

Suggested Answers

Final (New) Examination

Group II

November, 2009



Board of Studies
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

**SUGGESTED ANSWERS TO QUESTIONS SET AT THE
FINAL (NEW) EXAMINATION – GROUP II
NOVEMBER, 2009**



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

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Summary of Examiners' comments on the performance of the candidates

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Answer all question

Working notes should form part of the answer

Question 1

- (a) Lee Electronic manufactures four types of electronic products, A,B,C and D. All these products have a good demand in the market. The following figures are given to you:

	A	B	C	D
Material cost (Rs./u)	64	72	45	56
Machining Cost (Rs/u @ Rs. 8 per hour)	48	32	64	24
Other variable costs (Rs/u)	32	36	44	20
Selling Price (Rs/u)	162	156	173	118
Market Demand (Units)	52,000	48,500	26,500	30,000

Fixed overhead at different levels of operation are :

Level of operation (in production hours)	Total fixed cost (Rs.)
Upto 1,50,000	10,00,000
1,50,000 – 30,00,000	10,50,000
3,00,000 – 4,50,000	11,00,000
4,50,000- 6,00,000	11,50,000

At present, the available production capacity in the company is 4,98,000 machine hours. This capacity is not enough to meet the entire market demand and hence the production manager wants to increase the capacity. The company wants to retain the customers by meeting their demands through alternative ways. One alternative is to sub-contract a part of its production. The sub-contract offer received as under :

	A	B	C	D
Sub-contract Price (Rs./u)	146	126	155	108

The company seeks your advice in terms of products and quantities to be produced and/or sub-contracted, so as to achieve the maximum possible profit. You are required to also compute the profit expected from your suggestion. (18 Marks)

- (b) Explain briefly the concept of skimming pricing policy. (2 Marks)

Answer

(a)

Demand	52,000	48,500	26,500	30,000
	A	B	C	D
Direct Material	64	72	45	56

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M/c	48	32	64	24
Other Variable Cost	<u>32</u>	<u>36</u>	<u>44</u>	<u>20</u>
Total Variable Cost	<u>144</u>	<u>140</u>	<u>153</u>	<u>100</u>
Selling Price	162	156	173	118
Contribution (Rs./u)	18	16	20	18
M/s Hours per unit	6	4	8	3
Contribution (Rs./ M/c hr.)	<u>3</u>	<u>4</u>	<u>2.5</u>	<u>6</u>
Ranking	III	II	IV	I
Sub-Contract Cost Rs./u)	146	126	155	108
Contribution (Rs./u) on (Sub-Contract)	16	30	18	8

I Division: It is more profitable to sub-contract B, since contribution is higher sub-contract.

1st Level of Operations: 1,50,000 hours, Produce D as much as possible.

Hours required = 30,000 units × 3 = 90,000 hours

Balance hours available: 60,000 hours.

Produce the next best (i.e. A, Since B is better outsourced)

$$\frac{60,000 \text{ hrs}}{6 \text{ hrs/u}} = 10,000 \text{ units of A.}$$

1st Level of Operation:

		<i>Contribution (units)</i>	<i>Contribution (Rs.)</i>
A	Produce 10,000 units	18	1,80,000
A	Outsource 42,000 units	16	6,72,000
B	48,500 units		
	Outsource fully	30	14,55,000
C	26,500 units		
	Outsource fully	18	
D	30,000 units		
	Fully produce	18	5,40,000
	Total Contribution:		33,24,000
	Less: Fixed cost		10,00,000
	Net Gain		23,24,000

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2nd Level of Operation:

Both A and C increase contribution by own manufacture only by Rs.2/- per unit. 1,50,000 hrs can produce 25,000 units of A.

∴ Contribution increases by $25,000 \times 2 = 50,000$

(Difference in Contribution sub-contract and own manufacturing) = 2

But increase in fixed Cost = 50,000

At the 2nd level of operation, the increase in contribution by own manufacturing is exactly set up by increase in fixed costs by Rs.50,000/-. It is a point of financial indifference, but other conditions like reliability or possibility of the sub-contractor increasing his price may be considered and decision may then be towards own manufacture.

3rd Level Additional: 1,50,000 hrs available

Unit of A that are needed = $[52,000 - 25,000 \text{ (2nd Level)} - 10,000 \text{ (1st Level)}]$

= $17,000 \text{ units} \times 6 \text{ hrs/u} = 1,02,000 \text{ hrs.}$

Balance 48,000 hrs are available for C to produce 6,000 units.

Increase in Contribution over Level 1st or 2nd :

A: $17,000 \times 2 = \text{Rs. } 34,000$

C: $6,000 \times 2 = \underline{\text{Rs. } 12,000}$

= Rs.46,000

Increase in fixed costs = Rs.50,000

Additional Loss = Rs. 4,000

4th Level Additional: 1,50,000 hrs can give $\frac{1,50,000}{8} = 18,750$ unit of C.

Increase in Contribution $18,750 \times 2 = \text{Rs. } 37,500$

Increase in Cost = (Rs. 50,000)

Level 3rd loss c/fd = (Rs. 4,000)

Level 1st profit will order by = (Rs. 16,500)

Advice: Do not expand capacities; sell maximum

No. of units by operating at 1,50,000 hrs. capacity (level 1st) and gain Rs.23,24,000.

Summary:

Product	Produce (Units)	Sub-Contract (Units)	Contribution (Production)	Contribution (Sub-Contract)	Total Contribution
A	10,000	42,000	1,80,000	6,72,000	8,52,000
B	-	48,500	-	14,55,000	14,55,000

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C	-	26,500	-	4,77,000	4,77,000
D	30,000	-	5,40,000	-	5,40,000
					33,24,000
Fixed Cost					10,00,000
Profit					23,24,000

(b) Skimming Pricing Policy:

When the product enters the market, a high price is charged so that price covers the initial cost of production and the demand is unknown e.g. Mobile Phones, Flat LCD TVs, etc. Price are gradually reduced.

Question 2

- (a)** A bank offers three products, viz., deposits, Loans and Credit Cards. The bank has selected 4 activities for a detailed budgeting exercise, following activity based costing methods.

The bank wants to know the product wise total cost per unit for the selected activities, so that prices may be fixed accordingly.

The following information is made available to formulate the budget:

	Activity	Present Cost (Rs.)	Estimation for the budget period
(i)	ATM Services:		
	(a) Machine maintenance	4,00,000	(all fixed, no change)
	(b) Rents	2,00,000	(fully fixed; no change)
	(c) Currency Replenishment Cost	1,00,000	(expected to double during budget period)
		7,00,000	(This activity is driven by no. of ATM transactions)
(ii)	Computer Processing	5,00,000	(Half this amount is fixed and no change is expected) (The variable portion is expected to increase to three times the current level). This activity is driven by the number of computer transactions.
(iii)	Issuing Statements	18,00,000	Presently, 3 lac statements are made. In the budget period, 5 lac statements are expected; For every increase of one lac statement, one lac rupees is the

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- (iv) Computer Inquiries 2,00,000 *budgeted increase (this activity is driven by the number of statements)*
Estimated to increase by 80% during the budget period. (This activity is driven by telephone minutes).

The activity drivers and their budgeted quantifies are given below:

	Deposits	Loans	Credit Cards
No. of ATM Transactions	1,50,000	-	50,000
No. of Computer Processing Transactions	15,00,000	2,00,000	3,00,000
No. of Statements to be issued	3,50,000	50,000	1,00,000
Telephone Minutes	3,60,000	1,80,000	1,80,000

The bank budgets a volume of 58,600 deposit accounts, 13,000 loan accounts, and 14,000 Credit Card Accounts.

You are required to:

- (i) Calculate the budgeted rate for each activity.
(ii) Prepare the budgeted cost statement activity wise.
(iii) Find the budgeted product cost per account for each product using (i) and (ii) above. (12 Marks)
- (b) How do you know whether an alternative solution exists for a transportation problem? (4 Marks)

Answer

(a) Budget Cost Statement

Activity	Activity Cost (Rs.) (Budgeted)	Activity Driver	No. of Units of Activity Driver (Budget)	Activity Rate (Rs.)	Deposits	Loans	Credit Cards
1. ATM Services	8,00,000	ATM Transaction	2,00,000	4	6,00,000	-	2,00,000
2. Computer Processing	10,00,000	Computer Transaction	20,00,000	0.50	7,50,000	1,00,000	1,50,000
3. Issuing Statements	20,00,000	No. of Statements	5,00,000	4.00	14,00,000	2,00,000	4,00,000
4. Customer Inquiries	3,60,000	Telephone Minutes	7,20,000	0.50	1,80,000	90,000	90,000
Budgeted Cost	41,60,000				29,30,000	3,90,000	8,40,000
Units of product as estimated in the budget period					58,600	13,000	14,000
Budgeted Cost per unit of the product					50	30	60

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Working Notes:

- (i) ATM $4,00,000 + 2,00,000 + 2 \times 1,00,000 = 8,00,000$
- (ii) Computer $5,00,000$ (Fixed = 2,50,000) Variable = 10,00,000
 $2,50,000$ increase to 3 times = 7,50,000
- (iii) Issuing Statements $2,00,000 + 80\% \times 2,00,000 = 2 + 1.6 = 3,60,000$.

(b) The Δ_{ij} matrix = $\Delta_{ij} = C_{ij} - (u_i + v_j)$

Where c_i is the cost matrix and $(u_i + v_j)$ is the cell evaluation matrix for allocated cell.

The Δ_{ij} matrix has one or more 'Zero' elements, indicating that, if that cell is brought into the solution, the optional cost will not change though the allocation changes.

Thus, a 'Zero' element in the Δ_{ij} matrix reveals the possibility of an alternative solution.

Question 3

- (a) Hind Metals Manufactures an alloy product 'Incop' by using iron and Copper. The metals pass through two plants, X and Y. The company gives you the following details for the manufacture of one unit of Incop :

Materials	Iron: 10 kgs @ Rs.5 per kg. Cooper: 5 kg @ Rs.8 per kg.
Wages	3 hours @ Rs.15 per hour in Plant X 5 hours @ Rs.12 per hour in Plant Y
Overhead recovery	On the basis of direct labour hours
Fixed overhead	Rs.8 per hour in Plant X Rs.5 per hour in Plant Y
Variable overhead	Rs.8 per hour in Plant X Rs.5 per hour in Plant Y
Selling overhead :	(fully variable) – Rs.20 per unit

- (i) Find out the minimum price to be fixed for the alloy, when the alloy is new to the market. Briefly explain this pricing strategy.
- (ii) After the alloy is well established in the market. What should be the minimum selling price? Why? (6 Marks)
- (b) What are the critical success factors for the implementation of a "Total Quality Management" programme? (5 Marks)
- (c) How can value analysis achieve cost reduction? (5 Marks)

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Answer

(a)	Rs./u of alloy
<i>Materials:</i>	
Iron 10kg @ Rs.5/-	50
Copper 5 kg @ Rs.8/-	<u>40</u> 90
<i>Wages</i>	
X : 3 hrs @ 15 Rs./Hr.	45
Y : 5 hrs @ 12 Rs./Hr	<u>60</u> 105
<i>Variable OH (Production)</i>	
X : 8 hrs × 3 hrs	24
Y : 5 hrs × 5 hrs	<u>25</u> 49
<i>Variable OH – Selling</i>	<u>20</u>
<i>Total Variable Cost</i>	264
<i>Fixed Off:</i>	
X : 8/hrs × 3 hrs.	24
Y : 5/hrs × 5 hrs	<u>25</u> 49
<i>Total Cost</i>	<u>313</u>

- (i) If pricing strategy is to penetrate the market, the minimum price for a new product should be the variable cost i.e. Rs.264/-. In some circumstances, it can also be sold below the variable cost, if it is expected to quickly penetrate the market and later absorb a price increase. Total Variable Cost is the penetration price.
- (ii) When the alloy is well established, the minimum selling price will be the total cost – including the fixed cost i.e. Rs.313 per unit. Long run costs should cover at least the total cost.
- (b) Critical success factors of TQM:
- Focus on customer needs.
 - Everyone in the organisation should be involved.
 - Focus on continuous improvement.
 - Design quality in product and production process.
 - Effective performance measurement system.
 - Rewards and performance measurements should be renewed.
 - Appropriate training and education to everyone to understand the aim of TQM.

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(c) Value analysis can do cost reduction in the following manner:

- By identifying and removing unnecessary components in a product which had utility earlier.
- By introducing component substitution at a lesser cost without affecting the quality of the product.
- By simplifying the product design.
- By introducing alternative methods with less cost but improved efficiency.

Question 4

(a) *Optically Ltd. makes two kinds of products, P (lenses) and Q (swimming goggles) in divisions P and Q respectively. P is an input for Q and two units of P are needed to make one unit of Q.*

The following data is given to you for a period :

	<i>P</i> <i>Rs./u of P</i>	<i>Q</i> <i>Rs./u of Q</i>
<i>Direct Materials</i>	20	25 (excluding P)
<i>Direct Labour</i>	30	35
<i>Variable Overhead</i>	10	20
<i>External Demand (units)</i>	3,000	3,000
<i>Capacity (units)</i>	7,000	2,500
<i>Selling Price Rs./u (outside market)</i>	100	410

If Q buys P from outside, it has the following costs:

For order quantity 2,499 or less Rs.90 per unit for the entire quantity ordered.

For order quantity 2,500 – 5,000 Rs.80 per unit for the entire quantity ordered.

For order quantity more than 5,000 Rs.70 per unit for the entire quantity ordered.

You are required to:

- (i) *Evaluate the best strategies for Division P and Q.*
 - (ii) *Briefly explain the concept of goal congruence.* (12 Marks)
- (b) *In an assignment problem to assign jobs to men to minimize the time taken, suppose that one man does not know how to do a particular job, how will you eliminate this allocation from the solution?* (4 Marks)

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Answer

(a)

Opticals Ltd manufactures P(lenses) and Q (swimming goggles).

Division P has option to supply to Division Q or sell to outside market.

Division Q has option to buy from Division P or purchase from outside market.

However, both divisions have to work within their individual capacity.

Variable Cost for product P in Division P = Rs 60.

Variable cost for product Q in Division Q (excluding 2 Nos P's) = Rs 80.

Division P has better market price of its product P than the market price offered to Q division.

For maximizing profit of the organization : Rs

P division should optimise its profit by selling maximum units to outside market.

Contribution per unit for sale to outside for division P 40

Contribution per unit for Div Q as follows :

Sale price - Variable cost (excluding lenses) 330

Max Contribution per unit (if procured from P div at its variable cost i.e Rs 60) 210

Min Contribution per unit (if procured at Rs 90 per unit from outside) 150

Contribution per unit at transfer price of Rs 70 i.e minimum market price 190

Option 1 : Division Q buys 5001 units from market @ Rs 70 and meets its capacity. Division P sells 3000 units to outside market @ Rs 100

Sale / Transfer	Contrib. /unit	Contribution in thousand rupees		
		Rs P Div	Q Div	Total
DivP :Sale of 3000 units to outside market @ Rs 100	40	120		120
DivQ: Sale of 2500 units with P from market @ Rs 70	190		475	475
Less : cost of rejection of one unit of product P			-0.07	-0.07
Total		120	474.93	594.93

Option 2 : Division P sells 3000 units to outside market, transfer 4000 units to div Q and Division Q buys 1000 units from outside market to work within the capacity

P Division agrees to a transfer price so that profitability of Q is not affected. To maintain the same profitability of Q, contribution required from 2000 units for Div Q is Rs 400,000 i.e contribution per unit Rs 200 i.e transfer price per unit of P is Rs 65 per unit to make cost of lenses Rs 130

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Sale / Transfer	Contrib /unit	Contribution in thousand rupees		
	Rs	P Div	Q Div	Total
Div P : Sale of 3000 units to outside market	40	120		120
Div P : Transfer of 4000 units to div Q at Rs 65	5	20		20
Div Q :Sale of 2000 units with P from P div @ Rs 65	200		400	400
Div Q : Sale of 500 units with P from market @ Rs 90	150		75	75
Total		140	475	615

Under Option 1, both divisions worked dis-jointly without caring for capacity utilization resulting lower profitability of the organization.

Under Option 2, both divisions worked with mutual advantages for optimizing their individual profits and overall profit for the organization has gone up by effective utilization of capacity.

Product P from Division P fetches higher price from open market indicating good quality of product. Moreover, supply from P division is well assured in the long run which is the justification of establishment of two parallel divisions.

Hence, Option 2 is suggested.

- (ii) Division functioning as profit centers strive to achieve maximum divisional profits, either by internal transfers or from outside purchase. This may not match with the organisation's objective of maximum overall profits. Divisions may be commercial to advice overall objects objectives, where divisional decisions are in line with the overall best for the company, and this is goal congruence. Divisions at a disadvantage may be given due weightage while appraising their performance. Goal incongruence defeats the purpose of divisional profit centre system.
- (b) In an assignment minimization problem, if one task cannot be assigned to one person, introduce a prohibitively large cost for that allocation, say M, where M has a high the value. Then, while doing the row minimum and column minimum operations, automatically this allocation will get eliminated.

