defaulting assessees. Apart from other measures, the Schedule provides for attachment and sale of immovable property of the defaulters. When any such event of sale occurs and the price realised is in excess of the amount then such excess shall be paid within a period of 3 months from the date of delivery of possession of the property as per sub-rule (3) of Rule 68A of the schedule. If there is any delay in such payment, for the period commencing from the expiry of the said 3 months and ending with the date of payment of the amount remaining unpaid, simple interest at one half percent for every month or part of a month is payable to the defaulter.

7.a. The issue of allowability in relation to the expenditure will be governed by section 37(1). The fact that the car was used unauthorized by the Managing Director will not in any way act as a prohibition on the claim of such expenditure by the company. The expenditure should therefore be allowed as a deduction in computing the income of the company. However the expenditure may be treated as fringe benefit and attract fringe benefit tax.

7.b. The High Court in *Commonwealth Trust (India) Ltd v CIT [2000] 242 ITR 593 (Ker)* found that the objection on the part of the Revenue for the deduction and confirmed by the Tribunal was not correct as the entrustment was in the course of business and that the competency or otherwise of the employee to disburse the amount was not relevant. It was held that it was a trading loss and, therefore, deductible.

7.c. The Supreme Court in *Karthikeya V.Sarabhai v CIT [1997] 228 ITR 163* has held that on reduction of share capital there is an extinguishment of right and that therefore a charge under the head capital gains will arise. This view was earlier pointed out by the Supreme Court in *Anarkali Sarabhai Ltd v CIT [1997] 224 ITR 422* and later again in *CIT v G.Narasimhan [1999] 236 ITR 327*. In the hands of Ashmita therefore the gain or loss will have to be computed and offered under the head capital gains.

7.d. In *CIT v U.P.State Industrial Development Corporation [1997] 225 ITR 703 (SC)*, the issue related to the accounting of underwriting commission paid for purchase of shares. The assessee, a State Corporation, underwrites public issue of shares by companies consistent with its object of promotion of industrial projects or enterprises in the State. The commission so received was treated as its income, but in respect of shares, which it had to purchase as a result of underwriting obligations, such commission was treated as an abatement of cost of such shares and not treated as income. The Assessing Officer, however, treated even such underwriting commission relating to the assessee's own purchase of shares as income. Since the High Court upheld the assessee's contention, the matter came up on appeal to the Supreme Court, which found that the method which the assessee followed was in consonance with the principles of accountancy. The Supreme Court referred to a number of text books on accountancy and finding that the treatment accords with what is recommended therein, it observed that unless the Income-tax Act provides for a different accounting system, the system followed for ascertaining profits and gains under the ordinary principles of commercial accounting should be acceptable for computation of income for tax purposes as well.

8.a. The Assessing Officer would not be justified in reopening the case. In *CIT v Foramer France [2003] 129 Taxman 72 (SC)*, the Supreme Court held that the reopening of an assessment based on the view of the Tribunal would not be valid if the same has been considered and decided at the time of original assessment. The Court held that a notice of reassessment cannot be given on the basis of a mere change of opinion.

8.b. Attachment of the amount in the fixed deposit could be made by the income tax authorities under the proviso to section 226(3). Power under section 226 has been given to the Assessing Officer to recover in the modes provided the amount is outstanding. Section 226(3) contemplates that the Assessing Officer may require any person at any time or from time to time (1) from whom money is due, (2) or may become due to the assessee, (3) or any person who holds money for an assessee; (4) or may subsequently hold money on account of an assessee, to pay the Assessing Officer or TRO either forthwith upon the money becoming due or being held or at or within the time specified in the notice (not being before the money becomes due or is held). There should be an obligation on the person to whom notice is served to pay money to the assessee, i.e. the subsisting relationship of a debtor and creditor is a *sine qua non* for the exercise of the power under the section.

If the deposit receipt matures even at a subsequent date and the assessee wants to get the fixed deposit encashed earlier than the date of maturity, it is considered permissible. Though the contract is entered into by the assessee while obtaining the deposit receipt for receiving the money at a later date yet for the sake of the reputation of the bank or for the facility of the assessee or otherwise, payment is made before maturity of the deposit receipt. The Department steps into in the shoes of the assessee and can claim payment even before its maturity. Even the production of such receipt (deposit receipt) is not required in terms of section 226(3)(iv). *[Vysya Bank Ltd v Joint CIT [2000] 241 ITR 178 (Kar)]*

8.c. In *CIT v India Automobiles (1960) Ltd. [2001] 251 ITR (Cal)*, the assessee who was allowed corporation tax on the basis of payment got such tax remitted in appeal. The Assessing Officer sought to assess refund of such tax under the head "Other sources ". He obviously felt that it is only fair. But the High Court found that there was no provision in computation of property income corresponding to Section 41(1) of the Income tax Act available for taxing remission or waiver of liability in respect of business income.

8(d)

(i) a non refundable deposit given by a tenant -

In case where the tenant makes a non-refundable deposit, tax would have to be deducted at source as such deposit represents the consideration for the use of the land or the building etc. and therefore partakes the nature of rent as defined in section 194I. If however the deposit is refundable, no tax would be deductible at source. *[Circular No. 715 dated 8.8.1995]*

Tax has to be deducted at source u/s.194I at the rate of 15% where the payee is an individual or a Hindu Undivided Family and 20% where the payee is a person other than an individual or Hindu undivided family as increased by the appropriate surcharge and additional surcharge.

(ii) payments made to the electronic or print media –

The provisions of tax deduction at source would apply when a client makes payment to an advertising agency and not when advertising agency makes payment to the media, which includes both print and electronic media. The deduction is required to be made at the rate of 1% *[Circular No. 715 dated 8.8.1995]* as increased by the appropriate surcharge and additional surcharge.

The payments made directly to print and electronic media would be covered u/s.194C as these are in the nature of payments for purpose of advertising. Deduction will have to be made at the rate of 1% *[Circular No. 715 dated 8.8.1995]* as increased by the appropriate surcharge and additional surcharge.

9.a. In *ACIT v Om Prakash Gattani [2000] 242 ITR 638 (Gauhati)* a winner of lottery was not given credit for tax deducted at source on the ground that deductor did not intimate that date of actual payment. The Assessing Officer, therefore, declined to give credit while promising such credit, when evidence of the actual payment of the same is produced. The amount was also sought to be collected by attachment of the assessee's bank account. The High Court pointed out that the remedy for the revenue lay in enforcement of recovery from the deductor. Though section 202 does not debar direct recovery in respect of tax failed to be deducted, there can be no recovery, where tax has been deducted at source. The mandate in section 205 bars direct demand on the assessee where tax has been deducted at source.

