PAPER – 5: ADVANCED MANAGEMENT ACCOUNTING

QUESTIONS

Implementation of Kaizen Costing System

1. M. India Ltd. (MIL) is an automobile manufacturer in India and a subsidiary of Japanese automobile and motorcycle manufacturer Leon. It manufactures and sells a complete range of cars from the entry level to the hatchback to sedans and has a present market share of 22% of the Indian passenger car markets. MIL uses a system of standard costing to set its budgets. Budgets are set semi-annually by the Finance department after the approval of the Board of Directors at MIL. The Finance department prepares variance reports each month for review in the Board of Directors meeting, where actual performance is compared with the budgeted figures. Mr. Suzuki, group CEO of the Leon is of the opinion that Kaizen costing method should be implemented as a system of planning and control in the MIL.

   Required:

   RECOMMEND key changes vital to MIL's planning and control system to support the adoption of KAIZEN COSTING CONCEPTS.

Kaizen Costing– Basic Concepts

2. ABC Ltd. is planning to introduce Kaizen Costing approach in its manufacturing plant. State whether and why the following are VALID OR NOT in respect of Kaizen Costing.

   (i) VP (Finance) is of the view that company has to make a huge initial investment to bring a large scale modification in production process.

   (ii) Head (Personnel) has made a point that introduction of Kaizen Costing does not eliminate the training requirement of employees.

   (iii) General Manager (Manufacturing) firmly believes that only shop floor employees and workers' involvement is prerequisite of Kaizen Costing approach.

   (iv) Manager (Operations) has concerns about creation of confusion among employees and workers regarding their roles and degradation in quality of production.

Life Cycle Costing – Optimal Plant Capacity

3. Y-Connections, China based firm, has just developed ultra-thintablet S-5 with few features like the ability to open two apps at the same time. This tablet cost ₹ 5,00,000 to develop; it has undergone extensive research and is ready for production. Currently, the firm is deciding on plant capacity, which could cost either ₹ 35,00,000 or ₹ 52,00,000. The additional outlay would allow the plant to increase capacity from 500 units to 750 units. The relevant data for the life cycle of the tablet at different capacity level are as under:

Expected Sales	500 units	750 units
Sale Price	₹79,600 per unit	₹69,600 per unit

Variable Selling Costs	10% of Selling Price	10% of Selling Price
Salvage Value - Plant	₹ 6,25,000	₹ 9,00,000
Profit Volume Ratio	40%	

Required:

ADVISE Y-Connections, regarding the OPTIMAL PLANT CAPACITY to install. The tablet's life cycle is two years.

Note: Ignore the time value of money.

Value Chain Analysis– Basic Concepts

4. EXAMINE the VALIDITY of following statements along with the reasons:

   (i) The concepts, tools and techniques of value chain analysis apply only to all those organizations which produce and sell a product.

   (ii) Procurement activities are included in the Primary activities as classified by Porter under value chain analysis concept.

   (iii) Value chain analysis in the strategic framework consists of single cost driver concept.

Labour Related Decision – Strike

5. MFG Ltd. is producing a component called 'KDK'. Estimated costs are:

	Fixed Cost per year (₹ '000)	Variable Cost per 'KDK' (₹)
Production	32,000	3,600
Distribution	2,000	200

Direct labour costs are 40% of the variable production costs. In the production department machining and assembling of 'KDK', 90 men work 8 hours per day for 300 days in a year. Each worker can machine and assemble 1 'KDK' per uninterrupted 180 minutes time frame. In each 8 hours working day, 20 minutes are allowed for coffee-break, 30 minutes on an average for training and 22 minutes for supervisory instructions. Besides 10% of each day is booked as idle time to cover checking in and checking out changing operations, getting materials and other miscellaneous matters.

MFG Ltd. has been facing industrial relations problem as the workers of company have a very strong union. Company is faced with the possibility of a strike by direct production workers engaged on the assembly of 'KDK'. The trade union is demanding an increase of 15%, back-dated from the beginning of financial year, but the company expects that if a strike does take place, it will last 25 Days after which the union will settle for an increase of 10% similarly back-dated. The only product of the company is being sold at ₹6,000.

If the strike takes place, Sales of 1,300 'KDK' would be lost. The balance that would ordinarily have been produced during the strike period could, however be sold, but these

'KDK' would have to be made up in overtime working which would be at an efficiency rate of 90% of normal. This would entail additional fixed cost of ₹1,00,000 and wage payments at time and one-half.

Required:

Give necessary ADVICE to the management to allow the strike to go ahead or to accept the union's demand.

Pricing Strategy – Growth Stage (Antivirus Software)

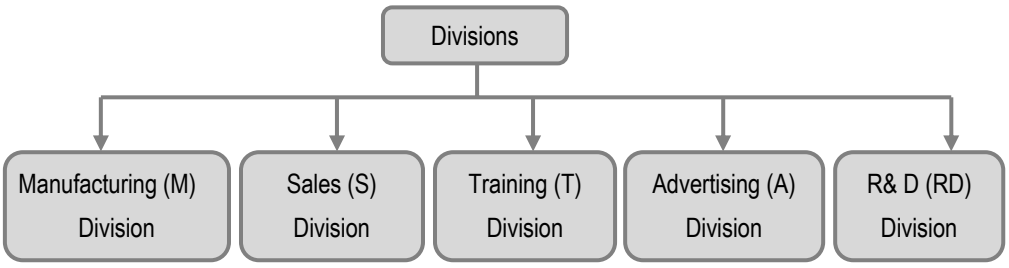
6. Rapid Heal Tech Ltd. (RHTL) is a leading IT security solutions and ISO 9001 certified company. The solutions are well integrated systems that simplify IT security management across the length and depth of devices and on multiple platforms. RHTL has recently developed an Antivirus Software and company expects to have life cycle of less than one year. It was decided that it would be appropriate to adopt a market skimming pricing policy for the launch of the product. This Software is currently in the Introduction stage of its life cycle and is generating significant unit profits.

   EXPLAIN, with reasons, the changes, if any, to the unit selling price that could occur when the Software moves from the Introduction stageto Growth stage of its life cycle.

   Also SUGGEST necessary STRATEGIES at this stage.

Zero Based Budgeting (Public Company – Telecommunications Sector)

7. Metro Communication Limited is a state-owned large public company in the telecommunications sector. One of its main planning and control tools is the preparation and use of traditional annual budgets. Its divisional structure is as under:



   Division T, A and RD incur substantial amount on discretionary expenses.

   Required:

   IDENTIFY the possibilities of introducing a ZERO BASED BUDGETING system for Division T, A and RD.

Standard Costing – Missing Figures

8. A company produces a product X, using raw materials A and B. Thestandard mix ofA and B is 1: 1 and the standard loss is 10% of input. You are required to COMPUTE theMISSING INFORMATION indicated by "?" based on the data given below:

	A	B	Total
Standard price of raw material (₹ / kg.)	24	30	
Actual input (kg.)	?	70	
Actual output (kg.)			?
Actual price ₹ / kg.	30	?	
Standard input quantity (kg.)	?	?	
Yield variance (sub usage)			270(A)
Mix variance			?
Usage variance	?	?	?
Price variance	?	?	?
Cost variance	0	?	1,300(A)

Decision Making (Public Transport – Bus Service)

9. Expert Roadways Services Pvt. Ltd. is planning to run a fleet of 15 buses in Birpur City on a fixed route. Company has estimated a total of 2,51,85,000 passenger kilometers per annum. It is estimated buses to have 100% load factor. Buses are purchased at a price of ₹ 44,00,000 per unit whose scrape value at the end of 5 years life is ₹ 5,50,000. Seating capacity of a bus excluding a Driver's seat is 42. Each bus can give a mileage of 5 kmpl. Average cost of fuel is ₹ 66 per liter. Cost of Lubricants & Sundries per 1,000 km would be ₹ 3,300. Company will pay ₹ 27,500 per month to Driver and two attendants for each bus.