Question 5

(a) The following information relates to labour of x Ltd.

Type of Labour	Skilled	Semi Skilled	Unskilled	Total
No. of workers in standard gang	4	3	2	9
Standard rate per hour (Rs)	6	3	1	-
Number of workers in actual gang				
Actual rate per hour (Rs.)	7	2	2	-

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In a 40 hours week, the gang produced 270 standard hours.

The actual number of semi-skilled workers is two times the actual number of unskilled workers. The rate variance of semi-skilled workers is Rs.160 (F).

Find the following:

- (i) The number of workers in each category
 - (ii) Total gang variance
 - (iii) Total Sub-efficiency variance
 - (iv) Total labour rate variance
 - (v) Total labour cost variance (10 Marks)
- (b) The following is a linear programming problem. You are required to set up the initial simplex tableau. (Please do not attempt further iterations or solution):

Maximise

$$100x_1 = 80x_2$$

Subject to

$$3x_1 + 5x_2 \leq 150$$

$$x_2 \leq 20$$

$$8x_1 + 5x_2 \leq 300$$

$$x_1 + x_2 \geq 25$$

$$x_1, x_2 \geq 0$$

(6 Marks)

Answer

(a)

	SR	SH		SR	RSH		SR	AH		AR	AH	
Skill	6×	120	720	6×	960	160	6×	120	120	7×	120	840
Semi-Skill	3×	90	270	3×	360	120	3×	160	480	2×	160	320
Unskilled	1×	60	<u>60</u>	1×	<u>80</u>	80	1×	80	<u>80</u>	2×	80	<u>160</u>
			<u>1050</u>		<u>1400</u>				<u>1280</u>			<u>1320</u>
	Sub-efficiency Variance				Gang Variance				Rate Variance			
	350 (A)				120 (F)				40 (A)			
	Cost Variance = 270 (A)											

Workings Note:

Standard hours produced = 270

Standard Mix : $270 \div 9 = 30$

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	<i>Skill</i>	<i>Semi-Skill</i>	<i>Unskilled</i>
Ratio	4:	3:	2:
Hrs.	120	90	60

Actual hrs = $40 \times 9 = 360$ hrs.

Actual hrs in Standard Ratio = 360

4:	3:	2:
$\frac{360}{9} \times 4 = 160$	$\frac{360}{9} \times 3 = 120$	$\frac{360}{9} \times 2 = 80$

$$[(\text{Standard Rate} - \text{Actual Rate}) \text{ Actual hrs.}] = \text{Rate Variance}$$

Semi-skilled = 160

(3 - 2) Actual hrs = 160

Actual hrs = 160 (for semi-skilled)

Actual Semi-skilled = 2 (Unskilled actual)

160 = 2 (Unskilled)

$$\text{Unskilled hrs (actual)} = \frac{160}{2} = 80$$

Total Actual = 360

$$\therefore \text{Actual hrs} - \text{skilled} = 360 - (160 + 80)$$
$$= 360 - 240 = 120$$

Actual Hrs.	Skilled	Semi-skilled	Unskilled
	120	160	80

40 hr week

$$\therefore \quad \frac{120}{40} = 3 \qquad \frac{160}{40} = 4 \qquad \frac{80}{40} = 2$$

No. of Workers

(i) $\begin{matrix} & & 3 & & 4 & & 2 \end{matrix}$

(ii) Gang Variance:

$$= (\text{Actual Hrs in Standard Ratio} - \text{Actual Hrs in Actual Ratio}) \times \text{Standard Rate}$$
$$= 1400 - 1280 = 120 \text{ (F)}$$

(iii) Sub-efficiency Variance:

= Standard Rate (Standard Hrs – Actual Hrs in Standard Ratio)
= 1050 – 1400 = 350 (A)

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(iv) Total Labour Rate Variance:

= Actual Hrs (Standard Rate – Actual Rate)

= 1280 – 1320 = 40 (A)

(v) Labour Cost Variance:

= (Standard Rate × Standard Hrs – Actual Rate × Actual Hrs.)

= 1050 – 1320 = 270 (A)

(b) Under the usual notations where

S1, S2, S3 are stock Variables,

A4 = the artificial variable

S4 = Surplus Variable

We have,

Max. $Z = 100x_1 + 80x_2 + 0S_1 + 0S_2 + 0S_3 + 0S_4 - M A_4$.

S.t.

$3x_1 + 5x_2 + S_1 = 150$

$x_2 + S_2 = 20$

$8x_1 + 5x_2 + S_3 = 300$

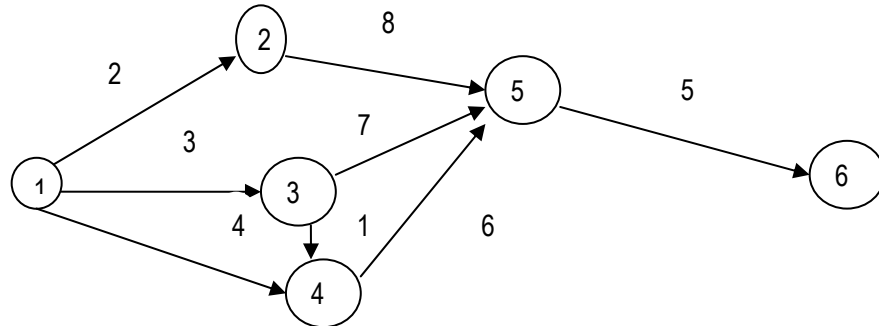
$x_1 + x_2 + - S_4 + A_4 = 25$

		x_1	x_2	S_1	S_2	S_3	S_4	A_4		
Basis	C_j C_B	100	80	0	0	0	0	- M		
S_1	0	3	5	1	0	0	0	0	150	✓
S_2	0	0	1	0	1	0	0	0	20	✓
S_3	0	8	5	0	0	1	0	0	300	✓
A_4	- M	1	1	0	0	0	-1	1	25	✓
Z_j		- M	- M	0	0	0	M	-M	-25M	✓
$C_j - Z_j$		100+M	80+M	0	0	0	-M	0		✓

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Question 6

(a) The following network gives the duration in days for each activity :



- (i) You are required to list the critical paths.
 - (ii) Given that each activity can be crashed by a maximum of one day, choose to crash any four activities so that the project duration is reduced by 2 days. (6 Marks)
- (b) In the past, a machine has produced pipes of diameter 50 mm. To determine whether the machine is in proper working order, a sample of 10 pipes is chosen, for which mean diameter is 53 mm and the standard deviation is 3 mm. Test the hypothesis that the machine is in proper working order, given that the critical value of the test statistic from the table is 2.26. (4 Marks)
- (c) The Gifts Company makes mementos for offering chief guests and other dignitaries at functions. A customer wants 4 identical pieces of hand-crafted gifts for 4 dignitaries invited to its function. (6 Marks)

For this product, the Gifts Company estimates the following costs for the 1st unit of the product

	Rs./unit
Direct variable costs (excluding labour)	2,000
Direct labour (20 hours @ Rs. 50 hour)	1,000

90 % learning curve ratio is applicable and one labourer works for one customer's order.

- (i) What is the price per piece to be quoted for this customer if the targeted contribution is Rs.1,500 per unit?
- (ii) If 4 different labourers made the 4 products simultaneously to ensure faster delivery to the customer, can the price at (i) above be quoted? Why?

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Answer

(a) Critical Paths:

All are critical paths:

$$(i) \quad 1 - 2 - 5 - 6 \quad \quad \quad 2 + 8 + 5 \quad \quad \quad = 15$$

$$(ii) \quad 1 - 3 - 5 - 6 \quad \quad \quad 3 + 7 + 5 \quad \quad \quad = 15$$

$$(iii) \quad 1 - 4 - 5 - 6 \quad \quad \quad 4 + 6 + 5 \quad \quad \quad = 15$$

$$(iv) \quad 1 - 3 - 4 - 5 - 6 \quad \quad \quad 3 + 1 + 6 + 5 \quad \quad \quad = 15$$

(i) Choose 5 – 6, common path;

Crash by 1 day

(ii) Choose: 1 – 2, 1 – 3, 1 – 4

Or

(iii) Choose: 1 – 2, 3 – 5, 4 – 5

Or

(iv) Choose: 2 – 5, 3 – 5, 4 – 5 Or

(v) Choose: 1 – 3, 1 – 4, 2 – 5

(b) Null Hypothesis $H_0 : \mu = 50$ mm i.e. the M/c works properly.

$H_1 : \mu \neq 50$ mm. i.e. the M/c does not work properly

Sample Size = 10, small.

use 't' statistic

$$t = \frac{\bar{x} - \mu}{S / \sqrt{n-1}}$$

$$\bar{x} = 53$$

$$\mu = 50$$

$$n = 10; \sqrt{n-1} = \sqrt{9} = 3$$

$$S = \text{std dev} = 3$$

$$T = \frac{53-50}{3/3} = \frac{3}{1} = 3$$

Table Value = 2.26

Calculated t > table value

Reject H_0

i.e. The M/c is not working properly.

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(c) (i)	<i>Rs/u</i>	
	<i>1st unit</i>	<i>Avg/u after 4th at</i>
Variable Cost	2000	2000
Labour	1000	810
Target Contribution		1500
Price to be quoted		4310 (Rs./u)

- (ii) No, the company cannot quote this price for varying products because the learning curve Ratio does not apply to non-repeated jobs. Each product will carry a different price according to its direct labour hours.

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Answer **all** questions. Each question carries 20 marks.

Question 1

Worldwide, a global telecom company is serving to more than 10 million customers in the area of communications through fixed land lines, mobiles, internet services, digital TV and satellite system etc.

The financial analysts of the company are located in different functional groups in six geographical regions. These analysts are missing the access to the same data, as well as timely access to the information. Dated budget and actual numbers for each business unit reside in seven different systems, separating critical components of the Profit and Loss account and inhibiting analyst's ability to assess results. The problem gets further complicated as the field analysts are not able to go to one universal place to retrieve the data themselves and they have to rely upon the home office for the same.

The objective of the company is to set some critical financial goals so that the company could remain competitive and increase market share.

Read the above carefully and answer the following with justifications:

- (a) To overcome the problems which the financial analysts are facing, what kind of software the company should select? (10 Marks)
- (b) The company is advised that the adoption of BS7799 International Standard will help in overcoming the problems and achieving its goals. Discuss. (5 Marks)
- (c) How should the human resources be enriched for effective utilization of the proposed new systems and standards? (5 Marks)

Answer

- (a) As the financial analysts of the company are working in six different geographical locations and the financial data is stored on seven different systems, located world wide, therefore they are facing several problems. Few of them are as under :

- Missing the access to the same data as well as timely access to information.
- Dated budget and actual numbers for each business unit reside in seven different systems, separating critical components of the profit and loss account thus failing the financial analysts to assess results.
- The field analysts are not able to retrieve the data themselves from one universal place and therefore they have to rely upon the home office for the same.

It is therefore important that the company should buy new software for the solution of the problems as mentioned above.

As far as software is concerned, of course the company should select the one which could make same data available to all the financial analysts. One such software is

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available from Oracle Corporation known as On Line Analytical Processing (OLAP) tool for better control over costs, analyze performance, evaluate opportunities, and formulate future directions. To improve the basis for making decisions quickly and accurately with real time, to provide consistent data which will improve cost control and to simplify and shorten the budgeting process, the software should be capable of the following:

- hands on ability to consolidate budgets, based on actual data in the process,
- enabling business units to make real-time, online decisions based on more accurate information,
- user friendly.

The company is expected to be benefited by significant financial saving and therefore it should reduce the length of the budgeting cycle and the number of people involved in the process, thus keeping the company financially competitive in a growing market. The system should provide online, real time access to the information.

- (b) The **BS 7799** (ISO 17799) consists of 127 best security practices which companies can adopt to build their Security Infrastructure. The model helps the companies to maintain IT security through ongoing, integrated management of policies and procedures, personnel training, selecting and implementing effective controls, reviewing their effectiveness and improvement. The benefits of an Information Security Management Systems (ISMS) tuned to the objective of the company are improved customer confidence, a competitive edge, better personnel motivation and involvement, and reduced incident impact leading to increased profitability.

The company can use BS 7799 for the following reasons:

- Reduced operational risk,
- Increased business efficiency, and
- Assurance that information security is being rationally applied.

This is achieved by ensuring that:

- Security controls are justified.
- Policies and procedures are appropriate.
- Security awareness is good amongst staff and managers.
- All security relevant information processing and supporting activities are auditable and are being audited.
- Internal audit, incident reporting / management mechanisms are being treated appropriately.
- Management actively focuses on information security and its effectiveness.

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(c) The human resources involved in the systems and standards can be enriched by the following activities:

- **Training Personnel:** A system can succeed or fail depending on the way it is operated and used. Therefore, the quality of training received by the personnel involved with the system in various capacities helps in the successful implementation of information system and standards. Thus, training is a major component of systems implementation. When a new system is acquired which often involves new hardware and software, both users and computer experts need training organized by the vendor through hands-on learning techniques.
- **Training Systems Operators:** The effective implementation of new systems and standards also depend on the computer-centre personnel, who are responsible for keeping the equipment running as well as for providing the necessary support services. Their training must ensure that they are able to handle all possible operations, both routine and extra-ordinary. As part of their training, operators should be given a trouble shooting list that identifies possible problems and remedies for them. Training also involves familiarization with run procedures, which involve working through the sequence of activities needed to use a new system on an on-going basis.
- **User training:** User training deals with the operation of the system itself. Training in data coding emphasizes the methods to be followed in capturing data from transactions or preparing data for decision support activities. Users should be trained on data handling activities such as editing data, formulating inquiries (finding specific records or getting responses to questions) and deleting records of data. From time to time, users will have to prepare disks, load paper into printers, or change ribbons on printers. Some training time should be devoted to such system maintenance activities. If a micro computer or data entry system uses disks, users should be instructed in formatting and testing disks.

It is also required to have managers directly involved in evaluating the effectiveness of training activities because training deficiencies can translate into reduced user productivity level.

Question 2

(a) *Identify and justify the type of each one of the following systems based on how they perform within an environment and/or certainty/ uncertainty:*

- (i) *Marketing system*
- (ii) *Communication system*
- (iii) *Manufacturing system*
- (iv) *Pricing system*
- (v) *Hardware-Software system.*

(5 Marks)

(b) *Explain the threats due to Cyber crimes.*

(5 Marks)

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- (c) Discuss 'Physical and Environmental Security with Control and Objectives' with respect to information Security Policy? (5 Marks)
- (d) How does the Information Technology Act, 2000 enable the authentication of records using digital signatures? (5 Marks)

Answer

(a)

System	System Type	Justification
(i) Marketing system	<i>Open System</i>	The marketing system plays a pivotal role in the running of a business in the competitive environment. The objective of the system is to maximize customer satisfaction by providing a free interactive environment. The system takes input/feedbacks and facilitates the outcomes as products of the company and to create new customers.
(ii) Communication System	<i>Open System</i>	The communication system in an organization is a point of contact to balance the external influence and render its services to the customers. The system interacts freely with its environment by taking input and returning output.
(iii) Manufacturing System	<i>Closed System</i>	This system is in place to meet a particular objective. It neither interacts with the environment nor changes with the change in the environment. A manufacturing unit is completely isolated from its environment for its operation.
(iv) Pricing System	<i>Probabilistic and Open System</i>	The system has a probable behavior and interacts freely with its environment by taking inputs and returning outputs. The pricing system is a dynamic one which influences the form of profit and goodwill of an organization.
(v) Hardware-Software System	<i>Closed Deterministic System</i>	The interaction among the various parts of the system is known with certainty and it does not interact with the environment and does not change with the change in the environment. Here the requirements of the hardware and software inventory are known with certainty. The operational state of these systems is predictable.

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(b) Threats due to cyber crimes are given as follows:

- **Embezzlement:** It is unlawful misappropriation of money or other things of value, by the person to whom it was entrusted, for his/her own use or purpose.
- **Fraud:** It occurs on account of intentional misappropriation of information or identifies to deceive others, the unlawful use of credential card or ATM, or the use of electronic means to transmit deceptive information, to obtain either money or other valuable things. Fraudulent may be an employee of the company or outsider.
- **Theft of proprietary information:** It is the illegal capturing of other's documentation or information. Usually it is done by electronic copying. The things illegally copied may be in the form of design, plans, blue prints, codes, computer programs, formulas, trade secrets, graphics, copyrighted material, data, forms, files and personal or financial information etc.
- **Denial of service:** This is the disruption or degradation of external services. This is usually caused by events like ping attacks, port scanning probes and excessive amount of incoming data.
- **Vandalism or sabotage:** It is the deliberate or malicious damage, defacement, destruction or other alteration of electronic files, data, web pages, and programs.
- **Computer virus:** They are hidden computer codes. They are destruction programs. They propagate by inserting themselves or modifying other programs.
- **Others:** Threat includes several other cases such as intrusions, breaches and compromises of the respondent's computer networks.