9.b. After the Tribunal decides, the appeal, an appeal shall lie to the High Court against the order of the Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law. The time prescribed for filing such an appeal is within 120 days from the date of receipt of order. The appeal can be filed by the Chief Commissioner or Commissioner or an assessee aggrieved by the Appellate Tribunal's Order.

Where the High Court is satisfied that a substantial question of law is involved, the High Court shall formulate that question. The High Court shall decide the question of law so formulated and deliver such judgment containing the grounds on which such decision is founded. The High Court may award such cost as it deems fit. The High Court may determine any issue which has not been determined by the Appellate Tribunal or any issue which has been wrongly determined by the Appellate Tribunal.

The appeal-filing fee will be in accordance with the relevant Court Rules applicable and the provisions of the Code of Civil procedure shall apply to all the appeals covered by Section 260A.

The expression “Substantial question of law” used under section 260A of the Income Tax Act is discussed by the Supreme Court in the case of *Santosh Hazari v Purushottam Tiwari [2001] 251 ITR 84*. According to this judgment, where,

(i) The law is debatable;
(ii) It is not be previously settled by law of land;
(iii) It does not have a binding precedent; or
(iv) It is to be understood as something in contradistinction with technical of no substance or consequence or academic merely

Then such question becomes a “Substantial question of law”. The word “Substantial” as qualifying “question of law” means having substance, essential, real, of sound worth, important or considerable.

10.a. Computation of Net Wealth of Samarajit

	Amount Rs.
House property at Kolkata occupied by the firm in which Samarajit is a partner (Refer Note 1)	NIL
House at Bangalore occupied by Samarajit for his own business [not taxable being outside the definition of asset under section 2(ea)]	NIL
Motor Car	4,40,000
Motor Van	2,20,000
Jeep	2,16,000
Cash in hand (in excess of Rs.50,000)	1,60,000
Jewellery	8,40,000
Commercial establishment at Chennai gifted to a trust for the benefit of the smaller HUF of the assessee – Exempt u/s.2(ea)	NIL
Urban House (Refer Note 2)	9,40,000
Impartible estate consisting of urban agricultural land	4,30,000
Gross Wealth	32,46,000
Less : Exemption u/s.5(vi) [Urban House Plot] (exempt being less than 500 Sq. Mt.)	9,40,000
Net Wealth	23,06,000

Note :

1. A building which is in the occupation of the firm in which the assessee is partner, is regarded as building used by the assessee for carrying on his business and it is not an asset under the Wealth Tax Act in view of the decision in *CIT v Rabindranath Dhol [1995] 211 ITR 799 (Orissa)* wherein it was held that when a partnership carries on business, each partner thereof must be said to carrying on that business.

2. Since the niece had died on 14.03.2008, power to revoke has already arisen on 31st March, 2008, the same shall be included in the net wealth of Samarajit. However it is exempt u/s.5(vi) the plot being less than 500 Sq. Mts.

10.b. Where an assessee agrees to sell a property, receives part consideration and gives possession of the property, the property is still owned by the assessee, since he continues to have title over the same and has to be included in the wealth of the assessee notwithstanding the deeming provision of presuming sale for purposes of computation of income from property and capital gains. The question that arose in *CWT v Bajoria Properties Pvt. Ltd. [2002] 258 ITR 29 (Cal)* was whether the amount received as part consideration for the agreement of sale could be treated as debt in relation to property, so as to require deduction of the same as a liability incurred in relation to the included wealth in computation of taxable wealth. The High Court pointed out that the payment received would be a charge on the property within the meaning of section 55 of the Transfer of Property Act, so that it has necessarily to be treated as debt incurred in relation to that asset and allowed as a deduction.

SI

Total No. of Questions: 9

Max Marks: 100

No.of Pages : 6 **Time Allowed: 3 Hours**

Question Nos.1, 6, and 9 are Compulsory
Answer any Two from Part A and One from Part B
PART - A

1

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

(i) Job work

(ii) Principal inputs

(iii) Deemed Cenvat Credit.

(2x2 = 4 marks)

(b) Briefly examine the correctness or otherwise of any **two** of the following statements with reference to the Central Excise Act, 1944 giving reasons to support your answers:

(i) Parts used for repair or replacement during warranty period are excisable.

(ii) In case of samples distributed free, valuation should be adopted on the basis of Rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 i.e. cost of production plus 10%.

(iii) Exemption from duty does not mean exemption from registration

(2x3=6 marks)

(c) M/s.Super Pipes Ltd. is engaged in the manufacture of m.s. galvanized pipes. The excise department has required the assessee to include the cost of galvanization in the assessable value of the m.s.galvanized pipes for the purposes of determination of excise duty. The assessee claims that as the process of galvanization does not amount to manufacture, the cost of galvanization is not includible in the assessable value of the said pipes made from H.R. coils. Briefly discuss whether the stand taken by the assessee is correct with reference to the provisions of the Central Excise Act, 1944

(5 marks)

(d) "Everything that is sold is not necessarily a marketable commodity chargeable to excise duty under the provisions of the Central Excise Act, 1944."

(5 marks)

2

(a) M/s KE Ltd., manufactured elastics with brand name of M/s XYZ Ltd., who in turn used these elastics in the manufacture of other excisable goods. These elastics were never sold in the open market. The general public only received the manufactured excisable goods. M/s KE Ltd., claimed the exemption based on value of clearances (SSI) in terms of Notify. No. 8/2003-C.E., dated 1.3.2003 on the ground that they did not use the brand name on the final product and that the brand name was used only in respect of the goods meant for captive consumption. This claim was disputed by the Excise Department on the basis that it is immaterial whether the ultimate customer got only the final product and the use of the brand name even if not sold in the open market would convey to the customer that the elastics had connection with the owner of the brand name. Briefly discuss whether the stand of the Department is valid in law?

