

PAPER – 5 : COST MANAGEMENT

Question No. 1 is compulsory.

Answer any four questions from the rest.

Working notes should form part of the answer.

Question 1

- (a) A company produces a product X, using raw materials A and B. The standard mix of A and B is 1 : 1 and the standard loss is 10% of input.

You are required to compute the missing information indicated by “?” based on the data given below:

	A	B	Total
Standard price of raw material (Rs./kg.)	24	30	
Actual input (kg.)	?	70	
Actual output (kg.)			?
Actual price Rs./kg.	30	?	
Standard input quantity (kg.)	?	?	
Yield variance (sub usage)	?	?	270(A)
Mix variance	?	?	?
Usage variance	?	?	?
Price variance	?	?	?
Cost variance	0	?	1300(A)

- (b) The initial allocation of a transportation problem, alongwith the unit cost of transportation from each origin to destination is given below. You are required to arrive at the minimum transportation cost by the Vogel's Approximation method and check for optimality.

(Hint : Candidates may consider $u_1 = 0$ at Row 1 for initial cell evaluation)

					Requirement	
	11	2	8	6	4	
	9	9	12	9	6	18
	7	6	3	7	7	10
	9	3	5	6	11	8
<u>Availability</u>	12	8	8	8	4	40

(c) How does the JIT approach help in improving an organisation's profitability?

(14 + 6 + 4 = 24 Marks)

Answer

(a) Computation of Yield Variance for 'A' and 'B'

$$\begin{array}{l} \text{DM yield} \\ \text{variance} \\ \text{for 'A'} \end{array} = \left[\begin{array}{l} \text{Std qty of} \\ \text{all DM} \\ \text{allowed} \\ \text{for actual} \\ \text{output} \end{array} - \begin{array}{l} \text{Actual} \\ \text{total qty} \\ \text{of all DM} \\ \text{used} \end{array} \right] \times \begin{array}{l} \text{Std} \\ \text{Mix} \\ \text{\%age} \\ \text{of 'A'} \end{array} \times \text{Std price of 'A'}$$

$$= [SQ_A - RSQ_A] \times \text{Std price of 'A'}$$

Where RSQ_A = Revised Standard Quantity of 'A' = (Actual total qty of all DM used) \times Std Mix %age of 'A' and

SQ_A = Standard Quantity of DM 'A' for Actual Production = Standard quantity of all DM allowed for actual output \times Std Mix %age of 'A'

$$\begin{array}{l} \text{DM yield} \\ \text{variance} \\ \text{for 'B'} \end{array} = \left[\begin{array}{l} \text{Std qty of} \\ \text{all DM} \\ \text{allowed} \\ \text{for actual} \\ \text{output} \end{array} - \begin{array}{l} \text{Actual} \\ \text{total qty} \\ \text{of all DM} \\ \text{used} \end{array} \right] \times \begin{array}{l} \text{Std} \\ \text{Mix} \\ \text{\%age} \\ \text{of 'B'} \end{array} \times \text{Std price of 'B'}$$

$$= [SQ_B - RSQ_B] \times \text{Std price of 'B'}$$

Where RSQ_B = Revised Standard Quantity of 'B' = (Actual total qty of all DM used) \times Standard Mix %age of 'B' and

SQ_B = Standard quantity of DM 'B' for Actual Production = Standard quantity of all DM allowed for actual output \times Standard Mix %age of 'B'

Since Standard Mix %age is the same for both 'A' and 'B' (1:1) we have,

Total Yield variance for 'A' and 'B' = $T \times (\text{Std price of 'A'} + \text{Std price of 'B'})$

Where $T = (\text{Std qty of all DM allowed for actual output} - \text{Actual total qty of all DM used}) \times 0.5$

As Total Yield variance for 'A' and 'B' is given as – Rs 270, we have

$$- \text{Rs } 270 = T \times \text{Rs } 24 + T \times \text{Rs } 30$$

$$\text{Or } T = - 5$$

Hence Yield Variance for 'A' = $- 5 \times 24 = - \text{Rs } 120$ and

Yield variance for 'B' = $- 5 \times 30 = - \text{Rs } 150$.

Also

$$(SQ_A - RSQ_A) \times 24 = -120 \text{ or } SQ_A - RSQ_A = -5$$

Similarly

$$(SQ_B - RSQ_B) \times 30 = -150 \text{ or } SQ_B - RSQ_B = -5$$

Alternative 1

Let total actual quantity consumed; X kg.

Then, Quantity of A = X – 70

$$RSQ = \frac{X}{2} \text{ of A \& } \frac{X}{2} \text{ of B. (Since the Mix ratio is 1:1)}$$

The Standard input for both 'A' and 'B' will be $0.5X - 5$

Since Cost Variance for 'A' is given to be nil, we have,

$$(SP_A \times SQ_A) - (AQ_A \times AP_A) = 0$$

$$\text{i.e. } 24 \times (0.5X - 5) - (X - 70) \times 30 = 0$$

or X = 110 Kgs

Therefore Actual Input for 'A' = 110 – 70 = 40 Kgs

Also, Standard Input for 'A' and 'B' will be $\left(\frac{110}{2} - 5\right) = 50$ Kgs. Using this quantity in the Cost Variance of 'B', the actual price per kg of 'B' (AP_B) will be ,

$$50 \times 30 - 70 \times AP_B = -1,300$$

Or $AP_B = \text{Rs } 40$.

Alternative 2

Let the standard input of 'A' = X kg. Therefore, the total standard input for 'A' + 'B' = 2X

Actual input = (2X + 10) Kgs. \therefore Actual input for 'A' = (2X + 10 – 70) = (2X – 60)Kgs

Forming the equation for nil cost variance of 'A'.

$$\text{Rs. } 24 \times X - \text{Rs. } 30 \times (2X - 60) = 0$$

Or X = 50 Kgs. Using this quantity in the Cost Variance of 'B', the actual price per kg. of 'B' (AP_B) will be ,

$$50 \times 30 - 70 \times AP_B = -1,300$$

Or $AP_B = \text{Rs. } 40$.

Alternative 3

Let the actual input of 'A' = X

Then the total actual input = $(X + 70)$. Therefore, RSQ of 'A' and 'B' each = $0.5X + 35$ and Standard Input of 'A' and 'B' each = $0.5X + 30$.

Forming the equation for nil cost variance of 'A', we have,

$$24 \times (0.5X + 30) - 30 \times X = 0$$

Or $X = 40$ Kgs.

\therefore Standard Input will be 50 Kgs. Using this, quantity in the Cost Variance of 'B', the actual price per kg. of 'B' (AP_B) will be,

$$50 \times 30 - 70 \times AP_B = -1,300$$

Or $AP_B = \text{Rs. } 40$.

Substituting various values for quantity and price, we get the following table.

	(1)	(2)	(3)	(4)
	Std. Price \times SQ	Std. Price \times RSQ	Std. Price \times Actual Qty.	Actual Price \times Actual Qty.
A	$24 \times 50 =$ 1200	$24 \times 55 = 1320$	$24 \times 40 = 960$	$30 \times 40 = 1200$
B	$30 \times 50 =$ 1500	$30 \times 55 = 1650$	$30 \times 70 = 2100$	$40 \times 70 = 2800$
	<u>2700</u>	<u>2970</u>	<u>3060</u>	<u>4000</u>

	(1) - (2)	(2) - (3)	(1) - (3)	(3) - (4)	(1) - (4)
	Yld variance	Mix variance	Usage variance	Price variance	Cost variance
A	$1200 - 1320 =$ 120(A)	$1320 - 960 =$ 360(F)	$1200 - 960 =$ 240(F)	$960 - 1200 =$ 240(A)	$1200 - 1200 =$ 0
B	$1500 - 1650 =$ 150(A)	$1650 - 2100 =$ 450(A)	$1500 - 2100 =$ 600(A)	$2100 - 2800 =$ 700(A)	$1500 - 2800 =$ 1300(A)
	<u>270A)</u>	<u>90A)</u>	<u>360A)</u>	<u>940A)</u>	<u>1300A)</u>

Actual Output = 90 Kgs.

(Actual output and standard output are always equal numerically in any material variance analysis)

Standard output = Standard input - Standard loss or $100 - 10 = 90$ Kgs.

- (b) The concept tested in this problem is Degeneracy with respect to the transportation problem. Total of rows and columns = $(4 + 5) = 9$. Hence, the number of allocations = $9 - 1 = 8$. As the actual number of allocation is 7, a 'zero' allocation is called for. To resolve this, an independent cell with least cost should be chosen. R4C2 has the least

cost (cost = 3), but this is not independent. The next least cost cell R4C3 (cost = 5) is independent.

	9 C1	2 C2	5 C3	6 C4	2 C5	Total
0R1	11	2	8	6	4	18
0R2	9	9	12	9	6	10
-2R3	7	6	3	7	7	8
0R4	9	3	5	6	11	4
Total	12	8	8	8	4	40

Forming Equations through allocated cells

Basic equation	Setting R1 = 0 other values
$R1 + C2 = 2$	Setting $R1 = 0, C2 = 2$
$R1 + C4 = 6$	$C4 = 6$
$R1 + C5 = 2$	$C5 = 2$
$R2 + C1 = 9$	$R2 = 0$
$R3 + C3 = 3$	$R3 = -2$
$R4 + C1 = 9$	$C1 = 9$
$R4 + C3 = 5$	$C3 = 5$
$R4 + C4 = 6$	$R4 = 0$

Evaluate unallocated cells

$R1C1 = 11 - 0 - 9 = 2$	$R3C1 = 7 + 2 - 9 = 0$
$R1C3 = 8 - 0 - 5 = 3$	$R3C2 = 6 + 2 - 2 = 6$
$R2C2 = 9 - 0 - 2 = 7$	$R3C4 = 7 + 2 - 6 = 7$
$R2C3 = 12 - 0 - 5 = 7$	$R3C5 = 7 + 2 - 2 = 7$
$R2C4 = 9 - 0 - 6 = 3$	$R4C2 = 3 - 0 - 2 = 1$
$R2C5 = 6 - 0 - 2 = 4$	$R4C5 = 11 - 0 - 2 = 9$

Since all the evaluation is 0 or +ve, the optimal solution is obtained.

Optimal cost = $(8 \times 2) + (6 \times 6) + (4 \times 2) + (10 \times 9) + (8 \times 3) + (2 \times 9) + (0 \times 5) + (2 \times 6) = 16 + 36 + 8 + 90 + 24 + 18 + 10 + 12 = \text{Rs. } 204.$

Note: As regards allocation of the zero values, the solution to the above problem is also obtained by allocating the zero value in other independent cells such as R1C3, R2C2, R2C3, R3C1, R3C2, R3C4, R3C5. In such situation there will be one more iteration.

- (c) JIT approach helps in the reduction of costs/increase in prices as follows:
- (i) Immediate detection of defective goods being manufactured so that early correction is ensured with least scrapping.
 - (ii) Eliminates/reduces WIP between machines within working cell.
 - (iii) OH costs in the form of rentals for inventory, insurance, maintenance costs etc. are reduced.
 - (iv) Higher product quality ensured by the JIT approach leads to higher premium in the selling price.
 - (v) Detection of problem areas due to better pdn/scrap reporting/labour tracing and inventory accuracy lead to reduction in costs by improvement.

Question 2

- (a) A company has produced 1,500 units against a budgeted quantity of 2,000 units. Actual sales were 1,300 units. The company's policy is to value stocks at standard absorption cost.

Other data are:

Direct material	Rs. 100 per unit
Direct labour	Rs. 100 per unit at normal efficiency
Variable OH	Rs. 50 per unit
Fixed OH at budgeted capacity	Rs. 1,00,000
Variable selling OH	Rs. 26,000
Budgeted fixed selling OH	Rs. 30,000
Actual fixed selling OH	Rs. 25,000
Selling price	Rs. 400 per unit

There was no opening stock.

- (i) Present the profitability statement under absorption costing system.
- (ii) Assuming actual labour was 25% below normal efficiency and that 100 units of production had to be scrapped after complete manufacture, compute the actual profit or loss.
- (iii) Reconcile the profits under (i) and (ii) above.

- (b) What is product life cycle costing? What are the costs that you would include in product life cycle cost?
- (c) The following information of a company is available for the year 2006:

	Rs.
Sales	40,000
Raw materials	20,000
Direct wages	6,000
Variable and fixed OH	10,000
Profit	4,000
Units sold	200 Nos.

In the year 2007, wages rate will increase by 50% and fixed cost will decrease by Rs. 600. If 300 units are sold in 2007, the total fixed and variable OH will be 11,400. How many units should be sold in 2007, so that the same amount of profit per unit as in year 2006 may be earned?
(11 + 4 + 4 = 19 Marks)

Answer

(a) Profitability under absorption costing system		Actual profit and loss account	
Particulars	Rs. 000's	Particulars	Rs. 000's
Sales (1,300×400)	520	Sales (1,300×400)	520
Absorption costs		Closing Stock (100×300)	30
Opening Stock	Nil	Total	550
Cost of production		Cost	
1,500 units × 300	450	Direct materials (1,500×100)	150
Less: Closing stock (200×300)	60	Direct labour (1,500×100/75%)	200
Net Absorption costs	390	Variable overhead (1,500×50)	75
Add: Under-absorption (500×50)	25	Fixed manufacturing overhead	100
Total absorption costs	415	Fixed Selling overhead	25
Gross profit	105	Variable selling overhead	26
Less: Selling overhead variable	26	Total costs	576
Selling overhead fixed	25		
Profit/(loss)	54	Profit / (Loss)	(26)

Working Notes:

	Rs.		Units
Absorption cost per unit		Budgeted capacity	2,000
Direct materials	100	Production	1,500
Direct labour	100	Under-absorption	500
Variable overhead	50	Sales	1,300
Fixed Overhead (1,00,000 / 2,000)	<u>50</u>	Closing stock	200
Total	<u>300</u>		

Reconciliation

	Rs. 000's
Profit under absorption costing	54
Less: Labour inefficiency**	(50)
Less: Value of units scrapped	(30)
Actual profit / (loss)	(26)

** $(1,500 \times (133 \frac{1}{3} - 100))$

Note: In case budgeted fixed selling overheads are considered while arriving at absorption profit a saving of Rs. 5,000 shall need to be identified as part of reconciliation.

- (b) Product life cycle costing traces costs and revenues of each product over several calendar periods throughout their entire life cycle.

The costs are included in different stages of the product life cycle.

Development phase – R & D cost / Design cost.

Introduction phase – Promotional cost / Capacity costs.

Growth phase / Maturity – Manufacturing cost / Distribution costs / Product support cost.

Decline / Replacement phase – Plants reused / sold / scrapped / related costs.

(c) Particulars (Data per unit)	2006	2007
	Rs.	Rs.
Selling price (40,000 / 200)		200
Raw materials (20,000 / 200)		100
Direct wages (6,000 / 200)	30	(30 × 150%) 45
Variable overhead		20
Total variable cost		165
Contribution		35

Profit per unit (4,000 /200)		20
Net contribution per unit to cover fixed overheads		15
Fixed overheads	6,000	5,400
No. of units		5,400/15 = 360 units

Working Notes:

No. of units sold	200	300
Total variable and fixed overheads	10,000	11,400 + 600 = 12,000
Differential cost in 2007		100 units Rs. 2,000
Variable overhead per unit		2,000 / 100 = 20
Total variable cost	4,000	6,000
Total fixed cost	6,000	(6,000 – 600) 5,400

Question 3

(a) A company had planned its operations as follows:

Activity	Duration (days)
1–2	7
2–4	8
1–3	8
3–4	6
1–4	6
2–5	16
4–7	19
3–6	24
5–7	9
6–8	7
7–8	8

- (i) Draw the network and find the critical paths.
- (ii) After 15 days of working, the following progress is noted:
 - (a) Activities 1–2, 1–3 and 1–4 completed as per original schedule.
 - (b) Activity 2–4 is in progress and will be completed in 4 more days.
 - (c) Activity 3–6 is in progress and will need 17 more days to complete.

- (d) The staff at activity 3–6 are specialised. They are directed to complete 3–6 and undertake an activity 6–7, which will require 7 days. This rearrangement arose due to a modification in a specialisation.
- (e) Activity 6–8 will be completed in 4 days instead of the originally planned 7 days.
- (f) There is no change in the other activities.

Update the network diagram after 15 days of start of work based on the assumption given above. Indicate the revised critical paths along with their duration.

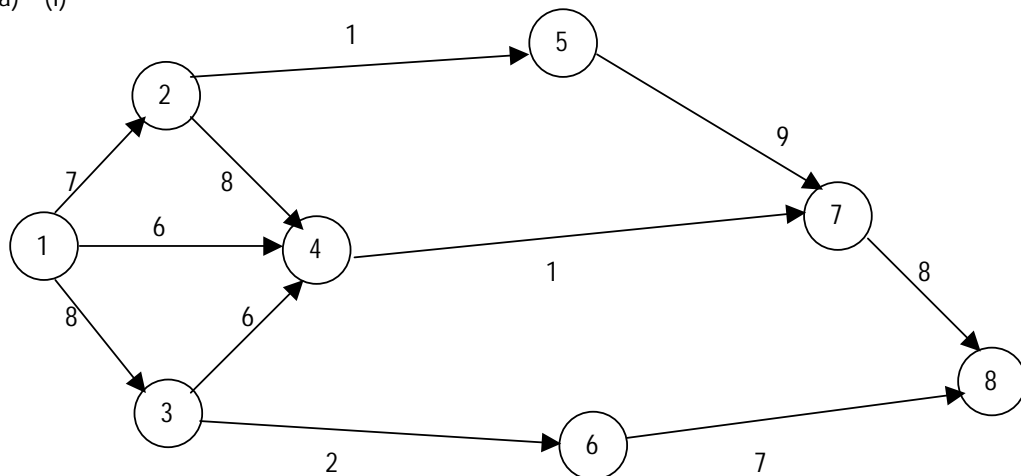
(b) Explain briefly the major components of a balanced score card.

(c) Describe the process of zero-base budgeting.