(c) **Physical and Environmental Security:** This is the beginning point of any security plan. It is designed to prevent unauthorized access, damage and interference to business premises and information. This involves physical security perimeter, physical entry control, creating secure offices, rooms, facilities, providing physical access controls, providing protection devices to minimize risks ranging from fire to electromagnetic radiation, providing adequate protection to power supplies and data cables. Cost effective design and constant monitoring are two key aspects to maintain adequate physical security control.

Maintenance of the physical operating environment in a computer server room is as important as ensuring that paper records are not subject to damage by mould, fire or fading. Supporting equipments such as air conditioning plant etc. should be properly maintained. Physical controls may be difficult to manage as they rely to some extent on building structure, but good physical security can be very effective.

The detailed **control and objectives** for this type of security are:

- *Secure areas:* To prevent unauthorized access, damage and interference to business premises and information,
- *Equipment Security:* To prevent loss, damage or compromise of assets and interruption to business activities, and

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- *General Controls:* To prevent compromise or theft of information and information processing facilities.
- (d) Chapter-II, Section 3 of IT Act, 2000 provides conditions subject to which an electronic record is authenticated by means of affixing digital signature.
- The digital signature is created in two distinct steps. First the electronic record is converted into a message digest by using a mathematical function known as “hash function” which digitally freezes the electronic record thus ensuring the integrity of the content of the intended communication contained in the electronic record.
Any tampering with the contents of the electronic record will immediately invalidate the digital signature.
 - Secondly, the identity of the person affixing the digital signature is authenticated through the use of a private key which attaches itself to the message digest and which can be verified by anybody who has the corresponding public key.
This will enable anybody to verify whether the electronic record is retained intact or has been tampered with; since it was fixed with the digital signature. It will also enable a person who has a public key to identify the originator of the message.

Question 3

- (a) *What analysis should be done for understanding the degree of potential loss (such as reputation damage, regulation effects) of an organization? Enumerate the tasks to be undertaken in this analysis. In what ways the information can be obtained for this analysis?* (10 Marks)
- (b) *Describe Risk Management Process.* (5 Marks)
- (c) *Explain the term “Cryptosystems”. Briefly discuss Data Encryption Standard.* (5 Marks)

Answer

- (a) **Business Impact Analysis (BIA)** should be done for assessing the potential impacts resulting from various events or incidents. It is intended to help in understanding the degree of potential loss which could occur. It covers not only financial loss but also other losses due to reputation damage, regulatory effects, etc.

For BIA, the following tasks are to be undertaken:

1. Identify organizational risks, and to minimize potential threats that may lead to a disaster.
2. Identify critical business processes.
3. Identify and quantify threats/ risks to critical business processes both in terms of outage and financial impact.
4. Identify dependencies and interdependencies of critical business processes and the order in which they must be restored.

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5. Identify the maximum allowable downtime for each business processes.
6. Identify the type and the quantity of resources required for recovery.
7. Determine the impact to the organisation in the event of a disaster, e.g. financial reputation etc.

The information for this analysis can be obtained in many ways, including:

1. Questionnaires,
2. Workshops,
3. Interviews, and
4. Examination of documents.

The BIA Report should be presented to the Steering Committee. This report identifies critical service functions and the timeframe in which they must be recovered after interruption. The BIA Report should be used as a basis for identifying systems and resources required to support the critical services provided by information processing and other services and facilities.

(b) Risk Management Process: The broad Risk Management Process comprises of the following:

1. Identify the technology related risks under the gamut of operational risks.
2. Assess the identified risks in terms of probability and exposure.
3. Classify the risks as systematic and unsystematic.
4. Identify various managerial actions that can reduce exposure to systematic risks and the cost of implementing the same.
5. Look out for technological solutions available to mitigate unsystematic risks.
6. Identify the contribution of the technology in reducing the overall risk exposure.
7. Evaluate the technology risk premium on the available solutions and compare the same with the possible value of loss from the exposure.
8. Match the analysis with the management policy on risk appetite and decide on induction of the same.

(c) Cryptosystems: A cryptosystem refers to a suite of algorithms needed to implement a particular form of encryption and decryption. Typically, it consists of following three algorithms:

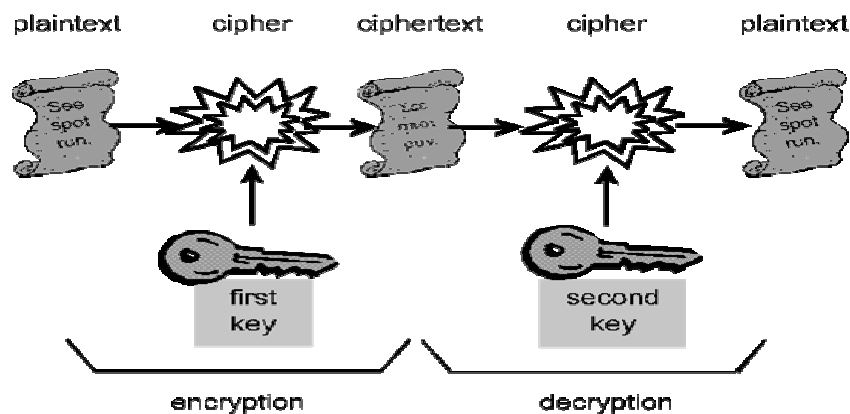
- Key Generation Algorithm,
- Encryption Algorithm and
- Decryption Algorithm.

The pair of algorithms of Encryption and Decryption is referred as Cipher or Cypher.

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Data Encryption Standard (DES): It is a cipher. It is a mathematical algorithm for encrypting and decrypting binary coded information. Encrypting of data converts it to an unintelligible form called cipher. Decrypting cipher converts the data back to its original form called plaintext. Encryption and Decryption operations are done by using a binary number called a key. A key consists of 64(bits) binary digits. Among these 64 bits, 56 bits are used for encryption/decryption and remaining 8 bits are used for error detection. Authorized users of the encrypted data must have the unique key that was used to encipher the data in order to decrypt it. Selection of a different key causes the cipher that is produced for any given set of inputs to be different. The cryptographic security of the data depends on the security provided for the key used to encipher and decipher the data. A standard algorithm based on a secure key thus provides a basis for exchanging encrypted computer data by issuing the key used to encipher it to those authorized to have the data.

The encryption and decryption processes are depicted in the following diagram:



Some documentation distinguishes DES from its algorithms. It refers algorithms as *DEA* (*Data Encryption Algorithm*).

Question 4

- (a) You have been asked to conduct an I.S. Audit for a bank. (i) How will you develop a documented audit program? (ii) What kind of working papers and documentation you will prepare? (10 Marks)
- (b) Explain the basic types of Information Protection that an Organization can use. (5 Marks)
- (c) Discuss the three processes of Access Control Mechanism, when an user requests for resources. (5 Marks)

Answer

- (a) (i) The **documented audit program** is developed with the help of following activities:
 - Documentation of the IS auditor's procedures for collecting, analysing, interpreting, and documenting information during the audit.

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- Objectives of the audit.
- Scope, nature, and degree of testing required to achieve the audit objectives in each phase of the audit.
- Identification of technical aspects, risks, processes, and transactions which should be examined.
- Procedures for audit will be prepared prior to the commencement of audit work and modified, as appropriate, during the course of the audit.

(ii) Audit Working Papers and Documentation

Working papers should record the audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained. All significant matters which require the exercise of judgment, together with the auditor's conclusion thereon, should be included in the working papers. The form and content of the working papers are affected by matters such as:

- The nature of the engagement
- The form of the auditor's report
- The nature and complexity of client's business
- The nature and condition of client's records and degree of reliance on internal controls.

In case of recurring audits, some working paper files may be classified as permanent audit files which are updated currently with information of continuing importance to succeeding audits, as distinct from the current audit files which contain information relating primarily to audit of a single period.

The permanent audit file normally includes:

- The organization structure of the entity.
- The IS policies of the organization.
- The historical background of the information system in the organization.
- Extracts of copies of important legal documents relevant to audit.
- A record of the study and evaluation of the internal controls related to the information system.
- Copies of audit reports and observations of earlier years.
- Copies of management letters issued by the auditor, if any.

The current file normally includes:

- Correspondence relating to the acceptance of appointment and the scope of the work.
- Evidence of the planning process of the audit and audit programme.
- A record of the nature, timing, and extent of auditing procedures performed, and the results of such procedures.

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- Copies of letters and notes concerning audit matters communicated to or discussed with the client, including material weaknesses in relevant internal controls.
- Letters of representation and confirmation received from the client.
- Conclusions reached by the auditor concerning significant aspects of the audit, including the manner in which the exceptions and unusual matters, if any, disclosed by the auditor's procedures were resolved and treated.
- Copies on the data and system being reported on and the related audit reports.

Working papers are the property of the auditor. The auditor may, at his discretion, make portions of, or extracts from his working papers available to the client. The auditor should adopt reasonable procedures for custody and confidentiality of his working papers and should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal and professional requirements of record retention.

(b) **Types of Information Protection:** The two basic types of information protection that an organization can use are given as follows:

1. Preventative Information Protection, and
2. Restorative Information Protection.

Preventative Information Protection: It is based on use of security controls, which itself is a group of three types of controls such as Physical, Logical, and Administrative.

Physical controls deal with Doors, Locks, Guards, Floppy Disk Access Locks, Cables locking systems to desks/walls, CCTV, Paper Shredders, Fire Suppression Systems,

Logical controls deal with Passwords, File Permissions, Access Control Lists, Account Privileges, Power Protection Systems, and

Administrative controls deal with Security Awareness, User Account Revocation, and Policy.

Restorative Information Protection: If an organization cannot recover or recreate critical information systems in an acceptable time period, the organization will suffer and possibly have to go out of business. Hence, the key requirement of any restorative information system protection plan is that the information systems can be recovered. The claim of back program to backup data automatically cannot be reliable. It has so many problems. The restorative information protection program must address the following:

- Whether the recovery process has been evaluated and tested recently?
- The time taken for restoration,
- The quantum of productivity loss,
- The strict adherence of plan, and
- The time needed to input the data changes since the last backup.

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(c) **Access control mechanism** processes the user request for resources in three steps. They are:

- Identification
- Authentication
- Authorization

The access control mechanisms operate in the following sequence:

1. The users have to identify themselves, thereby indicating their intent to request the usage of system resources,
2. The users must authenticate themselves and the mechanism must authenticate itself, and
3. The users request for specific resources, their need for those resources and their areas of usage of these resources.

The mechanism accesses

- (a) previously stored information about users,
- (b) the resources they can access, and
- (c) the action privileges they have with respect to these resources.

The mechanism verifies this information against the user entries and it then permits or denies the request.

Identification and Authentication: Users identify themselves to the access control mechanism by providing information such as a name, account number, badge, plastic card, finger print, voice print or a signature. To validate the user, his entry is matched with the entry in the authentication file. The authentication process then proceeds on the basis of information contained in the entry, the user having to indicate prior knowledge of the information.

Authorization: There are two approaches to implementing the authorization module in an access control mechanism:

- *Ticket oriented:* In this approach the access control mechanism assigns the users a ticket for each resource they are permitted to access. Ticket oriented approach operates via a row in the matrix. Each row along with the user resources holds the action privileges specific to that user
- *List oriented:* In this approach, the mechanism associates with each resource a list of users who can access the resource and the action privileges that each user has with respect to the resource.

Question 5

(a) *How does the Information Technology Act, 2000 enable the objective of the Government in spreading e-governance?* (5 Marks)

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- (b) *Briefly discuss Black Box Testing.* (5 Marks)
- (c) *Discuss anti-virus software and its types.* (5 Marks)
- (d) *ABC Limited has recently migrated to real-time Integrated ERP System. As an IS Auditor, advice the company as to what kinds of businesses risks it can face?* (5 Marks)

Answer

- (a) In Information Technology Act 2000, chapter III is related with the objective of the government in spreading e-governance. It deals with the procedures to be followed for sending and receiving of electronic records. This chapter contains sections 4 to 10.

Section 4 - This section provides the legal recognition of electronic records.

Section 5 - This section provides the legal recognition of Digital Signatures.

Section 6 – It lays down the foundation of Electronic Governance. It provides that the filing of any form, application or other documents, creation, retention or preservation of records, issue or grant of any license or permit or receipt or payment in Government offices and its agencies may be done through the means of electronic form.

Section 7 – This section provides that the documents, records or information which is to be retained for any specified period shall be deemed to have been retained in the electronic form with the following conditions:

- (i) the information therein remains accessible so as to be usable subsequently,
- (ii) it is retained in its original format ,
- (iii) the details such as origin, destination, dates and time of dispatch or receipt of such electronic record.

Section 8- It provides for the publication of rules, regulations and notifications in the Electronic Gazette.

- (b) **Black box testing:** Black box testing attempts to derive sets of inputs that will fully exercise all the functional requirements of a system. It is not an alternative to white box testing. This type of testing attempts to find errors in the following categories:

- incorrect or missing functions,
- interface errors,
- errors in data structures or external database access,
- performance errors, and
- initialization and termination errors.

Tests are designed to answer the following questions:

- How is the function's validity tested?
- What classes of input will make good test cases?
- Is the system particularly sensitive to certain input values?

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- How are the boundaries of a data class isolated?
- What data rates and data volume can the system tolerate?
- What effect will specific combinations of data have on system operation?

Some of the methods used for test cases are as follows:

- *Equivalence Partitioning*: This method divides the input domain of a program into classes of data from which test cases can be derived. Equivalence partitioning strives to define a test case that uncovers classes of errors and thereby reduces the number of test cases needed. It is based on an evaluation of equivalence classes for an input condition. An equivalence class represents a set of valid or invalid states for input conditions.
- *Boundary Value Analysis (BVA)*: This method leads to a selection of test cases that exercise boundary values. It complements equivalence partitioning since it selects test cases at the edges of a class. Rather than focusing on input conditions solely, BVA derives test cases from the output domain also.
- *Cause-Effect Graphing Techniques*: This technique provides a concise representation of logical conditions and corresponding actions. Causes (input conditions) and effects (actions) are listed for a module and represented in a cause-effect graph. This graph is converted to a decision table rules which are used to derive test cases.

- (c) **Anti-virus Software**: It is a program that is used to detect viruses, and prevent their further propagation and harm.

Three types of anti-virus software are briefly discussed below:

Scanners: Scanners for a sequence of bits called virus signatures that are characteristic of virus codes. They check memory, disk boot sectors, executables and systems files to find matching bit patterns. As new viruses emerge frequently, it is necessary to frequently update the scanners with the data on virus code patterns for the scanners to be reasonably effective.

Active Monitor and Heuristic Scanner: This looks for critical interrupt calls and critical operating systems functions such as OS calls and BIOS calls, which resemble virus action.

Integrity Checkers: These can detect any unauthorized changes to files on the system. These can detect any unauthorized changes to the files on the system. The software performs a “take stock” of all files resident on the system and computes a binary check data called the Cyclic Redundancy Check (CRC). When a program is called for execution, the software computes the CRC again and checks with the parameter stored on the disk.

- (d) The company, ABC Limited may face several new business risks when they migrate to real-time, integrated ERP systems. These risks include the following:

1. *Single point of failure* – All input data of an organization and transaction processing is within one application system.

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2. *Structural Changes* - Significant personnel and organizational structural changes associate with reengineering or redesigning business processes.
3. *Job Role Changes* - Traditional roles of users are changed to empowered-based role. They have more chances to access enterprise information in real-time. This point of control shifts from the back-end financial processes to the front-end point of creation.
4. *Online Real-Time* – This environment requires a continuous business interaction. This warrants the capabilities of utilizing the ERP application and responds quickly to any problem that requires a re-entry of information (e.g., if field personnel are unable to transmit orders from handheld terminals, customer service staff may need the skills to enter orders into the ERP system correctly so the production and distribution operations will not be adversely impacted).
5. *Change Management* - It is challenging to bring together a highly integrated environment when different business processes have existed among business units for long. The level of user acceptance of the system has a significant influence on its success. Training and awareness of users is mandatory, to understand that their actions or inaction have a direct impact upon other users and in the performance of their day-to-day duties.
6. *Distributed Computing Experience* - Inexperience with implementing and managing this kind of environment may pose significant challenges.
7. *Broad System Accessibility* – Increased remote access by users and outsiders and high integration among application functions allow increased access to the application and data.
8. *Dependency on External Assistance* – Organization accustomed to in-house legacy systems may find that they have to rely on external help. Unless such external assistance is properly managed, it could introduce an element of security and resource management risk that may expose the organizations to a greater risk.
9. *Program Interfaces and Data Conversions* - Extensive interfaces and data conversions from legacy systems and other commercial software are necessary. The exposures of data integrity, security and capacity requirements for ERP are much higher.
10. *Audit Expertise* – Specialist expertise is required to effectively audit and control an ERP environment. The relative complexity of ERP systems has created specialization such that each specialist may know only a relatively small fraction of the entire ERP's functionality in a particular core module, e.g. FI auditors, who are required to audit the entire organization's business processes, have to maintain a good grasp of all the core modules to function effectively.
11. *Single sign on* - It reduces the security administration efforts associated with administrating web-based access to multiple systems, but simultaneously introduces additional risks in that an incorrect assignment of access may result in inappropriate access to multiple systems.
12. *Data content quality* - As enterprise applications are opened to external suppliers and customers, the need for integrity in enterprise data becomes paramount.
13. *Privacy and confidentiality* - Regularity and governance issues surrounding the increased capture and visibility of personal information, i.e. spending habits.