(5 Marks)

(b) With reference to the CENVAT Credit Rules, 2004 discuss briefly whether the following statements are correct or not. (i) CENVAT credit cannot be taken on the inputs lying in stock on the date when the final product becomes dutiable because the said product was initially exempt (ii) CENVAT credit of duties of excise on inputs can be availed on the basis of an invoice, while credit of service tax paid on input services can be availed only upon payment of the full invoice value including service tax. (iii) In case of transfer of ownership of the factory by way of sale along with inputs and capital goods the unutilized input credit shall lapse

(6 Marks)

(c) Briefly answer with reference to the provisions of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 whether in the following cases any notional interest on the advance received is includible in the value for purpose of assessment : (i) Assessee sells his goods against full advance payment to X. He also sells such goods to Y without any advance payment at the same price per unit. (ii) A the assessee manufactures and supplies certain goods as per design and specification of B. A takes 50% of the price as advance against these goods and there is no sale of such goods to any other buyer (4 marks**)**

3

(a) The appellants were the manufacturers of rubber products. Some of the defective goods were returned by the buyers and the appellants took Cenvat credit of the duty originally paid under Rule 16 of Central Excise Rules, 2002. Defective goods were reprocessed, which activity however yielded only scrap and scrap was cleared on payment of duty. Department claimed that Cenvat credit taken by the appellants should be reversed since reprocessing did not amount to 'manufacture' whereas appellants argued that the process cannot be anything other than 'manufacture' in as much as the defective goods returned by their buyers were put to normal process of manufacture. Offer your comments to the appellants referring to decided case law.

(5 Marks)

(b) What are the provisions regarding general exemption to SSI units?

(5 Marks)

(c) M/s P. Ltd. used to label its products with a foreign brand and claimed exemption under a notification. The classification list was approved by the department after carrying out verifications and all returns were regularly filed. The invoice containing description of goods were also regularly approved by the department. The department denied the benefit of exemption to the assessee by invoking extended period of limitation under Section 11A on the ground that it failed to declare the particulars regarding affixing of labels. Is the department justified?

(5 marks)

4

(a) Write a brief note on the powers of review to be exercised by Committee of Chief Commissioners under section 35B and section 35E of the Central Excise Act, 1944 (3 marks)

(b) With regard to exports under the Central Excise Act, 1944 write a brief note on :

(i) Who is authorized to sanction rebate claim ?

(ii) The time limit for the filing of such rebate claim (2x2 = 4 marks)

(c) Write short note on "submission of list of records" under Rule 22(2) of the Central Excise Rules, 2002 (4 marks)

(d) With reference to Rule 8(3) and Rule 8(3A) of the Central Excise Rules, 2002 explain in brief the consequences, if duty is not paid fully on the due date or within 30 days after the due date . (4 marks)

5

(a) Write short notes on the following :

(i) Place of Removal

(ii) a.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

(a) Explain briefly with reference to the provisions of the Customs Act, 1962 any two of the following. :

(i) "Import" and "Importer" (ii) Meaning of "Assessment" (iii) "Home consumption" and "Clearance for warehousing"
(2 x 2 = 4 marks)

(b) (e) India Car Co. is manufacturing passenger cars and has entered into a joint venture agreement and collaboration with Videshi Car Co. - - India Car Co. imported from Videshi Car Co. a shipment of 24 CKD packs (completely knocked down condition) of passenger car components. They filed Bill of Entry for clearing the goods, which were claimed to be components of motor cars. They also claimed benefit of a Notification exempting components, including components of motor cars in semi-knocked down packs and completely knocked down packs. The Adjudicating Authority held that the imported components being complete cars in CKD packs, had the essential character of the finished product and as such the consignment were to be treated as Motor Cars and not components. It was also held that India Car Co. was not entitled to the benefit of the notification as the notification was only for components. The questions for consideration are : (i) Whether the CKD packs imported into the country could be considered to be Motor Cars for the purpose of classification and clearance? (ii) Whether India Car Co. were entitled to the benefit of exemption notification? (2 X 3 = 6 marks)

c) Examine the validity of the following statements with reference to the Customs Act, 1962 giving brief reasons ***(Answer any two).*** :

(i) Service charges paid to canalizing agent are not includible in the assessable value of imports.

(ii) Design and engineering charges are includible in the assessable value of the imported goods only if the goods imported are specifically manufactured on the basis of the design and engineering specification provided by the importer.

(iii) Inspection charges are not includible in the assessable value of the imported goods, if contract does not specify for certification by an independent agency

(iv) Goods exempt from basic customs duty would automatically be exempt from additional duty of customs

(2 x 2 = 4 marks)

(d) (i) With reference to Section 125 of the Customs Act, 1962 briefly explain the following :

(a) Option to pay fine in lieu of confiscation.

(b) Whether this fine once paid could be claimed as a refund if the importer decides to abandon the goods

(ii) Briefly explain the provision of Section 89 of the Customs Act, 1962 with regard to supply of ship stores

(4 +2 = 6 marks)

7

(a) After visiting USA, Mrs. & Mr.Z brought to India a lap-top computer valued at Rs. 80,000, personal effects valued at Rs. 90,000 and a personal computer for Rs. 52,000. What is the customs duty payable? (3 Marks)

(b) Write a brief note on the following with reference to the Customs Act, 1962:

(i) Remission of duty on imported goods lost;

(ii) Pilfered goods. (6 Marks)

(c) State the requirements to be satisfied to accept 'transaction value' under rule 4(2) of Customs Valuation Rules (6 Marks)

8

(a) M/s ABC Ltd. were liable for the duty assessed and payable on certain import which, it paid under protest and filed a claim for refund of duty on the ground that duty had been wrongly levied. On rejection of claim for refunds, the assessee filed an appeal before Tribunal which was also dismissed on the ground that as no appeal had been filed against the assessment order, the refund claim was not maintainable. Assessee seeks your advice for remedy. Discuss whether the stand taken by the Tribunal is correct. (5 Marks)

(b) Write a note on warehousing period under Section 61 of the Customs Act, 1962. (4 Marks)

(c) What is residual method of valuation? Bring out your answer with reference to the Customs Valuation (determination of price of Imported Goods) Rules, 1988 (6 Marks)

PART - C

9

(a) State whether in the following cases service tax is payable, with reason

(i) Temporary transfer of any intellectual property right.

(ii) Canteens in office run by the canteen contractor providing service directly to employees/workmen.