(11 + 4 + 4 = 19 Marks)

Answer

(a) (i)



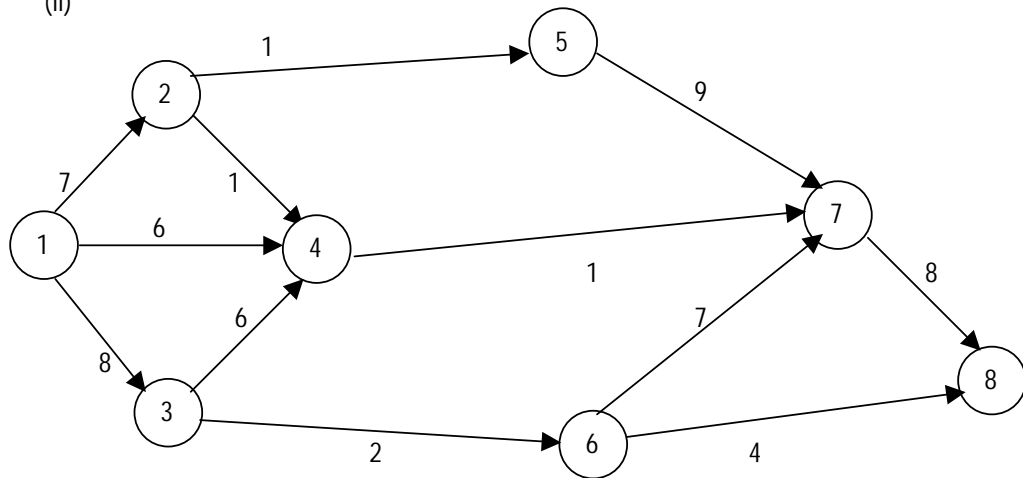
Paths	Duration
1 – 2 – 5 – 7 – 8	$7 + 16 + 9 + 8 = 40$
1 – 2 – 4 – 7 – 8	$7 + 8 + 19 + 8 = 42$
1 – 4 – 7 – 8	$6 + 19 + 8 = 33$
1 – 3 – 4 – 7 – 8	$8 + 6 + 19 + 8 = 41$
1 – 3 – 6 – 8	$8 + 24 + 7 = 39$

Critical path 1 – 2 – 4 – 7 – 8 = 42 days.

Revised Duration of activities 2 – 4 and 3 – 6 after 15 days for update.

Activity	Preceding Activity	Date of completion	Revised Duration
2 – 4	1 – 2	15 + 4 = 19 days	19 – 7 = 12 days
3 – 6	1 – 3	15 + 17 = 32 days	32 – 8 = 24 days
6 – 7 (new activity)	3 – 6		7 days
6 – 8	3 – 6		4 days

(ii)



Paths	Duration
1 – 2 – 5 – 7 – 8	7 + 16 + 9 + 8 = 40
1 – 2 – 4 – 7 – 8	7 + 12 + 19 + 8 = 46
1 – 4 – 7 – 8	6 + 19 + 8 = 33
1 – 3 – 4 – 7 – 8	8 + 6 + 19 + 8 = 41
1 – 3 – 6 – 7 – 8	8 + 24 + 7 + 8 = 47
1 – 3 – 6 – 8	8 + 24 + 4 = 36

Critical path = 1 – 3 – 6 – 7 – 8 = 47 days.

- (b) An ideal Balanced score card combines financial measures of past performance with measures of the firm's drivers of future performance. The following perspectives are evaluated:
- (i) Customer perspective – Measures of price / delivery / quality / support.
 - (ii) Internal perspective – Measures of efficiency / sales penetration and new product introduction.

- (iii) Innovation and learning perspective – Measures of technology / cost leadership.
- (iv) Financial perspective – Sales / Cost of sales / Return on capital employed etc.
- (c) The zero Base Budgeting involves the following steps:
 - (i) Corporate objectives should be established and laid down in details.
 - (ii) Decide about the techniques of ZBB to be applied.
 - (iii) Identify those areas where decisions are required to be taken.
 - (iv) Develop decision programmes and rank them in order of preferences.
 - (v) Preparation of budget, that is translating decision packages into practicable units/items and allocating financial resources.

Question 4

- (a) A gear manufacturing company makes two types of gears – A and B. Both gears are processed on 3 machines, Hobbing M/c, Shaping M/c and Grinding M/c. The time required by each gear and total time available per week on each M/c is as follows:

Machine	Gear (A) (Hours)	Gear (B) (Hours)	Available Hours
Hobbing M/c	3	3	36
Shaping M/c	5	2	60
Grinding M/c	2	6	60
Other data:			
Selling price (Rs.)	820	960	
Variable cost (Rs.)	780	900	

Determine the optimum production plan and the maximum contribution for the next week by simplex method. The initial table is given below:

		C _j					
		40	60	0	0	0	0
Qty.							
C _j	Variable	X ₁	X ₂	X ₃	X ₄	X ₅	
0	X ₃	36	3	3	1	0	0
0	X ₄	60	5	2	0	1	0
0	X ₅	60	2	6	0	0	1

- (b) What are the essential requirements for successful implementation of TQM?
- (c) A company makes 1,500 units of a product for which the profitability statement is given below:

	Rs.
Sales	1,20,000
Direct materials	30,000
Direct labour	36,000
Variable OH	<u>15,000</u>
Subtotal variable cost	81,000
Fixed cost	<u>16,800</u>
Total cost	<u>97,800</u>
Profit	<u>22,200</u>

After the first 500 units of production, the company has to pay a premium of Rs. 6 per unit towards overtime labour. The premium so paid has been included in the direct labour cost of Rs. 36,000 given above.

You are required to compute the Break-even point. (7 + 6 + 6 = 19 Marks)

Answer

(a) Table 1

		C_j	40	60	0	0	0	Ratio	
		Qty							
C_j	Variable		X_1	X_2	X_3	X_4	X_5		
0	X_3	36	3	3	1	0	0	12	
0	X_4	60	5	2	0	1	0	30	
0	X_5	60	2	6	0	0	1	10	←
	Z_j	0	0	0	0	0	0		
	$Z_j - C_j$		-40	-60	0	0	0		

Table 2

		C_j	40	60	0	0	0	Ratio	
		Qty							
C_j	Variable		X_1	X_2	X_3	X_4	X_5		
0	X_3	6	2	0	1	0	$-\frac{1}{2}$	3	←
0	X_4	40	$\frac{13}{3}$	0	0	1	-	$\frac{120}{13}$	

60	X_2	10		1	0	0	1/6	30	
	Z_j	600	20	60	0	0	10		
	$Z_j - C_j$		-20	0	0	0	10		



Table 3

		C_j	40	60	0	0	0
	Qty						
C_j	Variable		X_1	X_2	X_3	X_4	X_5
40	X_1	3	1	0	1/2	0	-1/4
0	X_4	27	0	0	-13/6	1	3/4
60	X_2	9	0	1	-1/6	0	1/4
	Z_j	660	40	60	10	0	5
	$Z_j - C_j$		0	0	10	0	5

Since all $Z_j - C_j$ are positive or zero, this is the optimum solution with. $X_1 = 40$ and $X_2 = 60$ and optimum $Z = 660$.

Note : Alternatively, $C_j - Z_j$ may be used whereby maximum positive value may be considered.

- (b) Commitment: Quality improvement must be everyone's job. Clear commitment from the top management, steps necessary to provide an environment for changing attitudes and breaking down barriers to quality improvement must be provided. Support and training for this must be extended.

Culture: Proper training must be given to effect changes in culture and attitude.

Continuous Improvement: Recognition of room for improvement continually as a process, and not merely a one-off programme.

Cooperation: Must be ensured by involving employees by resorting to mutually agreeable improvement strategies and associated performance measures.

Customer Focus: Perfect service with zero defectives with satisfaction to end user whether external customer or internal customer.

Control: Documentation, procedures and awareness of current practices ensure checking deviation from the intended course of implementation.

(c)

Data / Unit	1 – 500	501 – 1,500
	Rs.	Rs.
Sales (1,20,000 / 1,500)	80	80
Direct material (20,000 / 1,000)	20	20
Direct labour	20	26
Variable overheads 15,000 / 1,500	10	10
Contribution	30	24
No. of units	500	
Total contribution	15,000	
Fixed costs	16,800	
Shortfall	1,800	
No. of units required above 500 to recover shortfall		$1,800 / 24 = 75$
Break even point		$(500 + 75) = 575$ units

Let X be the Direct Labour per unit upto 500 units.

$$\text{Total Direct Labour } 500X + 1,000 (X + 6) = 36,000$$

$$1,500X + 6,000 = 36,000$$

$$X = 20.$$

Therefore, up to 500 units the Direct Labour is Rs. 20. After 500 units it is Rs. 26.

Question 5

- (a) A research project, to date, has cost a company Rs. 2,50,000 and is under review. It is anticipated that, should the project be allowed to proceed, it will be completed in about one year and can be sold for Rs. 4,00,000. The following additional information is available:
- (i) Materials have just been received for Rs. 60,000. These are extremely toxic, and if not used in the project, have to be disposed of by special means at Rs. 15,000.
 - (ii) Labour: Rs. 75,000. The men are highly skilled. If they are released from the Research Project, they may be transferred to the Works Department of the company and consequently the sales could increase by Rs. 1,50,000. The accountant estimates that the prime cost of those sales would be Rs. 1,00,000 and the overhead absorbed (all fixed) would amount to Rs. 25,000.
 - (iii) Research staff: Rs. 1,60,000. A decision has already been taken that this will be the last major piece of research undertaken and consequently, when work on the

project ceases, the staff involved will be made redundant. Redundancy and severance pay have been estimated at Rs. 25,000.

(iv) Share of General Building Expenses : Rs. 35,000.

The Managing Director is not sure what is included in this amount, but the accounts staff charge similar amounts each year to each department.

You are required to advise whether the project should be allowed to proceed and explain the reasons for the treatment of each of the amounts above in your analysis.

- (b) Discuss with examples, the basic costing methods to assign costs to services.
 (c) Discuss the application of the learning curve. (10 + 5 + 4 = 19 Marks)

Answer

(a) Research Project

Particulars	Relevancy	Reason	Amount (Rs. '000s)
Project cost till date	Not relevant	Sunk cost	–
Sale price of the project	Relevant	Incremental revenue/opportunity gain	400
Cost of materials received	Not relevant	Sunk cost	–
Cost of disposal of materials	Relevant	Avoidable/opportunity cost	15
Cost of labour	Not relevant	Common costs	–
Contribution lost on the alternative use	Relevant	Opportunity cost [Sales – (Prime cost – labour)]	(125)
Absorbed Fixed overheads	Not relevant	Sunk cost	–
Cost of Research Staff	Relevant	Incremental / out of pocket	(160)
Redundancy and severance pay	Not relevant	Common costs	–
Share of General Building expenses	Not relevant	Sunk costs	–
Total incremental inflow if the project is proceeded with			<u>130</u>

Decision: Better to continue the project.

- (b) (i) (i) Job costing method: The cost of a particular service is obtained by assigning costs to a distinct identifiable service.
 e.g. Job Costing method is used in service sectors – like Accounting Firm, Advertisement campaign.
 (ii) Process Costing method: Cost of a service is obtained by assigning costs to masses of similar unit and then computing cost / unit on an average basis.

e.g. Retail banking, postal delivery, credit card etc.

(iii) Hybrid method: Combination of both (i) & (ii) above.

- (c) Application of Learning curve: Learning curve helps to analyse cost-volume profit relationships during familiarisation phase of product or process to arrive at cost estimates.

It helps in budgeting and profit planning.

It helps in pricing and consequent decision making – e.g. acceptance of an order, negotiations in establishing contract prices etc. with the advantage of the knowledge of decreasing unit cost.

It helps in setting standards in the learning phase.

Question 6

- (a) Hardware Ltd. Manufactures computer hardware products in different divisions which operate as profit centres. Printer Division makes and sells printers. The Printer Division's budgeted income statement, based on a sales volume of 15,000 units is given below. The Printer Division's Manager believes that sales can be increased by 2,400 units, if the selling price is reduced by Rs. 20 per unit from the present price of Rs. 400 per unit, and that, for this additional volume, no additional fixed costs will be incurred.

Printer Division presently uses a component purchased from an outside supplier at Rs. 70 per unit. A similar component is being produced by the Components Division of Hardware Ltd. And sold outside at a price of Rs. 100 per unit. Components Division can make this component for the Printer Division with a small modification in the specification, which would mean a reduction in the Direct Material cost for the Components Division by Rs. 1.5 per unit. Further, the Component Division will not incur variable selling cost on units transferred to the Printer Division. The Printer Division's Manager has offered the Component Division's Manager a price of Rs. 50 per unit of the component.

Component Division has the capacity to produce 75,000 units, of which only 64,000 can be absorbed by the outside market.

The current budgeted income statement for Components Division is based on a volume of 64,000 units considering all of it as sold outside.

	Printer Division	Component Division
	Rs. '000	Rs. '000
Sales revenue	<u>6,000</u>	<u>6,400</u>
Manufacturing cost:		
Component	1,050	–
Other direct materials, direct labour		
And variable OH	1,680	1,920

Fixed OH	<u>480</u>	<u>704</u>
Total manufacturing cost	<u>3,210</u>	<u>2,624</u>
Gross margin	2,790	3,776
Variable marketing costs	270	384
Fixed marketing and Admn. OH	<u>855</u>	<u>704</u>
Non-manufacturing cost	<u>1,125</u>	<u>1,088</u>
Operating profit	<u>1,665</u>	<u>2,688</u>

- (i) Should the Printer Division reduce the price by Rs. 20 per unit even if it is not able to procure the components from the Component Division at Rs. 50 per unit?
- (ii) Without prejudice to your answer to part (i) above, assume that Printer Division needs 17,400 units and that, either it takes all its requirements from Component Division or all of it from outside source. Should the Component Division be willing to supply the Printer Division at Rs. 50 per unit?
- (iii) Without prejudice to your answer to part (i) above, assume that Printer Division needs 17,400 units. Would it be in the best interest of Hardware Ltd. for the Components Division to supply the components to the Printer Division at Rs. 50?

Support each of your conclusions with appropriate calculations.

- (b) What are the practical applications of Linear programming? (12 + 7 = 19 Marks)

Answer

(a)

Particulars	Printer Division			Components Division	
	Existing price	Reduction in selling price	If component is purchased internally	Existing	If transfer is effected
Selling price	400	380	380	100	50
Component cost	70	70	50		
Other direct materials, labour and Variable overhead	112	112	112	30	28.50
Variable marketing cost	18	18	18	6	
Contribution	200	180	200	64	21.50

Volume units	15,000	17,400	17,400	64,000	17,400
Total contribution ('000)	3,000	3,132	3,480	4,096	374.10
Volume lost in the market					6,400 units
Contribution lost					6,400×64 = 409.60

- (i) Yes, Printer Division should institute the Rs. 20 price reduction on its printer units because net income would increase by Rs. 1,32,000 (Rs. 31,32,000 – Rs. 30,00,000).

Alternatively by incremental approach the net increase can be computed as follows:

	Rs.
Contribution margin of sales increase (Rs. 180 × 2,400)	4,32,000
Loss in contribution margin on original volume arising from decrease in selling price (15,000 × Rs. 20)	3,00,000
Increase in operating profit	1,32,000

- (ii) No, the Component Division should not sell all 17,400 units to Printer Division for Rs. 50. If the Component Division does sell all 17,400 units to Printer, Component Division will only be able to sell 57,600 units to outside customers instead of 64,000 units due to the capacity restrictions. This would decrease Component Division's profit before taxes by Rs. 35,500. Supporting calculations are as follows:

	Rs.
Contribution from sales to printer (Rs. 21.50 × 17,400)	3,74,100
Loss in contribution from loss of sales to outsiders (Rs. 64 × 6,400)	<u>4,09,600</u>
Decrease in operating profit	<u>35,500</u>

- (iii) Yes, it would be in the best interest of Hardware Ltd. for the Component Division to sell the units to the Printer division at Rs. 50 each. The net advantage to the Hardware Ltd. is Rs. 3,12,500 as shown below. The net Advantage is the result of the cost savings from purchasing the Component unit internally and the contribution margin lost from 6,400 units that the Component Division otherwise would sell to outsiders.

	Total Company Rs. '000s
Incremental contribution – if the component is transferred within (Rs. '000) (3,480 – 3,132)	348.00
Contribution to the Component Division	374.10
Total incremental contribution	722.10
Less: Contribution lost by the Component Division	409.60
Net contribution gain	312.50

(b) Linear programming can be used to find optional solutions under constraints.

In production:

- pdt. mix under capacity constraints to minimise costs/maximise profits along with marginal costing.
- Inventory management to minimise holding cost, warehousing / transporting from factories to warehouses etc.

Sensitivity Analysis: By providing a range of feasible solutions to decide on discounts on selling price, decisions to make or buy.

Blending: Optional blending of raw materials under supply constraints.

Finance: Portfolio management, interest/receivables management.

Advertisement mix: In advertising campaign – analogous to pdn. management and pdt. mix.

Assignment of personnel to jobs and resource allocation problems.

However, the validity will depend on the manager's ability to establish a proper linear relationship among variables considered.

PAPER – 6 : MANAGEMENT INFORMATION AND CONTROL SYSTEMS

Question No. 1 is compulsory.

Answer any four questions from remaining six questions.

Question 1

- (a) Briefly describe the techniques used to preserve audit trails in a Computer Based Information system.
- (b) Briefly outline the contents of Information Security policy.
- (c) What are CASE tools? Discuss briefly its three categories.
- (d) Various software packages serve as aids in analysis of program logic. Explain briefly.

(5 + 5 + 5 + 5 = 20 Marks)

Answer

- (a) The following are examples of techniques used to preserve audit trails in a CBIS.
 - (i) Transaction Logs: Every transaction successfully processed by the system should be recorded on a transaction log, which serves as a journal. There are two reasons for creating a transaction log. First, the transaction log is a permanent record of transactions. Second, not all of the records in the validated transaction file may be successfully processed. Some of these records may fail tests in the subsequent processing stages. A transaction log should contain only successful transactions—those that have changed account balances. Unsuccessful transactions should be placed in an error file. The transaction log and error files combined should account for all the transactions in the batch. The validated transaction file may then be scratched with no loss of data.
 - (ii) Transaction Listings: The system should produce a (hard-copy) transaction listing of all successful transactions. These listings should go to the appropriate users to facilitate reconciliation with input.
 - (iii) Log of Automatic Transactions: Some transactions are triggered internally by the system. An example of this is when inventory drops below a preset reorder point, and the system automatically processes a purchase order. To maintain an audit trail of these activities, all internally generated transactions must be placed in a transaction log.
 - (iv) Listing of Automatic Transactions: To maintain control over automatic transaction processed by the system, the responsible end user should receive a details listing of all internally generated transactions.
 - (v) Unique Transaction Identifies: Each transaction processed by the system must be uniquely identified with a transaction number. This is the only practical means of tracing a particular transaction through a database of thousands or even millions of records. In systems that use physical source documents, the unique number printed on the documents can be transcribed during data input and used for this

purpose. In real-time systems, which do not use source documents, each transaction should be assigned a unique number by the system.

- (vi) Error Listing: A listing of all error records should go to the appropriate user to support error correction and resubmission.

(Students are required to discuss any five points)

- (b) The Information Security policy should describe:

- The importance of Information security to the organization;
- A statement from the chief executive officer in support of the goals and principles of effective information security;
- Specific statements indicating minimum standards and compliance requirements for specific areas;
- Assets classification;
- Data Security;
- Personnel security;
- Physical, logical and environmental security;
- Communications security;
- Legal, regulatory and contractual requirements;
- System development and maintenance life cycle requirements;
- Business continuity planning;
- Security awareness, training and education;
- Security breach detection and reporting requirements; and violation enforcement provisions;
- Definitions of responsibilities and accountabilities for information security with appropriate separation of duties;
- Particular information system or issue specific areas; and Reporting responsibilities and procedures.