   Other annual charges per bus: Insurance ₹ 55,000, Garage Charges ₹ 33,000, Repairs & Maintenance ₹ 55,000. Route Permit Charges upto 20,000 km is ₹ 5,500 and ₹ 2,200 for every additional 5,000 km or part thereof.

   Required:

   (i) CALCULATE a suggested fare per passenger/km taking into account markup on cost @20% to cover general overheads and sufficient profit.

   (ii) The Transport Sector of Birpur is highly regulated. The Government has fixed the fare @ ₹ 1.35 for next 2 years. COMMENT on the two year's profitability taking into consideration the inflation rate of 8%.

   Note: Route permit charges is not subject to Inflation.

Multinational Transfer Pricing

10. Standard Corporation Inc. (SCI) is a US based multinational company engaged in manufacturing and marketing of Printers and Scanners. It has subsidiaries spreading across the world which either manufactures or sales Printers and Scanners using the brand name of SCI.

The Indian subsidiary of the SCI buys an important component for the Printers and Scanners from the Chinese subsidiary of the same MNC group. The Indian subsidiary buys 1,50,000 units of components per annum from the Chinese subsidiary at CNY (¥) 30 per unit and pays a total custom duty of 29.5% of value of the components purchased.

A Japanese MNC which manufactures the same component which is used in the Printer and Scanners of SCI, has a manufacturing unit in India and is ready to supply the same component to the Indian subsidiary of SCI at ₹ 320 per unit.

The SCI is examining the proposal of the Japanese manufacturer and asked its Chines subsidiary to presents its views on this issue. The Chinese subsidiary of the SCI has informed that it will be able to sell 1,20,000 units of the components to the local Chinese manufactures at the same price i.e. ¥ 30 per unit but it will incur an excise duty @ 10% on sales value. Variable cost per unit of manufacturing the component is ¥ 20 per unit. The Fixed Costs of the subsidiaries will remain unchanged.

The Corporation tax rates and currency exchange rates are as follows:

Corporation Tax rates		Currency Exchange Rates
China	25%	1 US Dollar ($) = ₹61.50
India	34%	1 US Dollar ($) = ¥ 6.25
USA	40%	1 CNY (¥) = ₹ 9.80

Required:

(i) PREPARE a financial appraisal for the impact of the proposal by the Japanese manufacturer to supply components for Printers and Scanners to Indian subsidiary of SCI. [Present your solution in Indian Currency and its equivalent.]

(ii) IDENTIFY other issues that would be considered by the SCI in relation to this proposal.

(Note: While doing this problem use the only information provided in the question itself and ignore the actual taxation rules or treaties prevails in the above mentioned countries)

Balance Score Card (Telecom Company)

11. Standard Telecom Ltd. is a leading cellular service provider having a global presence. It aims to be the most innovative and trusted telecom company in the world. To achieve this aim, it is constantly working on its overall functioning. It is trying to adopt best managements practices in the world. Following are some information related to the company's performance for a particular period:

Particulars	Current Year	Base Year	Target
Operating Ratio	60%	54%	Reduce it to 50%
Average Revenue *per user*	₹ 225	₹ 210	Increase it to ₹250

Unresolved Consumer Complaints	27,500	25,000	Reduce it by 20%
Customer Relationship Centres	280	200	Take the total to 250
Employee Coverage under Training Programme	10%	8%	At least 15%

EVALUATE the performance of the company using BALANCE SCORECARD approach.

Profitability Analysis (Manufacturing Company)

12. Aditya Decors Ltd. (ADL) is a leading manufacturer of luxury sanitary products and has divided its whole business into different product segments. At the Last year the management of ADL has decided to make some changes in its one of product-line 'AADee', the improved version was made available for sale from 1st of April 2014.

At the end of the financial year 2014-15, the finance and accounts department has extracted some relevant data for the product line 'AADee' to analyse the decision taken last year. The data related with AADee for the financial year 2013-14 and 2014-15 are as follows:

	2013-14	2014-15
No. of Units Sold	4,00,000	4,30,000
Selling Price *per unit*	₹4,175	₹ 4,325
Direct Materials Consumed	24,00,000 kg.	25,10,000 kg.
Cost *per kg.* of Direct Materials	₹470	₹485
Direct LabourUsed	32,00,000 hrs.	34,80,000 hrs.
Rate *per labour hour*	₹30	₹ 31
Fixed Costs	₹1,60,00,000	₹ 1,76,00,000

ADL has the capacity to produce 5,00,000 units of AADee a year.

Required:

(i) ANALYSE the changes in the operating income from financial year 2013-14 to 2014-15 with respect to the following components:

(a) Growth, (b) Price- Recovery and (c) Productivity Components

(ii) RECONCILIATION of Operating Profit from 2013-14 to 2014-15.

Linear Programming and Transportation

13. IDENTIFY three SIMILARITIES and three DIFFERENCES between Linear Programming Model and Transportation Model.

Assignment and Transportation

14. EXPLAIN following statement-

"Assignment problem is special case of transportation problem; it can also be solved by transportation methods"

Program Evaluation and Review Technique

15. The Chennai Construction Company is bidding on a contract to install a line of microwave towers. It has identified, the expected duration of the critical path is 18 weeks and the sum of the variances of the activities on the critical path is 9 weeks.

Required:

CALCULATE the PROBABILITY that the project may be completed not earlier than 15 weeks and not later than 21 weeks.

Simulation- Perishable Stock

16. A cake vendor buys pieces of cake every morning at ₹4.50 each by placing his order one day in advance **(at the time of receiving his previous order)** and sale them at ₹ 7.00 each. Unsold cake can be sold next day at ₹2.00 per piece and there after it should be treated as no value. The pattern for demand of cake is given below:

Fresh Cake:

Daily Sale	100	101	102	103	104	105	106	107	108	109	110
Probability	.01	.03	.04	.07	.09	.11	.15	.21	.18	.09	.02

One day old cake:

Daily Sale	0	1	2	3
Probability	.70	.20	.08	.02

Use the following set of random numbers:

Fresh Cake	37	73	14	17	24	35	29	37	33	68
One day old cake	17	28	69	38	50	57	82	44	89	60

The vendor adopts the following rule.

If there is no stock of cake with him at the end of previous day, he orders for 110pieces otherwise he orders 100 or 105 pieces whichever is nearest actual fresh cake sale on the previous day. Starting with zero stock and a pending order of 105 pieces, simulate for 10 days and CALCULATE vendor's profit.

Learning Curve – Sensitivity Analysis

17. B-Parts Inc., USA based firm, has just invented a new part 'B-20'. New part has a budgeted total profit of ₹75,000 from the first 256parts. The time taken to produce the first part was 112.50 hours. The labour rate is ₹20 per hour. A 90% learning curve is expected to apply indefinitely.

Required:

CALCULATE the SENSITIVITY of the budgeted total profit from the first 256 parts to changes in the learning rate.

SUGGESTED ANSWERS/HINTS

1. **Kaizen Costing** emphasizes on *small but continuous improvement*. Targets once set at the beginning of the year or activities are *updated continuously* to reflect the improvement that has already been achieved and that are yet to be achieved.

The suggestive changes which are required to be adopted Kaizen Costing concepts in MIL are as follows:

Standard Cost Control System to Cost Reduction System: Traditionally Standard Costing system assumes stability in the current manufacturing process and standards are set keeping the normal manufacturing process into account thus the whole effort is on to meet performance cost standard. On the other hand Kaizen Costing believes in continuous improvements in manufacturing processes and hence, the goal is to achieve cost reduction target. The first change required is the standard setting methodology i.e. from earlier Cost Control System to Cost Reduction System.