(iii) Business auxiliary service provided by commission agents in relation to sale of agricultural produce. (4 Marks)

(b) M/s ABCL, providing management consultancy to its client, do not maintain any separate accounts and have paid Rs. 1,00,000 as service tax and excise duty towards input services and input material/capital goods used by them. They have used the inputs for partially exempted and partially taxable services. They are now providing the output services for which current tax liability is Rs. 1,40,000. How much credit out of Rs. 1,00,000 can be availed by them for paying output service tax liability, if they do not maintain any separate accounts. (3 Marks)

(c) Mr. AJAY, a Charted Accountant, raised an Invoice for Rs. 28,060 (25000+3060 service tax) to a client on 20.03.2008. The client, however, has paid a lump-sum of Rs. 26,000 on 28.04.2008 for full and final settlement: (i) How much service tax Mr. AJAY has to pay and when does this tax become due for payment? (ii) What will be his liability, if client refuses to pay service tax and pays only Rs. 25,000 in total? (4 Marks)

(d) (i) The service provider is abroad. He renders service to a subsidiary of an Indian Company located abroad. Payment to him is done by holding Indian Company. Does this attract service tax?

(ii) What do you understand by ‘Centralised Registration’? (4 Marks)

PRIME ACADEMY

PROGRESS TEST -FINAL

INDIRECT TAXES

Suggested Answers

Part A

1(a)(i).Job Work has been defined in Rule 2(n) as processing or working upon raw material or semi-finished goods supplied to the job worker, so as to complete a part or whole of the process resulting in the manufacture or finishing of an article or any operation which is essential for aforesaid process and the expression "job worker" shall be construed accordingly.

1(a)(ii).It means any input which is used in the manufacture of final products where the cost of such input constitutes not less than 10% of the total cost of the raw materials for the manufacture of unit quantity of the given final product.

1(a)(iii) Deemed Cenvat Credit :Rule 13 of Cenvat Credit Rules, 2004 empowers the Government to declare vide notifications certain inputs or input service on which excise duty, additional duty of customs or service tax shall be deemed to have been paid at a rate or equivalent to such amount as my be mentioned in the notification. Cenvat Credit shall be allowed on such inputs or input services even if such input or input services are not used directly by the manufacturer of final products or by provider of taxable service but are contained in the final products or used in providing taxable service.

1(b)(i) The statement is true. Under Valuation Rules, after sales service expenses for warranty are to be considered as part of value. Therefore, parts used for repair or replacement during warranty period are excisable.

1(b)(ii) No. The statement is not correct. 110% of Cost of Production under Rule 8 of CEV(DPEG) Rules, 2000 is applicable only in cases of captive consumption. Free samples supplied are not sale of goods for the purpose of central excise and hence, valuation on the basis of transaction value is not applicable and permissible in this case.

Q1(b)(iii)The statement is correct. It has been clearly held in the Tribunal decision in the case of Eagle Flask Vs. CCE – 1998 (104) ELT 384 (CEGAT) that exemption from excise duty does not mean automatic exemption from registration. Provisions of exemption and registration are independent of each other. Under Rule (2) registration and compliance of following of excise procedure is necessary even if a product is exempt from duty, unless exemption from registration has been granted under law.

1(c) The stand taken by the assessee is not correct. The cost of galvanization is includible in the Assessable Value of the said pipes made from HR Coils.

The assessee stand is correct in as much as to be categorized under the word 'manufacture', there must be transformation or emergence of new substance having distinct name, character or use must emerge. In the case of Galvanization, it only improves the utility of material and there is no emergence of any new product. The same view had been held by the Supreme Court in the case of Gujarat Steel Tubes Ltd. Vs. State of Kerala – 1989 (42) ELT 513 (SC).

However, the final product here is M.S.Galvanized pipes and the activity of galvanization is done in relation to manufacture of final product. Had the galvanization process has taken place post manufacture of Galvanized pipes, then the same does not amount to 'manufacture'. But, since the Galvanization activity is done in relation to the final product, the cost of Galvanization is also includible in the Assessable Value. Though the Pipe is made of H.R.Coils, the final product viz., Galvanized Pipes emerges only after the Galvanization is completed and hence, the cost is includible in the Assessable Value.

1(d) Yes. The Statement is true. For any 'Goods' to be dutiable, the test of marketability has to be applied. However, every marketable product cannot be subjected to excise duty.

Supreme Court in the case of UOI Vs. Indian Aluminium Co. Ltd. has held that 'Everything sold is not necessarily a marketable commodity as known to commerce and even rubbish can be sold and dross and skimming arise out of manufacture of Aluminium is not excisable goods'.

The same view is held in the case of CCE Vs. Tata Iron & Steel Co. Ltd. – 2004 9 SCC1 has held that zinc dross and skimming merely refuse skum or rubbish and it is not result of treatment, labour or manipulation even if it fetches some price in the market and everything which is sold is not necessarily a marketable commodity known to commerce and worthwhile to trade in.

Therefore, the statement cited above is correct.

2(a) The stand taken by the department is not valid. If the supplies are made to original equipment manufacturer for manufacture of final product, then it is exempt from duty.

SSI Units manufacturing components/parts as OE are eligible for SSI Exemption under Notification No.8/2003-CE dt.1.3.2003, even if the component bears a brand name or trade name of the large manufacturer. However, he should follow the procedure as prescribed in Central Excise (Removal of Concessional Rate of Duty for Manufacture of Excisable Goods) Rules (earlier known as Chapter X Procedure) while despatching the goods to the large unit if his turnover exceeds Rs.150 lakhs. If the turnover of such goods is less than Rs.150 lakhs, the SSI manufacturer should only file a declaration that the specified goods shall be used as Original Equipment by the buyer.

In view of the decision of the Tribunal in the case of Union Metals Vs. CCE – 2004 (172) ELT 329 (CESTAT) - if the Chapter X (now Central Excise (Removal at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules) procedure is not followed, then assessee will have to establish that goods are cleared to the manufacturer as OE.

Therefore, in the present case, KE Ltd. should have followed the aforesaid procedure of either filing a declaration or Chapter X Procedure, based on the catgory in which they fall or if not followed should prove the fact with documentary evidence that the goods have been supplied to OE. However, this is only a procedural requirement and the stand taken by the department is not correct.

2 (b)(i) The statement is incorrect. The eligibility of Input Credit depends on whether the final product is dutiable or not. When the duty is paid on the final product, then the Cenvat Credit can be taken on the inputs which were lying in stock and it is only the date of clearance on which the final product is cleared is material (whether it is dutiable or exempted at the time of clearance).

2(b)(ii) The statement is partially correct. The Cenvat Credit of excise duties are availed based on invoice (since in the case of excise, payment is made at the time of clearance from the factory).

In the case of Service Tax only upon payment of invoice value with service tax, the input service credit can be availed. However, even if the payment is not for full value and it is part payment or advance payment, in that case also, service tax needs to be calculated for that portion of payment and credit can be availed for the said amount. Therefore, the statement is not correct that only upon payment of value including service tax, the input service can be availed as even for part payment or advance payment, the input service credit can be availed.