- (c) CASE stands for "Computer Aided Software Engineering". CASE tools are automated software tools. CASE encompasses computer based procedures, techniques and tools which can be used to develop, maintain and re-engineer software. CASE technology allows different types of tools to be assessed and compared. It also provides a conceptual basis of understanding.

The three categories of CASE tools are:

1. Tools that support individual process tasks such as checking the consistency of a design, compiling a program, comparing test results and so on.

2. Work benches to support process phases such as specification, design etc. They consist of sets of tools with variable degree of integration.
 3. Environments support for all or part of software process. Includes several different workbenches which are integrated in some way.
- (d) The following software packages serve as aids in program analysis:
- Automated flowcharting programs, which interpret program source code and generate a corresponding program flowchart.
 - Automated decision table programs, which generate a decision table representing the program logic.
 - Scanning routines, which search a program for occurrences of a specified variable name or other character combinations.
 - Mapping programs, which identify unexecuted program code. This software could have uncovered the program code that is developed by the unscrupulous programmer who have inserted to erase all computer files when he was terminated
 - Program tracing, which sequentially prints all application program steps (line numbers or paragraph names) executed during a program run. This list is intermingled with regular output so that the auditors can observe the precise sequence of events that unfold during program execution. Program tracing helps auditors to detect unauthorized program instructions, incorrect logic paths, and unexecuted program code.

Question 2

- (a) State and briefly explain the various stages of developing an inhouse program.
- (b) How will you establish and implement Critical Success Factors (CSFs) and Key Performance Indicators (KPIs) is an organization for achieving the benefits of implementation of ERP? (10 + 10 = 20 Marks)

Answer

- (a) An In-house development of programs commonly involves the following six stages:
 - (i) Program Analysis: In this state, the programmer ascertains the input, processing and output required for a particular application. The programmer then determines whether the proposed application can be programmed at all. It is not unlikely that the proposal is shelved for modifications on technical grounds.
 - (ii) Program design: In this stage the programmer develops the general organization of the program as it relates to the main functions to be performed. Out of several other tools available to him input, output, file layouts and flowcharts are quite useful at this stage. These are provided to the programmer by the systems analyst.
 - (iii) Program Coding: The logic of the program outlined in the flowchart is converted into program statements or instructions at this stage. For each language, there are specific rules concerning format and syntax. There are special sheets for writing

the program instructions in each language. The format of these sheets facilitates writing error-free programs. The programmers broadly pursue three objectives: simplicity, efficient utilization of storage and least processing time. Future changes and development of the programs should be kept in mind.

- (iv) Debug the program: The process of debugging a program refers to correcting the language syntax and diagnostic errors so that the program compiles cleanly. A clean compile means that the program can be successfully converted from the source code written by the program into machine language instructions. Debugging consists of four steps:
 - (a) Inputting the source program to the compiler,
 - (b) Letting the compiler find errors in the program,
 - (c) Correcting lines of codes that are in error; and
 - (d) Resubmitting the corrected source program as input to the compiler.

These are followed by use of structured walkthroughs, testing of the program and review of the program code for adherence to standards.

- (v) Program documentation: The writing of narrative procedures and instructions for people who will use software is done throughout the program life cycle. The procedures and instructions should be reviewed and approved by the authorized persons. The documentation should be prepared in such a way that the user can clearly understand the instruction given in Program documentation.
 - (vi) Program maintenance: The requirements of business data processing applications are subject to continual change. This calls for modification of the various programs. There are usually separate categories of programmers called maintenance programmers who are entrusted with this task.
- (b) Effective use of ERP is a direct result of steps taken at the time of implementation toward preparing the organization. Change integration has to be necessarily embedded in the task list for any ERP implementation. The main tool for this is the process of communication in all forms-written, oral, workshops, meetings and follow up activities. The process should start quite early by educating all layers of the management on the particular ERP product, its relevant functionality, limitations and benefits.

Also at the start of the project, the Critical Success Factors (CSFs) for the company as whole should be listed. These should be drilled down to CSFs for respective departments like Finance, Marketing, Purchase, Stores, Production, Quality, Maintenance and HRD or Personnel. From these CSFs, performance measures required to address these CSFs should be culled out. The numeric figures against these performance measures can be classified as the Key Performance Indicators (KPIs). The process of firming up the above is usually done through workshops. This has to be completed before the processes to be configured on the ERP are drawn up. The important end users should be involved in evolving the process keeping ERP in mind. The KPIs derived from organisational goals and CSFs should be kept in mind.

The post implementation tasks are:

- Develop the new job descriptions and organization structure to suit the post ERP scenario.
- Determine the skill gap between existing jobs and envisioned jobs.
- Assessing training requirements, and create and implement a training plan.
- Develop and amend HR, financial and operational policies to suit the future ERP environment.
- Develop a plan for workforce logistic adjustment.

Then the major task is to monitor KPIs and take correct business decisions to improve them. Hence, the immediate task is to set attainable goals. Certain KPIs, though existing in the system, are better monitored and controlled after ERP System attains maturity. There will be resistance to change, but the management should be strong to continue implementation.

Question 3

- (a) What is Share accounting system? Describe briefly the input, outputs and processing steps involved in this system.
- (b) "Decision support systems are widely used as part of an Organisation's Accounting Information system". Give examples to support this statement. (10 + 10 = 20 Marks)

Answer

- (a) Share is an investment option used by many persons. A person may purchase shares either from the company (at the time of a public or a rights issue) or from the share market. A share accounting system, needs to maintain an updated list of shareholders. For each shareholder, the main information held is the name and address, names of joint holders (if any), the number of shares held, and the identification of the certificates through which these shares are held.

When a person purchases shares from a share holder, a share transfer form along with the certificates is sent by the buyer to the company for incorporating the transfer. The system records a change in ownership for the shares from the seller to the buyer. Periodically, the company declares a dividend. Dividend warrants (cheques) need to be mailed on a particular day to the various shareholders who hold shares. Calculation of income tax to be deducted at source is also done before the printing and mailing dividend warrants.

Other facilities usually provided in share accounting system are:

- Bank mandate facility, where the shareholder's dividend warrant is sent to a bank account at the shareholder's request.
- Splitting of share certificates, where a single certificate containing a large number of shares is replaced with a number of certificates containing a smaller number of shares.

- Consolidation of shares, where many certificates belonging to a single shareholder are combined into one share certificate.
- Mailing annual reports and invitations to various meetings.

Main Inputs in a share accounting systems are:

- Shareholding data from a fresh issue-this is usually supplied by the issue agency on electronic media.
- Share transfer request.
- Split request.
- Consolidation request.
- Request for bank mandate.
- Tax exemption forms.
- Request for duplicate certificates.
- Request for duplicate dividend warrants.
- Change in shareholder's address.

Main Processing in a share accounting systems are:

- Updating shareholders master file.
- Recording the transfer of shares.
- Handling splitting, consolidation and duplicate requests and printing new certificates.
- Calculation of dividend and income tax to be deducted.

Main Outputs in a share accounting systems are:

- Transferred share certificates.
- New share certificates in case of consolidations, splitting and duplicates.
- Dividend warrants and counterfoils.
- Statement of Tax deductions.

(b) Decision Support Systems are widely used as part of an organisation's AIS. The complexity and nature of decision support systems vary from organization to organization. Many are developed in-house using either a general type of decision support program or a spreadsheet program to solve specific problems. Below are the examples of DSS in Accounting includes:

- Cost Accounting System: The health care industry is well-known for its cost complexity. Managing cost in this industry requires controlling costs of supplies, expensive machinery, technology, and a variety of personnel. Cost Accounting applications help health care organisations calculate product costs for individual

procedures or services. Decision support systems can accumulate these product costs to calculate total costs per patient. Combining cost accounting DSS and Productivity system applications allows managers to measure the effectiveness of specific operating processes to improve its management decision-making.

- Capital Budgeting System: Companies require new tools to evaluate high-technology investment decisions. Decision makers need to supplement analytical techniques with decision support tools that consider some benefits of new technology. One decision support system designed to support decisions about investments in automated manufacturing technology that is AutoMan, which allows decision makers to consider financial, non-financial, quantitative, and qualitative factors in their decision-making processes. Using this decision support system, accountants, managers, and engineers identify and prioritize these factors. They can then evaluate up to seven investment alternatives at once.
- Budget Variance Analysis System: Financial institutions rely heavily on their budgeting systems for controlling costs and evaluating managerial performance. DSS allows comptrollers to graph, view, analyse, and annotate budget variances, as well as create additional one-and five year budget projections using the forecasting tools provided in the system. The decision support system thus helps the comptrollers create and control budgets for the cost-center managers reporting to them.
- General Decision Support System: These types of decision support systems are a decision-maker's tools that are used to input the data and answer questions about a specific problem domain to make use of this type of decision support system. An example is a program called Expert Choice. This program supports a variety of problems requiring decisions. The user works interactively with the computer to develop a hierarchical model of the decision problem. The decision support system then asks the users to compare decision variables with each other. Expert Choice analyses investment judgments and presents the decision maker with the best alternative.

Question 4

- (a) What is system manual? What information is included in it?
- (b) What are five control objectives of an Operating system?
- (c) What steps can be taken to detect computer fraud? (10 + 5 + 5 = 20 Marks)

Answer

- (a) A system manual or job specification manual is an output of the system design that describes the task to be performed by the system with complete layouts and flow charts. It contains:
 - (i) General description of the existing system: It describes the general structure of the existing system from top management to the bottom management.

- (ii) Flow of the existing system: It describes the input, processing and output of the data to be flow at various levels of organisation's structure.
 - (iii) Outputs of the existing system: The documents produced by existing system are listed and briefly described, including distribution of copies.
 - (iv) General description of the new system: Its purpose and functions and also major differences from the existing system are stated together with a brief justification for the changes.
 - (v) Flow of the new system: This shows the flow of the system from and to the computer operation and within the computer department.
 - (vi) Output Layouts: It describes the user interface or layouts for the user that is used for better communication in near future.
 - (vii) Output distribution: The output distribution is summarized to show what each department will receive as a part of the proposed system.
 - (viii) Input layouts: The inputs to the new system are described as well as a complete layouts of the input documents, input disks or tapes are described.
 - (ix) Input responsibility: The source of each input document is indicated as also the user department responsible for each item on the input documents.
 - (x) Macro Logic: The overall logic of the internal flows will be briefly described by the systems analyst, wherever useful.
 - (xi) Files to be maintained: The specifications will contain a listing of the tape, disk or other permanent record files to be maintained, and the items of information to be included in each file.
 - (xii) List of programs: A list of programs to be written shall be a part of the systems specifications.
 - (xiii) Timing estimates: A summary of approximate computer timing is provided by the system analyst.
 - (xiv) Controls: This shall include type of controls, and the method in which it will be operated.
 - (xv) Audit trail: A separate section of the systems specifications shows the audit trail for all financial information. It indicates the methods with which errors and defalcation will be prevented or eliminated.
 - (xvi) Glossary of terms used.
- (b) Five Control Objectives of an operating system are:
- (i) The operating system must protect itself from users: User applications must not be able to gain control of, or damage in any way, the operating system, thus causing it to cease running or destroy data.

- (ii) The operating system must protect users from each other: One user must not be able to access, destroy, or corrupt the data or programs of another user.
 - (iii) The operating system must protect users from themselves: A user's application may consist of several modules stored in separate memory locations, each with its own data. One module must not be allowed to destroy or corrupt another module.
 - (iv) The operating system must be protected from itself: The operating system is also made up of individual modules. No module should be allowed to destroy or corrupt another module.
 - (v) The operating system must be protected from its environment: In the event of a power failure or other disaster, the operating system should be able to achieve a controlled termination of activities from which it can later recover.
- (c) The following steps can be taken to detect computer fraud:
- (i) **Conduct Frequent Audit:** To conduct periodic external and internal audits as well as specific network security audits is the way to detect the computer fraud. Auditors regularly test system controls and periodically browse data files looking for suspicious activities. However, care must be exercised to make sure that employees' privacy rights are not violated.
 - (ii) **Use a Computer Security Officer:** Most frauds are not detected by internal or external auditors. The security officer should be independent of the information system function and can monitor the system and disseminate information about improper system uses and their consequences.
 - (iii) **Use Computer Consultants:** Outside computer consultants or in-house teams to test and evaluate their security procedures and that is closely evaluated, and corresponding protective measures are implemented.
 - (iv) **Monitor System Activities:** All system transactions and activities should be recorded in a log. The log should indicate who accessed what data, when, and from which terminal. These logs should be reviewed frequently to monitor system activity and trace any problems to their source. There are a number of risk analysis and management software packages that can review computer systems and networks. These systems evaluate security measures already in place and test for weaknesses and vulnerabilities. A series of reports is then generated that explain the weaknesses found and suggest improvements.
 - (v) **Use Fraud Detection Software:** People who commit fraud tend to follow certain patterns and leave behind telltale clues, such as things that do not make sense. Software has been developed to search out these fraud symptoms.

Question 5

- (a) What is prototyping approaches to systems development? Describe its advantages and disadvantages also.

- (b) Describe some of the powers of controller under section 89 to make regulations consistent with Information Technology Act, 2000.
- (c) What is Transaction processing cycle? Discuss briefly four common cycles of a business activity. (10 + 5 + 5 = 20 Marks)

Answer

- (a) Prototyping approaches: Prototyping technique is used to develop smaller systems such as decision support systems, management information systems and expert systems. The goal of prototyping approach is to develop a small or pilot version called a prototype of part or all of a system. A prototype is a usable system or system component that is built quickly and at a lesser cost, and with the intention of being modifying or replacing it by a full scale and fully operational system. Finally, when a prototype is developed that satisfies all user requirements, either it is refined and turned into the final system or it is scrapped. If it is scrapped, the knowledge gained from building the prototype is develop the real system.

Prototyping can be viewed as a series of four steps:

Step 1: Identify Information System Requirements: In traditional approach, the system requirements have to be identified before the development process start. However, under prototype, the process of determining them can be less formal and time-consuming than when performing traditional systems analysis.

Step 2: Develop the Initial Prototype: In this step, the designers create an initial base model-for example, using fourth-general programming languages or CASE tools. The main goal of this stage is 'rapid development' and 'low cost'.

Step 3: Test and Revise: After finishing the initial prototype, the designers first demonstrate the model to users for experiment. At the outset, users must be told that the prototype is incomplete and requires subsequent modifications based on their feedback. Thus, the designers ask users to record their likes and dislikes about the system and recommend changes. Using this feedback, the design team modifies the prototype as necessary and then resubmits the revised model to system user for reevaluation. Thus interactive process of modification and reevaluation continues until the users are satisfied-commonly, through four to six interactions.

Step 4: Obtain User Signoff of the Approved Prototype: At the end of Step 3, users formally approve the final version of the prototype, which commits them to the current design and establishes a contractual obligation about what the system will, and will not do or provide.

Advantages of Prototyping

1. Prototyping requires intensive involvement by the system users. Therefore, it typically results in a better definition of the users' needs and requirements than does the traditional system development approach.

2. A very short time period (e.g., a week) is normally required to develop and start experimenting with a prototype. This short time period allows system users to immediately evaluate proposed system changes.
3. Since system users experiment with each version of the prototype through an interactive process, errors are hopefully detected and eliminated early in the developmental process. As a result, the information system ultimately implemented should be more reliable and less costly to develop than when the traditional systems development approach is employed.

Disadvantages of Prototyping

1. Prototyping can only be successful if the system users are willing to devote significant time in experimenting with the prototype and provide the system developers with change suggestions.
 2. The interactive process of prototyping causes the prototype to be experimented with quite extensively. Because of this, the system developers are frequently tempted to minimize the testing and documentation process of the ultimately approved information system. Inadequate testing can make the approved system error-prone, and inadequate documentation make this system difficult to maintain.
 3. Prototyping may cause behavioral problems with system users. These problems include dissatisfaction by users if system developers are unable to meet all user demands for improvements as well as dissatisfaction and impatience by user when they have to go through too many interactions of the prototype.
- (b) The controller has been given the following powers under Section 89 to make regulations consistent with the Information Technology Act, 2000:
- The particulars relating to maintenance of data base containing the disclosure record of every Certifying Authority
 - The conditions and restrictions subject to which the Controller may recognize any foreign Certifying Authority
 - The terms and conditions subject to which a license may be granted
 - Other standards to be observed by a Certifying Authority
 - The manner in which the Certifying Authority may make the disclosure Under Section 34
 - The particulars of statement to be submitted along with an application for the issue of a Digital Signature Certificate
 - The manner in which the subscriber should communicate the compromise of private key to the Certifying Authority.
- (c) A Transaction Processing Cycle organizes transactions by an organization's business processes. The nature and types of transaction processing cycles vary, depending on the information needs of a specific organization. Most business organizations have in

common, transactions that may be grouped according to four common cycles of business activity. These common Cycles are:

- Revenue Cycle: Events related to the distribution of goods and services to other entities and the collection of related payments.
- Expenditure Cycle: Events related to the acquisition of good and services from other entities and the settlement of related obligations.
- Production Cycle: Events related to the transformation of resources into goods and services.
- Finance Cycle: Events related to the acquisition and management of capital funds including cash.

Question 6

- (a) Describe various steps that should be taken for successful installation of the equipment during the implementation phase.
- (b) What are control techniques that are essential for the security of the client/server environment?
- (c) Differentiate between open and closed systems. (10 + 5 + 5 = 20 Marks)

Answer

- (a) Following steps should be taken for successful installation of the equipment:

1. Site preparation: An appropriate location must be found to provide an operating environment for the equipment that will meet the vendor's temperature, humidity and dust control specifications. It is very important to lay down proper procedures for acquiring and planning space layout in the systems implementation. A bad layout cannot only drastically reduce the productivity of the data processing department but also that of the entire organization as a whole. If the system is micro computer, little layout and site preparation work is needed. However, the electric lines should be checked to ensure that they are free of static or power fluctuation. It will be better to install a 'clean' line that is not shared by other equipments. In case of mini computer, or a mainframe, the Project Manager should prepare a rough layout, make cost estimates and get budget approved from the management. Layout planning must be done well in advance in order to permit acquisition for long lead-time items like air-conditioning equipments, etc. The following factors should be taken into consideration for space planning:

- Space occupied by the equipments
- Space occupied by the people, and
- Movement of equipment and people.

The site-layout should allow ample space for moving the equipment in and setting it for normal operation. Vendors will provide clearance requirement for performing services and maintenance and for air circulation. These requirements must be

strictly adhered to otherwise warranties may become void and maintenance discontinued until specifications are met. Carpets etc, should be avoided whenever possible in the computer room since they can create static charge which can cause the introduction of errors in the data or, in some case, accidental erase of data. Highly waxed floors produce the same effect. It is best to have the site preparation completed prior to the delivery of the equipment, since vendors are reluctant to deliver equipment when construction work is still in progress.