Reduction in the periodicity of setting Standards and Variance Analysis: Under the existing planning and control system followed by the MIL, standards are set semi-annually and based on these standards monthly variance reports are generated for analysis. But under Kaizen Costing system cost reduction targets are set for small periods say for a week or a month. So the period covered under a standard should be reduced from semi-annually to monthly and the current practice of generating variance reports may be continued or may be reduced to a week.

Participation of Executives or Workers in standard setting: Under the Kaizen Costing system participation of workers or executives who are actually involved in the manufacturing process are highly appreciated while setting standards. So the current system of setting budgets and standards by the Finance department with the mere consent of Board of Directors required to be changed.

2. **(i)** **Invalid:** Kaizen Costing is the system of cost reduction procedures which involves making small and continuous improvements to the production processes rather than innovations or large-scale investment.

(ii) **Valid:** The training of employees is very much a long-term and ongoing process in the Kaizen costing approach. Training enhances the abilities of employees.

(iii) **Invalid:** Kaizen costing approach involves everyone from top management level to the shop floor employees. Every employee's active participation is a must requirement.

(iv) **Invalid:** Though the aim of Kaizen Costing is to reduce the cost but at the same time it also aims to maintain the quality. Kaizen costing also aims to bring the clarity in roles and responsibilities for all employees.

3. Workings

Statement Showing Variable Manufacturing Cost *per unit*

Particulars of Costs	₹ / unit
Sales	79,600
Less: Contribution (40%)	31,840
Variable Cost	47,760
Less: Variable Selling Costs (₹79,600 × 0.1)	7,960
Variable Manufacturing Cost	39,800

Statement Showing Expected Profit

Particulars of Costs	('000) ₹ / unit	
	500 units	750 units
Sales	39,800 (₹79,600 × 500)	52,200 (₹69,600 × 750)
Less: Variable Mfg. Cost	19,900 (₹39,800 × 500)	29,850 (₹39,800 × 750)
Less: Variable Selling Cost	3,980 (₹39,800 × 0.1)	5,220 (₹52,200 × 0.1)
Add: Salvage Value	625	900
Less: Cost of Plant	3,500	5,200
Net Profit	13,045	12,830

Development cost is sunk and is not relevant.

Advice---

Based on the above 'Expected Profit' statement which is purely based on *financial considerations* firm may go for high price – low volume i.e. 500 units level. However, *non-financial considerations* are also given due importance as they account for actions that may not contribute directly to profits in the short run but may contribute significantly to profits in long run. Here, it is important to note that life cycle of product is two years and there is no significant difference between the profits at both levels. In this scenario firm may opt the plant having high capacity not only to increase its market share but also to establish a long term brand image.

4. (i) Invalid: The concepts, tools and techniques of value chain analysis apply to organizations which produce and sell a product and also to organizations which provide a service.

(ii) Invalid: Procurement activities are included in the support activities rather than primary activities.

(iii) Invalid: Value chain analysis in the strategic framework consists of multiple cost drivers concept. In value chain analysis, a set of unique cost drivers is identified for each value activity instead of single cost driver application at the overall firm level. Multiple cost drivers may be classified into Structural drivers and Executional drivers.

5. Alternative-1 with No Strike: (Refer W.N.-2, 3) ---

Cost of Settlement is 15% Increase i.e. ₹216 per unit

Annual Cost of Settlement

= 54,000 units × ₹ 216

= ₹ 1,16,64,000

Alternative 2 i.e. if Strike Goes Ahead: (Refer W.N.-1, 2, 3) ---

Extra Cost	(₹)
Annual Incremental Labour Cost (Ex. Strike Days Production) [{54,000 units – (25 Days × 180 units per Day)} ×₹144.00]	71,28,000
Loss of Contribution *due to loss of sales*[1,300 units ×₹ 2,200]	28,60,000
Incremental Labour Cost for Balance 3,200 units [(25 Days × 180 units per Day) – 1,300 units} ×₹144.00]	4,60,800
Overtime Premium [3,200 units × 1,584 × 0.5]	25,34,400
Payment for Efficiency [3,200 units × 1/9 × 1,584 × 1.5]	8,44,800
Additional Fixed Cost	1,00,000
	1,39,28,000

If there is no strike, it will yield a financial benefit of ₹ 22,64,000 (₹1,39,28,000 – ₹ 1,16,64,000). Management should accept union's demand.

Working Note

(1) Statement Showing Contribution *per unit* of 'KDK' ----

	(₹)
Selling Price	6,000
Less: Variable Costs:	
Labour Cost	1,440
Production Ex. Wages (₹3,600 –₹1,440)	2,160
Distribution	200
Contribution	2,200

(2) Calculation of Labour Cost----

Direct Labour (40% of production costs of ₹3,600) = ₹1,440 *per unit*

With 15% Increase, Revised Labour Cost (₹1,440 + ₹216) = ₹1,656

With 10% Increase, Revised Labour Cost (₹1,440 + ₹144) = ₹1,584

(3) Statement Showing Budgeted Production----

Total Time in a Day: (8hrs. × 60 minutes)	=	480 minutes
Less: Idle Time	=	48 minutes
Coffee Break	=	20 minutes
Instructions	=	22 minutes
Training	=	30 minutes
Productive Time *per day*	=	360 minutes

Therefore, 'KDK' to be produced per man per day: (360/180 × 1) = 2 units

Since 'KDK' are produced at the rate of 2 'KDK' per man day, so total yearly production will be 54,000 units (2 units × 90 men × 300 days) of 'KDK'

☞ This question has been solved by comparing **'Existing Situation'** with both **'Alternatives (Strike or Non-Strike)'** *independently*. However this question can also be solved by comparing **'Alternatives (Strike or Non-Strike)'** *only* and final answer would be the same.

Students may also solve this question by taking **'Total Approach'** instead of **'Incremental Approach'**.

6. Following acceptance by early innovators, conventional consumers start following their lead. New competitors are likely to now enter the market attracted by the opportunities for large scale production and profit. RHTL may wish to discourage competitors from entering the market by lowering the price and thereby lowering the unit profitability. The price needs to be lowered so that the product becomes attractive to different market segments thus increasing demand to achieve the growth in sales volume. Strategies at this stage may include the following

(i) Improving quality and adding new features such as Data Theft Protection, Parental Control, Web Protection, Improved Scan Engine, Anti Spyware, Anti Malware etc.

(ii) Sourcing new market segments/ distribution channels.

(iii) Changing marketing strategy to increase demand.

(iv) Lowering price to attract price-sensitive buyers.

7. Discretionary costs are those that are incurred, typically each year, in an amount that is approved as part of the normal budget process. However, there is no clear relationship between the volume of services and the amount of cost that must be incurred. Manager must decide and justify the level that is deemed to be appropriate. This justification is to be made a fresh without making reference to previous level of spending in his/her department.

Zero based budgeting is undoubtedly most effective in terms of discretionary costs. The bottom line of a zero based budgeting is that it is important to understand what types of objectives are being accomplished by discretionary cost centers and what resources being devoted to accomplishing various objectives. This will allows a prioritization, so

that organization can evaluate the likely impact of substantial increase or decrease in the resources allocated to the discretionary center.

Accordingly, ZBB has extensive potential application to the division T, A and RD.