Q2b(iii) The statement is also incorrect. In terms of Rule 14(1) of Cenvat Credit Rules, if the factory is transferred on account of change of ownership, the manufacturer is allowed to transfer the Cenvat Credit lying unutilized in his account in such transferred, sold, merged, leased or amalgamated factory. Therefore, the unutilized input credit shall not lapse and it will be transferred to the changed ownership.

2(c) No. In terms of Rule 6 of Central Excise Valuation (Determination of Price of Excisable Goods) Rule, 2000, it has been clearly held under Explanation 2 of the said rules that where an assessee receives any advance payment from the buyer against any delivery of excisable goods, no notional interest on such advance shall be added to the value unless the Central Excise Officer has evidence to the effect that the advance received has influenced the fixation of the price of the goods by way of charging lesser price from or by offering a special discount to the buyer who has made advance deposit.

Therefore, in the case of (i) No Notional interest on Advance received from X is includible in the value and in the case of (ii) There is no evidence available with the central excise officer that the notional interest on the advance has resulted in lowering of the prices. Thus, no notional interest on the advance received shall be added to the Transaction Value.

3(a) As per Cenvat provisions, waste or scrap is treated as final product under Rule 2(h) of Cenvat Credit Rules and its clearance is as if it is a final product. Thus Cenvat Credit can be utilised for payment of duty on Waste and Scrap - Therefore, the department stand is not correct stating that reprocessing does not amount to manufacture.

The same view has been held by CBEC in Chapter 5 Para 3.2 of CBEC's CE Manual 2001 and also accepted the same fact in CBEC Circular No.724/40/2003-Cx. Dated 20.4.2003 that generation of waste and scrap is only incidental to the manufacturing process of the final products.

Therefore, the Cenvat Credit can be utilsied for payment of duty on waste and scrap as waste and scrap are 'final products' within the definition given under Cenvat Credit Rules.

3(b) General Exemption available to SSI Units:

SSI Units have been given two types of exemptions :-

a) SSI Unit can avail full exemption upto Rs.150 lakhs and pay normal duty thereafter. Such units can avail Cenvat Credit on inputs only after reaching turnover of Rs.150 lakhs in the financial year;

b) SSI Units can also pay full 100% duty and avail Cenvat Credit;-

When Second Option suitable

Option of payment of duty may be suitable in the following cases:-

1. When buyer intends to claim Cenvat Credit. In such cases, the effective cost will be lower as SSI Unit can claim Cenvat on Inputs;

2. When SSI Unit intends to export the products and has huge balance in Cenvat Credit account. In such cases, he can pay duty and claim rebate after export of goods and balance lying in Cenvat Credit account. However, such refund can be only of Cenvat on Inputs and not of Capital Goods.

Option must be indicated if SSI Units intend to avail Cenvat Credit.

The first option i.e, Nil duty upto Rs.150 lakhs is automatic and normal duty for subsequent clearances. In such cases, the assessee should intimate his option to the department.

Turnover from 1st April to be considered even if option availed from middle of year:

Choice of option of availing benefit of SSI Exemption notification of paying normal duty and availing Cenvat on Inputs can be made any time during the year. However, once it makes a choice, the option cannot be changed during the year under any circumstances. The SSI Unit can change the option only from 1st April next year. Even when the option is made in middle of the year, all turnover from 1st April onwards will be considered for calculating the limit of Rs.150 lakhs.

3(c) No. The department is not justified. The fact of non-declaration of particulars regarding affixing of labels is only a procedural requirement. Whereas the department has only approved the classification list and returns have been regularly filed by the department and in fact, the description of the product has been approved by the department. That being the case, the stand taken by the department invoking extended period of limitation is not justifiable.

The Supreme Court in the case of Mangalore Chemicals and Fertilizers Ltd. Vs. Dy. CCT – 55 ELT 437 (SC) has held that "When the question is whether a subject falls in the notification or exemption clauses, the interpretation should be strict as it is in the nature of exception. But, once the ambiguity about applicability is lifted and it is held that the subject falls in the notification, then full play should be given to it and it calls for a wider and liberal construction. It will be erroneous to attach equal importance to the non-observance of all conditions irrespective of the purposes they were intended to serve".

The said decision would be squarely applicable to the present case. The department is not disputing the fact that the subject goods are entitled for exemption and it has also approved the classification list. It is on account of non-observance of certain condition, it is defeating the main intention of the notification, which is incorrect and it cannot invoke extended period of limitation.

4(a) Under Sec.35B of CEA, 44 Committee of Commissioners if they are of the opinion that an order passed by Commissioner (Appeals) under Sec.35A is not legal or proper, then it may direct Central Excise Authorised in this behalf to file appeal before Appellate Tribunal against such order.

Under Sec.35E of CEA, 44 gives powers to Committee of Chief Commissioners of Central Excise or Committee of Commissioners to pass certain orders. The Committee of Chief Commissioners may of its own motion, call for and examine the record of any proceeding in which a Commissioner of Central Excise has passed any order so as to satisfy itself upon the legality or propriety of the order. Thereafter, the Committee of Chief Commissioners may direct such Commissioner or any other commissioner to apply to the Appellate Tribunal to determine such points as may be specified by it. Similar powers are also given to the Commissioner of Central Excise in respect of decisions taken by the adjudicating officers subordinate to him. In this case, the application is to be made by the Commissioner (Appeals).

4 (b) (i) The rebate can be sanctioned by any of the following officers of Central Excise :- 1) Deputy / Assistant Commissioner of Central Excise having jurisdiction over the factory of production of export goods or the warehouse; or b) Maritime Commissioner.

(ii) The rebate claim should be filed within a period of one year from the relevant date - 'Relevant date' in relation to exports would refer to a) when the ships or aircraft leaves India; b) If the goods are exported by land, the date on which the goods leave the Indian frontier (c) If export is by post, the date of dispatch of goods by post office to a place outside India.

4 (c) Under Rule 22 every assessee is required to furnish to the list of all records prepared or maintained by him for accounting of transactions in regard ot receipt, purchase, manufacture, storage, sales or delivery of goods including inputs and capital goods as that of old Rule 137G(5).

Records shall mean all the records prepared or maintained by the assessee for accounting of transactions with regard to receipt, purchase, manufacture, storage, sales or delivery of the goods including inputs and capital goods. All accounts, agreements, invoice, price list, return, statement or any other source document, whether in writing or in any other form shall be treated as records. Source documents are those documents which form the basis of accounting of transactions and include sales invoice, purchase invoice, journal voucher, delivery challan and debit or credit note.