2. Equipment installation: The equipment must be physically installed by the manufacturer, connected-to the power source and wired to communication lines, if required.
 3. Equipment check out: The equipment must be turned on for testing under normal operating conditions. Not only the routine 'diagnostic test' should be run by the vendor, but also the implementation team should devise and run extensive tests of its own to ensure that equipments are in proper working condition.
- (b) In Client/Server environment the security issue is the prime consideration at all access point that is known. The number of routes exist to access the application data on client/server, which should be examined and checked. To increase the security, the following control techniques are used:
- Access to data and application is secured by disabling the floppy disk drive.
 - Diskless workstation prevents unauthorized access.
 - Unauthorised users may be prevented from overriding login scripts and access by securing automatic boot or startup batch files.
 - Network monitoring can be done to know about the client so that it will be helpful for later investigation, if it is monitored properly.
 - Data encryption techniques are used to protect data from unauthorized access.
 - Authentication system can be provided to a client, so that they can enter into system, only by entering login name and password.
 - Smart cards can be used. It uses intelligent hand held devices and encryption techniques to decipher random codes provided by client-server based operating systems.
 - Application controls may be used and users will be limited to access only those functions in the system that are required to perform their duties.
- (c) A Closed System is self-contained and does not interact or make exchange across its boundaries with its environment. Closed systems do not get the feed back they need from the external environment and tend to deteriorate. A Closed Systems one that has only controlled and well defined input and output. Participant in a closed system become closed to external feed back without fully being aware of it. Some of the examples of closed systems are manufacturing systems, computer programs etc.

Open System actively interact with other systems and establish exchange relationship. They exchange information, material or energy with the environment including random and undefined inputs. Open systems tend to have form and structure to allow them to adapt to changes in their external environment for survival and growth. Organisations are considered to be relatively open systems.

Question 7

Write short notes on the following:

- (a) Data dictionary
- (b) System maintenance
- (c) Holistic protection
- (d) Snapshot technique.

(4 × 5 = 20 Marks)

Answer

- (a) **Data Dictionary:** A data dictionary is a computer file that contains descriptive information about data items in the files of a business information System. Each computer record of a data dictionary contains information about a single data item used in a business information system. This information may include:
 - (i) Codes describing the data items length, data type and range.
 - (ii) The identity of the source documents used to create the data item.
 - (iii) The names of computer files that store the data item.
 - (iv) The names of the computer program that modify the data item.
 - (v) The identity of the computer program or individuals permitted to access the data item for the purpose of file maintenance, upkeep, or inquiry.
 - (vi) The identity of the computer programs or individuals not permitted to access the data file.

As new data fields are added to the record structure of a business file, information about each new data item is used to create a new computer record in the data dictionary. The data dictionary is updated to indicate the data items that are added /created. When data fields are deleted from the structure of the file records, their corresponding records in the data dictionary are dropped.

- (b) **Systems Maintenance:** Most information systems require at least some modification after development. The need for modification arises from a failure to anticipate all requirements during system design and / or from changing organisational requirements. The changing organizational requirements continue to impact most information systems as long as they are in operation. Consequently periodic systems maintenance is required for most of the information systems. Systems maintenance includes adding new data elements, modifying reports, adding new reports and changing calculations.

Maintenance can be categorised in the following two ways:

- (1) Scheduled maintenance is anticipated and can be planned for. For example the implementation of a new inventory coding scheme can be planned in advance.
- (2) Rescue maintenance refers to previously undetected malfunctions that were not anticipated but require immediate solution. A system that is properly developed and tested should have few occasions of rescue maintenance.

More and more systems are developed, a greater portion of systems analyst and programmer time is spent on maintenance which is a continuous exercise.

- (c) Holistic Protection: Protection must be done holistically and give the organization the appropriate level of security at a cost that is acceptable to the business. One must plan for the unexpected and unknown, expect the worst events to happen, and recover from these events if and when they occur, as though nothing ever happened. Such events cannot be planned, and they always seem to happen at the most inopportune times.
- (d) Snapshot Technique: It examines the way transactions are processed. Selected transactions are marked with a special code that triggers the snapshot process. Audit modules in the program, records these transactions and their master file records before and after processing. Snapshot data are recorded in a special file and reviewed by the auditor to verify that all processing steps have been properly executed.

The Suggested Answers for Paper 7: Direct Taxes are based on the provisions applicable for A.Y. 2007-08, which is the assessment year relevant for May, 2007 examinations.

PAPER – 7 : DIRECT TAXES

Answer all questions

Question 1

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2002. H, I and G were partners in their individual capacity. The deed of partnership provided for payment of salary amounting to Rs.1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2006 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2002, for the first time provided for payment of simple interest @ 12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2006. The firm was dissolved on 31.3.2007 and the Capital assets of the firm were distributed among the partners on 20.4.2007. The net profit of the firm for the year ending 31.3.2007 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was Rs.1,50,000:

- (i) Interest amounting to Rs.1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2006 to 31.3.2007.
- (ii) Interest amounting to Rs.50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2006 to 31.3.2007.
- (iii) Interest amounting to Rs.20,000 paid to the Hindu undivided family of partner H @ 18% per annum.
- (iv) Payment of Rs.25,000 towards purchase of television sets made by crossed cheque on 1.11.2006.
- (v) Rs.30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.
- (vi) Depreciation amounting to Rs.15,000 on motor car bought and used exclusively for business purposes, but not registered in the name of the firm.
- (vii) Depreciation under section 32(1)(ii) amounting to Rs.37,500 of new machinery bought and installed for manufacture of pens on 1.11.2006 at a cost of Rs.5,00,000. There was no increase in the installed capacity as a result of the installation of the new machinery.
- (viii) Interest amounting to Rs.25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

- (a) Closing stock-in-trade was valued at Rs.60,000 as per the method of lower of cost or market rate consistently followed by it. The market value of the closing stock-in-trade was Rs.65,000.

- (b) Brought forward business loss relating to the assessment year 2006-07 was Rs.50,000.
 (c) The fair market value of the capital assets as on 31.3.2007 was Rs.20,00,000 and the cost of their acquisition was Rs.15,00,000.

Compute the total income of M/s. HIG for the assessment year 2007-08.

You are required to furnish explanations for the treatment of the various items given above.

(16 Marks)

Answer

Computation of total income of M/s.HIG for the A.Y. 2007-08

Particulars	Rs.	Rs.
Net profit as per profit & loss account		1,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2006 to 30.9.2006	50,000	
Interest to partners on current accounts from 1.4.2006 to 31.3.2007	50,000	
20% of Rs.25,000 paid towards purchase of television sets	5,000	
Difference on account of valuation of closing stock-in-trade at market value	5,000	
Salary paid to working partners considered separately	<u>2,50,000</u>	
		<u>3,60,000</u>
		5,10,000
Less: Additional depreciation on new machinery		<u>50,000</u>
		4,60,000
Less: Interest received from bank on fixed deposits considered separately		<u>25,000</u>
Book profit		4,35,000
Less: Salary to working partners -		
On first Rs.75,000 book profit @ 90%	67,500	
On next Rs.75,000 book profit @ 60%	45,000	
On balance Rs.2,85,000 book profit @ 40%	<u>1,14,000</u>	
		<u>2,26,500</u>
		2,08,500
Less: Business loss relating to assessment year 2006-07 set off		<u>50,000</u>
Income from business		1,58,500
Income from other sources		
Interest received from bank on fixed deposits		<u>25,000</u>
Total Income		<u>1,83,500</u>

Explanation for the treatment of various items

- (i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2006 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2006. Interest for the period prior to 1.10.2006 is not allowed.
- (ii) The partnership deed of 1.10.2006 provided for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT & Anr.* (2001) 251 ITR 704 (Ker), on identical facts, held that interest paid to the partners on their current account balances is not allowable.
- (iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv).
- (iv) Section 40A(3) has been amended by the Taxation Laws (Amendment) Act, 2006 with effect from 13.7.2006 to provide that expenditure, in respect of which payment exceeding Rs.20,000 has been made otherwise than by an account payee cheque / account payee bank draft, will attract disallowance at 20% thereof. Since the firm has made payment of Rs.25,000 towards purchase of television sets after 13.7.2006 by a crossed cheque and not by an account payee cheque, 20% of such expenditure would be disallowed.
- (v) Gold jewellery valued at Rs.30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.
- (vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT* (1999) 239 ITR 775.
- (vii) The firm is entitled to additional depreciation@ 20% under section 32(1)(iia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%.
- (viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.
- (ix) The Supreme Court has, in *A.L.A Firm v. CIT* (1991) 189 ITR 285, held that the closing stock has to be valued at market rate in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the market rate.
- (x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per Explanation 3 to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought

forward business loss relating to the assessment year 2006-07 is not considered for calculation of book-profit.

- (xi) Section 45(4) is not applicable to the firm for the assessment year 2007-08, since though the dissolution of the firm took place on 31.3.2007, there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2007. The capital gains will be assessable in the assessment year 2008-09.

Question 2

- (a) Examine whether the following items of expenditure incurred/payments made by a company in the course of its business during the year ending 31.3.2007 are liable to fringe benefit tax for the assessment year 2007-08:
- (i) Reimbursement to employees of expenditure on food and beverages consumed by them in the office.
 - (ii) Sales commission paid to agents.
 - (iii) Advance towards travelling expenses to be incurred during April 2007.
 - (iv) Distribution of free samples of medicines to hospitals.
 - (v) Get-together of employees on Diwali and on Republic Day.
 - (vi) Contribution to approved superannuation fund in respect of two employees A and B amounting to Rs.90,000 and Rs.20,000 respectively. (6 Marks)
- (b) Discuss the taxability or otherwise of the following gifts received by M, an individual, during the financial year 2006-07:
- (i) Rs.24,000 each from his four friends on the occasion of his birthday.
 - (ii) Wrist watch valued at Rs.60,000 from his friend. (3 Marks)
- (c) T, an individual, filed his return of income for the assessment year 2006-07 on 15.6.2006 declaring a total income of Rs.1,20,000. He later discovered that he had not claimed a particular deduction amounting to Rs.2,10,000 while computing his business income in the said return. He filed a revised return on 3.1.2007 declaring a total loss of Rs.90,000. The Assessing Officer proposes to disallow the claim of T for carry forward of the business loss amounting to Rs.90,000 for the reason that the revised return declaring loss for the first time was filed beyond the time prescribed under section 139(3). Examine the validity of the proposed action of the Assessing Officer. (3 Marks)

Answer

- (a) (i) Yes, it is liable to fringe benefit tax, since only expenditure incurred on food or beverages procured by the employer for providing to his employees in an office or factory is exempt from fringe benefit tax.
- (ii) No, it is not liable to fringe benefit tax, since brokerage and selling commission paid to selling agents are in the nature of ordinary selling expenses and do not constitute

expenditure for the purposes of sales promotion including publicity. Therefore, the sales commission paid to agents is not liable to fringe benefit tax.

- (iii) No, it is not liable to fringe benefit tax. Fringe benefit tax is payable in the year in which the expenditure is incurred. Therefore, payment of advance towards expenditure to be incurred in the future will not attract fringe benefit tax. Hence, fringe benefit tax will not be payable on the advance paid towards travelling expenses to be incurred during April 2007.
 - (iv) Yes, it is liable to fringe benefit tax. Only expenditure on distribution of free samples of medicines or of medical equipment to doctors has been excluded from "sales promotion including publicity" and is consequently, exempt from levy of fringe benefit tax. Therefore, the expenditure on distribution of free samples of medicines to persons other than doctors like hospitals, nursing homes etc. will be liable to fringe benefit tax.
 - (v) The expenditure on meeting/get-together of employees and their family members on the occasion of any festival like 'Navratri', 'Diwali' etc., is expenditure on festival celebrations and, is therefore, liable to fringe benefit tax. However, such expenditure on celebration of Independence Day and Republic Day will not be liable to fringe benefit tax as they are not festivals as normally understood. Hence, while expenditure incurred on get-together of employees on Diwali is liable to fringe benefit tax, such expenditure incurred on Republic Day is not liable to fringe benefit tax.
 - (vi) No, it is not liable to fringe benefit tax. Under section 115WB(1)(c) read with section 115WC(1)(b), any contribution by the employer to an approved superannuation fund for employees in excess of Rs.1,00,000 in respect of each employee will be considered as a fringe benefit and would be liable to fringe benefit tax. In the instant case, contribution to such fund in respect of each of the two employees is less than Rs.1,00,000. Hence, the contribution made to the said fund in respect of both the employees A & B is not liable to fringe benefit tax.
- (b) (i) Section 56(2)(vi) inserted by the Taxation Laws (Amendment) Act, 2006 provides that where any sum of money is received without consideration by an individual or a Hindu undivided family from any person or persons on or after 1.4.2006 exceeding Rs.50,000 in the aggregate in any previous year, the whole of the aggregate value of such sum will be liable to tax. In the instant case, M has received Rs.24,000 from each of his four friends. The aggregate amount of gifts received works out to Rs.96,000. As such, the entire amount of Rs.96,000 is taxable under the head "Income from other sources".
- (ii) A plain reading of section 56(2)(vi) indicates that only sums of money received towards gift fall within its purview. Gifts in kind are not liable to tax thereunder. The gift of wrist watch valued at Rs.60,000 received by M from his friend is, therefore, not taxable.

- (c) T has filed his original return of income for the assessment year 2006-07 within the due date specified in section 139(1). Section 139(5) empowers an assessee, who discovers any omission or wrong statement in the return filed by him under section 139(1), to file a revised return before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier. T, having discovered an omission to claim a particular deduction in the return filed by him under section 139(1), has filed a revised return within the time prescribed under section 139(5). A revised return has the effect of replacing the original return and relates back to the date of the original return. Thus, where a return was filed under section 139(1) declaring income and later it was revised declaring a loss, the loss shall be allowed to be carried forward as the revised return shall substitute the original return which was filed within time. There is no bar on filing a revised return showing loss for the first time. Therefore, the proposed action of the Assessing Officer to deny the benefit of carry forward of business loss to T is not valid in law.

Question 3

- (a) V, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the previous year relevant to the assessment year 2007-08. Within a month from the date of such sale, the four brothers executed a release deed in respect of their shares in the co-owned residential house in favour of V for a monetary consideration. V utilised the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to his four brothers. V is not using the house, in respect of which his brothers executed a release deed, for his own residential purposes, but has let it out to another person, who is using it for his residential purposes. Is V eligible for exemption under section 54 of the Income-tax Act, 1961 for the assessment year 2007-08 in respect of the long-term capital gain arising from the sale of his residential house, which he utilised for acquiring the shares of his brothers in the co-owned residential house? Will the ownership of two more houses by him on the date of sale of the residential house and non-use of the new house for his own residential purposes disentitle him to exemption? (6 Marks)
- (b) ABC Ltd. took on sub-lease a building from J, an individual, with effect from 1.9.2006 on a rent of Rs.10,000 per month. It also took on hire machinery from J with effect from 1.10.2006 on hire charges of Rs.9,000 per month. ABC Ltd. entered into two separate agreements with J for sub-lease of building and hiring of machinery. The rent of building and hire charges of machinery for the financial year 2006-07 amounting to Rs.70,000 and Rs.54,000 respectively were credited by ABC Ltd. to the account of J in its books of account on 31.3.2007. Examine the obligation of ABC Ltd. to deduct tax at source in respect of the rent and hire charges. (4 Marks)
- (c) P, an individual, borrowed Rs.20,00,000 for repair and reconstruction of his self-occupied house property and paid interest of Rs.1,60,000 thereon during the year ending 31.3.2007. What is the amount of interest allowable as a deduction under section 24 for the assessment year 2007-08? (3 Marks)

Answer

- (a) The long-term capital gain arising on sale of residential house would be exempt under section 54 if it is utilized, inter alia, for purchase of a new residential house within one year before or two years after the date of transfer. Release by the other co-owners of their share in co-owned property in favour of V would amount to "purchase" by V for the purpose of claiming exemption under section 54 [CIT v. T.N. Aravinda Reddy (1979) 120 ITR 46 (SC)]. Since such purchase is within the stipulated time of two years, V is eligible for exemption under section 54. As V has utilised the entire long-term capital gain arising out of the sale of the residential house for payment of consideration to the other co-owners who have released their share in his favour, he can claim full exemption under section 54.

The ownership of two more houses on the date of sale of the residential house by V will not disentitle him from claiming the exemption under section 54. Such restriction is contained only in section 54F and not in section 54. Further, there is no requirement in section 54 that the new house should be used by the assessee for his own residence. The condition stipulated is that the new house should be utilised for residential purposes. This requirement would be satisfied even when the new house is let out for residential purposes.

- (b) Section 194-I dealing with deduction of tax at source from payment of rent has been amended by the Taxation Laws (Amendment) Act, 2006 with effect from 13.7.2006. The scope of the section has also been extended to include within its ambit, rent for machinery, plant and equipment. Tax is required to be deducted at source from payment of rent, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of, inter alia, building and machinery, irrespective of whether such assets are owned or not by the payee. The limit of Rs.1,20,000 for tax deduction at source will apply to the aggregate rent of all the assets. Even if two separate agreements are entered into, one for sub-lease of building and the other for hiring of machinery, rent and hire charges under the two agreements have to be aggregated for the purpose of application of the threshold limit of Rs.1,20,000. Therefore, ABC Ltd. has to deduct tax at source under section 194-I @ 15% as increased by education cess of 2% in respect of the rent and hire charges aggregating to Rs.1,24,000 credited to the account of J, the payee.
- (c) Section 24(b) provides that where the self-occupied house property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, deduction towards interest payable thereon shall not exceed Rs.30,000. Therefore, only Rs.30,000 would be allowed as deduction on account of interest on loan borrowed for repair and reconstruction of self-occupied house property. The higher limit of Rs.1,50,000 in respect of interest on loan borrowed on or after 1.4.99 would be available only where such loan is borrowed for acquisition or construction of self-occupied property and not for repair or reconstruction of such property.

Question 4

(a) The following trusts claim that anonymous donations received by them during the financial year 2006-07 are not liable to tax under section 115BBC:

- (i) A charitable trust referred to in section 11 which applied the entire amount of anonymous donations for purposes of the trust during the relevant financial year.
- (ii) A trust established wholly for religious purposes which applied 75% of the amount of anonymous donations for the purposes of the objects of the trust during the relevant financial year.

Examine the validity of the claim made by the trusts. (4 Marks)

(b) PQR Co-operative Bank, a co-operative society, having its area of operation confined to Gubbi Taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities, has received the following amounts during the year ending 31.3.2007 :

- (i) Interest amounting to Rs.1,00,000 from its members on loans advanced to them.
- (ii) Interest amounting to Rs.1,50,000 on deposits with other co-operative societies.
- (iii) Rent amounting to Rs.2,00,000 from letting out its godowns for storage of commodities.