8. Working for Finding – Missing Figures

Cost Variance $_{A}$ = 0

Cost Variance $_{(A+B)}$ = ₹ 1,300 (A)

Yield Variance $_{(A+B)}$ = ₹ 270 (A)

Standard Cost and Actual Cost (Incomplete Information)

Raw Material	Standard Data			Actual Data		
	Qty. (Kg.) [SQ]	Price (₹) [SP]	Amount (₹) [SQ x SP]	Qty. (Kg.) [AQ]	Price (₹) [AP]	Amount (₹) [AQ x AP]
A	? ??	24	? ? ?	? ? ?	30	? ? ?
B	? ??	30	? ? ?	70	? ? ?	? ? ?
Total	? ? ?		? ??	? ??		? ? ?

Material Cost Variance $_{A}$ = Standard Cost – Actual Cost

$\Rightarrow$ 0 = $(SQ_A \times ₹\ 24 - AQ_A \times ₹\ 30)$

$\Rightarrow$ SQ_A = $1.25\ AQ_A$

Material Yield Variance $_{(A+B)}$ = *Average* Standard Price *per unit* of Standard Mix × [Total Standard Quantity (units) – Total Actual Quantity (units)]

$$\Rightarrow ₹270\ (A) = \left(\frac{₹\ 24 \times SQ_A + ₹\ 30 \times SQ_B}{SQ_A + SQ_B}\right) \times [(SQ_A + SQ_B) - (AQ_A + 70)]$$

$SQ_A = SQ_B$ as Standard Mix is in ratio 1:1

$$\Rightarrow ₹\ 270\ (A) = \left(\frac{₹\ 24 \times SQ_A + ₹\ 30 \times SQ_A}{SQ_A + SQ_A}\right) \times [(SQ_A + SQ_A) - (AQ_A + 70)]$$

$\Rightarrow$ ₹ 270 (A) = $27 \times [2 \times SQ_A - (AQ_A + 70)]$

$\Rightarrow$ ₹ 270 (A) = $27 \times [2 \times 1.25\ AQ_A - (AQ_A + 70)]$

$\Rightarrow AQ_A$ = 40 Kg.

As SQ_A = $1.25\ AQ_A$

= 1.25 × 40 Kg.

= 50 Kg.

As SQ_B = SQ_A

= 50 Kg.

Cost Variance $_{(A+B)}$ = Standard Cost – Actual Cost

$\Rightarrow$ 1,300 (A) = (50 Kg. × ₹ 24 + 50 Kg. × ₹ 30) – (40 Kg. ×₹ 30 +70 Kg. × AP_B)

$\Rightarrow$ AP_B = ₹ 40

Standard Cost and Actual Cost (Complete Information)

Raw Material	Standard Data			Actual Data			Std. Cost of Actual Qty. (₹) [AQ x SP]
	Qty. (Kg.) [SQ]	Price (₹) [SP]	Amount (₹) [SQ x SP]	Qty. (Kg.) [AQ]	Price (₹) [AP]	Amount (₹) [AQ x AP]	
A	50	24	1,200	40	30	1,200	960
B	50	30	1,500	70	40	2,800	2,100
Total	100		2,700	110		4,000	3,060

Computation of Variances

Material Cost Variance = Standard Cost – Actual Cost

= SQ × SP – AQ × AP

(A) = ₹1,200 – ₹1,200

= ₹0

(B) = ₹1,500 – ₹2,800

= ₹1,300 (A)

Total = ₹0 + ₹1,300 (A)

= ₹1,300 (A)

Material Price Variance = Standard Cost of Actual Quantity – Actual Cost

= AQ × SP – AQ × AP

Or

= AQ × (SP – AP)

(A) = 40 Kg. × (₹24.00 – ₹30.00)

= ₹240 (A)

(B) = 70 Kg. × (₹30.00 – ₹40.00)

= ₹700 (A)

Total = ₹240 (A) + ₹700 (A)

= ₹940 (A)

Material Usage Variance = Standard Cost of Standard Quantity for Actual Output – Standard Cost of Actual Quantity

= SQ × SP – AQ × SP

Or

= SP × (SQ – AQ)

(A) = ₹24 × (50 Kg. – 40 Kg.)

= ₹240 (F)

(B) = ₹30 × (50 Kg. – 70 Kg.)

= ₹600 (A)

Total = ₹240 (F) + ₹600 (A)

= ₹360 (A)

Material Mix Variance = Total Actual Quantity (units) × (*Average* Standard Price *Per unit* of Standard Mix – Average Standard Price *per unit*of Actual Mix)

$$= 110 \text{ Kg.} \times \left(\frac{₹\ 2,700}{100 \text{ Kg.}} - \frac{₹\ 3,060}{110 \text{ Kg.}} \right)$$

= ₹90 (A)

Material Yield Variance = *Average* Standard Price *per unit* of Standard Mix × [Total Standard Quantity (units) – Total Actual Quantity (units)]

$$= \left(\frac{₹\ 2,700}{100 \text{ Kg.}} \right) \times (100 \text{ Kg.} - 110 \text{ Kg.})$$

= ₹ 270 (A) (Given)

Standard Output = Standard Input – Standard Loss

= 100 Kg. – 10 Kg.

= 90Kg.

Actual Output = 90 Kg.

(Actual Output and Standard Output are always equal numerically in any Material Variance Analysis)

9. (i) Statement Suggesting Fare *per passenger – km* (Each Bus)

Particulars	Cost per annum (₹)
Fixed Expenses:	
Insurance	55,000.00

Garage Charges	33,000.00
Depreciation	7,70,000.00
Running Expenses:	
Repair and Maintenance	55,000.00
Cost of Lubricants and Sundries	1,38,517.50
Fuel Cost	5,54,070.00
Salary of Driver and Two Attendants	3,30,000.00
Route Permit Charges	16,500.00
Total Cost *per annum*	19,52,087.50
Add: Markup @ 20% of Total Cost or 16.67% of Total Revenue	3,90,417.50
Total Revenue	23,42,505.00

Rate *per passenger- km* equals to ₹1.395

Workings

Total Passenger Kms = 2,51,85,000

Total Buses = 15

Passenger Kms*per bus* = 16,79,000(2,51,85,000 Kms / 15)

Total Passenger Capacity *per bus* = 42 – 2

= 40

Annual Distance Covered *by a bus* = 41,975 Kms. (16,79,000Kms/40)

(ii) Regulated Fare *per passenger km* is ₹1.35

Profitability Statement for *Each Bus*

Particulars	Year 1 (₹)	Year 2 (₹)
Fixed Expenses:		
Insurance	59,400.00	64,152.00
Garage Charges	35,640.00	38,491.20
Depreciation	7,70,000.00	7,70,000.00
Running Expenses:		
Repair and Maintenance	59,400.00	64,152.00
Cost of Lubricants and Sundries	1,49,598.90	1,61,566.81
Fuel Cost	5,98,395.60	6,46,267.25
Salary of Driver and Two Attendants	3,56,400.00	3,84,912.00

Route Permit Charges		16,500.00	16,500.00
Total Cost	[A]	20,45,334.50	21,46,041.26
Total Revenue (Regulated)	[B]	22,66,650.00	22,66,650.00
Profit	[B] – [A]	2,21,315.50	1,20,608.74
Profit to Total Revenue		9.76%	5.32%

The gross margin is showing a downward trend because the cost components have taken into the effect of inflation hence increasing year by year but the total revenue has remained stagnant due to Government regulations which resulted in reduction in gross margin per bus.

The company's gross margin to total revenue ratio has come out to be 9.76% and 5.32% in first and second year respectively but initially the company's desired gross margin to total revenue ratio is 16.67% to cover general overheads and sufficient profit. Though the amount of general overheads is not given but we can safely assume that they may also subject to inflation i.e. increase year by year then in such case the company needs to maintain or increase its gross margin per bus to maintain its net profit after general overheads which is not possible in regulated environment. The information about regulated fare in the given case is regarding first two years only but if this regulated fare scenario persists for further years then the project may not be viable for the company.