PAPER – 7 : DIRECT TAX LAWS

Answer **all** questions.

Question 1

(a) The net profit of ABC Ltd. for the year ending 31.03.2009 amounted to Rs.7,22,000 after debiting/crediting following items:

- (i) Payment of interest on money borrowed from bank for purchase of land and building Rs.2,22,000.
- (ii) Commission Rs.1,00,000 paid in the month of February, 2009 and Rs.1,25,000 paid in March, 2009. Tax deducted at source from the payments was deposited to the Government on 20.09.2009.
- (iii) Travelling expenses of Rs.90,000 on a foreign tour of a director for negotiating collaboration with a foreign manufacturer for initiation of new line of business.
- (iv) Securities transaction tax paid Rs.10,000. Income from trading in shares already credited to profit and loss account Rs.3,82,000.
- (v) As part of the restructuring of its debt, the company has converted arrears of interest of Rs.3,00,000 on term loan into a new term loan with a revised repayment schedule.

The company has paid Rs.50,000 towards such funded interest during the year. Entire Rs.3,00,000 has been debited to profit and loss account. However, out of this, a further sum of Rs.50,000 was paid before the due date of filing of return.

- (vi) Rs.5,00,000, being contribution to S Ltd. (wholly owned subsidiary company) for construction of a school for the benefit of its employees.
- (vii) Provision for gratuity based on actuarial valuation Rs.6,00,000. Actual gratuity paid Rs.1,50,000 was debited to provision for gratuity account.

Other information:

- (1) Provision for bonus for the year 2007-08 paid on 15.11.2008 Rs.98,000. It is inclusive of payment by bearer cheque of Rs.34,000.
- (2) The company has purchased a commercial vehicle of Rs.8,00,000 for the purpose of business on 21.03.2009 and calculated depreciation@15% for the full year. Depreciation debited to the profit and loss account is calculated on all other assets as per the rates prescribed in the Income-tax Act.

The Suggested Answers for Paper 7: - Direct Tax Laws are based on the provisions applicable for A.Y. 2009-10, which is the assessment year relevant for November, 2009 examination.

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- (3) The company collected Rs.3,00,000 from its customers towards sales tax in the year 1996-97 and remitted it to the State Government in due time. On the levy being challenged in the High Court, the Court held the levy as illegal and the State Government refunded the amount to the company in February, 2009. The company refunded Rs.2,00,000 to the customers and the remaining amount of Rs.1,00,000 was shown under the head "current liabilities".

Compute the income chargeable to tax in assessment year 2009-10 and work out the amount of tax payable on such income, ignoring the provisions of section 115JB.

(15 Marks)

- (b) Kalpesh Kumar is a musician deriving income of Rs.75,000 from concerts performed outside India. Tax of Rs.10,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance agreement with that country. His income in India amounted to Rs.2,25,000. Compute tax liability of Kalpesh Kumar for the assessment year 2009-10 assuming he has deposited Rs.10,000 in Public Provident Fund and paid medical insurance premium in respect of his father Rs.20,000. (5 Marks)

Answer

- (a) **Computation of total income and tax liability of ABC Ltd. for A.Y.2009-10**

Particulars	Rs.	Rs.
Profits & Gains of Business of Profession		
Net Profit as per Profit & Loss Account		7,22,000
Add: Items debited but to be considered separately or to be disallowed		
Commission paid in February, 2009, but TDS from such payment deposited after the end of the previous year (Note 2)	1,00,000	
Travelling expenses on foreign tour in connection with new line of business (Note 3)	90,000	
Interest on term loan converted into new term loan (Note 5)	2,00,000	
Provision for gratuity	6,00,000	
Less: Gratuity paid	<u>1,50,000</u> (Note 7)	4,50,000
Depreciation on commercial vehicle (Note 9)	1,20,000	
Sales tax refund not returned to the customers (Note 10)	<u>1,00,000</u>	<u>10,60,000</u>
		17,82,000
Less: Items credited but to be considered separately and those not charged but to be allowed		
Bonus paid on 15.11.2008 in respect of previous year 2007-08 disallowed last year but allowable now (Note 8)	64,000	
Depreciation on commercial vehicle (Note 9)	<u>2,00,000</u>	<u>2,64,000</u>
Business Income		15,18,000

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Deduction under Chapter VI-A	NIL
Total Income	<u>15,18,000</u>
Tax payable @ 30%	4,55,400
Education cess @ 2%	9,108
Secondary and higher education cess@1%	<u>4,554</u>
Total tax payable	<u>4,69,062</u>

Notes:

- (1) As per section 36(1)(iii), interest on borrowed capital is allowed as deduction, if the borrowed capital is used for the purpose of business of the assessee. The section does not distinguish between borrowed capital used for financing capital expenditure and borrowed capital used for the financing revenue expenditure. Assuming that land and building was acquired for business purpose, interest on money borrowed is allowable under section 36(1)(iii). It is presumed that the interest liability pertains to a period after the asset is put to use.
- (2) As per section 40(a)(ia), in case tax is deducted in the last month (March, 2009) but deposited on or before the due date for filing return of income under section 139(1) (i.e. 30th September, 2009), the related expenses shall be allowed in the year to which the expenses relate. However, if TDS relates to any other month of the previous year (i.e., April 2008 to February, 2009), the expenditure shall be allowed, only if tax is deducted and deposited before the end of the previous year. In the instant case, commission paid in March, 2009 is to be allowed, as the TDS was deposited before due date for filing income-tax return. TDS from commission paid in February, 2009 should be deposited on or before 31st March, 2009, for claiming deduction of the expenditure in the A.Y.2009-10. Since such TDS was deposited only on 20.9.2009, commission paid in February, 2009 shall be allowed only in the assessment year 2010-11.
- (3) Travelling expenses incurred on foreign tour of a director for initiating a new line of business is a capital expenditure. The same is, therefore, not deductible under section 37(1).
- (4) Securities transaction tax is allowable as deduction under section 36(1)(xv) if the income arising from taxable securities transaction is included in computing the income under the head "Profits and gains of business or profession". As income from trading in shares is included in computation of business income, securities transaction tax of Rs.10,000 is allowable as deduction.
- (5) As per section 43B, any sum payable by the assessee as interest on any loan or borrowing from, *inter alia*, any public financial institution or scheduled bank shall be allowed only in computing the income of that previous year in which sum is actually paid. In respect of the previous year in which the liability to pay such sum was

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incurred, deduction will also be allowed in relation to the sum or part thereof which is paid on or before the due date of filing of return for that year. As per Explanations 3C and 3D to section 43B, a deduction of any sum, being interest payable on any loan or borrowing from a public financial institution or scheduled bank shall be allowed, if such interest has been actually paid and such interest which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

The manner in which the converted interest will be allowed as deduction has been clarified vide Circular No.7/2006 dated 17.7.2006. The unpaid interest, whenever actually paid to the financial institution or scheduled bank, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid.

Accordingly, out of Rs.3 lakh, only Rs.1 lakh (Rs. 50,000 + Rs. 50,000), being the funded interest actually paid, is allowable as deduction while computing business income of P.Y.2008-09. It is presumed that the installment of Rs. 50,000 paid before the due date of filling the return relates to P.Y.2008-09. Since the entire amount of Rs.3 lakh, representing arrears of interest converted into term loan, has been debited to the profit and loss account, the balance Rs.2 lakh (i.e., Rs.3 lakh – Rs.1 lakh) has to be added back.

- (6) Contribution to a wholly owned subsidiary company for construction of a school for the benefit of its employees is allowable under section 37(1).
- (7) Under section 40A(7), no deduction is allowed in respect of any provision made for the payment of gratuity to the employees on retirement or termination of employment for any reason. However, gratuity actually paid is admissible as deduction. Therefore, provision for gratuity of Rs.6,00,000 is to be disallowed. Actual gratuity paid Rs.1,50,000 debited to provision for gratuity account is allowable. Hence, only the net sum of Rs.4,50,000 has to be added back.
- (8) As per section 40A(3), expenditure in respect of which payment is made in a day in a sum exceeding Rs.20,000 otherwise than by account payee cheque or account payee bank draft is disallowed. In this case, provision for bonus for the previous year 2007-08 would have been disallowed under section 43B for non-payment by due date for filing of return of income for assessment year 2008-09. Payment of bonus made after the said date is allowed in the year of actual payment. However, such deduction allowable in the year of payment is subject to the provisions of section 40A(3). Hence, the sum of Rs.34,000 being bonus paid by bearer cheque shall not be allowed as deduction in the year of payment. Assuming that the balance amount of Rs.64,000 (i.e., Rs.98,000 – Rs.34,000) is paid by account payee cheque or account payee bank draft, it is admissible as deduction in the A.Y.2009-10.
- (9) Depreciation on commercial vehicle has been calculated @15% and, consequently, Rs.1,20,000 has been debited to profit and loss account. The same has to be added back for separate consideration.

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Depreciation will be allowed @ 50% on the purchase of new commercial vehicle after 1st January, 2009 but before 1st October, 2009 and put to use for the business before 1st October, 2009. Hence, the depreciation on purchase of commercial vehicle has to be calculated @ 25% (50% of the rate prescribed), as the asset was acquired and put to use for less than 180 days during the previous year 2008-09. Therefore, the eligible depreciation on commercial vehicle is Rs.2,00,000 (i.e., 25% of Rs.8 lakh) for A.Y.2009-10. It is presumed that the commercial vehicle was put to use during the previous year 2008-09.

- (10) Sales tax collected by the assessee is to be treated as a trading receipt of the assessee as held by the Supreme Court in the case of *Chowringhee Sales Bureau Private Limited v. CIT (1973) 87 ITR 542 (SC)*. Sales tax paid by the assessee is to be deducted from its profits. If any deduction is so allowed and subsequently the sales tax is refunded by the Government, the refund so made has the character of a revenue receipt. Therefore, the amount is taxable as deemed income under section 41(1). However, the assessee is entitled to claim deduction of the amount of refund of sales tax as and when the same is refunded by the assessee to the purchaser. This view finds support from *CIT v. Thirumalaiswamy Naidu and Sons v. CIT 230 ITR 534 (SC)*. In view of this, the amount not yet refunded to the customers is not deductible. Accordingly, the sum of Rs.1,00,000, being sales tax not refunded to the customers, has to be added back.
- (b) An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled :-
- (a) The assessee is a resident in India during the relevant previous year.
 - (b) The income accrues or arises to him outside India during that previous year.
 - (c) Such income is not deemed to accrue or arise in India during the previous year.
 - (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
 - (e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In view of the aforesaid provisions, deduction under section 91 will be calculated as follows:

Particulars	Rs.	Rs.
Indian Income		2,25,000
Foreign Income		<u>75,000</u>
Gross Total Income		3,00,000
Less: <u>Deduction under section 80C</u>		
PPF Contribution	10,000	

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<u>Deduction under section 80D</u>		
Medical insurance premium of father (See Note 2 below)	<u>20,000</u>	<u>30,000</u>
Total Income		<u>2,70,000</u>
Tax on total income		12,000
Add: Surcharge		Nil
Add: Education Cess @ 2%		240
Secondary and higher education cess @ 1%		<u>120</u>
		<u>12,360</u>
Average rate of tax in India [i.e. Rs.12,360/2,70,000 x 100]		4.58%
Average rate of tax in foreign country [i.e. Rs.10,000/ Rs.75,000 x 100]		13.33%
Doubly taxed income		75,000
Rebate under section 91 on Rs.75,000 @ 4.58% (lower of average Indian tax rate and foreign tax rate]		3,435
Tax payable in India [Rs.12,360 – Rs.3,435]		8,925

Notes:

- (1) It has been assumed that Mr. Kalpesh Kumar is a resident.
- (2) It has been assumed that Mr. Kalpesh Kumar's father is a senior citizen, and hence, deduction of Rs.20,000 in respect of medical insurance premium paid for father has been allowed in full under section 80D.

Question 2

- (a) *Yaman Limited is a company in which 60% shares are held by Piloo Limited. Yaman Limited declared a dividend amounting to Rs.35 lacs to its shareholders for the financial year 2007-08 in its Annual General Meeting held on 10th May, 2008. Dividend distribution tax was paid by Yaman Limited on 15th May, 2008. Piloo Limited declared an interim dividend amounting to Rs.50 lacs on 15th October, 2008 for the year ended 31st March, 2009.*

Compute the amount of tax on dividend payable by Piloo Limited.

What would be your answer, if 58% shares of Piloo Limited are held by Kafi Limited, an Indian company?

Does the position change further, if Kafi Limited is a foreign company? (6 Marks)

- (b) *Does the Assessing Officer have power to make any adjustment to income disclosed by the assessee in the return of income in course of processing the return under section 143(1)? (5 Marks)*

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- (c) *Mahanadi Limited has taken a 3,000 sq. ft. flat on rent from Yamuna Limited to set up its Branch Office. The rent payable to Yamuna Limited for the flat is Rs.60,000 per month plus applicable service tax. Mahanadi Limited wishes to know whether tax is required to be deducted at source under section 194-I from gross amount of rent including service tax. Give your advice. (3 Marks)*

Answer

- (a) As per section 115-O, dividend distribution tax at the rate of 16.995% (i.e., 15% plus surcharge@10%, education cess@2% and secondary and higher education cess@1%) is leviable on dividend declared, distributed or paid by a domestic company. As per sub-section (1A), inserted in section 115-O by the Finance Act, 2008, a holding company receiving dividend from its subsidiary company can reduce the same from dividend declared, distributed or paid by it. For this purpose, the matching principle does not apply. This means that even if the dividend received and dividend distributed relate to different periods, the same can be adjusted for the purpose of computing dividend distribution tax of the holding company. However, the dividend shall not be considered for reduction more than once.

The conditions to be fulfilled for this purpose are as follows:

- (1) The subsidiary company should have actually paid the dividend distribution tax;
- (2) The holding company should be a domestic company;
- (3) The holding company should not be a subsidiary company of any other company.

For this purpose, a holding company is a company which holds more than 50% of the nominal value of equity shares of another company.

On the basis of the aforesaid provision, dividend distribution tax payable by Piloo Limited shall be 16.995% of Rs.29 lacs [Rs.50 lacs – (Rs.35 lacs x 60%)] i.e. Rs.4.93 lacs.

If 58% of shares of Piloo Ltd. are held by Kafi Ltd., then Piloo Ltd is a subsidiary company of Kafi Ltd. In that case, the condition (See condition no.3 above) laid down in section 115-O(1A) is not satisfied and Piloo Ltd. cannot reduce the amount of dividend received from Yaman Ltd. for computation of dividend distribution tax. Therefore, dividend distribution tax payable by Piloo Ltd. shall be 16.995% of Rs.50 lacs i.e. Rs.8.50 lacs.

The above position does not change even if Kafi Ltd. is a foreign company.

- (b) A significant amendment has been made by the Finance Act, 2008 with regard to the procedure to be followed for summary assessment under section 143(1). As per the amended section 143(1), the total income or loss of an assessee shall be computed after making the following adjustments to the returned income:
- (i) any arithmetical error in the return; or
 - (ii) an incorrect claim, if such incorrect claim is apparent from any information in the return.

For the purpose of section 143(1), "an incorrect claim apparent from any information in the return" means such claim on the basis of an entry, in the return of income:

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- (i) if an item, which is inconsistent with another entry of the same or some other item in such return;
- (ii) in respect of which, the information required to be furnished under the Income-tax Act to substantiate such entry, has not been so furnished;
- (iii) in respect of a deduction, where such deduction exceeds specified statutory limit which may be expressed as monetary amount or percentage or ratio or fraction.

Thus, the Assessing Officer, in course of processing the return of income under section 143(1), has the power to make the above adjustments to the income disclosed by the assessee in the return.

- (c) CBDT Circular No.4/2008 dated 28.04.2008 has clarified that service tax paid by the tenant does not partake the nature of income of the landlord. The landlord only acts as a collecting agency for Government for collection of service tax. Therefore, tax deduction at source under section 194-I would be required to be made on the amount of rent paid/payable without including the service tax.