PQR Co-operative Bank seeks your advice in the matter of taxability of the above amounts and the eligibility for deduction, if any, in respect thereof for the assessment year 2007-08. (5 Marks)

(c) MNO Ltd. is a company in which the public are not substantially interested. K is a shareholder of the company holding 15% of the equity shares. The accumulated profits of the company as on 31.3.2006 amounted to Rs.10,00,000. The company lent Rs.1,00,000 to K by an account payee bank draft on 1.10.2006. The loan was not connected with the business of the company. K repaid the loan to the company by an account payee bank draft on 30.3.2007. Examine the effect of the borrowal and repayment of the loan by K on the computation of his total income for the assessment year 2007-08. (3 Marks)

Answer

- (a) (i) Section 115BBC(1) provides for levy of tax @ 30% on anonymous donation received by, inter alia, charitable trusts or institutions referred to in section 11. Further, section 13(7) provides that the exemption provisions contained in sections 11 and 12 shall not be applicable in respect of any anonymous donation liable to tax under section 115BBC. As such, application of the anonymous donations received by the charitable trust for charitable purposes does not confer any exemption from tax. Therefore, the claim for non-taxability under section 115BBC of anonymous donations received by the charitable trust is not valid in law.
- (ii) Section 115BBC(2) provides that the provisions contained in section 115BBC(1) relating to the taxability of anonymous donations are not applicable to any trust or institution created or established wholly for religious purposes. As such, the trust

established wholly for religious purposes is not liable to be taxed in respect of the anonymous donations received by it. The application or non-application of such anonymous donation for the purposes of trust during the relevant financial year is not germane to the issue of taxability under section 115BBC.

- (b) Sub-clause (vii) has been inserted in section 2(24) by the Finance Act, 2006 to include within the scope of definition of income, the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members. Hence, the interest of Rs.1,00,000 received by PQR Co-operative Bank on loans advanced to its members constitutes its income.

Further, interest received amounting to Rs.1,50,000 on deposits with other co-operative societies and rent amounting to Rs.2,00,000 received from letting out its godowns for storage of commodities also constitute the income of the co-operative bank.

Sub-section (4) inserted in section 80P by the Finance Act, 2006 with effect from the assessment year 2007-08 provides that section 80P shall not apply to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank. Explanation to section 80P(4) defines a primary co-operative agricultural and rural development bank to mean a society having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities. PQR Co-operative Bank is a primary co-operative agricultural and rural development bank as defined in the said Explanation since it is a co-operative society having its area of operation confined to Gubbi Taluk and its principal object is to provide long-term credit for agricultural and rural development activities. Therefore, it is eligible for deduction under section 80P.

Interest of Rs.1,00,000 received by the bank on loans advanced to its members is eligible for deduction in full under section 80P(2)(a)(i).

Interest of Rs.1,50,000 received by the bank from deposits with other co-operative societies qualifies for deduction in full under section 80P(2)(d).

Rent of Rs.2,00,000 received by the bank from letting out its godowns for storage of commodities is eligible for deduction in full under section 80P(2)(e).

- (c) As per section 2(22)(e), any payment by a company, in which the public are not substantially interested, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of the voting power, shall be treated as dividend to the extent to which the company possesses accumulated profits.

In the instant case, MNO Ltd. is a company in which the public are not substantially interested. The company has accumulated profits of Rs.10,00,000 on 31.3.2006. The loan given by the company to K was not in the course of its business. K holds more than 10% of the equity shares in the company. Therefore, assuming that K has voting power equivalent to his shareholding, section 2(22)(e) comes into play and the sum of Rs.1,00,000, representing the amount lent by the company to K, is includible as dividend in the total income of K for the assessment year 2007-08.

Under section 2(22)(e), the liability arises the moment the loan is borrowed by the shareholder and it is immaterial whether the loan is repaid before the end of the accounting year or not. Therefore, the repayment of loan by K to the company on 30.3.2007 will not affect the taxability of the sum of Rs.1,00,000 as dividend in his hands.

Question 5

- (a) XYZ Ltd. incurred expenditure amounting to Rs.3,00,000 in connection with the issue of rights shares and Rs.2,00,000 in connection with the issue of bonus shares during the year ending 31.3.2007. The company seeks your opinion in the matter of eligibility for deduction of the expenditure incurred from its business profits for the assessment year 2007-08. (4 Marks)
- (b) X, an individual, has got his books of account for the year ending 31.3.2007 audited under section 44AB. His total income for the assessment year 2007-08 is Rs.1,90,000. He desires to know if he can furnish his return of income for the assessment year 2007-08 through a Tax Return Preparer. (3 Marks)
- (c) Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts in the course of the business of operation of aircraft during the year ending 31.3.2007:
- (i) Rs.2 crores in India on account of carriage of passengers from Chennai.
 - (ii) Rs.1 crore in India on account of carriage of goods from Chennai.
 - (iii) Rs.3 crores in India on account of carriage of passengers from Singapore.
 - (iv) Rs.1 crore in Singapore on account of carriage of passengers from Chennai.
- The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2007 was Rs.6.75 crores.
- Compute the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2007-08. (4 Marks)
- (d) JKL Ltd. filed its return of loss for the assessment year 2006-07 on 10.1.2007 beyond the time prescribed under section 139(3) declaring a total loss of Rs.15,00,000. It approaches you for advice regarding the course of action to be taken to secure the benefit of carry forward of the business loss for set off against future profits. Advise the company suitably in the matter. (2 Marks)

Answer

- (a) The Supreme Court has, in *Brooke Bond India Ltd. v. CIT* (1997) 225 ITR 798 (SC), held that expenditure incurred by a company in connection with issue of shares with a view to increase its share capital is directly related to the expansion of its capital base and, therefore, constitutes a capital expenditure. The issue of rights shares results in expansion of the capital base of XYZ Ltd. Hence, expenditure of Rs.3,00,000 incurred by the company in connection with the issue of rights shares is a capital expenditure and is not allowable as a business expenditure.

On the other hand, the issue of bonus shares does not result in inflow of fresh funds or increase in the capital employed. It is merely capitalization of reserves. The issue of bonus shares does not expand the capital base of the company. The total funds available with the company and its capital structure will remain the same on issue of bonus shares. The Supreme Court, in CIT v. General Insurance Corporation (2006) 286 ITR 232, considered this effect of issue of bonus shares and ruled that expenditure incurred in connection with the issue of bonus shares was allowable as a revenue expenditure. In view of the decision of the Supreme Court, XYZ Ltd. will be eligible for deduction of the expenditure amounting to Rs.2,00,000 incurred in connection with the issue of bonus shares from its business profits for the assessment year 2007-08.

- (b) Section 139B inserted by the Finance Act, 2006 with effect from 1.6.2006 provides for the scheme for submission of returns of income through Tax Return Preparers. It empowers the Central Board of Direct Taxes (CBDT) to frame a scheme for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income through Tax Return Preparers. Specified class or classes of persons have been defined to mean any person, other than a company or a person whose accounts are required to be audited under section 44AB or under any other existing law, who is required to furnish a return of income under the Act. Thus, companies and persons whose accounts are liable for tax audit under section 44AB do not fall within the definition of 'specified class or classes of persons' and consequently, cannot furnish their returns of income through Tax Return Preparers. In the instant case, the books of account of X for the year ending 31.3.2007 have been audited under section 44AB. As such, he cannot furnish his return of income for the assessment year 2007-08 through a Tax Return Preparer.
- (c) Section 44BBA incorporates special provisions for computing profits and gains of the business of operation of aircraft in the case of non-residents. Section 44BBA starts with a non-obstante clause. Therefore, section 44BBA overrides the provisions contained in sections 28 to 43A. As such, the business income of Mr. Q is required to be computed in accordance with the provisions of section 44BBA.

Under section 44BBA(1), a sum equal to 5% of the aggregate of the amounts specified in sub-section (2) is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession". Sub-section (2) specifies the following amounts -

- (a) the amount paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and
- (b) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Keeping in view the provisions of section 44BBA, the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder -

	Rs.
Amount received in India on account of carriage of passengers from Chennai	2,00,00,000
Amount received in India on account of carriage of goods from Chennai	1,00,00,000
Amount received in India on account of carriage of passengers from Singapore	3,00,00,000
Amount received in Singapore on account of carriage of passengers from Chennai	1,00,00,000
	7,00,00,000

Income from business under section 44BBA at 5% of Rs.7,00,00,000 is Rs.35,00,000, which is the income of Mr.Q chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y.2007-08.

- (d) JKL Ltd. is advised to file an application under section 119(2)(b) with the Central Board of Direct Taxes(CBDT) seeking a direction to the concerned Assessing Officer to allow its claim for carry forward of business loss. The Karnataka High Court has, in *Associated Electro Ceramics v. Chairman, CBDT (1993) 201 ITR 501*, held that the Board has the power to condone the delay, in cases having claim of carry forward of losses, in exercise of its power under section 119(2)(b). Further, Circular No.8 of 16.5.2001 clarifies that the CBDT has the power under section 119(2)(b) to condone the delay in filing a return of loss having a claim of carry forward of losses.

Question 6

- (a) State briefly the provisions relating to furnishing of annual information return under the Income-tax Act, 1961. What are the consequences of not furnishing the annual information return? (7 Marks)
- (b) S, an individual, carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Punjab State Financial Corporation and State Bank of India and has not paid interest as detailed hereunder:

	Rs.
(i) Punjab State Financial Corporation (Previous years 2004-05, 2005-06 & 2006-07)	36,00,000
(ii) State Bank of India (Previous years 2005-06 & 2006-07)	72,00,000
	1,08,00,000

Both Punjab State Financial Corporation and State Bank of India, while restructuring the loan facilities of S during the year ended 31.3.2007, converted the above interest payable by S to them as loan repayable in 36 equal instalments. During the year ended 31.3.2007, S paid six instalments to Punjab State Financial Corporation and five

instalments to State Bank of India. S claimed the entire interest of Rs.1,08,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities. Discuss whether his claim is valid and if not, what is the amount of interest, if any, allowable. (4 Marks)

- (c) R, an individual, filed his return of income for the assessment year 2006-07 on 15.6.2006. He later discovered that he had not claimed deduction under section 80-C in the said return. He claimed the said deduction through a letter addressed to the Assessing Officer. The Assessing Officer completed the assessment without allowing the deduction claimed by R. Is the Assessing Officer justified in doing so? (2 Marks)

Answer

- (a) Section 285BA provides that any assessee, who enters into any financial transaction, as may be prescribed, with any other person, shall furnish, within the prescribed time, an annual information return in such form and manner, as may be prescribed, in respect of such financial transactions entered into by him during any previous year.

Sub-section (1) casts responsibility on an assessee or the prescribed person in the case of an office of Government or certain other authorities, who are responsible for registering or maintaining books of account or other documents containing a record of any specified financial transaction, to furnish an annual information return.

Such annual information return should be furnished to the prescribed income-tax authority or such other authority or agency as may be prescribed in respect of –

- (i) such transactions registered or recorded by him during any financial year beginning on or after 1st April, 2004, and
- (ii) information relating to which is relevant and required for the purposes of this Act

The annual information return has to be furnished within the prescribed time after the end of such financial year in such form and manner (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any computer readable media) as may be prescribed.

“Specified financial transaction” includes the following transactions, which may be prescribed by the CBDT –

- (i) a transaction of purchase, sale or exchange of goods or property or right or interest in a property, or
- (ii) a transaction for rendering any service, or
- (iii) a transaction under a works contract, or
- (iv) a transaction by way of an investment made or an expenditure incurred, or
- (v) a transaction for taking or accepting any loan or deposit

The CBDT may prescribe different values for different transactions in respect of different persons, having regard to the nature of such transactions. The value or the aggregate value of such transactions during a financial year so prescribed referred to above should not be less than fifty thousand rupees.

Section 271FA provides a penalty for not furnishing a return as required under section 285BA(1). Penalty of Rs.100 is attracted for every day during which failure continues, if a person who is required to furnish an annual information return fails to furnish such return within the time prescribed.

- (b) Section 43B allows deduction only on “payment” basis in respect of certain expenditure specified therein, irrespective of the method of accounting followed by the assessee. Such expenditure would be allowed as deduction in the previous year in which the liability to pay such sum was incurred only if the payment is made on or before the due date for filing the return of income under section 139(1). If the payment is made after the stipulated due date, deduction can be claimed only in the year of actual payment. Such specified expenditure include, inter alia,
- (1) interest on loan or borrowing from any public financial institution or a State financial corporation or a State industrial investment corporation; and
 - (2) interest on any loan or advances from a scheduled bank.

A clarification has been given by way of insertion of Explanations 3C and 3D in section 43B by the Finance Act, 2006. These Explanations clarify that if any sum payable by the assessee as interest on any such loan or borrowing or advance is converted into a loan or borrowing or advance, the interest so converted and not “actually paid” shall not be deemed as actual payment, and hence would not be allowed as deduction. The clarificatory explanations reiterate the rationale that conversion of interest into a loan or borrowing or advance does not amount to actual payment. Therefore, Rs.1,08,00,000, being the aggregate of interest on loan (from a State Financial Corporation and a scheduled bank) converted into loan will not be allowed as deduction. Consequently, the claim of S is not valid.

The manner in which the converted interest will be allowed as deduction has been clarified in Circular No.7/2006 dated 17th July, 2006. The unpaid interest, whenever actually paid to the bank or financial institution, 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.

Hence, the repayment of Rs.16,00,000 during the A.Y. 2007-08, as detailed hereunder, will be allowed as deduction while computing the business income of S.

Particulars	Rs.
Paid to Punjab State Financial Corporation (36,00,000 x 6/36)	6,00,000
Paid to State Bank of India (72,00,000 x 5/36)	10,00,000
	16,00,000

- (c) The Supreme Court has, in Goetze (India) Ltd. v. CIT (2006) 284 ITR 323, ruled that the assessing authority has no power to entertain a claim for deduction made after filing of the return of income otherwise than by way of a revised return. In the instant case, R

has claimed the deduction under section 80C, which he omitted to claim in the original return of income, through a letter addressed to the Assessing Officer and not by filing a revised return under section 139(5). In view of the decision of the Supreme Court cited above, the Assessing Officer was justified in completing the assessment without allowing the deduction under section 80C.

Question 7

- (a) The directors of a private company are personally liable to pay the income tax due from the company. Discuss. (4 Marks)
- (b) GP Ltd. was incorporated on 31.12.2005 for manufacture of tyres and tubes for motor vehicles. The manufacturing unit was set up on 30.4.2006. The company commenced its manufacturing operations on 1.5.2006. The total cost of the plant and machinery installed in the unit is Rs.100 crores. The said plant and machinery included second hand plant and machinery bought for Rs.10 crores and new plant and machinery for scientific research relating to the business of the assessee acquired at a cost of Rs.10 crores.
- Compute the amount of depreciation allowable under section 32 of the Income-tax Act, 1961 in respect of the assessment year 2007-08. Furnish explanations in support of your computation. (4 Marks)
- (c) The Assessing Officer lodged a complaint against M/s. KLM, a firm, under section 276CC of the Income-tax Act, 1961 for failure to furnish its return of income for the assessment year 2005-06 within the prescribed time. The tax payable on the assessed income, as reduced by the advance tax paid and tax deducted at source, was Rs.60,000. The appeal filed by the firm against the order of assessment was allowed by the Commissioner (Appeals). The Assessing Officer passed an order giving effect to the order of the Commissioner (Appeals). The tax payable by the firm as per the said order of the Assessing Officer was Rs.1,000. The Assessing Officer has accepted the order of the Commissioner (Appeals) and has not preferred an appeal against it to the Income Tax Appellate Tribunal. The firm desires to know of the maintainability of the prosecution proceedings in the facts and circumstances of the case. (3 Marks)

Answer

- (a) Section 179 contains the provisions relating to the liability of directors of a private company in liquidation in respect of tax due from the company. Where any tax due from a private company in respect of income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of such company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax. However, the director shall not be so liable if he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Where a private company is converted into a public company and the tax assessed in respect of income of any previous year during which such company was a private

company cannot be recovered from the company, then such tax dues shall be recovered from every person who was a director during the relevant previous year.

(b) Computation of depreciation allowable for the A.Y. 2007-08 in the hands of GP Ltd.

Particulars	Rs. in crores
Total cost of plant and machinery	100.00
Less: Used for Scientific Research (Note 1)	<u>10.00</u>
	<u>90.00</u>
Normal Depreciation at 15% on Rs.90 crores	13.50
Additional Depreciation:	
Cost of plant and machinery	100.00
Less: Second hand plant and machinery (Note 2)	10.00
Plant and machinery used for scientific research, the whole of the actual cost of which is allowable as deduction under section 35(2)(ia) (Note 2)	<u>10.00</u> <u>20.00</u>
	80.00
Additional Depreciation at 20%	<u>16.00</u>
Depreciation allowable for A.Y.2007-08	<u>29.50</u>

Notes:

1. As per section 35(2)(iv), no depreciation shall be allowed in respect of plant and machinery purchased for scientific research relating to assessee's business, since deduction is allowable under section 35 in respect of such capital expenditure.
2. As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing, at the rate of 20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, inter alia, –

- (i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;
- (ii) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profit and gains of business or profession" of any one previous year.

In view of the above provisions, additional depreciation cannot be claimed in respect of -

- (i) Second hand plant and machinery; and
- (ii) New plant and machinery purchased for scientific research relating to assessee's business in respect of which the whole of the capital expenditure can be claimed as deduction under section 35(1)(iv) read with section 35(2)(ia).
- (c) Section 276CC provides for prosecution for willful failure to furnish a return of income within the prescribed time. However, prosecution proceedings will not be attracted if the tax payable by the assessee on the total income determined on regular assessment, as reduced by the advance tax, if any, paid and any tax deducted at source, does not exceed Rs.3,000. Even though the tax liability of the firm as per the original order of assessment exceeded Rs.3,000, however, as a result of the order of the Commissioner (Appeals), it got reduced to Rs.1,000, which is, less than Rs.3,000. Therefore, since the tax liability of the firm on final assessment was determined at Rs.1,000, the prosecution proceedings are not maintainable. In *Guru Nanak Enterprises v. ITO* (2005) 279 ITR 30, where the facts were similar, the Supreme Court held that prosecution was unwarranted

Question 8

- (a) S gifted Rs.2,00,000 to his wife on 10.4.2006. His wife bought gold jewellery on 31.1.2007 out of the said sum of Rs.2,00,000. The fair market value of the gold jewellery as on 31.3.2007 was Rs.2,50,000. S claims that since his wife has not held on 31.3.2007 the sum of Rs.2,00,000 which he gifted to her, no amount is includible in his net wealth for the assessment year 2007-08. Examine the claim of S. (3 Marks)
- (b) Wealth tax is not payable by an assessee in respect of any property held under trust or other legal obligation for any public purpose of a charitable or religious nature in India. Do you agree with the statement? (2 Marks)
- (c) Compute the net wealth of UMV Ltd. (carrying on the business of running cars on hire and also dealing in jewellery) which furnishes the following particulars of its assets and liabilities as on 31.3.2007:

	(Rs. in crores) Book value	(Rs. in crores) If valued as per Schedule III
Assets		
(i) Fixed Assets:		
Plant & Machinery	10	15
Factory Building	25	10
Urban land (450 sq. meters)	40	100
Motor cars	5	10
(ii) Investments		
Jewellery	15	30
Plot of land in Mumbai (480 sq. meters)	10	50

	Equity shares in subsidiary companies	20	25
(iii)	Current assets :		
	Inventories (Jewellery)	150	150
	Sundry Debtors	10	10
	Cash and bank balances (includes cash balance of Rs.1,00,000)	5	5
	Liabilities		
(i)	Current Liabilities	40	40
(ii)	Loans secured on Fixed Assets (Urban land)	30	30

(5 Marks)

Answer

- (a) Section 4(1)(a) of the Wealth-tax Act, 1957 provides that the value of assets which are transferred, directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart, by a husband to his wife or vice versa, are to be clubbed in the hands of the transferor, whether the assets are held in the form in which they were transferred or otherwise. The Supreme Court has, in CWT v. Kishan Lal Bubna (1993) 204 ITR 600, held that where the assessee transfers money and the transferee utilises that money to acquire an asset, it is the value of that asset on the valuation date which is relevant for the purposes of computing the net wealth of the assessee. Where what is transferred by the assessee is an asset and the transferee disposes of the asset and acquires with the consideration received another asset, it is the value of that acquired asset on the valuation date which is relevant for the purposes of computing the net wealth of the assessee. In view of this legal position, the claim of S is not valid. The value of gold jewellery as per Schedule III on the valuation date 31.3.2007 is includible in the net wealth of S for A.Y.2007-08. Therefore, Rs.2,50,000, being the fair market value of gold jewellery as on 31.3.2007 is includible in the net-wealth of S under section 4(1)(a).
- (b) The statement is valid. This exemption is provided in section 5(i). However, wealth-tax is payable in respect of the following properties:
- Any property held under any trust or other legal obligation forming part of any business, other than the business referred to in section 11(4A)(a) or section 11(4A)(b) of the Income-tax Act, 1961 in respect of which separate books of accounts are maintained; or
 - Any property forming part of a business carried on by an institution, fund or trust referred to in section 10(23B) or 10(23C) of the Income-tax Act, 1961.