10. (i) Impact of the Proposal by the Japanese Manufacturer to Supply Components for Printers and Scanners to the Indian Subsidiary of the SCI.

On Indian Subsidiary of SCI

Particulars	**Amount (₹)**
Cost of Purchase from the Chinese Manufacturer :	
Invoiced Amount {(1,50,000 units × ¥ 30) × ₹9.80}	4,41,00,000
Add: Total Custom Duty (₹ 4,41,00,000 × 29.5%)	1,30,09,500
Total Cost of Purchase from the Chinese Manufacturer (A)	5,71,09,500
Cost of Purchase from Japanese Manufacturer in India:	
Invoice Amount (1,50,000 units × ₹ 320)	4,80,00,000
Total Cost of Purchase from Japanese Manufacturer in India (B)	4,80,00,000
Savings on Purchase Cost Before Corporate Taxes (A) – (B)	91,09,500
Less: Corporate Tax @34%	30,97,230
Savings after Corporate Taxes	60,12,270

On Chinese Subsidiary of SCI

Particulars	Amount (₹)
Loss of Contribution [{(1,50,000 – 1,20,000 units) × ¥ (30 – 20)} × ₹ 9.80]	29,40,000
Add: Excise Duty on Local Sale - Chinese Manufacturer [{(1,20,000 units × ¥ 30) × 10%} × ₹ 9.80]	35,28,000
Total Loss Before Corporate Taxes	64,68,000
Less: Tax Savings on the Losses (₹ 64,68,000 × 25%)	16,17,000
Net Loss after Corporate taxes	48,51,000

On SCI Group

Particulars	Amount (₹)
Saving from Indian Subsidiary	60,12,270
Loss from Chinese Subsidiary	48,17,000
Net Benefit to SCI Group	11,61,270

From the above analysis it can be seen that the proposal from the Japanese manufacturer in India is beneficial for the SCI as it give a net benefit of ₹ 11,61,270.

(ii) The SCI need to consider various other issues before reaching at a final decision of accepting the proposal of the Japanese manufacturer in India. The few suggestive issues that should be considered are as follows:

- *The longevity of the proposal of the Japanese manufacturer:* Whether Japanese manufacturer will supply the components in the future also. For this purpose a long term agreement between the Indian Subsidiary of SCI and Japanese manufacturer in India needs to be entered.
- *Certainty of the fiscal policy in India:* The Japanese manufacturer will not be able to supply the component at the present price if the fiscal policy of India will change in the future.
- *Repatriation of Profit earned in India:* Though the Indian subsidiary is making profit but it depends on the Government policy on the repatriation of profit from India to USA.
- *Operating Conditions in China:* The SCI has to make sure that the Chinese subsidiary is operating profitably and able to use the spare capacity in the future as well.
- *The fiscal policy in China:* If the Government of China liberalize its fiscal policies in China in future then the manufacturing cost will be cheaper than the today's cost.

Apart from above suggestive points the foreign relations and other tax treaties and accords should also be kept in consideration.

11. The balanced scorecard is a method which displays organisation's performance into four dimensions namely financial, customer, internal and innovation. The four dimensions acknowledge the interest of shareholders, customers and employees taking into account of both long-term and short-term goals. The detailed analysis of performance of the company using Balance Scorecard approach as follows:

(i) Financial Perspective: Operating ratio and average revenue will be covered in this prospective.

Company is unable to achieve its target of reducing operating ratio to 50% instead it has increased to 60%. Company is required to take appropriate steps to control and manage its operating expenses. Average revenue per user has increased from ₹ 210 to ₹ 225 but remains short of targeted ₹ 250. This is also one of the reasons of swelled operating ratio. Company can boost up its average revenue per user either by increasing the price of its services or by providing more paid value added services.

(ii) Customer Perspective: Service complaints will be covered under this perspective. The company had set a target of reducing unresolved complaints by 20% instead unresolved complaints have risen by 10%[(27,500-25,000)/(25,000) × 100]. It shows dissatisfaction is increasing among the consumers which would adversely impact the consumer's general perception about the company and company may lose its consumers in long run.

(iii) Internal Business Perspective: Establishing customer relationship centres will be covered under this perspective. Company has established 80 relationship centres in the current period exceeding its target of 50 (250-200) to cater to the needs of existing consumers as well as soliciting new consumers. This shows the seriousness of the company towards the consumer satisfaction and would help them in the long run.

(iv) Learning and Growth Perspective: Employee training programmes are covered under this perspective.

Company had set a target to cover at least 15% employee under its training programmes but covered only 10%. This could hurt capabilities of the employees which are needed for long term growth of the organisation necessary to achieve the objectives set in the previous three perspectives. People or the human resource of the company is one of the three principle sources where organisational learning and growth comes.

12. Analysis of Changes in the Operating Income from Financial Year 2013-14 to 2014-15.

Growth Component

Revenue Effect of Growth Component

$$= \left(\begin{matrix}\text{Actual Units of Output}\\ \text{Sold in 2014-15}\end{matrix} - \begin{matrix}\text{Actual Units of Output}\\ \text{Sold in 2013-14}\end{matrix}\right) \times \text{Selling Price in 2013-14}$$

$$= (4,30,000 \text{ units} - 4,00,000 \text{ units}) \times ₹4,175$$

= ₹12,52,50,000 (F)

Cost Effect of Growth Component (Variable Costs)

Direct Materials

$$= \left(\begin{matrix}\text{Direct Materials Required to}\\ \text{Produce 4,30,000 Units}\\ \text{in 2013-14}\end{matrix} - \begin{matrix}\text{Direct Materials Used to}\\ \text{Produce 4,00,000 Units}\\ \text{in 2013-14}\end{matrix}\right) \times \text{Cost per Kg. in 2013-14}$$

$$= \left(\frac{24,00,000 \text{ Kg.}}{4,00,000 \text{ units}} \times 4,30,000 \text{ units} - 24,00,000 \text{ Kg.}\right) \times ₹470$$

$$= (25,80,000 \text{ Kg.} - 24,00,000 \text{ Kg.}) \times ₹470$$

= ₹8,46,00,000 (A)

Direct Labour

$$= \left(\begin{matrix}\text{Labour Hours Required to}\\ \text{Produce 4,30,000 Units}\\ \text{in 2013-14}\end{matrix} - \begin{matrix}\text{Labour Hours Used to}\\ \text{Produce 4,00,000 Units}\\ \text{in 2013-14}\end{matrix}\right) \times \text{Rate per hr. in 2013-14}$$

$$= \left(\frac{32,00,000 \text{ hrs.}}{4,00,000 \text{ units}} \times 4,30,000 \text{ units} - 32,00,000 \text{ Kg.}\right) \times ₹30$$

$$= (34,40,000 \text{ hrs.} - 32,00,000 \text{ hrs.}) \times ₹30$$

= ₹72,00,000 (A)

Price-Recovery Component

Revenue Effect of Price-Recovery Component

$$= \left(\begin{matrix}\text{Selling Price in}\\ \text{2014-15}\end{matrix} - \begin{matrix}\text{Selling Price in}\\ \text{2013-14}\end{matrix}\right) \times \begin{matrix}\text{Actual Units of Output Sold in}\\ \text{2014-15}\end{matrix}$$

= (₹4,325 –₹4,175) × 4,30,000 units

= ₹6,45,00,000 (F)

Cost Effect of Price-Recovery Component (Variable Costs)

Direct Material

$$= \begin{pmatrix} \text{Direct Material Price in 2014-15} \\ - \\ \text{Direct Material Price in 2013-14} \end{pmatrix} \times \begin{pmatrix} \text{Direct Material Required to Produce 4,30,000 Units in 2013-14} \end{pmatrix}$$

= (₹485 –₹470) × 25,80,000 kg.