Question 3

- (a) *Ishwar is a commission agent receiving commission from his principal. He collected certain amount as deposit towards sales tax and showed the amount so received under the head "Contingency deposit" in the Balance Sheet. He did not deposit the amount to the Government. The Assessing Officer invoked section 43B and added back the said amount to the business income of Ishwar. Examine the correctness of the action of the Assessing Officer.* (4 Marks)
- (b) *3 Star & Company, a partnership firm, entered into a contract to purchase an immovable property. The agreement was not honoured by the seller. Therefore, the firm filed a suit for specific performance of contract against the owner of the property. Ultimately, a compromise was arrived at. In terms of the compromise, the owner agreed to pay 3-Star & Company Rs.15 lacs as consideration. State with reasons whether the receipt should be treated to be in the nature of capital gain in the hands of the firm.* (4 Marks)
- (c)
 - (i) *Can a rectification order under section 254 of the Income-tax Act be passed by the Income-tax Appellate Tribunal beyond four years from the date of the order sought to be revised?* (3 Marks)
 - (ii) *Sumit voluntarily filed a revised return of income within the prescribed time limit after discovering that interest received from bank was not disclosed in the original return. Can he be absolved of penalty under section 271(1)(c)?* (3 Marks)

Answer

- (a) The facts of the case are similar to that in *Ishwardas Sons v. CIT* (2007) 295 ITR 473 (Ker). The issue is whether sales tax collected and kept as a contingency deposit can be considered as a trading receipt. The assessee collected certain amount as deposit towards sales tax and showed the amount so collected under the head "contingency deposit" account in the balance sheet. He did not deposit the amount to the Government. The Kerala High Court observed that the amount of sales tax collected

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formed part of the trading receipts of the assessee. The mere fact that the assessee created a head of account “Contingency Deposit” would not alter the nature of receipt. The court held that the sales tax collected by the assessee and shown under the head “Contingency Deposit” had to be considered as a trading receipt and included in the total income of the assessee. The disallowance under section 43B would be attracted for non-payment of sales tax collected irrespective of the nomenclature used and the accounting head under which it is categorized.

Therefore, the action of the Assessing Officer in adding back the amount by invoking section 43B in this case, is correct.

- (b) The assessee, 3-Star & Company, entered into a contract to buy an immovable property,. On failure on the part of the seller, the assessee filed a suit for specific performance of the contract. Subsequently, the assessee received Rs.15 lacs from owner in terms of a compromise agreed to by the parties.

In the case of *CIT v. Smt. Laxmidevi Ratani (2008) 296 ITR 363 (MP)*, the High Court, on identical facts, held that the receipt is exigible to capital gains tax as it involved transfer of property within the meaning of section 2(47). The action on the part of the assessee in giving up its right to claim the property and instead accepting money compensation is a clear case of extinguishment of right in the property resulting in transfer as defined in section 2(47).

- (c) (i) The issue as to whether a rectification order can be passed by the Income-tax Appellate Tribunal under section 254 beyond four years from the date of its order sought to be rectified has been addressed in *Sree Ayyanar Spinning and Weaving Mills Ltd. v. CIT (2008) 301 ITR 434 (SC)*. Section 254(2), dealing with the power of the Appellate Tribunal to pass an order of rectification of mistakes, is in two parts. The first part refers to the *suo motu* exercise of the power of rectification by the Appellate Tribunal, whereas the second part refers to rectification on an application filed by the assessee or Assessing Officer bringing any mistake apparent from the record to the attention of the Appellate Tribunal. Where the application for rectification is made within four years from the date of the order, the Appellate Tribunal is bound to decide the application on merits and not on the ground of limitation.
- (ii) On this issue, the Gujarat High Court, in *CIT v. Manibhai & Brothers (2007) 294 ITR 501 (Guj.)*, observed that for imposition of penalty under section 271(1)(c), there should be a deliberate concealment of particulars or furnishing of inaccurate particulars by the assessee. For this purpose, the conduct of the assessee from the beginning till the end of the assessment proceedings in totality should be considered. If a revised return of income is filed by the assessee after the omission or wrong statement in the original return is discovered by the Assessing Officer in the course of assessment proceedings, then the Assessing Officer can impose penalty under section 271(1)(c). However, if the assessee voluntarily files a revised return of income *suo motu* before the assessment order is passed, after he himself discovers an omission or wrong statement in the original return, then, penalty cannot be levied under section 271(1)(c).

In view of above legal position, Sumit can be absolved of penalty under section 271(1)(c).

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Question 4

- (a) *The business profit of T Ltd., a tea growing and manufacturing company, is Rs.120 lakh (before deduction under section 33AB) for the assessment year 2009-10. It deposits Rs.50 lakh with NABARD for claiming deduction under section 33AB. It wants to claim set-off of brought forward business loss of Rs.40 lakh. Find out the taxable income of T Ltd. for the assessment year 2009-10.* (5 Marks)
- (b) *What do you mean by substantial question of law?* (5 Marks)
- (c) *Mr. X filed the return of A.Y.2005-06 declaring an income of Rs.3,25,000. He had been assessed under section 143(3) and the Assessing Officer made the following additions:*
- (i) *Unexplained cash credit for want of confirmation from creditors Rs.2,00,000.*
 - (ii) *Disallowance in respect of travelling expenditure of Rs.46,000 for tour to Chennai for effecting sales there, as Mr. X failed to establish that the expenditure had been incurred for the purpose of business.*

At a later stage, he has been served with a notice under section 148 for income escaping assessment in respect of A.Y. 2005-06. During the course of reassessment proceeding, the Assessing Officer sought to add unaccounted sales of Rs.4,00,000 made at Chennai.

During the course of hearing, the assessee produced confirmation from creditors and requested to delete the addition for unexplained cash credit of Rs.2,00,000 and to allow deduction of travelling expenditure of Rs.46,000. Discuss the validity of the contention raised by the assessee. (4 Marks)

Answer

- (a) An assessee, engaged in growing and manufacturing tea in India, is entitled to a deduction under section 33AB, in respect of the amount deposited by the assessee to an account maintained with NABARD as per scheme approved by Tea Board, to the extent of lower of the following two amounts –
- (i) Amount deposited to the account maintained with NABARD within 6 months from the end of the previous year or before the due date for filing the return of income, whichever is earlier;
 - (ii) 40% of profits of such business computed under the head “Profits and Gains of Business or Profession” before making any deduction under this section.

The above deduction will be allowed before setting off brought forward business loss under section 72.

Computation of taxable income of T Ltd. for the A.Y.2009-10

Particulars	Rs. in lakh	Rs. in lakh
Profit before deduction under section 33AB		120.00
Less: Deduction under section 33AB for deposit to the account with NABARD being lower of the following amounts:		

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Amount deposited with NABARD	50	
40% of business profit i.e., 40% of Rs.120 lacs	<u>48</u>	<u>48.00</u>
		72.00
Less: 60% of Rs.72 lakh, being agricultural income as per Rule 8		<u>43.20</u>
		28.80
Less: Set of brought forward loss under section 72		<u>28.80</u>
Taxable business income		<u>Nil</u>

Total Income **Nil**

Note - The balance business loss of Rs.11.20 lakh (i.e., Rs.40 lakh – Rs.28.80 lakh) can be carried forward to the next year, assuming that the time limit of 8 years for carry forward of business loss has not expired.

- (b) The expression “substantial question of law” has not been defined anywhere in the Act. However, it has acquired a definite meaning through various judicial pronouncements. The tests are:
- (1) whether directly or indirectly it affects substantial rights of the parties; or
 - (2) the question is of general public importance; or
 - (3) whether it is an open question in the sense that issue is not settled by the pronouncement of the Supreme Court or Privy Council or by the Federal Court; or
 - (4) the issue is not free from difficulty; and
 - (5) it calls for a discussion for alternative view.
- (c) Where reassessment is made under section 147 in respect of income which had escaped tax, the Assessing Officer’s jurisdiction is confined only to such income which has escaped tax and does not extend to reopening or reconsidering the whole assessment or permitting the assessee to reargue questions which had been decided in original assessment proceedings, unless relatable to an item sought to be taxed as “escaped income”[*CIT v. Sun Engineering Works (P) Ltd. [1992] 198 ITR 297(SC)*].

Therefore, considering the Supreme Court decision in the above case, the assessee cannot seek a review of a concluded item, i.e., unexplained cash credit, which is unconnected with escaped income. However, request for allowing traveling expenditure can be considered because it is relatable to income which is sought to be assessed as escaped income i.e., unaccounted sales effected in Chennai.

Question 5

- (a) JK Associates is an Association of Persons (AOP) consisting of two members, J and K. Shares of the members are: 60% (J) and 40%(K). Income of the AOP for the previous year 2008-09 is Rs.6 lakh.

Compute tax liability of the AOP and the members in the following situations:

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- (i) *J and K have their income, other than income from AOP, amounting to Rs.1 lakh and Rs.1.70 lakh, respectively.*
- (ii) *J and K's income, other than income from AOP, amount to Rs.1 lakh and Rs.1.20 lakh, respectively.* (6 Marks)
- (b) *During the financial year 2008-09, Mr. A received a sum of Rs.1,80,000 (Rs.60,000 p.a.) by way of enhancement for the last three years as the Government department (tenant) enhanced the rate of rent with retrospective effect. Will the sum of Rs.1,80,000 be taxable in the assessment year 2009-10 ? Can it be spread over the last three years?* (3 Marks)
- (c) *A charitable trust derives its income from the business of providing mineral water to various companies situated in software technology park in Hyderabad. A sum of Rs.10 lakh has been derived as net income from such business activity, which has been applied for the object of general public utility. Examine the taxability of application of the income, if the income so derived relates to the previous year 2008-09. Would your answer be different, if the trust runs a school in a backward district and applies the profits from the business for such school's activity?* (5 Marks)

Answer

- (a) Computation of tax of AOP is governed by section 167B of the Income-tax Act. Tax on total income of AOP is computed as follows:
 - (i) If individual share of a member is known, and the total income of any member exceeds the basic exemption limit, then the AOP will pay tax at the maximum marginal rate.
 - (ii) If individual share of a member is known and no member has total income exceeding the basic exemption limit, then the AOP will pay tax at the rates applicable to an individual.

Section 86 provides for assessment of share in the hands of members of AOP as follows:

A member's share in the total income of AOP will be treated as follows:-

- (i) If an AOP has paid tax at the maximum marginal rate or a higher rate, the member's share in the total income of AOP will not be included in his total income and will be exempt.
- (ii) If the AOP has paid tax at regular rates applicable to an individual, the member's share in the income of AOP will be included in his total income and he will be allowed rebate at the average rate of tax in respect of such share.

Tax Liability of J K Associates, AOP

- (i) As K's income, other than that from the AOP, exceeds the basic exemption limit, the AOP shall pay tax at maximum marginal rate of 33.99% (i.e. 30% plus surcharge@10% plus education cess@2% plus secondary and higher education cess@1%). Thus the tax payable by AOP = Rs.6,00,000 x 33.99% = Rs.2,03,940.

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- (ii) Since none of the members have income, other than income from the AOP, exceeding the basic exemption limit, the AOP would be taxed at the rates applicable to an individual. Therefore, the AOP's tax liability = Rs.85,000 + Rs.2,550 = Rs.87,550.

Tax Liability of J and K

Particulars		J Rs.	K Rs.
(i)	Share of profit from AOP	Exempt	Exempt
	Income from other sources	<u>1,00,000</u>	<u>1,70,000</u>
	Total Income	<u>1,00,000</u>	<u>1,70,000</u>
	Tax liability	NIL	2,000
	Education cess@2% + SHEC@1%	—	<u>60</u>
	Total tax payable	<u>NIL</u>	<u>2,060</u>
(ii)	Share of profit from AOP	3,60,000	2,40,000
	Income from other sources	<u>1,00,000</u>	<u>1,20,000</u>
		<u>4,60,000</u>	<u>3,60,000</u>
	Tax liability	47,000	27,000
	Education cess@2% + SHEC@1%	<u>1,410</u>	<u>810</u>
	Total tax payable	<u>48,410</u>	<u>27,810</u>
	Average rate of tax	10.524%	7.725%
	Total tax liability	48,410	27,810
	Less: Rebate under section 86 in respect of share of profit from AOP	<u>37,890</u>	<u>18,540</u>
	Tax liability of members	<u>10,520</u>	<u>9,270</u>

- (b) As per section 25B, the arrears of rent shall be taxable in the previous year in which such arrears are received. The assessee shall be allowed deduction @ 30% of such amount received. Further, it is not necessary that the assessee should be owner of such house property in the previous year in which such arrears are received.

As the arrear rent of Rs.1,80,000 is received in the previous year 2008-09, the same is taxable in the A.Y.2009-10. Thus, the net sum of Rs.1,26,000 (i.e. Rs.1,80,000 – Rs.54,000) shall be chargeable to tax under the head "Income from house property".

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There is no provision in the Income-tax Act enabling the assessee to spread over the arrears of rent over the last three years.

- (c) Section 2(15) defines “charitable purpose” to include relief of the poor, education, medical relief and the advancement of any other object of general public utility. Section 2(15) was amended by the Finance Act, 2008 to provide that “advancement of any other object of general public utility” would not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business or, any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity or the retention of such income, by the concerned entity.

Based on the above amendment, in the first case, net income from the business of supplying mineral water to various companies i.e. Rs.10 lakh is not eligible for exemption under section 11. This is because “advancement of any object of general public utility” would not be a charitable purpose if it involves carrying on of any activity in the nature of trade, commerce or business, for example, supply of mineral water for a consideration, as in this case. It is immaterial that the net income from such business is applied for the object of general public utility.

On the other hand, where the trust runs a school in a backward district, this restriction is not applicable. The reason is that the restriction contained in section 2(15) is applicable only to the fourth limb of the definition of “charitable purpose” i.e. advancement of object of general public utility. It does not affect the other three limbs of the definition viz. “relief of the poor”, “education”, and “medical relief”.

Section 11(4) clarifies that “property held under trust” includes a business undertaking so held. As per section 11(4A), exemption can be availed in respect of profits and gains of business, if such business is incidental to the attainment of the objectives of the trust and separate books of account are maintained in respect of such business. Therefore, in this case, the profit from the business of providing mineral water shall be eligible for exemption under section 11, assuming that the said business is incidental to the attainment of the objects of the trust (i.e., education) and books of account for such business activity is maintained separately.

Question 6

- (a) *Specify with reason whether the following acts can be considered as (i) tax management; or (ii) tax planning; or (iii) tax evasion:*
- (i) *P deposits Rs.50,000 in PPF account so as to reduce his total income from Rs.3,40,000 to Rs.2,90,000.*
 - (ii) *PQR Industries Ltd. installed an air conditioner costing Rs.75,000 at the residence of a director as per terms of his appointment; but treats it as fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.*

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- (iii) SQL Ltd. maintains register of tax deduction at source effected by it to enable timely compliance.
- (iv) R. Ltd. issues a credit note for Rs.40,000 for brokerage payable to Suresh, who is son of R, managing director of the company. The purpose is to increase his income from Rs.1,40,000 to Rs.1,80,000 and reduce its income correspondingly. (4 Marks)
- (b) Mr. Kadam is entitled to a salary of Rs.25,000 per month. He is given an option by his employer either to take house rent allowance or a rent free accommodation which is owned by the company. The HRA amount payable was Rs.5,000 per month. The rent for the hired accommodation was Rs.6,000 per month at New Delhi. Advice Mr. Kadam whether it would be beneficial for him to avail HRA or Rent Free Accommodation. Give your advice on the basis of "Net Take Home Cash benefits". (6 Marks)
- (c) I Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2008-09. I. Limited also supplied the same product to another UK based company, V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U. Limited. (4 Marks)

Answer

- (a) (i) It is a case of tax planning, since depositing money in PPF and claiming deduction under section 80C is as per the provisions of law.
- (ii) It is a case of tax evasion, as the air conditioner fitted at residential place is furniture, depreciable@10%, whereas the rate of depreciation applicable for plant and machinery is higher. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit.
- (iii) It is tax management because maintaining register of payments subject to TDS helps in complying with the obligations under the Income-tax Act.
- (iv) Net effect of the transaction is reduction of tax liability of the company by improper means. The company is liable to tax at a flat rate of 30% whereas Suresh would be liable to pay tax @10% slab rate on Rs.30,000, being the excess of Rs.1,80,000 over the basic exemption limit of Rs.1,50,000. The issue of credit note to reduce the liability of company amounts to tax evasion.

(b) Computation of tax liability of Kadam under both the options

Particulars	Option I – HRA	Option II – RFA
Basic Salary (Rs.25,000 x 12 Months)	3,00,000	3,00,000
Perquisite value of rent-free accommodation (15% of Rs.3,00,000)	N.A.	45,000
House rent Allowance (Rs.5,000 x 12 Months)	60,000	
Less: Exempt u/s 10(13A) – least of the following -		
- 50% of Basic Salary	1,50,000	

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- Actual HRA	60,000		
- Rent less 10% of salary	<u>42,000</u>	<u>42,000</u>	18,000
Income taxable under the head "Salaries"			3,18,000 3,45,000
Less: Deduction under Chapter VIA			- -
Total Income			3,18,000 3,45,000
Tax on total income			18,600 24,000
Add: Education cess@1% and SHEC @ 2%			558 720
Total tax payable			19,158 24,720

Cash Flow Statement

Particulars	Option I – HRA	Option II – RFA
<i>Inflow</i> : Salary	3,60,000	3,00,000
<i>Less: Outflow</i> : Rent paid	(72,000)	-
Tax on total income	(19,158)	(24,720)
Net Inflow	2,68,842	2,75,280

Since the net cash inflow under option II (RFA) is higher than in Option I (HRA), it is beneficial for Mr. Kadam to avail Option II, i.e., Rent free accommodation.