If there is any modification in the list, the same may be communicated to the department as and when such modification takes place.

4 (d) Sub-rule 3 lays down that if the assessee fails to pay the amount by due date, then he is liable to pay the outstanding amount along with interest at the rate as specified by the Central Government starting from the date on which the amount is due till the payment is made.

Further, if the assessee makes a default in payment of duty by due date and the same is discharged beyond a period of 30 days from the due date then he shall loose the facility to pay the duty in monthly installments for a period of two months. The period will start from the date of communication of the order passed by Asst. Commissioner or Dy. Commissioner of Central Excise, from the date on which all dues along with interest has been paid. Further, during this period, the assessee shall not be able to utilize the Cenvat Credit for the payment of duty on final product as per Rule 3(4) of Cenvat Credit Rules, 2004. He shall be compulsorily pay the excise duty for each and every consignment by debit to the current account and in the event any failure, it shall be deemed that such goods have been cleared without payment of duty and the consequences and penalties as provided in the rules will follow.

5(a)(i) – Place of Removal

Sec.4(3)(c) defines 'Place of Removal' to mean

a) a factory or any other palce or premises of production or manufacture of excisable goods;

b) a warehouse or any other place or premises wherein the excisable goods have been permitted to be deposited without payment of duty from where such goods are removed;

c) a depot, premises of consignment agent or any other place or premises from where the excisable goods are to be sold after their clearance form the factory.

5(a)(ii) – Interest under Sec.11AB(b)

If duty is not paid when it ought to have been paid, interest is payable at the rate specified by Central Government by notification in the Official Gazette. Such rate cannot be less than 10% and not more than 36%. The interest is payable from the first day of the month following the month in which the duty ought to have been paid, till the date of payment. The actual interst rate is 13% with effect from 12.9.2003.

5(b) – Personal Ledger Account

Assessee should pay duty through account current (popularly known as PLA – Personal Ledger Account). Any assessee who has obtained 15 digit ECC number from Superintendent can operate a current account. No specific permission is necessary.

The PLA is credit when duty is deposited in bank by TR6/GAR-7 Challan and duty is required to be paid by making a debit entry in PLA on monthly basis. PLA and Cenvat Credit should be used only for payment of excise duty and not for other payment like rent, fines, penalties etc.

PLA contains the following details:- a) Serial No. and date, b) details of credit like TR6/GAR7, challan number, date and amount – separately for each sub-head of excise duty like basic excise duty, special duty, additional duty etc. c) the details of debit and; d) balance

PLA has to be maintained in triplicate using indelible pencil and both sided carbons. Each entry should be serially numbered and should be made on a separate line. The running serial number should start from every financial year. Both debit and credit entry should not be on same line and there should be separate line for each debit or credit entry. Mutilations or erasures of entries once made in PLA are not allowed. If any correction is necessary, the original entry should be neatly scored out and attested by assessee. Two copies of PLA and copies of TR6/GAR7 receipted challan shall be submitted along with monthly/quarterly ER-1/ER-3 return.

5(c) – Removal of Goods by 100% EOU for DTA

Goods manufactured in EOU should be normally exported. However, since export market is often fluctuating and certain, these units are allowed to sell part of their products in DTA (Domestic Tariff Area) within India.

As per proviso to Sec.3(1) of Central Excise Act, in case of sale by EOU Units, duty payable in case of DTA shall be equal to aggregate of duties of customs which would be payable under Customs Act, if the goods are imported into India.

Though ‘tariff rate’ of excise duty payable is equal to aggregate of duties of Customs, there is partial exemption under Excise Notification No.23/2003- CE dt.31.3.2003.

The excise duty payable for sale in India is at the rate of 50% of aggregate duties of customs payable if these were imported or normal excise duty payable if these were produced in India, whichever is higher.

Part B

6(a)(i) – Import and Importer

As per Sec.2(23) means, bringing into India from a place outside India. Sec.2(27) of Customs Act defines 'India' as inclusive of territorial waters. Hence, it was thought that 'import' is complete as soon as goods enter territorial waters

As per Sec.2(26) of the Customs Act, 'Importer' in relation to any goods at any time between their transportation and the time when they are cleared for home consumption includes any owner or any person holding himself to be the importer. Thus 'importer' may or may not be 'owner' of goods.

6(a)(ii) – Assessment

Section 17(1) of Customs Act provides that assessment of goods will be made after Bill of Entry is filed. Goods will be examined and tested and then duty leviable on such goods will be assessed. (Sec.17(2) of Customs Act). Assessment can be made before examination or testing of goods on the basis of statements made in Bill of Entry and document produced. Examination and testing of goods will be done subsequently (Sec.17(4)). Assessment includes provisional assessment, reassessment and order of assessment in which the duty assessed is Nil.

6(b)(i) As per Rule 2(a) any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this rule) presented unassembled or dis-assembled.

This rule lays emphasis on the essential character of the goods. Thus goods which have the essential character of finished goods will be classified under the same heading in which final product has to be classified.

In the given case, the passenger components as such cannot be treated as finished product as it is in a completely knocked down condition. The basic requirement of incomplete or unfinished article should have the essential character of finished goods is missing here. Unless manufacturing and further activity is carried out on the Passenger Car Components, the final product viz., Motor Car will not come into existence. Otherwise, the components as such does not have the essential character of finished goods as it has to undergo manufacturing process and only after the said process, final product will be manufactured. Therefore, the CKD packs which were cleared has to be classified only as Components of Motor Cars and cannot be considered as Motor Cars as such for the purpose of clearance. In fact, in the decision of TELCO Vs. CC 1990 (50) ELT T-B2 it was held that synchrocones are components of automobiles. Forgings for synchrocones cannot be treated as parts of automobiles in view of extensive operations to be carried on, on the forgings. In view of that it cannot be said that they have the essential character of finished product. The said decision is squarely applicable to this case.

6(b)(ii) Yes. India Car is entitled for claiming exemption under Notification as the said exemption is applicable if the components of motor cars is imported in semi-knocked down and completely knocked down condition. Whatever is imported in this case is CKD packs of Motor Cars only and as the condition stipulated in the notification is fulfilled, the company is entitled to claim exemption.