= ₹3,87,00,000 (A)

Direct Labour

$$= \begin{pmatrix} \text{Labour Hour Rate in 2014-15} \\ - \\ \text{Labour Hour Rate in 2013-14} \end{pmatrix} \times \text{Labour Hours Required to Produce 4,30,000 units in 2013-14}$$

= (₹ 31 –₹ 30) × 34,40,000 hrs.

= ₹34,40,000 (A)

Cost effect of Price-Recovery Component (Fixed Costs)

$$= \begin{pmatrix} \text{Rate per Unit in 2014-15} \\ - \\ \text{Rate per Unit in 2013-14} \end{pmatrix} \times \text{Actual Units of Capacity in Last Year, if Adequate to Produce Current Year's Output in Last Year}$$

$$= \left(\frac{₹1,76,00,000}{5,00,000 \text{ units}} - \frac{₹1,60,00,000}{5,00,000 \text{ units}} \right) \times 5,00,000 \text{ units}$$

= (₹35.2 – ₹32) × 5,00,000 units

= ₹16,00,000 (A)

Productivity Component

Productivity Component (for Variable Costs)

Direct Material

$$= \begin{pmatrix} \text{Direct Materials Used to Produce 4,30,000 units in 2014-15} \\ - \\ \text{Direct Materials Required to Produce 4,30,000 units in 2013-14} \end{pmatrix} \times \text{Cost per Kg. in 2014-15}$$

= (25,10,000kg. – 25,80,000 kg.) × ₹ 485

= ₹3,39,50,000 (F)

Direct Labour

$$= \begin{pmatrix} \text{Labour Hours Used to Produce 4,30,000 Units in 2014-15} \\ - \\ \text{Labour Hours Required to Produce 4,30,000 Units in 2013-14} \end{pmatrix} \times \text{Rate per Hour in 2014-15}$$

= (34,80,000 hours – 34,40,000 hours) × ₹ 31

= ₹12,40,000 (A)

Reconciliation of Operating Profit from 2013-14 to 2014-15

	Amount (₹)	Amount (₹)
Operating Profit in 2013-14 (Refer to Working Note)		43,00,00,000
Add: Revenue effect of Growth Component	12,52,50,000	
Revenue effect of Price-Recovery	6,45,00,000	
Productivity Component (Direct Material)	3,39,50,000	22,37,00,000
Less: Cost effect of Growth Component (Direct Material)	8,46,00,000	
Cost effect of Growth Component (Direct Labour)	72,00,000	
Cost effect of Price-Recovery (Direct Material)	3,87,00,000	
Cost effect of Price-Recovery (Direct Labour)	34,40,000	
Cost effect of Price-Recovery (Fixed Cost)	16,00,000	
Productivity Component (Direct Labour)	12,40,000	13,67,80,000
		51,69,20,000

Working Note

Calculation of Operating Profit in 2013-14 and 2014-15

	2013-14 (₹)	2014-15 (₹)
Sales (₹ 4,175 × 4,00,000 units; ₹ 4,325 × 4,30,000)	167,00,00,000	185,97,50,000
Less: Costs		
Direct Materials (₹470 × 24,00,000 Kg.;₹485 × 25,10,000 Kg.)	112,80,00,000	121,73,50,000
Direct Labour (₹ 30 × 32,00,000 hrs.; ₹31 × 34,80,000 hrs.)	9,60,00,000	10,78,80,000
Fixed Cost	1,60,00,000	1,76,00,000
Operating Profit	43,00,00,000	51,69,20,000
Increase/ (Decrease) in Operating Profit	8,69,20,000	

13. Similarities

(i) Both the models have an objective function.

(ii) Both models' objective functions are linear.

(iii) Both the models require non-negativity constraints.

Differences

(i) The general linear programming problem may be of *maximization* or *minimization* type, whereas, transportation problem predominately deals with *minimization* problem.

(ii) A general linear programming problem is solved by using *simplex algorithm*; whereas transportation problem is solved by using *transportation algorithm* (as simplex method is less appropriate to solve).

(iii) The resources, for which the structural constraints are built up is *homogeneous* in transportation model; whereas in Linear Programming model they are *heterogeneous*.

14. The assignment problem is special case of transportation problem; it can also be solved by transportation method. But the solution obtained by applying this method would be severely degenerate.This is because the optimality test in the transportation method requires that there must be m+n-1 allocations/assignments. But due to the special structure of assignment problem of order n × n, any solution cannot have more than n assignments. Thus, the assignment problem is naturally degenerate. In order to remove degeneracy, n-1* number of dummy allocations will be required in order to proceed with the transportation method. Thus, the problem of degeneracy at each solution makes the transportation method computationally inefficient for solving an assignment problem.

☞ (*) $\underline{m+n-1} - n \Rightarrow \underline{n+n-1} - n \Rightarrow \underline{2n-1} - n \Rightarrow \underline{n-1}$

15. Probability of Completing the Project by Schedule Time T_s is given by

$$Z = \frac{T_s - T_e}{\sigma_e}$$

Probability if the Project is required to be completed in 15 weeks:

Probability if the Project is required to be completed in 15 weeks is given by

$$Z = \frac{15 - 18}{3}$$

$$Z = -1$$

Probability (Z = –1) = 0.1587

Probability if the Project is required to be completed in 21 weeks:

Probability if the Project is required to be completed in 21 weeks is given by

$$Z = \frac{21 - 18}{3}$$

$$Z = +1$$

Probability (Z = +1) = 0.8413

Probability that the Project may be completed not earlier than 15 weeks and not later than 21 weeks

= 0.8413–0.1587

= 0.6826

Or = 68.26%

16. **Random No- Coding for Fresh Cake**

No. of Cakes	Probability	Cumulative Probability	Random Numbers
100	0.01	0.01	00 – 00
101	0.03	0.04	01 – 03
102	0.04	0.08	04 – 07
103	0.07	0.15	08 – 14
104	0.09	0.24	15 – 23
105	0.11	0.35	24 – 34
106	0.15	0.50	35 – 49
107	0.21	0.71	50 – 70
108	0.18	0.89	71 – 88
109	0.09	0.98	89 – 97
110	0.02	1.00	98 – 99

Random No. Coding for One Day Old Cake

No. of Cakes	Probability	Cumulative Probability	Random Numbers
0	0.70	0.70	00 – 69
1	0.20	0.90	70 – 89
2	0.08	0.98	90 – 97
3	0.02	1.00	98 – 99

Let us simulate the sale of fresh and one day old cakes for the next ten days using the given random numbers / information.

Simulation Sheet

Day	R. No. of Fresh Cake	Fresh Stock	Demand	Sales Pcs.	Cl. Stock	Order Initiated	One Day Old Stock	R.N. of Old Cake	Sale of Old Cake Pcs.	Loss Pcs.
1	37	105	106	105	0	110	0	17	0	0
2	73	110	108	108	2	110	0	28	0	0
3	14	110	103	103	7	105	2	69	0	2

4	17	105	104	104	1	105	7	38	0	7
5	24	105	105	105	0	105	1	50	0	1
6	35	105	106	105	0	110	0	57	0	0
7	29	110	105	105	5	110	0	82	0*	0
8	37	110	106	106	4	105	5	44	0	5
9	33	105	105	105	0	105	4	89	1	3
10	68	105	107	105	0	110	0	60	0	0
				1051					1	18

Calculation of Vendor's Profit

	Amount (₹)
Sales of Fresh Cakes (1,051 Pcs. × ₹7)	7,357.00
Sale of One Day Old Cake (1 Pcs. × ₹2)	2.00
Total Sales Revenue	7,359.00
Less: Cost of Cakes Sold [₹4.50 × (1,051 + 1) Pcs.]	4,734.00
Less: Cost of Spoilt Cakes [₹4.50 × 18 Pcs.]	81.00
Profit	2,544.00

☞ Order for **Day 2's Sale** - Vendor will initiate order in day one's morning i.e. one day in advance ***at the time of receiving previous order.***

Vendor follows - *If there is no stock of cake with him at the end of previous day, he orders for 110 pieces otherwise he orders 100 or 105 pieces whichever is nearest actual fresh cake sale on the previous day.*

Accordingly to initiate order in day one's morning vendor has to consider previous day's stock i.e. Day 0's stock. But, there is no stock at the end of Day 0 or beginning of Day 1 (given in the question). Accordingly Vendor will initiate order of 110 pieces in day 1's morning for day 2's sales.