(c) Computation of Net Wealth of UVM Limited as on the valuation date 31.03.2007

Particulars	Reasons	Value (Rs. in crores)
Assets:		
(i) Fixed Assets:		
Plant & Machinery	Not an asset u/s 2(ea)	Nil
Factory building	Commercial property. Hence, not an asset u/s 2(ea)	Nil
Urban land (450 sq. meters)	It is an asset u/s 2(ea) - Refer Note 2	100
Motor cars	Used for running on hire. Hence, not an asset u/s 2(ea) – Refer Note 3	Nil
(ii) Investments:		
Jewellery	Not stock-in-trade. Hence, an asset u/s 2(ea)	30
Plot of land in Mumbai	An asset u/s 2(ea). Refer Note 2	50
Equity shares in subsidiary companies	Not an asset u/s 2(ea)	Nil
(iii) Current assets:		
Inventories (Jewellery)	Stock-in-trade. Hence, not an asset u/s 2(ea)	Nil
Sundry Debtors	Not an asset u/s 2(ea)	Nil
Cash and bank balances (includes cash balance of Rs.1,00,000)	Bank balance – not an asset under section 2(ea). Cash in hand – recorded in books – hence, not an asset under section 2(ea).	Nil
Value of assets as per Schedule III of the Wealth-tax Act, 1957(A)		180
Liabilities:		
(i) Current Liabilities	Not incurred in relation to an asset under section 2(ea). Hence, not eligible for deduction.	Nil
(ii) Loans secured on Fixed Assets (Urban land)	Assuming that the loan is taken for purchase of urban land, which is included in the net wealth, it is eligible for deduction.	30
Liabilities eligible for deduction (B)		30
Net wealth [(A) – (B)]		150

Notes:

1. The value of any asset other than cash shall be its value as on the valuation date determined in the manner laid down in Schedule III.
2. Plot of land not exceeding 500 sq. meters is exempt only in the case of an individual or HUF and not in the case of a company.
3. It is assumed that all the motor cars are used in the business of running on hire.

The suggested answers for Indirect Taxes (Paper 8) are based on the provisions as amended by the Finance Act, 2006 and Notifications/Circulars issued up to 31.10.2006 which are relevant for May 2007 examinations.

PAPER – 8 : INDIRECT TAXES

Question Nos. 1, 6 and 9 are compulsory. In addition thereto, answer any two questions from Part "A" and one question from Part "B".

PART – A

Question 1

- (a) Briefly explain any two of the following with reference to the provisions of the Central Excise Act, 1944:
- (i) Adjudicating Authority
 - (ii) Central Excise Officer
 - (iii) Duty paid under protest (2 x 2 = 4 Marks)
- (b) What is the period of validity of registration certificate granted by the Appropriate Excise Authority? (2 Marks)
- (c) Discuss the validity or otherwise of the following statements, with reasons:
- (i) Inputs cleared as such to a job worker on 01.10.2006 were not returned in 180 days (assessable value being Rs.20,000, excise duty @ 16.32%). 50% of the inputs were received on 1.4.2007. In this situation, no cenvat will be allowed in the year ending on 31.3.2007.
 - (ii) Captive consumption of excisable goods should always be valued on the basis of sale price of similar goods manufactured by others. (2 x 3 = 6 Marks)
- (d) State the offences under Rule 25(1) of the Central Excise Rules, 2002. (4 Marks)
- (e) A2Z & Co., manufactured shikai powder. They purchased shikai seeds crushed them and sold the same. The assessee did not pay excise duty on such powder contending that such powder was not excisable goods. However, the Central Excise Department treated the said goods as excisable goods by classifying them under the chapter heading "3305.99 – Cosmetic or toilet – preparations, essential oil etc. – preparations for use on the hair – other". Discuss the validity of the contention of the assessee. (4 Marks)

Answer

- (a) (i) As per section 2(a) of the Central Excise Act, 1944, adjudicating authority means any authority competent to pass any order or decision under this Act, but does not include the Central Board of Excise and Customs constituted under the Central Boards of Revenue Act, 1963, Commissioner of Central Excise (Appeals) or Appellate Tribunal.
- (ii) As per section 2(b) of the Central Excise Act, 1944, Central Excise Officer means

the Chief Commissioner of Central Excise, Commissioner of Central Excise, Commissioner of Central Excise (Appeals), Additional Commissioner of Central Excise, Joint Commissioner of Central Excise, Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise or any other officer of the Central Excise Department or any person (including an officer of the State Government) invested by the Central Board of Excise and Customs constituted under the Central Boards of Revenue Act, 1963 with any of the powers of a Central Excise Officer under the Act.

- (iii) Sometimes it happens that the classification and assessable value of goods determined by the excise authorities are not agreeable to or acceptable to the assessee. In such cases, the assessee can file an appeal and in the meanwhile he can pay duty under protest if no stay is obtained from Appellate Authorities.

The assessee shall inform the Superintendent or Inspector of Central Excise in writing giving reasons for paying duty under protest and obtain a dated acknowledgement. The assessee shall mark invoices or monthly/quarterly return indicating the goods on which duty is paid 'under protest'.

- (b) Once registration certificate is granted, it has a permanent status unless it is suspended or revoked by the appropriate authority in accordance with law or is surrendered by the person or company concerned. If the person who applies for registration with the department is an individual, then the certificate ceases to be valid in the event of the death of the said individual. In the case of limited company, death of a director does not affect the status of registration, since registration is issued to the body corporate recognizing the same as a legal person. In the case of partnership firms also, normally, no difficulty arises with regard to succession, since the surviving partners continue either in the same name or with the change of name of the business.
- (c) (i) True. Rule 4(5)(a) of the CENVAT Credit Rules, 2004 inter alia provides that CENVAT credit is allowed on the inputs or capital goods sent to the job worker for further processing, testing repair etc. if the same are received back in the factory of the manufacturer within 180 days of their being sent. If the inputs or capital goods are not received back within the said period, the manufacturer is required to pay an amount equal to the CENVAT credit attributable to such inputs or capital goods. However, the manufacturer can subsequently avail of the CENVAT credit again (which was debited when the said goods were not received) when the inputs or capital goods are received back.

In the given case, the inputs are received back on 01.04.2007 viz., after the expiry of 180 days of their being sent to the job worker. Therefore, the credit of Rs.3264 (Rs.20,000 x 16.32%) allowed earlier will have to be reversed.

However, credit of Rs.1632 (50% of Rs.3264) can be taken again on 01.04.07 since 50% of the inputs sent to the job worker are received back on 01.04.07, though the same cannot be shown in the CENVAT records made for financial year 2006-2007.

- (ii) False. It is incorrect to state that captive consumption of excisable goods should

always be valued on the basis of sale price of similar goods manufactured by others.

As per Rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 where the excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles, then such captively consumed goods have to be valued at 110% of the cost of production or manufacture of such goods. CBE&C has clarified that such cost of production or manufacture should be computed in accordance with the Cost Accounting Standard - 4 issued by the Institute of Cost and Works Accountants of India.

- (d) Subject to the provisions of section 11AC of the Central Excise Act, 1944, following offences have been prescribed under rule 25(1) of the Central Excise Rules, 2002:
- (a) removal of any excisable goods in contravention of any of the provisions of these rules or the notifications issued under these rules; or
 - (b) non accounting of any excisable goods produced or manufactured or stored; or
 - (c) manufacture, production or storage of any excisable goods without having applied for the registration certificate required under section 6 of the Act; or
 - (d) contravention of any of the provisions of these rules or the notifications issued under these rules with intent to evade payment of duty.

If any producer, manufacturer, registered person of a warehouse or a registered dealer commits any of the above-mentioned offences then, he shall be liable to the penalty as prescribed and such goods shall be liable to confiscation.

- (e) The facts of the given case are similar to the case of *Mayil Mark Nilayam v. Superintendent of Central Excise, Madras* 2001 (127) E.L.T. 659 (Mad.). In this case, the High Court has held that Seeakkai is not an excisable commodity as it does not fall under the ambit of 'other' items grouped under Heading 3305.99 of the Central Excise Tariff. Seeakkai is a natural product, which is crushed into powder for removing oil stains and is also used for taking oil bath. Seeakkai means 'soap pod wattle' and is clearly distinct from soapnut powder or soapnut. It is neither a detergent or scouring powder nor does it have any application to the oil or to the hair.

Hence, the contention of the assessee is correct.

Note: Heading No.3305.99 now reads as 3305 90 90 in view of the new eight digit Central Excise Tariff being introduced with effect from 28.02.2005.

Question 2

- (a) M/s P Ltd. manufactured concentrates of non-alcoholic beverages and sold it to various bottlers. The bottlers after processing the concentrates bottled the outcome and sold the same. Under the agreement between P Ltd. and the bottlers, P Ltd. was required to advertise the finished products. Subsequently, the bottlers formed S Ltd. to work as a centralized agency for the advertisement of the finished products. The shareholders as

well as the directors of S Ltd. were the representatives of the bottlers.

Determine whether or not the expenses of advertisement incurred by S Ltd. to advertise aerated products manufactured by the third party i.e. bottlers, is includible in the assessable cost of concentrate manufactured by P Ltd. (4 Marks)

- (b) Examine the validity of the following statements:
- (i) Purchased a plant for Rs.1,16,320 cum-duty price on 12.12.2006 and received the plant in the factory on 5.4.2007. Excise duty rate 16.32%. Cenvat allowed will only be Rs.8,160 for the year ended 31.3.2007.
- (ii) An assessee purchased inputs weighing 400 tons. The duty paid on inputs was Rs.4,000. During transit, 20 tons of the inputs were destroyed. The destroyed quantity of inputs does not qualify to be 'inputs' within the meaning of the Cenvat Credit Rules, 2004. (2 x 2 = 4 Marks)
- (c) Explain the non-applicability of 'transaction value' with reference to section 4 of the Central Excise Act, 1944. (5 Marks)
- (d) What are "exempted goods" under the Cenvat Credit Rules, 2004? (2 Marks)

Answer

- (a) The facts of the given case are similar to the case of CCEx. Mumbai v. Parle International Ltd. 2006 (198) ELT 486 (SC). In this case, the Apex Court has held that advertisement expenses incurred by the centralized agency to advertise aerated products manufactured by third party bottlers would not be includible in the assessable value of concentrates manufactured by the assessee, as only the advertisement and sales expenses incurred for the goods under assessment (here concentrate) could be added to the assessable value.

Thus, in this case the advertisement expenditure incurred by S Ltd. to advertise aerated products manufactured by the third party i.e. bottlers would not be includible in the assessable value of the concentrates manufactured by P Ltd.

- (b) (i) Cum-duty price of plant is Rs.1,16,320
Therefore, duty component = $1,16,320 \times (16.32/116.32) = \text{Rs.}16,320$
As per rule 4(2) of the CENVAT Credit Rules, 2004, out of the total credit of Rs.16,320 available on the plant, credit not exceeding up to 50% can be taken in the first year of acquisition and the balance in the subsequent years. Further, credit in respect of duty paid on capital goods can be taken only on receipt of the capital goods in the factory of the manufacturer.
Hence, in the given case, credit of Rs.8,160 (50% of Rs.16,320) in respect of duty paid on plant can be taken only on or after 05.04.2007. Accordingly, the same cannot be taken in the financial year 2006-2007.
- (ii) As per rule 2(k) of the CENVAT Credit Rules, 2004 inputs should be used in or in relation to production or manufacture of excisable goods. In the given case, 20 tons

of the inputs are destroyed in transit. Thus, they could not be used in or in relation to manufacture of excisable goods. Hence, they do not qualify to be 'inputs' within the meaning of CENVAT Credit Rules, 2004.

Therefore, the CENVAT credit admissible to the assessee will be Rs.3800/ only

$$\left[4000 - \left(\frac{4000 \times 20}{400} \right) \right]$$

- (c) The concept of 'transaction value' is applicable only in the circumstances where:
- there is a sale of goods;
 - the goods are sold for delivery at the time and place of removal;
 - the assessee and the buyer of the goods are not related; and
 - the price is the sole consideration for the sale.

In cases where any of the above-mentioned requirements are missing, the concept of 'transaction value' does not apply and the assessable value is determined on the basis of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 notified under section 4(1)(b) of the Central Excise Act, 1944.

- (d) Rule 2(d) of the CENVAT Credit Rules, 2004 defines 'exempted goods' as goods which are exempt from the whole of the duty of excise thereon and includes goods which are chargeable to 'NIL' rate of duty.

Question 3

- (a) The appellants were the manufacturers of rubber products. Some of the defective goods were returned by the buyers and the appellants took Cenvat credit of the duty originally paid under Rule 16 of the Central Excise Rules, 2002. Defective goods were reprocessed, which however yielded only scrap and such scrap was cleared on payment of duty. Department claimed that Cenvat credit taken by the appellants should be reversed since reprocessing did not amount to 'manufacture' whereas appellants argued that the process cannot be anything other than 'manufacture' in as much as the defective goods returned by their buyers were put to normal process of manufacture.
- Offer your comments to the appellants referring to the decided case law. (5 Marks)
- (b) What are the provisions regarding general exemption to SSI units? (5 Marks)
- (c) M/s P Ltd. used to label its products with a foreign brand and claimed exemption under a notification. The classification list was approved by the department after carrying out verifications and all returns were regularly filed. The invoice containing description of goods were also regularly approved by the department. The department denied the benefit of exemption to the assessee by invoking extended period of limitation under section 11A on the ground that it failed to declare the particulars regarding affixing of labels. Is the department justified? (5 Marks)

Answer

- (a) The facts of the given case are similar to the case of Sundaram Industries Ltd. v. CCE, Madurai 2006 (202) ELT 538 (Tri.-Chennai). In this case, the Tribunal relied on the case of Commissioner v. Tata SSL Ltd. 2005 (191) ELT 799 (Tri. Mumbai) wherein it was held that ".....what is ultimately cleared from the factory is scrap resulting out of further processing of rejected wire".

Thus, the Tribunal held that the "process" undergone by the defective/returned final product amounted to "manufacture" though it resulted in scrap. The Tribunal further elaborated that on this fact, rule 16 got attracted and it was open to the appellants to remove the scrap on payment of duty, after availing CENVAT credit on the defective/returned final product.

Thus, the contention of the appellants is correct.

- (b) The Government has given various concessions to small scale industries. The most important notification governing these concessions is Notification No. 8/2003 CE dated 01.03.2003. The provisions of the notification are:
- (i) A unit is entitled for SSI exemption only if its turnover in previous year does not exceed Rs.4 crore e.g. a unit whose turnover is more than Rs.4 crore in financial year 2005-06 will not be eligible for any SSI concession in financial year 2006-07. However, a unit whose turnover is less than Rs.4 crore in financial year 2005-06 will be eligible for SSI exemption in financial year 2006-07. SSI exemption is available in respect of the goods specified in the said notification.
 - (ii) For a unit entitled for SSI exemption, turnover up to Rs.100 lakhs is fully exempt if the unit does not avail of CENVAT credit on inputs. However, if the SSI unit avails of CENVAT credit on inputs, it has to pay normal duty on all clearances.
 - (iii) A unit availing SSI exemption can avail of CENVAT credit on capital goods but such credit can be utilized only after the turnover crosses Rs.100 lakhs.
 - (iv) The limit of Rs.100 lakh or Rs.4 crore is calculated by taking into account the clearances in respect of one manufacturer from one or more factories or from a factory by one or more manufacturers.
 - (v) SSI exemption is not available if the SSI unit uses a brand name of another person on its clearances.
- (c) The facts of the given case are similar to the case of Pahwa Chemicals Private Ltd. v. CCEx., Delhi 2005 (189) ELT 257 (SC) wherein the Apex Court has held that mere failure to declare the particulars does not amount to mis-declaration or willful suppression. Some positive act on the part of the assessee to establish either willful mis-declaration or willful suppression is must.

The Apex Court explained that there was no willful mis-declaration or willful suppression as all the facts were within the knowledge of the department and the assessee did not make the declaration on the belief that affixing of a label made no difference. Thus, the Apex Court held that since all the facts were within the knowledge of department, hence

extended period of limitation was not invocable.

Thus, in view of the abovementioned judgement, the department is not justified in invoking the extended period of limitation in the given case.

Question 4

- (a) Explain whether a person who is neither a producer nor a curer nor a manufacturer of excisable goods, but only stores such goods in a warehouse, can be called upon to pay the duties of excise on such goods? (3 Marks)
- (b) "The value of price support incentives received from the raw materials supplier should be included in the assessable value of the final products". Do you agree? Explain. (3 Marks)
- (c) Briefly explain the procedure to be adopted in respect of exported goods subsequently re-imported and returned to factory. (4 Marks)
- (d) Explain the concept of 'Provisional Assessment' under Rule 7 of the Central Excise Rules, 2002. (5 Marks)

Answer

- (a) As per rule 4(1) of the Central Excise Rules, 2002, every person who produces or manufactures any excisable goods, or who stores such goods in a warehouse, shall pay the duty leviable on such goods. No excisable goods, on which any duty is payable, shall be removed without payment of duty from any place, where they are produced or manufactured or from a warehouse, unless otherwise provided.

Thus, a warehouse keeper though not a producer or manufacturer or curer, shall be liable to pay duty of excise on the goods stored by him.