6(c)(i) The statement is not correct. Under Rule 9 of Customs Valuation (Determination of price of Imported Goods) Rules, 1988, it has been provided under Rule 9(2)(a) that all expenses incurred by the importer in bringing the goods to the landmass of the country will be includible in the assessable value (Clarified vide Ministry of Finance (DF) Circular NO.29/2004-Cus. dated 13.4.2004). Therefore, the service charges paid to Canalizing Agent will come within the category of all expenses incurred by the importer in bringing the goods and it is includible in the Assessable Value of the import.

6(c)(ii) This statement is also not correct. Under Rule 9(1)(b)(iv) of CV(DPIG) Rules, 1988 engineering, development, art work, design work and plans and sketches undertaken elsewhere than in India and necessary for the production of imported goods is required to be added to the Assessable Value. Therefore, it is not correct to state that the design and engineering charges are includible if they are specially manufactured out of specification provided by the importer as if it is manufactured at any place other than India irrespective of the specification or requirement, it has to be included in the Assessable Value.

6(c)(iii) This statement is correct. Only if the contract specifies for certification by independent agency, inspection charges are includible in the Assessable Value. It has been provided under Rule 9(1)(e) of CV(DPIG) Rules, 1988, it has been provided that all other payments actually made or to be made as a condition of sale of the imported goods by the buyer to the seller or by the buyer to a third party to satisfy an obligation of the seller to the extent that such payments are not included in the price actually paid or payable

6(c)(iv) The statement is not correct. Exemption from Customs Duty does not automatically mean exemption from additional duty. If a notification exempts basic customs duty, it does not mean that CVD is automatically exempted. This has been held in the case of UOI Vs. Modi Rubber Ltd. – 1986(25)ELT 849 (SC). Further, CVD is leviable under Sec.3(1) of Customs Tariff Act, while Customs duty is levied under Sec.12 of Customs Act. These are two separate independent duties under different statutes.

6(d)(i)(a) As per Sec.125(1) of Customs Act, whenever confiscation of goods is ordered, the adjudicating officer may give option to owner of goods to pay 'fine' in lieu of confiscation. If the importation or exportation of the goods are not prohibited, the option to pay redemption fine shall be given to the owner of the goods and this is called redemption fine.

(b) No. The fine once paid cannot be claimed as refund if the importer decides to abandon the goods. After goods are confiscated, these becomes the property of Central Government and Central Government can sell/auction the goods. The goods are released only on the basis of redemption fine. The assessee can resort appeal proceedings against such redemption fine paid only in cases where the imported goods are not required to be confiscated and only when they prove their eligibility, the adjudicating authority depending on the genuineness of the case may either waive or reduce the redemption fine. It is only the discretion of the Appellate / Adjudicating Authority and it is not possible in cases where the importer himself wants to abandon the goods after payment of redemption fine.

6(d)(ii) Sec.89 of the Customs Act covers the case of indigenous goods, which are supplied to a vessel as ship stores. It states that the goods produced or manufactured and required as stores on foreign going vessel or aircraft may be exported free of duty in such quantities as the proper officer may determine having regard to the size of the vessel or aircraft, the number of passengers and the crew and the length of the voyage or journey on which the vessel or aircraft is about to depart. Further, duty free supply of ship stores should be reasonable and not in commercial quantities.

7(a) There is no customs duty on personal effects. One laptop computer can be brought without payment of Customs Duty. The General Free Allowance cannot be pooled i.e, husband and wife cannot have combined allowance of Rs.50,000 in respect of one item, though individually they are eligible for General Free Allowance of Rs.25,000 each. Thus, they are eligible for general free allowance of Rs.25,000. They have to pay duty on Rs.27,000 (Rs.52,000-Rs.25,000) @ 35% i.e., Customs Duty Payable is Rs.9,450 plus Education Cess of Rs.189 plus SAH Education Cess of Rs.94.50

7 (b) (i) – Remission of duty on imported goods lost

Sec.23(i) of Customs Act provides for remission of duty on imported goods lost (other than pilferage) or destroyed, if such los or destruction is at any time before clearance for home consumption. It has been held that remission of duty has to be allowed if goods were lost or destroyed for any reason at any time before clearance.

7 (b)(ii) – Pilfered Goods

Sec.13 provides that if imported goods are pilfered after unloading but before order for clearance is passed by Customs Officer for clearance for home consumption or deposit in a warehouse, no duty is payable on the goods unless the pilfered goods are restored to the importer.

7 (c) – Requirement to be satisfied to accept 'Transaction Value' under Customs Act

The value of imported goods shall be the transaction value subject to rules 9 and 10A (rule 3(i)). If value cannot be determined as per rule 3(i), it shall be determined by preceding sequentially through rules 5 to 8 of Valuation rules.

Transaction Value, i.e, the price at which such goods are actually sold is the primary method and is expected to be used in majority of cases. However, some times, transaction value of some goods cannot be accepted as the conditions prescribed for accepting such value are not fulfilled (e.g., no abnormal discount, sale in competitive conditions, uncondito9nal sale from un-related person, no restriction on use etc.) Occasionally, transaction value may not be available when actual sale does not take place. For example, actual transaction value for goods imported on lease, hire, loan or gift may not be available. In such cases, other methods to be used.

8(a) Yes. The stand taken by the Tribunal is correct. In view of the Supreme Court decision in the case of Flock India Pvt. Ltd. – 2000 (120) ELT 285 (SC) – it has been held that if an appealable order passed by an authority is not challenged by filing an appeal, it is not open to the assessee to question the correctness of the order subsequently by filing the refund claim. Further, Ministry of Finance vide Circular No.24/2004-Cus. dt.18.3.2004 has clarified that refund claim is not maintainable when assessment order is not challenged.

In this case, M/s.ABC Limited is very well aware of the fact that when the duty was made payable on certain imports and if they had substantial ground that duty was not payable, then they should have resorted to filing an appeal against the said assessment order. Though they remitted the duty payment under protest which will only facilitate non-denial of refund claim on time limit aspect, the non-challenging of assessment order will not entitle them to resort to refund route.

Even if they file an appeal against the Order of the Tribunal before the higher Courts, the chances of their success in this case is very remote and hence, M/s.ABC Ltd has no option other than to treat this issue as closed.

8(b) – Warehousing Period

The warehousing period for capital goods and other goods used in 100% EOU is 5 years and 3 years respectively and for the rest of the goods it is one year.

The power to extend the warehousing period beyond 5 years / 3 years has been delegated to the Commissioner of Customs for such further period as he may deem fit. The period of 1 year can be extended by the Commissioner of Customs for further 6 months. However, for further extension, authorization of Chief Commissioner of Customs is required.