(*)

On 7th Day Demand for 'One Day Old' cake is one piece (as per random no. 82). But there was nil stock at the end of the 6th Day. Accordingly, sale of one Day old cake is nil.

17. Cumulative Average Time for 256 parts = 48.43 hrs.*

[112.50 × (0.90^8)]

Total Time for 256 parts = 12,398.08 hrs.

[48.43 hrs.× 256 parts]

Total Labour Cost of 256 parts = ₹ 2,47,961.60
[12,398.08 hrs.× ₹ 20]

Revised Labour Cost for *zero profit* = ₹ 3,22,961.60
[₹ 2,47,961.60 + ₹ 75,000]

Total Time for 256 parts (Revised) = 16,148.08 hrs.
[₹ 3,22,961.60/₹ 20]

Cumulative Average Time for 256 parts (Rev.) = 63.08 hrs.
[16,148.08/256]

The usual learning curve model is

$y = ax^b$

Where

y = Cumulative Average Time per part for x parts
a = Time required for first part
x = Cumulative number of parts
b = Learning coefficient (log r/log 2)

Accordingly

$\Rightarrow 63.08 = 112.50 \times (256)^b$

$\Rightarrow 0.5607 = 2^{8b}$

$\Rightarrow \log 0.5607 = \log 2^{8b}$

$\Rightarrow \log 0.5607 = 8 \times b \times \log 2$

$\Rightarrow \log 0.5607 = 8 \times \frac{\log r}{\log 2} \times \log 2$

$\Rightarrow \log 0.5607 = 8 \log r$

$\Rightarrow \log 0.5607 = \log r^8$

$\Rightarrow 0.5607 = r^8$

$\Rightarrow r = \sqrt[8]{0.5607}$

$\Rightarrow r = 0.9302$

Learning Rate (r) = 93.02%.

Therefore

Sensitivity = 3.02/90
= 3.36%

☞ Students may also take 48.38 hrs. (112.50 × 0.43)

PAPER – 6: INFORMATION SYSTEMS CONTROL AND AUDIT

QUESTIONS

Concepts of Governance and Management of Information Systems

1. (a) What are the key management practices, which are required for aligning IT strategy with enterprise strategy?

   (b) Discuss the key governance practices for evaluating risk management.

2. Discuss COBIT and its components in brief.

3. Discuss major benefits of Governance.

Information System Concepts

4. (a) What is an Expert System? Discuss some of its business applications.

   (b) Why do we need Expert Systems?

5. What do you mean by the term "Information"? Discuss different attributes of it.

6. Discuss different types of Information Systems.

Protection of Information Systems

7. Discuss Information System Security and its objectives.

8. Discuss major techniques to commit cyber frauds.

9. Discuss different means of controlling physical access in an organization.

Business Continuity Planning and Disaster Recovery Planning

10. List down the key objectives and goals of Business Continuity Planning.

11. Discuss all the phases involved in a methodology for developing a Business Continuity Plan (BCP).

12. An enterprise XYZ implemented a Business Continuity Plan and decided to get its plan audited. What factors should be verified while auditing or self assessment of the enterprise's Business Continuity Management (BCM) program?

Acquisition, Development and Implementation of Information Systems

13. What can be the major user-related issues that may come in achieving the System Development Objectives?

14. Discuss strengths and weaknesses of Waterfall Model.

15. Discuss System Testing and its types.

Auditing of Information Systems

16. Discuss different categories of Information System Audit.

17. Discuss Audit Trail. How can it be used to support enterprises' security objectives?

Information Technology Regulatory Issues

18. Explain the power of Controller to give directions under Section 68 of the Information Technology (Amendment) Act, 2008.

19. What are the powers of a Police Officer under the Information Technology (Amendment) Act, 2008 to enter and search etc?

Emerging Technologies

20. Discuss Cloud Computing architecture.

Short Note Based Questions

21. Write short notes on the following:

    (a) Segregation of Duties

    (b) Corrective Controls

    (c) Cryptography

    (d) Schedule Feasibility

    (e) System Control Audit Review File (SCARF)

22. Differentiate between the following:

    (a) Asset and Threat

    (b) Abstract System and Physical System

    (c) Full Backup and Incremental Backup

    (d) Platform as a Service (PaaS) and Software as a Service (SaaS)

Questions based on the Case Studies

23. ABC industries Ltd., a company engaged in a business of manufacture and supply of automobile components to various automobile companies in India, had been developing and adopting office automation systems, at random and in isolated pockets of its departments.

    The company has recently obtained three major supply contracts from International Automobile companies and the top management has felt that the time is appropriate for them to convert its existing information system into a new one and to integrate all its office activities. One of the main objectives of taking this exercise is to maintain continuity of business plans even while continuing the progress towards e-governance.

    (a) What are the popular implementation strategies that may be used to convert an old system into new system?

(b) What is the provision given in Information Technology (Amendment) Act, 2008 for the retention of electronic records?

24. PQR Technologies Ltd. is in the development of web applications for various domains. For the development purposes, the company is committed to follow the best practices suggested by System Development Life Cycle. A system development methodology is a formalized, standardized, documented set of activities used to manage a system development project. It refers to the framework that is used to structure, plan and control the process of developing an information system. Each of the available methodologies is best suited to specific kinds of projects, based on various technical, organizational, project and team considerations.

Read the above carefully and answer the following:

(a) Discuss the Feasibility study and its types under SDLC.

(b) What can be various fact finding techniques that may be adopted to gather the requirement?

(c) Briefly describe any five weaknesses of Rapid Application Development (RAD) Methodology.

25. Mr. A has received some information about Mr. B on his cell phone. He knows that this information has been stolen by the sender. He not only retained this information but also sends it to Mr. B and his friends. Because of this act, Mr. B is annoyed and his life is in danger.

Mr. B seeks your advice, under what sections of Information Technology (Amendment) Act, 2008; he can file an FIR with police against Mr. A? Advise Mr. B detailing the applicable sections of the Act.

SUGGESTED ANSWERS/HINTS

1. (a) The key management practices, which are required for aligning IT strategy with enterprise strategy, are as follows:

- **Understand enterprise direction:** This considers the current enterprise environment and business processes, as well as the enterprise strategy and future objectives. This further considers the external environment of the enterprise (industry drivers, relevant regulations, basis for competition).
- **Assess the current environment, capabilities and performance:** This assesses the performance of current internal business and IT capabilities and external IT services, and develop an understanding of the enterprise architecture in relation to IT. This further identifies issues currently being experienced and develops recommendations in areas that could benefit from

improvement and considers service provider differentiators and options and the financial impact and potential costs and benefits of using external services.