- (b) In the case of CCEx. v. Bisleri International Private Limited 2005 (186) ELT 257 (SC), the value of the price support incentives was held as not includible in the assessable value of the final product as
 - there was no flow back of any additional consideration from the buyers;
 - the price uniformity was maintained;
 - there was no evidence of any concession to any of the buyers or existence of any favoured buyers.

It is possible to take a view that if the conditions pointed out by the Apex Court are not satisfied, the value of the price support incentives would be includible in the assessable value of the final product.

- (c) Exported excisable goods, which are re-imported for carrying out repairs, reconditioning, refining, remaking or subject to any similar process, may be returned to the factory of manufacturer for carrying out the said processes and subsequent re-export.

Notification No. 42/2001-CE (NT) as amended prescribes the procedure in respect of exported goods subsequently re-imported and returned to the factory as under:

- (i) The manufacturer shall maintain separate account for return of such goods in the

daily stock account and shall make suitable entry in the said account after the goods are processed, repaired, reconditioned, refined or remade.

- (ii) Such re-import and re-export shall be governed by the provisions of the Customs Act, 1962.
 - (iii) Any waste or refuse arising as a result of the said processes shall be removed from the factory after the payment of appropriate duty or destroyed after informing the proper officer in writing at least 7 days in advance and after observing such conditions and procedure as may be specified by the Commissioner of Central Excise.
 - (iv) Thereafter, the duty payable on such waste or refuse may be remitted by the said Commissioner of Central Excise.
- (d) Rule 7 of the Central Excise Rules, 2002 contains the provisions in respect of provisional assessment. Provisional assessment can be requested by the assessee. Department itself cannot order provisional assessment.

An assessee can request for provisional assessment if he:

- (i) is unable to determine the value of the excisable goods or
- (ii) is unable to determine the applicable rate of duty.

In aforesaid cases, assessee may request Assistant/Deputy Commissioner in writing giving reasons for provisional assessment of duty. After such request, the Assistant/Deputy Commissioner may by order allow payment of duty on provisional basis. The Assistant/Deputy Commissioner shall also specify the rate or value at which duty will be provisionally paid. Payment of duty on provisional basis will be allowed subject to execution of bond for payment of differential duty.

The Assistant/Deputy Commissioner should pass the order for final assessment within 6 months from the date of order of provisional assessment. If after final assessment, any differential amount becomes payable, interest shall be payable from the first day of the month succeeding the month for which such amount is determined, till the date of payment thereof. However, if a refund arises consequent to the order of final assessment, interest shall be payable on such refund from the first day of the month succeeding the month for which such refund is determined, till the date of refund. The refund shall be subject to the provisions of unjust enrichment.

Question 5

- (a) Discuss the power of the Central Government to amend First and Second Schedules of the Central Excise Tariff. (3 Marks)
- (b) What would be the outcome, if retail price is not indicated or wrongly indicated at the time of removal? (3 Marks)
- (c) State the non-application of provisions of unjust enrichment under section 11B(2) of the Central Excise Act, 1944. (4 Marks)

- (d) State the powers of the Settlement Commission under section 32 of the Central Excise Act, 1944. (5 Marks)

Answer

- (a) Section 5 of the Central Excise Tariff Act, 1985 empowers the Central Government to amend the First and Second Schedules. It provides that where the Central Government is satisfied that it is necessary so to do in the public interest, it may, by notification in the Official Gazette, amend the First Schedule and the Second Schedule. However, such amendment shall not alter or affect in any manner the rates specified in the First Schedule and the Second Schedule in respect of goods at which duties of excise shall be leviable on the goods under the Central Excise Act, 1944. Such notifications shall be laid before each House of Parliament, while it is in session, for a total period of thirty days as soon as it is issued.
- (b) Section 4A(4) of the Central Excise Act, 1944 inter alia provides that where a manufacturer removes the excisable goods from the place of manufacture without declaring the retail sale price of such goods on the packages or declares a retail sale price which is not the retail sale price as required to be declared under the central excise provisions or any other law then, such goods shall be liable to confiscation. Further, the retail sale price of such goods shall be ascertained in the prescribed manner and duty shall be payable as per the retail price so determined.
- (c) As per proviso to section 11B(2) of the Central Excise Act, 1944, a refund of excise duty is not hit by the bar of unjust enrichment (i.e., the refund, instead of being credited to the Fund, is paid to the applicant) if the amount of excise duty is relatable to:
- (a) rebate of excise duty on excisable goods exported out of India (if export is on payment of duty)
 - (b) rebate of excise duty on excisable materials used in manufacture of goods exported out of India (if CENVAT credit has not been availed)
 - (c) refund of credit of duty paid on inputs in accordance with any rules or notifications
 - (d) unspent advance deposits lying in balance in the applicant's account current
 - (e) the excise duty paid by the manufacturer, if he had not passed on the incidence of such duty to any other person
 - (f) the excise duty borne by the buyer, if he had not passed on the incidence of such duty to any other person
 - (g) the excise duty borne by certain notified applicants
- (d) The powers of the Settlement Commission are briefed hereunder:
- (i) It has all the powers of a Central Excise Officer.
 - (ii) It can attach the property of an applicant during the pendency of proceedings, to protect revenue.
 - (iii) It can regulate its own procedure and decide the places where the bench will sit.

- (iv) It has the power to grant immunity from prosecution, penalty, fine and interest.
- (v) It has the power to reopen any proceedings within five years from the date of application, if for proper disposal of the case pending before it, an earlier case which was settled is required to be reopened.
- (vi) It has the power to send back a case to proper officer if the applicant has not cooperated with it.

Note: Section 32 of the Central Excise Act, 1944 contains the provisions relating to the constitution of the Customs and Excise Settlement Commission. The powers of the Settlement Commission are given in section 32G, section 32H, section 32I etc.

PART - B

Question 6

- (a) Explain briefly with reference to the provisions of the Customs Act, 1962 any two of the following:
 - (i) Conveyance
 - (ii) Dutiable goods
 - (iii) India (2 x 2 = 4 Marks)
- (b) State the situations in which the proper officer is authorized to issue show-cause notice under section 28 of the Customs Act, 1962 and also the time limit. (5 Marks)
- (c) The assessee M Ltd. entered into a joint venture with a foreign collaborator N for promotion and selling antennas, accessories and other communication equipments. The agreement between them indicates that N owned majority of equity shares in M Ltd. Technical services were provided by N to M Ltd. for various functions that were carried out in respect of manufacture of antenna system in India, for which technical services fee was paid to N by M Ltd. Based on the above facts, the department opined that both M Ltd. and N were related persons in terms of Rules 2(2)(i) and 2(2)(iv) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988 and that the technical fee paid by M Ltd. was includible in the assessable value of the imported components in terms of Rule 9(1)(c) of the Rules. Decide referring to decided case law. (5 Marks)
- (d) From the following particulars, calculate assessable value and total custom duty payable:
 - (i) Date of presentation of bill of entry : 20.6.2006 [Rate of BCD 25%; Exchange Rate : Rs.43.60 and rate notified by CBEC Rs.43.80].
 - (ii) Date of arrival of goods in India : 30.6.2006 [Rate of BCD 20%; Exchange Rate: Rs.43.90 and rate notified by CBEC Rs.44.00].
 - (iii) Rate of Additional Customs Duty : 16%.
 - (iv) CIF value 2,000 US Dollars; Air Freight 500 US Dollars, Insurance cost 100 US Dollars [Landing charges not ascertainable].

- (v) Education cess applicable 2%.
- (vi) Assume there is no special CVD. (6 Marks)

Answer

- (a) (i) As per section 2(9) of the Customs Act, 1962, conveyance is defined to include vessel, an aircraft and a vehicle. As the Customs Act seeks to consolidate the laws relating to levy of duties on import and export of goods, it is necessary to cover all the modes of transport. Therefore, the Act uses the term "conveyance" with an inclusive definition covering all the 3 modes of transport i.e. water, air and land. The specific terms are vessel (by sea), aircraft (by air) and vehicle (by land).
 - (ii) As per section 2(14) of the Customs Act, 1962, dutiable goods is defined to mean any goods which are chargeable to duty and on which duty has not been paid. In order to be dutiable, any article should be within the ambit of the word goods as defined under section 2(22) and should find a mention in the Custom tariff.
 - (iii) As per section 2(27) of the Customs Act, 1962, India includes the territorial waters of India. Territorial waters of India extend to 12 nautical miles into sea from the appropriate base line. Goods are deemed to have been imported if the vessel enters the imaginary line on the sea at the 12th nautical mile i.e., if the vessel enters the territorial waters of India. India includes not only the surface of sea in the territorial waters but also the air space above and the ground at the bottom of the sea.
- (b) As per section 28 of the Customs Act, 1962, the proper officer is authorized to issue show cause notice in the following situations:
- (i) when duty has not been levied
 - (ii) when duty has been short-levied
 - (iii) when duty has been erroneously refunded
 - (iv) when interest payable has not been paid
 - (v) when interest payable has been part paid
 - (vi) when interest has been erroneously refunded

Time Limit for issue of show-cause notice

- (a) In case of any import made by an individual for his personal use or by the Government or by any educational, research or charitable institution or hospital – within one year from the relevant date
- (b) In any other case – within six months from the relevant date
- (c) In the case of collusion or any willful mis-statement or suppression of facts by the importer or the exporter or the agent or employee of the importer or exporter, the time period shall be extended to 5 years.

Note: Relevant date is defined in sub-section (3) of section 28 of the Customs Act, 1962.

- (c) The given case relates to the Supreme Court's decision in the case of CCus. v. Prodelin India (P) Ltd. (2006) 202 ELT 13 (SC). It was held by the Apex Court in this case that the technical fee paid by the assessee to the foreign collaborator for design, drawing, fabrication etc. was in respect of the manufacture of antenna system in India and not with regard to the imported parts of the antenna. Further, the Apex Court pointed out that the Department was not able to prove that the relationship between the assessee and the foreign collaborator had influenced the value of the imported goods. Therefore, this case indicates that the technical fee charged in respect of post importation activities should not be included in the assessable value of the imported goods under Rule 9(1)(c) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988.

Thus, in view of the above-mentioned decision, the technical fee paid by M Ltd. should not be included in the assessable value of the imported components.

(d)	CIF value		2000 US Dollars
	Less : Freight	500	
	Insurance	<u>100</u>	<u>600</u> US Dollars
	FOB Value		1400 US Dollars
	Add: Air Freight @ 20% of FOB Value	280	
	Insurance (actual amount)	<u>100</u>	<u>380</u> US Dollars
			1780 US Dollars
			Rs.
	Value @ 43.80/-		77964.00
	Add: 1% for landing charges		<u>779.64</u>
	Assessable Value		78743.64
	Basic Custom Duty @ 20% (a)		15,748.73
			94,492.37
	Additional Custom Duty (b)		15,421.15
	(@ 16% + 2% cess on 16% = 16.32% on Rs.94,492.37)		
	Total of Basic Duty + Additional Duty (c) = (a + b)		31,169.88
	Education Cess @ 2% on Rs.31,169.88 (d)		623.40
	Total Duty (c + d)		31,793.28

Notes:

- (i) Rate of exchange notified by CBEC on the date of presentation of bill of entry has been considered.
- (ii) Rate of duty as applicable on the date of the arrival of aircraft which is later than the date of submission of the bill of entry has been considered.

- (iii) Landing charges have been considered as per rule 9(2)(b) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988.

Question 7

- (a) After visiting USA, Mrs. & Mr. X brought to India a lap-top computer valued at Rs.80,000, personal effects valued at Rs.90,000 and a personal computer for Rs.52,000. What is the customs duty payable? (3 Marks)
- (b) Write a brief note on the following with reference to the Customs Act, 1962:
- (i) Remission of duty on imported goods lost
- (ii) Pilfered goods (2 x 3 = 6 Marks)
- (c) State the requirements to be satisfied to accept 'transaction value' under rule 4(2) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988. (6 Marks)

Answer

- (a) As per the baggage provisions:
- (i) personal effects and one laptop are exempt from customs duty.
- (ii) general free allowance is Rs.25,000
Hence, duty shall be payable on Rs.52,000 – Rs.25,000 = Rs.27,000.
- (iii) Effective rate of duty for baggage = 35% + 2% education cess
Therefore, duty payable = Rs.9,450 + Rs.189
Total customs duty = Rs.9,639
- (b) (i) Remission of duty on imported goods lost
Section 23(1) of the Customs Act, 1962 provides for remission of duty on imported goods lost (otherwise than as a result of pilferage) or destroyed, if such loss or destruction is at any time before clearance for home consumption. Such loss or destruction covers loss by leakage. Duty is payable under this section but it is remitted by Assistant/Deputy Commissioner of Customs if the importer is able to prove the loss or destruction. Thus, unless remitted, duty has to be paid and burden of proof is on the importer. Remission is at the discretion of Customs authorities. The provisions of this section are applicable for warehoused goods also.
- (ii) Pilfered goods
Section 13 provides that if imported goods are pilfered after unloading thereof but before the proper officer has made an order for clearance for home consumption or deposit in a warehouse, no duty is payable on the goods, unless the pilfered goods are restored to importer. In such a case, duty on pilfered goods is payable by the Port authorities. Also, the importer does not have to prove pilferage. However, the loss must be only due to pilferage. Section 13 is not applicable for warehoused goods.

- (c) The transaction value can be accepted under rule 4(2) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988 when:
- (i) the sale is in the ordinary course of trade under fully competitive conditions [Rule 4(2)(a)];
 - (ii) the sale does not involve any abnormal discount or reduction from the ordinary competitive prices [Rule 4(2)(b)];
 - (iii) the sale does not involve special discounts limited to exclusive agents [Rule 4(2)(c)];
 - (iv) objective and quantifiable data exists with regard to adjustments required to be made, under the provisions of rule 9, to the transaction value [Rule 4(2)(d)];
 - (v) there are no restrictions as to the disposition or use of the goods by the buyer other than restrictions which —
 - (i) are imposed or required by law or by the public authorities in India; or
 - (ii) limit the geographical area in which the goods may be resold; or
 - (iii) do not substantially affect the value of the goods [Rule 4(2)(e)];
 - (vi) the sale or price is not subject to some condition or consideration for which a value cannot be determined in respect of the goods being valued [Rule 4(2)(f)];
 - (vii) no part of the proceeds of any subsequent resale, disposal or use of the goods by the buyer will accrue directly or indirectly to the seller, unless an appropriate adjustment can be made in accordance with the provisions of rule 9 of these rules [Rule 4(2)(g)]; and
 - (viii) the buyer and seller are not related [Rule 4(2)(h)].

Question 8

- (a) Enumerate the penalties in respect of improper exportation of goods under section 114 of the Customs Act. (3 Marks)
- (b) State the difference between transit and transshipment of goods under the provisions of the Customs Act. (4 Marks)
- (c) State the ingredients in the case of seizure under section 123 of the Customs Act. (4 Marks)
- (d) Explain the provisions under section 15 of the Customs Act for determining the rate of duty and tariff valuation of imported goods. (4 Marks)

Answer

- (a) Section 114 of the Customs Act, 1962 provides that any person who, in relation to any goods, does or omits to do any act which act or omission would render such goods liable to confiscation under section 113, or abets the doing or omission of such an act, shall be liable:

- (i) in the case of goods in respect of which any prohibition is in force under this Act or any other law for the time being in force, to a penalty not exceeding three times the value of the goods as declared by the exporter or the value as determined under this Act, whichever is the greater;
 - (ii) in the case of dutiable goods, other than prohibited goods, to a penalty not exceeding the duty sought to be evaded or five thousand rupees, whichever is the greater;
 - (iii) in the case of any other goods, to a penalty not exceeding the value of the goods, as declared by the exporter or the value as determined under this Act, whichever is the greater.
- (b) Differences between transit and transshipment has been summarized in the table hereunder:-

Transit	Transshipment
(i) Section 53 of the Customs Act, 1962 provides for transit of goods.	(i) Section 54 of the Customs Act, 1962 provides for transshipment of goods.
(ii) In case of transit of goods, goods are allowed to remain on the same conveyance.	(ii) In case of transshipment of goods, the conveyance changes i.e., the goods are unloaded from one conveyance and loaded in another conveyance.
(iii) In case of transit, the record already made in the ship's/aircraft's manifest continues. The imported goods are shown in the manifest as the same bottom cargo. Thus, there is continuity in the records and there is no chance of the control over such transit goods being lost.	(iii) In transshipment of goods, continuity in the records is not maintained as the goods are transferred to another conveyance.

- (c) There are four ingredients in section 123 of the Customs Act:
- (i) there should be seizure under the provisions of Customs Act;
 - (ii) seizure must have been from the possession of the person proceeded against or the one claiming ownership of the goods;
 - (iii) seizure must be in respect of goods for which section 123 applies;
 - (iv) seizure must be in the reasonable belief that the goods seized are smuggled.

Section 123 applies in case of gold and manufactures thereof, watches and other notified goods. In a case where all these four ingredients are established by the seizing authorities, the burden to prove that the seized goods are not smuggled goods lies on the

owner or possessor of the seized goods.

Note: The provisions relating to seizure are dealt in section 110 of the Customs Act, 1962. Therefore, this question may also be answered in light of the provisions of section 110. The provisions of section 110 dealing with seizure are as follows:

An Officer of Customs can seize any goods, if he has reason to believe that the same are liable to confiscation, under the Customs Act. The proper officer may also seize any document or things that may be relevant to any proceedings under the Customs Act. However, the person from whom these documents are seized is entitled to make copies of the same.

The person from whom the goods are seized is issued a show cause notice, usually within six months. If the notice is not issued within six months, the seized goods are returned to the person from whom they were seized. However, the Commissioner of Customs, on sufficient cause being shown, can extend the time period for issue of show cause notice, by a further period of six months.

If the seized goods are perishable or hazardous in nature or are prone to depreciate in value over time or there is constraint in storage space, the Government may notify such goods and the same can be disposed off before the conclusion of the proceedings.

- (d) Section 15 provides that the rate of duty and tariff valuation, if any, applicable to any imported goods, shall be the rate and valuation in force -
- (a) in the case of goods entered for home consumption under section 46, on the date on which a bill of entry in respect of such goods is presented under that section;
 - (b) in the case of goods cleared from a warehouse under section 68, on the date on which bill of entry for home consumption in respect of such goods is presented;
 - (c) in the case of any other goods, on the date of payment of duty;

However, if a bill of entry has been presented before the date of entry inwards of the vessel or the arrival of the aircraft by which the goods are imported, the bill of entry shall be deemed to have been presented on the date of such entry inwards or the arrival, as the case may be.

The provisions of section 15 do not apply to baggage and goods imported by post.

PART – C

Question 9

- (a) State whether in the following cases service tax is payable, with reasons:
- (i) Temporary transfer of any intellectual property right.
 - (ii) Canteens in office run by the canteen contractor providing service directly to employees/workmen.