- (c) In this case, I Ltd., the Indian company, supplied billets to its foreign holding company, U Ltd. Since the foreign company, U Ltd., holds more than 26% shares in I Ltd., I Ltd. and U Ltd. shall be deemed to be associated enterprises within the meaning of section 92A.

As I Ltd. supplies similar product to an unrelated entity, V Ltd., UK, the transactions between I Ltd. and V. Ltd. can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between I. Ltd. and U Ltd. Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with U Ltd. are on FOB basis, whereas transactions with V Ltd. are on CIF basis. This difference has to be adjusted before comparing the prices.

Amount in Euro

Price per MT of billets to V. Ltd.	700
Less: Cost of insurance and freight per M.T.	<u>200</u>
Adjusted Price per M.T.	<u>500</u>

Since the adjusted price for V. Ltd., UK and the price fixed for U Ltd. are the same, the arm's length price is Euro 500 per MT. Since the sale price to related party (i.e., U Ltd.) and unrelated party (i.e., V Ltd.) is the same, the transaction with related party U Ltd. has also been carried out at arm's length price.

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Question 7

- (a) Mrs. A furnishes the following particulars for the computation of her wealth tax liability for the assessment year 2009-10:
- (1) Gifts of jewellery and gold ornaments received from her mother on the occasion of her marriage aggregating Rs.5,00,000. However, the said jewellery were forcibly taken away from her by her mother-in-law after marriage.
 - (2) She owns two residential house properties each valuing Rs.10,00,000.
 - (3) She is one of the partners in the business with her husband. The value of her interest in assets of the firm as at 31st March, 2009 is Rs.12,75,500. The said business is conducted in one of the house properties owned by Mrs. A.
 - (4) She has two motor cars of Rs.12,50,000, one of which is imported by her for Rs.7,50,000.
 - (5) She has invested Rs.10,00,000 in a bank deposit for five years to meet the future expense of children on their education.
 - (6) Mrs. A has signed "agreement to sell" for purchase of new residential house property of Rs.20,00,000 and has made advance payment of Rs.5,00,000 on 1st March, 2009 and has taken possession. However, the sale deed has not been executed till 31st March, 2009. She has taken loan of Rs.15,00,000 from bank for purchase of said property.
 - (7) She has cash balance of Rs.75,000.

Compute the wealth tax payable by Mrs. A for assessment year 2009-10. (7 Marks)

- (b) Under what circumstances can the Assessing Officer make a reference to the Valuation Officer for the purpose of making an assessment under the Wealth Tax Act? (3 Marks)

Answer

- (a) **Computation of wealth-tax payable by Mrs.A for A.Y.2009-10**

Asset	Amount in Rs.	Reason
Jewellery	Nil	Jewellery forcibly taken by mother-in-law and not in the possession of the assessee, is not chargeable to wealth-tax in the hands of the assessee.
House Property 1	Nil	A house used exclusively for residential purpose is treated as an asset under section 2(ea), but the same is exempt under section 5(vi).
House Property 2	Nil	Building owned by a partner but used in firm's business is deemed to be used by the partner for his business purposes and is, hence, not an asset chargeable to tax under section 2(ea).

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Value of interest in assets of the firm	12,75,500	Included in the net wealth of Mrs. A by virtue of section 4(1)(b). It has been assumed that the assets are those covered under section 2(ea).
Motor Cars	12,50,000	Motor cars, whether indigenous or imported, are assets chargeable to wealth-tax under section 2(ea).
Bank Deposit	Nil	Not an asset under section 2(ea) and hence, not chargeable to tax under the Wealth-tax Act.
House Property 3	20,00,000	Since the possession of the house property is taken, it is deemed as an asset and is chargeable to wealth-tax. It may be noted that only one house property is exempt under section 5(vi) and this exemption has already been availed in respect of House Property 1.
Cash balance	25,000	For an individual, cash in hand in excess of Rs.50,000 shall be chargeable to wealth tax (Rs.75,000 – 50,000)
Gross Wealth	45,50,500	
Less: Loan borrowed from Bank	15,00,000	Money borrowed by the assessee for purchase of House Property 3 is deductible under section 2(m), since the value of House Property 3 is included in gross wealth.
Net Wealth	30,50,500	

Wealth-tax payable by Mrs. A will be Rs.15,505 i.e. 1% of Rs.15,50,000 (i.e., Rs.30,50,500 – Rs.15,00,000).

- (b) Under section 16A of the Wealth-tax Act, a reference to the Valuation Officer may be made by Assessing Officer, where the market value of any asset is to be taken into account in the wealth tax assessment. Such reference can be made in the following cases -
- Where the value of the asset adopted by the assessee is on the basis of the estimate by a registered valuer and the Assessing Officer is of the opinion that such value returned is less than the fair market value;
 - In any other case, if the fair market value, in the opinion of Assessing Officer, exceeds the value of the asset (as disclosed in the return), by 33-1/3% or Rs.50,000; or
 - having regard to the nature of the asset and other relevant circumstances, the Assessing Officer is of the opinion that it is necessary to make a reference.

PAPER – 8 : INDIRECT TAX LAWS

PART – A

Question 1

- (a) Determine the total amount of excise duty payable under section 4 of the Central Excise Act, 1944 from the following information:

Particulars	Rs.
(i) Price of machinery excluding taxes and duties	5,50,000
(ii) Installation and erection expenses	21,000
(iii) Packing charges (primary and secondary)	11,500
(iv) Design and engineering charges	2,000
(v) Cost of material supplied by buyer free of charge	8,500
(vi) Pre-delivery inspection charges	500

Other information:

- (a) Cash discount @ 2% on price of machinery was allowed as per terms of contract since full payment was received before dispatch of machinery.
- (b) Bought out accessories supplied along with machinery valued at Rs. 6,000.
- (c) Central excise duty rate 16% and educational cess as applicable @ 3%.

Make suitable assumptions as are required and provide brief reasons. (5 Marks)

- (b) XYZ Co. is engaged in the manufacture of water pipes. From the following details for the month of May, 2009, compute the available Cenvat credit under the Cenvat Credit Rules, 2004 :

Cenvat paid on purchases as detailed below:

Particulars	Rs.
Raw steel	22,000
Water pipe making machine	18,000
Spare parts for the above machine	7,500
Grease and oil	2,800
Office equipment	20,000
Diesel	12,000

Provide explanation for treatment of various items. (5 Marks)

The suggested answers for Indirect Tax Laws (Paper 8) are based on the provisions as amended by the Finance Act, 2008 and notifications/circulars issued up to 30.04.2009 which are relevant for November 2009 examinations.

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- (c) *Small & Company, a small scale industry, provides the following details. Determine the eligibility for exemption based on value of clearances for the financial year 2009-10 in terms of Notification No. 8/2003-CE dated 1.3.2003 as amended:*

	<i>Particulars</i>	<i>Rs. (Lakhs)</i>
(i)	Total value of clearances during the financial year 2008-09 (including VAT Rs. 50 lakhs)	870
(ii)	Total exports (including for Nepal and Bhutan Rs. 200 lakhs)	500
(iii)	Clearances of excisable goods without payment of duty to a unit in Software Technology Park	20
(iv)	Job work under Notification No. 84/94-CE dated 11.4.94	50
	Job work under Notification No. 214/86-CE dated 25.3.86	50
(v)	Clearances of excisable goods bearing brand name of Khadi and Village Industries Board (sic).	200

Make suitable assumptions and provide brief reasons for your answers where necessary.

(5 Marks)

Answer

(a) Determination of excise duty payable:

<i>Particulars</i>	<i>Rs.</i>
Price of machinery	5,50,000
Packing charges (Note 6)	11,500
Design and engineering charges (Note 7)	2,000
Cost of material supplied by buyer (Note-3)	8,500
Pre-delivery inspection charges (Note-4)	<u>500</u>
Total	5,72,500
Less : 2% cash discount on price of machinery=550,000 x 2 % (Note-5)	<u>11,000</u>
Assessable value	<u>5,61,500</u>
Excise duty @ 16.48%	92,535.20
Excise duty rounded off	92,535

Notes :-

While computing the assessable value:-

1. installation and erection expenses will not be included [Circular No. 643/34/2002 dated 01.07.2002].
2. bought out accessories, supplied along with the machinery, will not be included.

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3. cost of material supplied by buyer free of charge will form part of assessable value as it is the additional consideration flowing from buyer to seller.
4. pre-delivery inspection charges are includible [*Circular No. 643/34/2002 dated 01.07.2002*].
5. cash discount will be allowed as deduction if actually passed on to the buyer and if transaction is on principal to principal basis [*Circular No. 643/34/2002 dated 01.07.2002*].
6. amount charged from the buyer in relation to packing, whether primary or secondary, shall be included [*Circular No. 354/81/2000 dated 30.06.2000*].
7. design and engineering charges shall be included as such payment is 'in connection with sale'.

(b) CENVAT credit admissible to XYZ Co. for the month of May, 2009:-

<i>Particulars</i>	<i>Rs.</i>
Raw Steel	22,000
Water pipe making machine (Rs. 18,000 × 50%) (Note-1)	9,000
Grease and Oil	2,800
Spare parts for the machinery (Rs. 7,500 × 50%) (Note-1)	<u>3,750</u>
CENVAT credit admissible	<u>37,550</u>

Notes :

In respect of:-

1. water pipe making machine and spare parts, being capital goods, only 50% of CENVAT credit is available [Rule 4(2) of the CENVAT Credit Rules, 2004].
2. office equipment, no credit is available since the definition of capital goods under rule 2(a)(A) of the CENVAT Credit Rules, 2004 specifically excludes any equipment/appliance used in an office.
3. diesel, no credit is available since the definition of input under rule 2(k)(i) of the CENVAT Credit Rules, 2004 specifically excludes it.

(c) Calculation of value of clearances during financial year 2008-09:-

<i>Particulars</i>	<i>Rs. (in lakhs)</i>
Total value of clearance in 2008 - 09	870
Less : VAT included in above	<u>50</u>
	820
Less : 1. Exports excluding exports to Nepal and Bhutan Rs. (500-200) lakh	300

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2. Clearances of excisable goods without payment of duty to a unit in Software Technology Park	20
3. Job work done under Notification No. 84/94-CE dated 11.04.94 and under Notification No. 214/86-CE dated 25.3.86 i.e. Rs. (50 + 50) lakh	<u>100</u>
Value of clearances	<u>400</u>

In order to claim the benefit of exemption under Notification No. 8/2003 – C.E. in a financial year, the total turnover of a unit should not exceed Rs.400 lakh in the preceding year. For the purpose of computing the turnover of Rs. 400 lakh:-

1. export turnover has to be excluded. However, export to Nepal and Bhutan cannot be excluded as these are treated as “clearance for home consumption”.
2. job work under *Notification No. 214/86 - CE* and *Notification No. 84/94-CE* is not to be taken into consideration.
3. clearances of excisable goods without payment of duty to a unit in Software Technology Park are to be deducted.
4. clearances of excisable goods bearing brand name of Khadi and Village Industries Commission are includible.

Since the value of clearances in the previous financial year 2008-09 does not exceed Rs. 400 lakh, the Small & Company is eligible to claim the benefit of *Notification No. 8/2003 dated 1st March, 2003* in the financial year 2009-10.

Question 2

- (a) *I Ltd. was a manufacturer of excisable goods such as polyester yarn. A ground plan of the factory was provided by the assessee to the jurisdictional Central Excise Officer and the same was approved. The ground plan showed the area in which the manufacturing is carried out as also the areas occupied for purpose of storage godowns, cycle sheds, canteen as well as the housing complex for staff and workers. The assessee had a captive power plant in the approved area. The electricity generated was supplied to the housing complex as well as for use in the manufacturing activity. I Ltd. claimed Cenvat credit on the duty paid on furnace oil used for generation of electricity as it was used within the factory and was covered by the expression "for any other purpose" in rule 2(k) of the Cenvat Credit Rules, 2004. The Central Excise Department wanted to deny the Cenvat credit on the duty paid on furnace oil for generation of electricity which in turn is supplied to the housing complex on the ground that it was not used in relation to manufacture of the final product. Examine, with the help of a decided case law, if the stand of the Department is correct in law. (5 Marks)*
- (b) *The assessee manufactured compressors and filters and removed them as "stand alone" items. He also manufactured and removed safety valves and filters on payment of duty.*

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The assessee also supplied bought out items like V belts, motor, pulley etc. to their buyers. The Excise Department relying on rule 2(a) of the General Interpretative Rules for classification has decided to include the value of safety valves and filters together with value of bought out items in the value of compressors for purposes of duty under section 4 of the Central Excise Act, 1944. Write a brief note, with any decided case law, whether the stand taken by the Department is correct. (5 Marks)

- (c) *The assessee's premises were searched by the Anti Evasion wing of the Excise Department. A show cause notice was issued alleging that the assessee had cleared goods without the cover of duty paid invoice and without accounting the same in the stock register. The assessee was required to pay the duty demanded with interest. The assessee filed an application before the Settlement Commission to put an end to the litigation and buy peace. The application was dismissed by the Settlement Commission on the ground that the petitioner in its petition had not admitted the entire duty liability. The assessee's contention is that Department is yet to substantiate the allegations made in the show cause notice and the dismissal order is not correct in law. Briefly discuss, with a note, whether the action of the Settlement Commission is correct in law. (5 Marks)*

Answer

- (a) The facts of this case are similar to the case of *M/s Indorama Synthetics (I) Ltd. v. CCEx.* (2008) 226 ELT A181(SC). In this case, the Supreme Court maintained the judgment of the Bombay High Court wherein it was held that the CENVAT credit of the duty paid on furnace oil used in the generation of electricity in turn used in the residential complex was not allowable. The assessee submitted that "factory" under section 2(f) of the Central Excise Act, 1944 is wide enough to cover precincts thereof, even if the manufacturing is carried out only in a part of such premises. Therefore, the electricity supplied to the residential complex situated within the factory premises must be covered within the meaning of the word 'for any other purpose' set out in the erstwhile rule 57(B)(w) of the Central Excise Rules, 1944 [similar to present rule 2(k) of the CENVAT Credit Rules, 2004]. The assessee's submission was rejected by the High Court observing that credit of duty would be available on inputs used in the generation of electricity, provided the electricity is used for manufacture of final products or for any other purpose connected with or related to manufacture of final products. In other words, the use of electricity must have nexus with the goods manufactured in the factory. The mere fact that the residential complex is situated within the licensed premises would not entitle the assessee to avail the credit of duty paid on the furnace oil used in the manufacture of electricity supplied to the residential complex. Thus, the stand taken by the Department of disallowing the CENVAT credit is correct in law.
- (b) A similar question had come up for consideration before the Supreme Court in the case of *CCEx., Delhi v. M/s Frick India Ltd.* 2007 (216) ELT 497 (S.C). In the instant case, the Supreme Court observed that rule 2(a) of the General Interpretative Rules for

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classification could not be applied in this case as:

- (i) The compressors manufactured by assessee were removed as 'stand alone' item and not in an unassembled or disassembled condition; and
- (ii) Section and Chapter notes in Tariff and the Interpretative Rules do not provide guidelines for valuation of excisable goods because they decide the classification, and valuation is different from classification.

Thus, the Supreme Court held that the parts and accessories could not be classified as 'compressors' and therefore, were independently classifiable under respective headings applicable to them. The concept of 'classification' is different from that of 'valuation'. Therefore, the contention of the Department is not correct in law.

- (c) The dismissal order is valid in law. In the case of *Cus. & C.Ex. Settlement Commission v. Mars Therapeutics & Chem. Ltd 2008 (223) ELT 363 (AP)*, the High Court held that an application made under section 32E of the Central Excise Act, 1944 could be admitted and proceeded with only when Settlement Commission was satisfied that the applicant had made a full and true disclosure of duty liability and the manner in which same was arrived at. The assessee's plea that obligation to make truthful disclosure of duty liability would arise after application was admitted and not before and that Revenue was required to first establish the stand taken in show cause notice, was not acceptable.

HC further clarified that it was only when the Settlement Commission was satisfied that the applicant had made a full and true disclosure, the application could be admitted and proceeded with. This was for the reason that the object behind the enactment of the provisions relating to settlement was the creation of a forum for self- surrender. The Settlement Commission was constituted as an extraordinary measure for providing an opportunity to such persons to make a true confession and to have matters settled once for all. The Settlement Commission was not a forum for challenging the legality of orders passed under the provisions of the Act. The Settlement Commission, in the case on hand, having found that the applicant-petitioner did not fully satisfy the mandatory requirements of full and true disclosure of its liability, was justified in rejecting the application. Thus, the validity of the dismissal order was upheld by the Court.