The goods that are likely to deteriorate fall under the category of "others" alone. Their warehousing period can be reduced to a shorter period by the Commissioner of Customs.

8(c) – Residual Method of Valuation

Under Rule 8(1) of CV(DPIG) Rules, 1988 subjection to provisions of rule 3, where the value of imported goods cannot be determined under any of the provisions of any preceding rules, the value shall be determined as per Sec.14(1) of Customs Act, 1962.

Under Rule 8(2) no value shall be determined under the provisions of this rule on the basis of –

(i) the selling price in India of the goods produced in India;

(ii) a system which provides for the acceptance for customs purposes of the highest of the two alternative values;

(iii) the price of the goods on the domestic market of the country of exportation

(iiia) the cost of production other than computed values which have been determined for identical or similar goods in accordance with the provisions of rule 7A;

(iv) the price of the goods for export to a country other than India

(v) minimum customs values; or

(vi) arbitrary or fictitious value;

Part C

9 (a)(i) Yes. Service Tax is payable under "Intellectual Property Right Service". As per Section 65(105)(zzr) any service provided or to be provided by any person by the holder of intellectual property right, in relation to intellectual property service is 'taxable service'.

As per Sec.65(55a), 'intellectual property right' means any right to intangible property, namely trademarks, designs, patents or any other similar intangible property under any law in force, but does not include any copyright.

Hence, temporary transfer of intellectual property right is liable to Service Tax under IPR Service.

9(a)(ii) Yes. Service Tax is payable under "Outdoor Caterer's Service". Outdoor catering services are taxable if these are provided at a place provided by way of tenancy or otherwise by the person receiving such services. In case of canteens in factory or offices given on contract to canteen contractor, the space is provided to canteen contractor by the owner, either free or at nominal rent. Such canteen contractors will get covered under the new definition, if the service is received by the employer. However, if the service is directly provided to employees, / workmen, then the canteen will not come within the new definition, since the place is not provided by the person receiving the service.

9(a)(iii) No. Service Tax not applicable. Services of Commission Agents in relation to sale or purchase of agriculture produce are exempt from Service Tax vide Notification No.13/2003 – ST dated 20.6.2003. As per explanation (ii) to Notification No.13/2003, 'agricultural produce' means any produce resulting from cultivation or plantation, on which either no processing is done or such processing is done by cultivator like tending, pruning, cutting, harvesting, drying which does not alter its essential characteristics but makes it only marketable. It includes all cereals, pulses, fruits, nuts and vegetables, spices, copra, sugarcane, jaggery, raw vegetable fibres such as cotton, flax, jute etc. indigo,un-manufactured tobacco, betel leaves, rice coffee and tea. However, it does not include manufactured products such as sugar, edible oils, processed food, processed tobacco.

9 (b) If an assessee does not maintain separate accounts, he can utilize Cenvat only upto 20% of tax payable on taxable output service. Mr.Ajay can utilize credit of Rs.28,000 of his input service for payment of output service and balance of Rs.1,12,000 he needs to pay in cash. However, he is entitled to avail Credit of Rs.72,000 in his Service Tax (Receivable) account and it may remain in his account. He can utilize the same in future, only if any opportunity arises.

9 (c) Rule 6(1) of Service Tax Rules make it clear that Service Tax is payable on value of taxable services received. Thus, if the service provider does not receive any payment from his customer, there is no liability of service tax. Service tax is payable on *'value of taxable service'* actually 'received', and not on amount '*billed'.*

If the service receiver does not pay full amount of bill and pays less amount, then proportionately less tax is payable.

In case of (i) Ajay received a payment of Rs.26,000 on 28.4.2008, though the bill was raised on the month of Mar. 2008. Ajay is liable to effect Service Tax payment on the 5th of May, 2008 to be calculated as under;-

Assessable Value (AV) is equal to Z:

AV	=	26,000 Z
Duty @ 12.36%	=	0.1236 X Z
Sub-total	=	1.1236 X Z
1.1236Z	=	26,000
Hence, Z	=	26,000 / 1.1236
i.e, Z or AV	=	Rs.23139.91
Service Tax	=	Rs.2776.79
Education Cess	=	Rs.55.53
SAH Cess	=	Rs.27.77

In case (ii) also, the same calculation needs to be made. The amount received by him should be considered as inclusive of Service Tax amount and the same calculation needs to be made

Assessable Value (AV) is equal to Z:

AV	=	25,000 Z
Duty @ 12.36%	=	0.1236 X Z
Sub-total	=	1.1236 X Z
1.1236Z	=	25,000
Hence, Z	=	25,000 / 1.1236
i.e, Z or AV	=	Rs.22,249.91
Service Tax	=	Rs.2669.99
Education Cess	=	Rs.53.40
SAH Cess	=	Rs.26.70

Therefore, in case (i) Mr.Ajay's invoice value is Rs.23,140 and in (ii) Rs.22,250

In both the cases, he has to pay the Service Tax with Cess on 5th of April, 2008.

9 (d)(i) Under Import of Services Rules - Rule 4 of Taxation of Services (provided from Outside India) and Received in India) Rules, 2006 state that the recipient of taxable service provided from outside India and received in India shall apply for registration depending on the category of service under which it is classifiable under Import of Services Rules and if it is liable under the said category, then the Service Receiver has to effect the Service Tax Payment on behalf of the Service Provider.

In the instant case, though both the Service Provider and Service Receiver is located abroad and Services also consumed abroad, since the payment is made by the Holding Company of the located in India, the nature of service needs to be analysed.

However, the test of Import of Services Rules needs to be made here 1) Services in relation to Immovable Property 2) Services to be performed in India in part atleast prescribed 3) Services received by recipient located in India and 4) Services which never be treated as Import of Services. If the services rendered is classifiable under the category listed in (3) above, irrespective of the fact that both the service provider and service receiver in India, the Services will be liable to Service Tax and Holding Company in India needs to get themselves registered under the required category and has to effect Service Tax payment.

9(d)(ii) In some cases, a person liable for paying service tax on a taxable service

(i) provides such service from more than one premises or offices; or

(ii) receives such service in more than one premises or offices; or

(iii) is having more than one premises or offices which are engaged inr elation to such service in any other manner, making such person liable for paying service tax.

In such cases, such person can obtain Centralised Registration at his option if (a) he has centralized bill system or centralised accounting system in respect of such service, and (b) such centralized billing or centralized accounting system are located in one or more premises.