- (iii) Business auxiliary service provided by commission agents in relation to sale of agricultural produce. (3 x 1 = 3 Marks)
- (b) M/s TCCL, providing management consultancy to its client, do not maintain any separate accounts and have paid Rs.1,00,000 as service tax and excise duty towards input services and input material/capital goods used by them. They have used the inputs for partially exempted and partially taxable services. They are now providing the output services for which current tax liability is Rs.1,40,000. How much credit out of Rs.1,00,000 can be availed by them for paying output service tax liability, if they do not maintain any separate accounts? (4 Marks)
- (c) Mr. AJAR, a Chartered Accountant, raised an invoice for Rs.28,060 (25,000 + 3,060 service tax) to a client on 20.1.2007. The client, however, has paid a lump-sum of Rs.26,000 on 28.4.2007 for full and final settlement.
- (i) How much service tax Mr. AJAR has to pay and when does this tax become due for payment?
- (ii) What will be his liability, if the client refuses to pay service tax and pays only Rs.25,000 in total? (4 Marks)
- (d) (i) The service provider is abroad. He renders service to a subsidiary of an Indian Company located abroad. Payment to him is done by holding Indian Company. Does this attract service tax?
- (ii) What do you understand by 'Centralised Registration'? (2 x 2 = 4 Marks)

Answer

- (a) (i) Section 65(55b) of the Finance Act, 1994 defines intellectual property service as:
- (a) transferring, temporarily; or
- (b) permitting the use or enjoyment of, any intellectual property right.
- Thus, temporary transfer of any intellectual property right (IPR) shall be subject to service tax.
- (ii) Section 65(76a) of the Finance Act, 1994 defines outdoor caterer as a caterer engaged in providing services in connection with catering at a place other than his own but including a place provided by way of tenancy or otherwise by the person receiving such services.
- Thus, if service is directly provided to employees/workmen, then the canteen will not come within the purview of the definition of the outdoor caterer as the place is not provided by the person receiving the service. Hence, this service would not be chargeable to service tax.
- (iii) Business auxiliary services provided by commission agents in relation to sale or purchase of agricultural produce is exempt from service tax vide Notification No. 13/2003 ST dated 20.06.03 as amended.

- (b) Rule 6(3) of the CENVAT Credit Rules, 2004 inter alia provides that where common input/input services are used for providing taxable as well as exempted services and separate accounts are not maintained, the output service provider shall utilize credit only up to 20% of the amount of service tax payable on taxable output service.

Therefore, M/s. TCCL can take full credit of Rs.1,00,000 but can utilize credit only upto 20% of the amount of service tax payable on taxable output service i.e.:

$$20\% \text{ of Rs.1,40,000} = \text{Rs.28,000}$$

In this case, out of Rs.1,40,000 M/s. TCCL shall pay output service tax of Rs.1,12,000 in cash and balance Rs.28,000 shall be paid by utilizing CENVAT credit. Remaining credit available with M/s. TCCL shall be Rs.72,000 (i.e. Rs.1,00,000 - Rs. 28,000).

- (c) (i) The Department has clarified vide the Frequently Asked Questions issued by it that service tax is required to be paid only on the value/amount of taxable service received and not on the gross amount billed to the client. However, where the amount received is less than the gross amount charged/billed to the client, the assessee is required to amend the bills either by rectifying the existing bill or by issuing a revised bill and by properly endorsing such change in the billed amount.

Assuming that Mr.AJAR has amended the bill, amount of service tax payable shall be computed by back calculations. Effective rate of service tax is 12.24% (12% service tax + 2% education cess on service tax).

$$\begin{aligned} \text{Service tax and education cess payable} &= \frac{\text{Gross value} \times \text{Rate of tax}}{100 + \text{rate of tax}} \\ &= \frac{26000 \times 12.24}{100 + 12.24} \\ &= \frac{26000 \times 12.24}{112.24} \\ &= \text{Rs.2835} \end{aligned}$$

Such service tax should be paid along with the tax of 1st quarter of financial year 2007-08 by 5th of July, 2007.

- (ii) The Department has clarified vide the Frequently Asked Questions issued by it that where the assessee only receives the service charges and not the service tax payable thereon, the amount so realized from the client would be treated as gross amount inclusive of service tax. Accordingly, the value of taxable service and the service tax liability will be worked out by back calculations. Effective rate of service tax is 12.24% (12% service tax + 2% education cess on service tax).

$$\begin{aligned}\text{Service tax and education} &= \frac{\text{Gross value} \times \text{Rate of tax}}{100 + \text{rate of tax}} \\ \text{cess payable} &= \frac{25000 \times 12.24}{100 + 12.24} \\ &= \frac{25000 \times 12.24}{112.24} \\ &= \text{Rs.2726}\end{aligned}$$

- (d) (i) Section 64(1) of the Finance Act, 1994 provides that provisions of service tax law extend to whole of India except the State of Jammu & Kashmir. Service tax is paid by the person or firm or a company who provides the services. In this case, service tax will not be attracted as service provider is abroad and renders service outside India.
- (ii) Sometimes an assessee provides taxable service from more than one premises. Rule 4(2) of the Service Tax Rules, 1994 provides that in such cases, the assessee can obtain centralized registration at his option if:
- (a) he has centralized billing or centralized accounting in respect of such service, and
 - (b) such centralized billing or centralized accounting systems are located in one or more offices or premises.

The assessee can register such offices or premises where centralized accounting or centralized billing systems are located.

SUMMARY OF EXAMINERS' COMMENTS ON THE PERFORMANCE OF CANDIDATES

PAPER – 5 : COST MANAGEMENT

General Comments

The performance of the candidates in both theory and practical questions is short of what is expected of a CA Final student. Students are advised to understand clearly, the basic concepts underlying various techniques and tools used in both traditional and modern Cost Management. Such an understanding is necessary for correctly analysing practical questions and also for writing better theoretical answers.

Specific Comments

Question 1. (a) This was a practical question part from the area of Standard Costing. Students were required to calculate the missing information from other cost details given in the question. Most of the students were unable to identify the Yield Variances relating to raw material 'A' and 'B' and hence were unable to proceed further.

(b) This practical question part relating to Transportation was attempted well by most of the students. A few students wrongly evaluated the unallocated cells and hence got the answer wrong.

(c) This theory question part relating to the JIT approach was answered reasonably well by a majority of the students.

Question 2. (a) This practical question part required candidates to have a conceptual understanding of absorption costing. Many candidates were unable to find profits under absorption costing as well as actual profit and loss account and hence were unable to reconcile the two.

(b) This theory part was attempted reasonably well by most of the students.

(c) This practical question part required candidates to identify future sale quantum so that existing profits may be maintained. Many candidates were unable to bifurcate Fixed and Variable Overheads and hence got their answers wrong.

Question 3. (a) This was a practical question part from the area of CPM. Many candidates were unable to find the revised duration of Network and revised duration of activity (3-6).

(b) This theory question part required examinees to describe briefly the various components of a Balanced Scorecard. Many of the students identified the 'Perspectives' correctly but gave vague answers for the measures to be used.

(c) This theory question part required students to describe the process of Zero Based Budgeting. Many candidates explained the concept of ZBB but failed to elaborate upon the process.

Question 4. (a) This was a practical question part requiring candidates to determine the optimum production plan and the maximum contribution by using the simplex method. Most of the

students got the first table/iteration right but could not proceed on the desired lines subsequently.

(b) The answer to this theory question part was average.

(c) In this practical question part candidates are required to calculate the BEP from the give data. Answer to this part was satisfactory; however some students computed wrong labour cost and hence arrived at the wrong answer.

Question 5. (a) This question part required students to identify relevant and irrelevant costs from the given scenario. Examiners have reported a lack of knowledge of concepts because of which many students were unable to get the entire answer right.

(b & c) These theory question parts were attempted fairly well by most of the students.

Question 6. (a) This practical question part was attempted very poorly by most of the candidates. Examiners have noted that students lacked concepts relating to marginal costing /contribution analysis and hence were not able to arrive at correct decisions.

(b) This theory question part required students to write about the practical applications of Linear Programming. The answer to this part was average.

PAPER – 6 : MANAGEMENT INFORMATION AND CONTROL SYSTEMS

General Comments

The understanding of the question is necessary to give relevant answer that was not reflected in the Answer Sheet prepared by the students. Lack of adequate preparation and presentation of the answers were the part of the student as far as the student's knowledge is concerned. The students are required to take examination with more seriously and sincerity as to perform well. They also need to understand the importance of the subject in particular domain, in today's scenario.

Specific Comments

Question 1.(a) Most of the students attempted this question but the performance was not satisfactory. Understanding of the question and the description of the techniques are necessary to secure good marks that was not seen in the answers given by the students.

(b) Answered given by most of the students with an average performance. Lack of understanding of the security policy versus security techniques was the major problem of the students.

(c) Attempted by the majority of the students and performed well.

(d) Most of the students were confused with general software packages versus specific software packages used for various purposes. They were also misunderstood the meaning of the question. Hence, the performance was very poor.

Question 2.(a) Answered by the majority of the students and performed well.

(b) Most of the students answered wrongly. Students are required to understand the basic concepts of ERP system with CSF and KPI. Hence, the performance was very poor.

Question 3.(a) Not many of the students answered correctly. Some of the students were confused with the sharing accounting system and account sharing system in c/s networking system. Although the performance was average.

(b) Average number of the students answered correctly. Many of the students were not clear about the basic concept of DSS as well as its organizational structure. Hence, the performance was below average.

Question 4.(a) The answers are readily available in the course material but average number of students have given the answer correct. Although, the performance was satisfactory.

(b) Most of the students attempted the question and performed well.

(c) More than average number of students attempted this question nicely.

Question 5.(a) Answers by the majority of the students and performed well.

(b) Many of the students have answered wrongly. Some of the students did not know the powers of the controller under section 89 in Information Technology Act, 2000 which is readily available in the study material. Hence, the performance is very poor.

(c) Most of the students attempted this question nicely.

Question 6.(a) Answered given by most of the students with an average performance.

(b) Most of the students attempted this question and performed well. Although some of the students attempted the question with incorrect or vague answer without understanding the basic concepts of the question on Client / Server security.

(c) Good performance by the majority of the students.

Question 7.(a) Well answered by almost all the students and secured good marks.

(b) More than average number of students attempted this question nicely.

(c) Performance was not satisfactory. More than average number of students did not explain the Holistic Protection which is a part of Information security.

(d) Satisfactory performance by the majority of the students.

PAPER – 7 : DIRECT TAXES

General Comments

Overall performance of the candidates is not satisfactory. The candidates lack conceptual clarity. The explanations given by them and analysis of the facts were not up to the mark due to lack of understanding and clarity of the provisions of Income tax Act and Wealth tax Act. It has been noticed that when it comes to applying the law to the facts, most of the candidates have not been able to analyse and discuss the relevant provisions to support their conclusions.

Specific Comments

Question 1.(a) Most of the candidates have not understood the problem and failed to compute total income correctly. Some common mistakes are:

- (i) Most of the candidates were not aware of the provisions of the section 45(4). They have considered the capital gain on distribution of assets as arising on the date of dissolution of the firm instead of on the actual date of distribution of assets.
- (ii) Many candidates have considered the value of gold jewellery received as a gift for achieving sales target as a capital receipt instead of treating the same as a perquisite or benefit arising in the course of business chargeable as business income under section 28.
- (iii) Most of the candidates have not computed the additional depreciation on new plant and machinery.
- (iv) Many candidates were not aware that stock-in-trade has to be valued at market price in the case of a dissolved firm.
- (v) Majority of the candidates were not aware of the amendment made by the Taxation Laws (Amendment) Act, 2006 in section 40A(3), requiring payments in excess of Rs.20,000 to be made by an account payee cheque/account payee bank draft.
- (vi) Very few candidates have stated that the interest on current accounts of partners are not allowable in the absence of authorisation in the partnership deed.
- (vii) A number of candidates have treated purchase of television sets as capital expenditure without considering that the assessee firm was engaged in the business of television sets.
- (viii) Very few candidates could correctly compute the Book Profit of the firm.

Question 2.(a) Most of the candidates have showed lack of awareness of the clarifications given by the CBDT on the various issues arising out of FBT provisions vide Circular No. 8/2005. Some of the candidates have stated that reimbursement of expenditure on food & beverages in the office is not liable to FBT. Distribution of free samples to hospitals has been wrongly understood as distribution to doctors.

(b) Most of the candidates were not aware of the amendment made by the Taxation Laws (Amendment) Act, 2006 in section 56(2). They were not aware that if the aggregate value of gifts received from non-relatives during the year exceeds Rs. 50,000/-, the entire sum is taxable under section 56(2)(vi).

(c) Many candidates have failed to explain that the revised return filed under section 139(5) replaces the original return. They have wrongly concluded that the loss disclosed in the revised return cannot be carried forward.

Question 3.(a) Most of the candidates have confused the conditions of section 54 with that of section 54F. Many candidates were not aware that purchase of share of other co-owners is considered as purchase of residential property for the purpose of availing exemption under section 54.

(b) Candidates were not aware of the amendment made by the Taxation Laws (Amendment) Act, 2006 to the definition of 'rent' under section 194-I to include within its scope, rent for plant & machinery as well. They treated the hire charges of machinery as falling under the provisions of section 194C.

(c) Most of the candidates have not been able to understand the difference between construction and repair of house property and considered the limit of Rs.1,50,000 applicable for construction of residential house property for repairs and reconstruction also.

Question 4.(a) Most of the candidates have not understood the provisions of section 115BBC and treated the anonymous donations received and applied for charitable purposes under section 11 as non-taxable and anonymous donations received by trust wholly for religious purposes but not utilized fully as taxable under section 115BBC(1).

(b) Most of the candidates were not aware that the deduction under section 80P is still available to a primary co-operative agricultural and rural development bank.

(c) Most of the candidates have not understood the provisions of section 2(22)(e) and confused the same with the provisions of section 269SS and section 269T.

Question 5.(b) Most of the candidates have wrongly answered that only a Tax Return Preparer can file a return of the assessee whose accounts are audited under section 44AB.

(c) Many candidates were not aware of the presumptive tax provisions under section 44BBA relating to profit from the business of operation of aircraft by a non-resident. Some have applied different rates for presumptive taxation like 7.5% or 10%.

Question 6. (a) A number of candidates did not know the provisions relating to furnishing of annual information return and got confused with furnishing of return of income under section 139.

(b) This question pertains to conversion of interest into term loan vis-à-vis section 43B. Most of the candidates have not mentioned the relevant provisions of Explanations 3C & 3D inserted in section 43B by the Finance Act, 2006.

Question 7.(b) Most of the candidates were not aware of the rate of depreciation allowable under section 32 in respect of plant and machinery and have wrongly charged 20% or 25%. Further, most of them have not computed additional depreciation.

(c) Majority of the candidates were not aware of the provisions of section 276CC that prosecution proceedings were not maintainable unless the tax liability exceeds Rs. 3,000.

Question 8.(a) Some of the candidates have taken cost of jewellery as taxable instead of its fair market value.

(c) Many candidates were not able to identify the assets specified under section 2(ea) and apply the provisions of valuation of business assets. Some candidates have treated urban land as not taxable.

PAPER – 8 : INDIRECT TAXES

General comments

The overall performance of the candidates was unsatisfactory. It was observed that candidates lacked conceptual clarity. Thus, the explanations and analysis of the facts given by them were very poor. Very few candidates were able to cite the case laws while answering the questions. Majority of the candidates were not aware of the recent developments in the indirect tax laws. Many candidates got confused as to whether the question related to customs or central excise even though the questions were divided properly. It has been noticed that when it comes to applying law to the facts, most of the candidates are not able to analyse and discuss relevant points supporting the conclusion.

Specific comments

Question 1.(a) Many candidates were not aware of the difference between the Adjudicating Authority and the Central Excise Officer. They gave the same meaning for both the terms. Further, many of them did not explain as to who could not be an adjudicating authority.

(b) Some candidates wrongly explained the period of validity of registration as five years, one year, six months or even till the date of completion of any project.

(d) Many candidates were not able to explain the offences under rule 25(1) of the Central Excise Rules, 2002.

(e) A large number of the candidates wrongly concluded that the process was manufacture and the product i.e. shikai powder was an excisable goods chargeable to excise duty.

Question 2.(a) Only a handful of the candidates were able to cite the case law. Most of the candidates wrongly explained that since there was a nexus between the advertisement and the product manufactured by P Ltd., the cost of such advertisement should be included in the assessable value of the concentrates.

(b)(i) Most of the candidates failed to answer that CENVAT credit in respect of duty paid on capital goods can be taken only on receipt of the capital goods in the factory of the manufacturer.

(b)(ii) Many candidates wrongly mentioned that the destroyed goods qualify to be inputs within the meaning of CENVAT Credit Rules, 2004.

Question 3.(b) Very few candidates were aware of the provisions regarding general exemption to SSI units.

(c) In this question, candidates were required to comment on the departments' action of invoking the extended period of limitation. However, many candidates wrote about brand name etc. Their understanding of the concept of invocation of extended period was not up to the mark. Further, many candidates discussed the applicability of exemption instead of discussing whether the department was justified in invoking the extended limit.

Question 4.(b) Most of the candidates wrongly explained that the value of price support incentives received from raw material supplier should be included in the value of the final products.

(c) Candidates performed poorly in this question. They were required to explain the procedure to be adopted in respect of exported goods subsequently re-imported and returned to factory. However, they wrote irrelevant details about duty draw back etc.

(d) Most of the candidates failed to explain as to who can initiate provisional assessment and mentioned unnecessary details.

Question 5.(a) This question required the candidates to discuss the power of the Central Government to amend First Schedule and Second Schedule of the Central Excise Tariff. However, majority of the candidates discussed the emergency powers of the Central Government under section 3 of the Central Excise Tariff Act, 1985. They wrongly explained that the Central Government has the power to amend the schedules of the Central Excise Tariff only for amending the rate of duty.

(c) The concept of unjust enrichment and its exceptions were not known to many candidates.

(d) Some candidates, instead of explaining the powers of the Settlement Commission, wrongly explained the procedure to make an application to the Settlement Commission.

Question 6.(b) Many candidates failed to explain the situations in which the show cause notice can be issued under the Customs Act, 1962.

(d) Most of the candidates were not able to determine the correct assessable value of the imported goods. The difference between the CIF value and the FOB value was not clear to many candidates.

Question 7.(a) Majority of the candidates allowed Rs.50,000 (25,000 x 2) as deduction by wrongly pooling the general free allowance of the two individuals involved.

(c) Instead of explaining the conditions to be satisfied under rule 4(2) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988, many candidates discussed the provisions relating to value under section 14(1) of the Customs Act, 1962.

Question 8.(a) A large number of the candidates were not aware of the provisions relating to penalties in respect of improper exportation of goods under section 114 of the Customs Act, 1962.

(b) Very few candidates were able to correctly distinguish between transit and transshipment of goods.

(c) The performance in this question was very poor. Most of the candidates were ignorant about the ingredients in case of seizure under section 123 of the Customs Act, 1962.

Question 9.(b) Many candidates wrongly concluded that the entire amount of CENVAT credit of Rs.1,00,000 could be utilized for payment of output tax liability.

(c) Most of the candidates wrongly answered that Mr.AJAR would be required to pay the entire service tax of Rs. 3,060 irrespective of whether he is able to recover the same from the client or not.



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