Question 3

- (a) Explain briefly the concept of "excisable goods" as amended by the Finance Act, 2008.
(2 Marks)
- (b) Explain briefly, how the value of goods will be ascertained for purpose of excise duty where the assessee sells the goods partly to a related person and the balance to unrelated third parties.
(2 Marks)
- (c) Write a brief note on Cenvat monthly return of information relating to principal inputs in Form ER 6.
(2 Marks)

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- (d) Briefly mention any four categories of persons who are exempted from obtaining registration under rule 9(2) of the Central Excise Rules, 2002. (2 Marks)
- (e) Write a short note on the principle of "unjust enrichment" under Central Excise Law. (2 Marks)

Answer

- (a) As per section 2(d) of the Central Excise Act, 1944, "excisable goods" means goods specified in the First Schedule and Second Schedule to the Central Excise Tariff Act, 1985 as being subject to the duty of excise and includes salt.
- By Finance Act, 2008, an explanation has been added which clarifies that "goods" include any article, material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable. Thus, the concept of deemed marketability is introduced by this amendment.
- (b) There is no specific rule covering such a situation. Transaction value in respect of sales to unrelated buyers cannot be adopted for sales to related buyers since as per section 4(1), transaction value is to be determined for each removal. For sales to unrelated buyers, valuation will be done as per section 4(1)(a) and for sales of the same goods to related buyers, recourse will have to be taken to the residuary rule 11 read with rule 9 (or 10). Rule 9 cannot be applied in such cases directly since it covers only those cases where all the sales are made to related buyers only [*Circular No. 643/34/2002 dated 01.07.2002*].
- (c) ER-6 is a monthly return of receipt and consumption of each of principal inputs. It is to be submitted, by the assessee by 10th of the following month. Only those assessees who are required to submit ER-5 return are required to submit ER-6 return [Rule 9A(3) of the CENVAT Credit Rules, 2004].
- (d) Central Board of Excise and Customs, as per the power given under rule 9(2) of the Central Excise Rules, 2002, vide *Notification No.36/2001-CE. (NT) dated 26.06.2001*, has exempted the following specified categories of persons from obtaining registration:
- (i) Persons who manufacture the excisable goods, which are chargeable to nil rate of duty or are fully exempt from duty by a notification subject to the declaration to be made in a specified form.
 - (ii) Small scale units having the slab exemption based on value of clearances under a notification. However, they have to give the declaration when their clearances touch Rs. 90 lakh.
 - (iii) In respect of final products falling under chapter 61 or 62, the job-worker need not get registered if the principal manufacturer undertakes to discharge the duty liability. If the job worker undertakes to pay the duty, the principal manufacturer need not get registered.

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- (iv) Persons manufacturing excisable goods by following the warehousing procedure under the Customs Act, 1962 subject to certain prescribed conditions.
- (v) The person who carries on whole sale trade or deals in excisable goods except first and second stage dealer, as defined in the CENVAT Credit Rules, 2004.
- (vi) A hundred percent Export Oriented Undertaking or a unit in EPZ or a unit in SEZ licensed or appointed; as the case may be under the Customs Act, 1962 if they do not procure excisable goods from Domestic Tariff Area or do not remove excisable goods to Domestic Tariff Area.
- (vii) Persons who use excisable goods for any purpose other than the processing or manufacture of goods availing benefit of concessional duty exemption notification.
- (viii) Person who gets his goods manufactured on his account from any other person subject to the conditions that the said person authorizes the person actually manufacturing or fabricating the said goods, to comply with all procedural formalities under the Central Excise Act, 1944 and the rules made there under and to furnish information in order to enable the determination of value of the said goods.

Note: Any four points may be mentioned.

- (e) If the manufacturer has charged excise duty to his buyer, it is clear that he has passed on the burden to the buyer and has already recovered duty from his customer. In such cases, refund of excess duty paid to the manufacturer will amount to excess and undeserved profit to him. It will not be equitable to refund the duty to him as he will get double benefit-first from the customer and again from the Government. This is called "unjust enrichment". Accordingly, refund will be paid to the manufacturer only if he proves that he has borne the burden of duty. Otherwise, the amount will be paid to Consumer Welfare Fund.

PART - B

Question 4

- (a) Determine the taxable turnover, input tax credit and net VAT payable by a works contractor from the details given below on the assumption that the contractor maintains sufficient records to quantify the labour charges. Assume output VAT at 12.5%:

Particulars	Rs. (in lakh)
(i) Total contract price (excluding VAT)	100
(ii) Labour charges paid for execution of the contract	35
(iii) Cost of consumables used not involving transfer of property in goods	5
(iv) Material purchased and used for the contract taxable at 12.5% VAT (VAT included)	45

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The contractor also purchased a plant for use in the contract for Rs. 10.4 lakhs. In the VAT invoice relating to the same, VAT was charged at 4% separately and the said amount of Rs. 10.4 lakhs is inclusive of VAT. Assume 100% input credit on capital goods.

Make suitable assumption wherever required and show the working notes. (5 Marks)

- (b) Calculate the value of taxable service under 'cargo handling services' of Cargo Ltd., providing brief reasons where required with suitable assumptions based on the following information for the month of April, 2009:

Particulars	Rs. (in lakh)
(i) Total amount charged for all services	40
(ii) Receipts for services in relation to export cargo and handling of passenger baggage included in (i) above	13
(iii) Charges for storage and cleaning of empty containers of shipping lines included in (i) above	10
(iv) Charges for packing and transport of cargo included in (i) above	3
(v) Charges for handling of agricultural produce included in (i) above	2
(vi) Charges for transportation of cargo included in (i) above	5
	(5 Marks)

Answer

- (a) Under the works contract, the turnover for imposition of VAT is the sale price of the goods in which there is a transfer of property. The amount representing the labour & other charges incurred for such execution is deductible.

Computation of the taxable turnover, input tax credit and net VAT payable by the works contractor:-

Particulars	Rs.
Total contract price	1,00,00,000
Less : Deductions admissible	
1. Labour charges paid for executing the contract	35,00,000
2. Cost of consumables in which no property is transferred	<u>5,00,000</u>
Total deductions	<u>40,00,000</u>
Taxable turnover	<u>60,00,000</u>
Output VAT payable @ 12.5% (on Rs. 60,00,000)	7,50,000 (A)

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Less : Input tax credit admissible

1. On the material purchased (on Rs. 45,00,000 x 12.5/112.5)	5,00,000	
2. On the plant purchases (on Rs. 10,40,000 x 4/104)	<u>40,000</u>	
Input tax credit	<u>5,40,000</u>	(B)
Net VAT payable	<u>2,10,000</u>	(A-B)

(b) Calculation of the value of taxable service under 'cargo handling services' of Cargo Ltd.:-

<i>Particulars</i>	<i>Rs.</i>
Total receipts from services rendered	40,00,000
Less : Exemptions:-	
1. Receipts in relation to export cargo & handling baggage of passenger (Note-1)	13,00,000
2. Charges received for storage, washing etc. of empty containers of shipping lines (Note-4)	10,00,000
3. Charges received in relation to handling of agricultural produce (Note-3)	2,00,000
4. Charges received only for transportation of cargo (Note-5)	<u>5,00,000</u>
Taxable services under cargo handling	<u>10,00,000</u>

Notes:

- The definition of 'cargo handling service' under section 65(23) specifically excludes handling of export cargo or passenger baggage. Hence, they do not form part of taxable services.
- Charges received for packing together with transportation of cargo, Rs.3,00,000, is taxable in view of amendment made in section 65(23) by Finance Act, 2008.
- Notification No. 10/2002 dated 01.08.2002* exempts the taxable service provided to any person by a cargo handling agency in relation to agricultural produce or goods intended to be stored in a cold storage from payment of service tax.
- Circular No. B.11/1/2002-TRU dated 1/8/2002* clarifies that activity of storing/washing/repairing and handling empty containers for the shipping lines does not come within the purview of "cargo handling services".
- It is assumed that these are the charges merely for the transportation. The definition of 'cargo handling service' under section 65(23) specifically excludes mere transportation of goods. Hence, they do not form part of taxable services.

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Question 5

- (a) *M/s M Construction Ltd. constructs, builds and sells premises/flats in a building. During the course of development and construction of the building, it enters into a flat purchase agreement in terms of which the buyers are allotted flats in the building. The buyers pay the consideration to M/s. M Construction in installments. The said 'flat purchase agreement' reflects the entire consideration for the purchase of flat. This agreement is registered and advance payments in installments are collected. The contention of M/s M Construction is that the consideration is for the purchase and sale of the entire flat/premises and the company does not carry out any construction activity. Examine, with a brief note, whether the company is liable to pay service tax in terms of the Finance Act, 1994.* (5 Marks)
- (b) *Good Luck Agencies is engaged in the purchase of lottery tickets in bulk from the State Government and sells them subsequently on behalf of the Government. However, no service tax is paid on the said activity. The Department has sought to levy service tax under the category of 'business auxiliary service' under section 65(19) as service in relation to promotion or marketing of service provided by the client. Discuss briefly, with a note and decided case law, if any, whether the action of the Department is correct in law.* (5 Marks)

Answer

- (a) The facts of the given case are similar to the case of *M/s Magus Construction Private Ltd. v. Union of India* (11) STR 225 (Gauhati), wherein it has been held by the Gauhati High Court that Circular No. 332/35/2006-TRU dated 01.08.2006 (now Circular No. 96/7/2007-ST dated 23.8.07) clarifies that when a builder, promoter or developer undertakes construction activity for own self, then, in such cases, in absence of relationship of "service provider" and "service recipient", the question of providing taxable service, to any person by any other person does not arise at all. In this case also, the facts clearly show that the construction activity undertaken by the assessee was in respect of its own work and it was only the completed construction work which was sold by the petitioner company to the buyers, who might have made agreements for sale before the construction had actually started or during the progress of the construction activity. Any advance, made by the prospective buyer or the deposit received by the company, is against the consideration of sale of flat/building to such prospective buyer and not for the purpose of obtaining service from M Construction Ltd. Therefore, the contention of M Construction Ltd. is correct in law and it is not liable to pay service tax.
- (b) The action taken by the Department is valid in law. Section 65(19)(ii), inter alia, provides that 'business auxiliary service' means any service in relation to promotion or marketing of service provided by the client. Finance Act, 2008 has inserted explanation to section 65(19)(ii) which provides that for the purpose of this sub-clause, "service in

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relation to promotion or marketing of service provided by the client” includes any service provided in relation to promotion or marketing of games of chance, organized, conducted or promoted by the client, in whatever form or by whatever name called, whether or not conducted online, including lottery, lotto, bingo. This makes it amply clear that services of selling the lottery tickets are liable to service tax under the category ‘business auxiliary service’ with effect from 16.05.2008. Consequently, Good Luck Agencies is liable to pay service tax.

Question 6

- (a) *Briefly explain whether the following are chargeable to service tax under the provisions of the Finance Act, 1994 :*
- (i) *Service provided by a person to another person in relation to information technology software for use in course or furtherance of business or commerce.*
 - (ii) *Transaction allowing another person to use goods without giving legal right of possession and control to the user of the goods.* (2 × 2 = 4 Marks)
- (b) *Write a brief note explaining the circumstances under which expenditure or costs incurred by a service provider as a pure agent of the recipient of service shall be excluded from the value of taxable services under the Service Tax (Determination of Value) Rules, 2006.* (4 Marks)
- (c) *Briefly explain the provisions in the Service Tax Rules, 1994 relating to furnishing of list of records at the time of filing of return for the first time.* (4 Marks)
- (d) *Briefly explain the following with reference to the Service Tax Rules, 1994 and the Finance Act, 1994:-*
- (i) *Gross amount charged*
 - (ii) *e-payment of service tax.* (2 × 2 = 4 Marks)
- (e) *Briefly explain the importance of VAT invoice.* (2 Marks)

Answer

- (a) (i) Information technology software means any representation of instructions, data, sound or image including source code and object code recorded in a machine readable form that is capable of being manipulated or providing interactivity to a user by means of a computer or an automatic data processing machine or any other device or equipment. Services like service provided in relation to information technology software including development of information technology software, study, analysis, design and programming, providing advice, consultancy and assistance on these matters, acquiring right to use information technology software for commercial exploitation including right to reproduce, distribute etc. and acquiring the right to use information technology software supplied electronically, have been made liable to service tax with effect from 16th May, 2008.

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- (ii) Transfer of right to use any goods is leviable to Sales tax/VAT as a deemed sale of goods. Transfer of right to use involves transfer of both possession and control of the goods to the user of the goods.

Transaction of allowing another person to use the goods, without giving legal right of possession and effective control, not being treated as sale of goods, is liable to service tax with effect from 16.05.2008. The taxable service shall include service provided to any person by any other person in relation to supply of tangible goods, including machinery, equipment, and appliances for use, without transferring right of possession and effective control of such machinery, equipment and appliances.

- (b) Expenditure or costs incurred by the service provider as a pure agent of the recipient of the service shall be excluded from the value of the taxable service if all the following conditions are satisfied:-
- (a) The service provider acts as a pure agent of the recipient of the service while making payment to the third party.
 - (b) The recipient of service receives and uses the goods or services so procured by the service provider in his capacity as pure agent of the recipient of service.
 - (c) The recipient of service is liable to make payment to the third party.
 - (d) The recipient of service authorizes the service provider to make payment on his behalf.
 - (e) The recipient of service knows that the goods and services for which payment has been made by the service provider shall be provided by the third party.
 - (f) The payment made by the service provider on behalf of the recipient of service is separately indicated in the invoice issued by the service provider to the recipient of service.
 - (g) The service provider recovers from the recipient of service only such amount as has been paid by him to the third party.
 - (h) The goods or services procured by the service provider from the third party as a pure agent are in addition to the service he provides on his own account.
- (c) Rule 5(2) of the Service Tax Rules, 1994 lays down that every assessee shall furnish to the Superintendent of Central Excise at the time of filing of return for the first time or the 31st day of January 2008, whichever is later, a list in duplicate, of
- (i) all the records prepared or maintained by the assessee for accounting of transactions in regard to,
 - (a) providing of any service, whether taxable or exempted;
 - (b) receipt or procurement of input services and payment for such input services;
 - (c) receipt, purchase, manufacture, storage, sale, or delivery, as the case may be, in regard of inputs and capital goods;

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- (d) other activities, such as manufacture and sale of goods, if any.
- (ii) all other financial records maintained by him in the normal course of business.
- (d) (i) **Gross amount charged:**

Explanation to section 67 of the Finance Act, 1994 as amended provides that “gross amount charged” includes payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and book adjustment, and any amount credited or debited, as the case may be, to any account, whether called “Suspense account” or by any other name, in the books of account of a person liable to pay service tax, where the transaction of taxable service is with any associated enterprise.
- (ii) **E-payment:**

The assessee who has paid service tax of Rs. 50,00,000 or above in the preceding financial year or has already paid service tax of Rs. 50,00,000 in the current financial year has to compulsorily deposit the service tax liable to be paid electronically, through internet banking [Proviso to rule 6(2) of the Service Tax Rules, 1994].
- (e) Invoices are crucial documents for administering VAT. In the absence of invoices, VAT paid by the dealer earlier cannot be claimed as set off. Invoices should be preserved with full care. In case any original invoice is lost or misplaced, a duplicate authenticated copy must be obtained from the issuing dealer.

A VAT invoice:

 - (i) helps in determining the input tax credit;
 - (ii) prevents cascading effect of taxes;
 - (iii) facilitates multi-point taxation on the value addition;
 - (iv) promotes assurance of invoices;
 - (v) assists in performing audit and investigation activities effectively;
 - (vi) checks evasion of tax.

PART – C

Question 7

Compute the duty payable under the Customs Act, 1962 for an imported equipment based on the following information:

- (i) *Assessable value of the imported equipment US \$ 10,100,*
- (ii) *Date of bill of entry is 25.4.2009. Basic customs duty on this date is 20% and exchange rate notified by the Central Board of Excise and Customs is US \$ 1 = Rs. 65.*

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- (iii) Date of entry inwards is 21.4.2009. Basic customs duty on this date is 16% and exchange rate notified by the Central Board of Excise and Customs is US \$ 1 = Rs. 50.
- (iv) Additional duty payable under section 3(1) and (2) of the Customs Tariff Act, 1975: 15%
- (v) Additional duty under section 3(5) of the Customs Tariff Act, 1975: 4%.
- (vi) Educational cess @ 2% in terms of the Finance Act (No.2), 2004 and secondary and higher educational cess @ 1% in terms of the Finance Act, 2007.

Make suitable assumptions where required and show the relevant workings and round off your answer to the nearest rupee. (5 Marks)

Answer

Computation of custom duty payable:

Particulars	Rs.
Assessable value (10,100 x 65)	6,56,500
Add: Basic custom duty @ 20%	<u>1,31,300</u>
Total	7,87,800
Add : CVD @ 15.45%	<u>1,21,715.10</u>
Total	9,09,515.10
Add : Education Cess (131300 + 121715.10) x 3%	<u>7,590.45</u>
Total	<u>9,17,105.60</u>
Additional duty u/s 3(5) @ 4%	36,684.22
Total Custom Duty Payable (131300 + 121715.10+7590.45+36684.22)	2,97,289.77
Custom Duty (rounded off to nearest rupee)	2,97,290

Notes:

1. Since bill of entry was presented after grant of entry inwards, exchange rate Rs.65 per USD is applicable as it is the rate notified by CBEC on the date of presentation of Bill of Entry.
2. Basic customs duty @ 20% is applicable as it is prevalent on the date of presentation of bill of entry (Section 15 of the Custom Act, 1962).

Question 8

The assessee had imported capital goods under a licence with a condition to fulfill an export obligation within a certain time limit. The assessee failed to discharge the export obligation within the said time limit. Consequently, the Department invoked the bank guarantee and realized the amount. However, subsequently the assessee was able to fulfill the export obligation and the Department cancelled the bank guarantee. The assessee thereafter filed a refund claim for the amount realized by invocation of the bank guarantee by the Department. The Department rejected the refund claim on the ground that it was barred in terms of section

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27(1)(b) of the Customs Act, 1962 as the assessee had not been able to establish that the incidence of duty had not been passed on by him to any other person. Examine briefly, with the help of any decided case law, whether the stand taken by the Department is correct in law.

(5 Marks)

Answer

In *CCus. (Exports) v. Jraj Exports (P) Ltd.* 2007 (217) ELT 504 (Mad.), the High Court observed that when the Department had accepted the fulfillment of export obligation, there was no need to invoke the bank guarantee and retain the amount. The High Court opined that the Department's claim that refund had been time barred was not sustainable as furnishing of bank guarantee in order to fulfill the export obligation could not be regarded as payment of duty.

The High Court relied on the Supreme Court's ruling in the case of *Oswal Agro Mills Ltd. and Another v. Asstt. Collector of Central Excise* 1994 (70) ELT 48 (SC), wherein it was held that furnishing of bank guarantee pursuant to an order of the Court would not be equivalent to payment of excise duty. The furnishing of bank guarantee is only a security to safeguard the interest of the Revenue. Applying the principle laid down in this case, the Court stated that the requirement to establish that the duty incidence had not been passed on by the assessee to any other person would also not get attracted since section 27 has no application to this case. Therefore, the stand of the Revenue is not correct in law.

Question 9

- (a) Explain briefly the expression 'person-in-charge' under the Customs Act, 1962. (2 Marks)
- (b) Explain briefly the provisions of the Customs Act, 1962 relating to the powers vested in the customs officers to take samples. (2 Marks)
- (c) Explain, with a brief note, how the duty is arrived under the Customs Act, 1962 where the imported goods consist of articles liable to different rates of duty. (2 Marks)
- (d) Write a brief note on the 'residual method' of determination of value of imported goods under the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. (2 Marks)
- (e) Briefly state the rights of the owner of warehoused goods under the Customs Act, 1962.

(2 Marks)

Answer

- (a) Section 2(31) provides that 'person in charge' means:
 - (a) in relation to a vessel, the master of the vessel.
 - (b) in relation to an aircraft, the commander or the pilot in charge of the aircraft.
 - (c) in relation to a railway train, the conductor, guard or other person having the chief direction of the train.

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- (d) in relation to any other conveyance, the driver or other person in charge of the conveyance.
- (b) As per the provisions of section 144 of the Customs Act, the proper officer may, on the entry or clearance of any goods or at any time while such goods are being passed through the customs area, take samples of such goods in the presence of the owner thereof, for:
 - (a) examination or testing or,
 - (b) ascertaining the value thereof, or
 - (c) any other purposes of this Act
- (c) Where goods consist of a set of articles, duty shall be calculated as follows as per section 19 of the Customs Act, 1962:
 - (a) articles liable to duty with reference to quantity shall be chargeable to that duty;
 - (b) articles liable to duty with reference to value shall, if they are liable to duty at the same rate, be chargeable to duty at that rate, and if they are liable to duty at different rates, be chargeable to duty at the highest of such rates;
 - (c) articles not liable to duty shall be chargeable to duty at the rate at which articles liable to duty with reference to value are liable under clause (b).
- (d) Residual Method under rule 9 of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007:

Subject to the provision of rule 3 of the aforesaid rules, where the value of imported goods cannot be determined under the provisions of any of the preceding rules, the value shall be determined using reasonable means consistent with the principles and general provisions of these rules and on the basis of data available in India subject to the conditions laid down in rule 9(2) of the aforesaid rules.
- (e) With the sanction of the proper officer, and on payment of the prescribed fees, the owner of any goods either before or after warehousing the same -
 - (a) inspect the goods;
 - (b) separate damaged or deteriorated goods from the rest;
 - (c) sort the goods or change the containers for the preservation, sale, export or disposal of the goods;
 - (d) deal with the goods & their containers in such manner as may be necessary to prevent loss, deterioration or damage to the goods;
 - (e) show the goods for sale;
 - (f) take samples of the goods without entry for home consumption, if the proper officer so permits, without payment of duty on such samples.

SUMMARY OF EXAMINERS' COMMENTS ON THE PERFORMANCE OF CANDIDATES

PAPER – 5 : ADVANCED MANAGEMENT ACCOUNTING

General Comments

Overall performance of the candidates was not satisfactory, question paper was a standard one. Preparation on the part of the student for the subject was lacking.

Specific Comments

Question 1. Part (a) was a question of make or sub-contract . Most of the candidates failed to answer full question correctly. Performance is below average. Part (b) was on theory of skimming pricing policy and performance was fairly good.

Question 2. Part (a) was on budgeting and performance of candidates was fairly good. Part (b) was on theory on transportation problem and performance was average.

Question 3. Part (a) was on product pricing and pricing strategy. Performance was fair. Part (b) was on theory of Total Quality Management and performance was good. Part (c) was on value analysis and performance was average.

Question 4. Part (a) was question on transfer pricing and the performance was poor. Concept of goal congruence was good. Part (b) was a theoretical question of assignment - performance was average.

Question 5. Part (a) is on variance analysis which involves calculation of workers of different categories and then computation of variances. Performance is average. Part (b) is on setting up initial simplex tables from a linear programming problem. Performance was not satisfactory.

Question 6. Part (a) was on PERT- CPM : critical path & crashing. Performance was average. Part (b) was on Testing of Hypothesis . Performance was not satisfactory. Part (c) was on learning curve ratio and performance was average.

Observation on the question paper.

The question paper covers syllabus contents evenly and aims at testing knowledge on Management Accounting.

PAPER – 6: INFORMATION SYSTEMS CONTROL AND AUDIT

General Comments

The overall performance of the examinees was not satisfactory. Thorough reading of the study material was lacking on the part of the candidates. They were required to have in-depth knowledge of various case studies, discussed in the study material to answer the practical oriented questions.

SUMMARY OF EXAMINERS' COMMENTS

Specific Comments

Question 1. This was a case study based question.

(a) A similar case study has been discussed in the study material but examinees were not able to give a clear answer to the question.

(b) Many examinees failed to discuss the international standard BS7799, which showed lack in thorough reading of the chapter on Auditing Standards.

(c) The examinees were not able to contrive the ways to enrich human resources for effective utilization of the proposed new system.

Question 2.(a) Application of the concept of systems, discussed in the study material was required to answer this question. Lack of understanding resulted in poor performance.

(b) The answer of this question was well replied by the examinees, as examinee were aware of the threats due to cyber crimes.

(c) This was a straight forward question on 'Physical and Environmental Security with Control and Objectives' and was attempted well.

(d) This was also a straight forward question on IT Act, 2000 and was attempted well by the examinees.

Question 3.(a) The answer to this question based on 'the analysis to be done to understand the degree of potential loss to the organization' is clearly discussed in the study material but most of the examinees could not attempt it properly.

(b) The question was based on the 'Risk Management Process'. Candidates seems to have neglected the study material contents and gave a generalized answer.

(c) Most of the examinees were unable to give the proper explanation of 'Cryptosystems' and 'Data Encryption Standard'.

Question 4.(a) Most of the candidates failed to discuss IS Audit documentation procedures.

(b) Majority of the examinees correctly explained the basic types of Information Protection that an organization can use.

(c) In this question also, majority of the examinees discussed the processes of Access Control Mechanism, correctly.

Question 5.(a) Performance of the examinees was satisfactory as the question was based on IT Act, 2000.

(b) Examinees were not clear with the technical term, Black Box Testing.

(c) The question, based on anti-virus software and its types, was poorly attempted by the examinees.

(d) This question, based on ERP System, was well attempted by the examinees.

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PAPER – 7 : DIRECT TAX LAWS

General Comments

The overall performance of the candidates was found to be below the expected level depicting lack of knowledge and application skills. Answers to some questions were found to be extremely vague and lacking in substance. Though the concept asked in some of the questions was simple and straight, but the candidates have failed to understand the issues raised in those questions.

Specific Comments

Question 1.(a) The adjustments relating to traveling expense incurred on foreign tour of a director, non-refund of sales-tax to the customers and depreciation on the commercial vehicle purchased were not properly dealt with by many candidates.

(b) Deduction under section 91 was not worked out rightly since the candidates have not computed the Indian rate of tax and rate of tax on the income in foreign country correctly.

Question 2.(b) This question is based on the amendment in section 143(1), but many of the candidates have wrongly explained the powers of the Assessing Officer while making an assessment under section 143(3) or section 148.

Question 3.(a) Majority of the candidates have wrongly answered that the non-deposit of sales tax shown under “Contingency Deposit” was not a default for invoking the provision of section 43B and therefore, the action of the Assessing Officer in invoking section 43B and taxing the amount of sales tax kept in contingency deposit account was incorrect.

(b) Many of the candidates have wrongly answered that the receipt is taxable as business income or income under the head “Income from other sources”.

(c) Many candidates have simply stated that the Appellate Tribunal cannot rectify the order under section 254 beyond 4 years from the date of the order sought to be revised. Very few candidates have mentioned that where the application for rectification is made within four years from the date of the order, the Appellate Tribunal is bound to decide the application on merits and not on the ground of limitation.

Question 4.(a) Very few candidates could apply the provisions of section 33AB and Rule 8 correctly to compute the taxable income.

(b) Very few candidates could give the correct answer to this part of question and instead, explained the meaning of “question of law, “question of fact” and “mixed question of law and fact”.

(c) Some candidates have stated that the expenditure disallowed in an assessment completed under section 143(3) can be allowed as deduction when the case is being reopened under section 147 and section 148 on production of evidence by the assessee.

Question 5.(a) Most of the candidates were not able to apply the provisions of section 167B and 86 correctly to compute the income of the AOP and its members.

SUMMARY OF EXAMINERS' COMMENTS

(c) Though the candidates have correctly explained the provisions of section 2(15), as amended by the Finance Act, 2008, however, the application thereof in both the situations was not correct in some cases.

Question 6.(b) Some candidates have not calculated the tax liability under both the options and wrongly concluded that since, in case of HRA, the take-home-salary is more, Mr. Kadam should avail HRA.

Question 7.(a) The various items to be included in the computation of wealth of the individual were correctly considered except that the gold jewellery not held by the assessee on the valuation date was treated as chargeable to tax and the exemption of one house was claimed in respect of the house against which the loan of Rs.15 lacs was outstanding.

PAPER – 8 : INDIRECT TAX LAWS

General comments

Overall performance in the paper was unsatisfactory. Candidates showed marked tendency to write general answers instead of referring to actual provisions in a concise and to the point manner. Candidates are advised to carefully study the latest case laws, particularly decided by the Supreme Court and the latest amendments made in the Acts (relevant for the particular exams). Further, the presentation of answers was not up to the mark. Candidates are advised to improve their presentation skills and follow an analytical approach and logical reasoning while answering the questions.

Specific Comments

Question 1.(a) Many candidates did not deduct the installation and erection charges and cost of bought out accessories while computing the transaction value.

(b) A large number of candidates included the CENVAT credit of duty paid on the office equipment and diesel while arriving at the total amount of CENVAT credit admissible.

Question 3. In sub-part (a), majority of the candidates were not aware of the explanation inserted in the section 2(d) by the Finance Act, 2008.

Question 4.(a): Most of the candidates did not compute the taxable turnover correctly on which VAT is payable.

(b) Many candidates failed to compute the value of taxable services correctly.

Question 5.(a): A large number of candidates did not attempt the question properly and failed to quote the correct case law.

Question 6. Candidates failed to discuss the specific provisions of law and provided vague answers.

Question 7. Candidates wrongly took the exchange rate as US \$ 1=Rs. 50. Further, proper working notes were not provided with the answers.

Question 8. Majority of the candidates provided general answers without referring to the case law.



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Information Technology	150	150		
Strategic Management	<u>100</u>	<u>100</u>		
	750	750	180	180
Both Groups	1800	1800	395	395
Professional Competence Course – Study Material) in CD in English.	40		40	
Information Technology Training Course Material				
Information Technology Training Programme -	500		90	
Modules - I & II				
100 Hours Information Technology Training Course Material in Cds (8 Nos.)	320		40	
(Self Assessment and Summarised Study Material.)				
INTEGRATED PROFESSIONAL COMPETENCE COURSE (IPCC)				
Group I				
Accounting				
Vol. I Study Material	250	250		
Vol. II Practice Manual	80			
Business Laws & Ethics and Communication	325	325		
Cost Accounting and Financial Management Part 1				
Vol. I Study Material	250	250		
Vol. II Practice Manual	125			
Cost Accounting and Financial Management Part 2				
Vol. I Study Material	175	175		
Vol. II Practice Manual	80			
Taxation	<u>300</u>	<u>300</u>		
	1585	1300	460	460
Group II				
Advanced Accounting				
Vol. I Study Material	350	350		
Vol. II Practice Manual	75			
Auditing and Assurance Vol.I	250	250		
Auditing and Assurance Vol.II	150	150		
Information Technology & Strategic Management	<u>300</u>	<u>300</u>		
	1125	1050	300	300
Both Groups	2710	2350	750	750
IPCC Study Material CD in English	40		40	

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	<i>English</i>	<i>Hindi</i>
	<i>Rs.</i>	<i>Rs.</i>
ACCOUNTING TECHNICIAN COURSE (ATC)		
Accounting	250	250
Business Laws & Ethics and Communication	325	325
Cost Accounting and Financial Management Vol I	250	250
Cost Accounting and Financial Management Vol II	175	175
Taxation	300	300
	1300	1300
ATC Study Material CD in English	40	40
FINAL (NEW COURSE)		
Group I		
Financial Reporting	600	600
Strategic Financial Management	260	260
Advanced Auditing and Professional Ethics	520	520
Corporate and Allied Laws	<u>200</u>	<u>200</u>
	1580	1580
Group II		
Advanced Management Accounting	240	240
Information Systems Control and Audit	150	150
Direct Tax Laws	340	340
Indirect Tax Laws	<u>290</u>	<u>290</u>
	1020	1020
Both Groups	2600	2600
Final (New Course) – Study Material in CD in English.	40	40
FINAL COURSE		
Group I		
Advanced Accounting	150	225
Management Accounting & Financial Analysis	200	275
Advanced Auditing	300	350
Corporate Laws and Secretarial Practice	<u>200</u>	<u>250</u>
	850	1100
Group II		
Cost Management	200	250
Management Information & Control Systems	150	175
Direct Taxes	150	250
Indirect Taxes	<u>150</u>	<u>225</u>
	650	900
Both Groups	1500	2000

		Postal Charges by Regd. Parcel	
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		Rs.	Rs.
II. COMPILATIONS OF SUGGESTED ANSWERS			
Professional Education (Examination –II)			
1.	Accounting (May 1999 to Nov. 2008)	60	40
2.	Auditing (May, 2000 to November 2008)	50	40
3.	Business and Corporate Laws (May 2000 to November 2008)	50	40
4.	A.: Cost Accounting (May 1999 to November 2008)	40	40
	B : Financial Management (May 1999 to November 2008)	30	40
5.	Income Tax and Central Sales Tax (November 2002 to June 2009)	40	40
6.	Information Technology (November 2002 to November 2008)	40	40
	Complete Set	270	110
Final			
1.	Advanced Accounting (May 1999 to November 2008)	60	40
2.	Management Accounting & Financial Analysis (May 1999 to November 2008)	60	40
3.	Advanced Auditing (May 2000 to November 2008)	50	40
4.	Corporate Laws and Secretarial Practice (May 2000 to November 2008)	50	40
5.	Cost Management (May 1999 to May 2008)	60	40
6.	Management Information and Control Systems (May 1999 to November 2008)	30	40
7.	Direct Taxes (May 2000 to November 2005)	60	40
	Complete Set	370	150
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	Professional Education (Course - II) (Nov. 2002 to Nov. 2005)	40	40
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	Integrated Professional Competence Course(Group I & II) – November 2009 only		
	Accounting Technician Course – November 2009 only		
	Final (Group I & II)		
	Final New Course (Group I & II) – November, 2008 and onwards		
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	Accounting Technician Course (ATC)	40	40
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6.	Supplementary Study Paper -2009 Direct taxes and Indirect taxes for Final Course Direct tax laws and Indirect tax laws for Final (new) Course	60	40
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