- **Define the target IT capabilities:** This defines the target business and IT capabilities and required IT services. This should be based on the understanding of the enterprise environment and requirements; the assessment of the current business process and IT environment and issues; and consideration of reference standards, best practices and validated emerging technologies or innovation proposals.
- **Conduct a gap analysis:** This identifies the gaps between the current and target environments and consider the alignment of assets (the capabilities that support services) with business outcomes to optimize investment in and utilization of the internal and external asset base. This also considers the critical success factors to support strategy execution.
- **Define the strategic plan and road map:** This creates a strategic plan that defines, in co-operation with relevant stakeholders, how IT- related goals will contribute to the enterprise's strategic goals. This further includes how IT will support IT-enabled investment programs, business processes, IT services and IT assets. IT should define the initiatives that will be required to close the gaps, the sourcing strategy, and the measurements to be used to monitor achievement of goals, then prioritize the initiatives and combine them in a high-level road map.
- **Communicate the IT strategy and direction:** This creates awareness and understanding of the business and IT objectives and direction, as captured in the IT strategy, through communication to appropriate stakeholders and users throughout the enterprise.

(b) The key governance practices for evaluating risk management are given as follows:

- **Evaluate Risk Management:** This continually examines and makes judgment on the effect of risk on the current and future use of IT in the enterprise. This further considers whether the enterprise's risk appetite is appropriate and that risks to enterprise value related to the use of IT are identified and managed;
- **Direct Risk Management:** This directs the establishment of risk management practices to provide reasonable assurance that IT risk management practices are appropriate to ensure that the actual IT risk does not exceed the board's risk appetite; and
- **Monitor Risk Management:** This monitors the key goals and metrics of the risk management processes and establishes how deviations or problems will be identified, tracked and reported on for remediation.

2. Control Objectives for Information and Related Technology (COBIT) is a set of best practices for Information Technology management developed by Information Systems

Audit & Control Association (ISACA) and IT Governance Institute in 1996. ISACA develops and maintains the internationally recognized COBIT framework, helping IT professionals and enterprise leaders fulfill their IT Governance responsibilities while delivering value to the business. The latest ISACA's globally accepted framework COBIT 5 is aimed to provide an end-to-end business view of the governance of enterprise IT that reflects the central role of IT in creating value for enterprises. COBIT 5 incorporates the latest thinking in enterprise governance and management techniques and provides globally accepted principles, practices, analytical tools and models to help increase the trust in, and value from information systems.

Components in COBIT

- **Framework -** Organize IT governance objectives and good practices by IT domains and processes, and links them to business requirements.
- **Process Descriptions -** A reference process model and common language for everyone in an organization. The processes map to responsibility areas of plan, build, run and monitor.
- **Control Objectives -** Provide a complete set of high-level requirements to be considered by management for effective control of each IT process.
- **Management Guidelines -** Help assign responsibility, agree on objectives, measure performance, and illustrate interrelationship with other processes.
- **Maturity Models -** Assess maturity and capability per process and helps to address gaps.

3. Some of the major benefits of Governance can be as follows:

- Achieving enterprise objectives by ensuring that each element of the mission and strategy are assigned and managed with a clearly understood and transparent decisions rights and accountability framework;
- Defining and encouraging desirable behavior in the use of IT and in the execution of IT outsourcing arrangements;
- Implementing and integrating the desired business processes into the enterprise;
- Providing stability and overcoming the limitations of organizational structure;
- Improving customer, business and internal relationships and satisfaction, and reducing internal territorial strife by formally integrating the customers, business units, and external IT providers into a holistic IT governance framework; and
- Enabling effective and strategically aligned decision making for the IT Principles that define the role of IT, IT Architecture, IT Infrastructure, Application Portfolio and Frameworks, Service Portfolio, Information and Competency Portfolios and IT Investment & Prioritization.

4. (a) Expert System - An Expert System is a highly developed Decision Support System that utilizes knowledge generally possessed by an expert to share a problem. Expert System is software system that imitates the reasoning processes of human experts and provides decision makers with the type of advice they would normally receive from such expert systems. For instance, an expert system in the area of investment portfolio management might ask its user a number of specific questions relating to investments for a particular client like – How much can be invested? Does the client have any preferences regarding specific types of securities? And so on.

A characteristic of Expert System is the ability to declare or explain the reasoning process that was used to make decisions. Some of the business applications of Expert Systems are as follows:

- **Accounting and Finance -** It provides tax advice and assistance, helping with credit- authorization decisions, selecting forecasting models, providing investment advice.
- **Marketing -** It provides establishing sales quotas, responding to customer inquiries, referring problems to telemarketing centers, assisting with marketing timing decisions, determining discount policies.
- **Manufacturing -** It helps in determining whether a process is running correctly, analyzing quality and providing corrective measures, maintaining facilities, scheduling job-shop tasks, selecting transportation routes, assisting with product design and faculty layouts.
- **Personnel -** It is useful in assessing applicant qualifications and assisting employees in filling out forms.
- **General Business -** It helps in assisting with project proposals, recommending acquisition strategies, educating trainees and evaluating performance.

(b) Major reasons for the need of Expert Systems are as given:

- Expert labor is expensive and scarce. Knowledge workers employee, who routinely work with data and information to carry out their day-to-day duties are not easy to find and keep and companies are often faced with a shortage of talent in key positions.
- Moreover, no matter how bright or knowledgeable certain people are, they often can handle only a few factors at a time.
- Both these limitations imposed by human information processing capability and the rushed pace at which business is conducted today put a practical limit on the quality of human decision making, thus putting a need for expert systems.

5. Information: Technically, Information means processed data. Data is facts or values of results and information is the relations between data and other relations. e.g. in spread

sheet student name, roll number and marks obtained in science and arts subjects represents data whereas the graph that shows the percentage of students acquire more than 80% in science subjects and 65% in arts subjects represents information. Information may be represented in the form of text, graph, pictures, voice, videos etc.

Information relates to description, definition, or perspective (what, who, when, where). Information is essential because it adds knowledge, helps in decision making, analyzing the future and taking action in time. Information products produced by an information system can be represented by number of ways e.g. paper reports, visual displays, multimedia documents, electronic messages, graphics images, and audio responses.

Attributes of Information: Some of the important attributes of useful and effective information are given as follows:

- **Availability -** Information is useless if it is not available at the time of need. Database is a collection of files which is collection of records and data from where the required information is derived for useful purpose.
- **Purpose/Objective -** Information must have purpose/objective at the time it is transmitted to a person or machine, otherwise it is simple data. The basic objective of information is to inform, evaluate, persuade, and organize. This indeed helps in decision making, generating new concepts and ideas, identify and solve problems, planning, and controlling which are needed to direct human activity in business enterprises.
- **Mode and format -** The mode of communicating information to humans should be in such a way that it is easily understandable by the people. The mode may be in the form of voice, text and combination of these two. Format should also be designed in such a way that it assists in decision making, solving problems, initiating planning, controlling and searching. According to the type of information, different formats can be used e.g. diagrams, graphs, curves are best suited for representing the statistical data. Format of information should be simple, relevant and should highlight important points but should not be too cluttered up.
- **Current/Updated -** The information should be refreshed from time to time as it usually rots with time and usage. For example, the running score sheet of a cricket match available in Internet sites should be refreshed at fixed interval of time so that the current score will be available.
- **Rate -** The rate of transmission/reception of information may be represented by the time required to understand a particular situation. Useful information is the one which is transmitted at a rate which matches with the rate at which the recipient wants to receive. For example - the information available from internet site should be available at a click of mouse.

- **Frequency -** The frequency with which information is transmitted or received affects its value. For example - the weekly report of sales shows little change as compared to the quarterly and contribute less for accessing salesman capability.
- **Completeness and Adequacy -** The information provided should be complete and adequate in itself because only complete information can be used in policy making. For example - the position of student in a class can be find out only after having the information of the marks of all students and the total number of students in a class.
- **Reliability -** It is a measure of failure or success of using information for decision-making. If information leads to correct decision on many occasions, we say the information is reliable.
- **Validity -** It measures how close the information is to the purpose for which it asserts to serve. For example, the experience of employee supports in evaluating his performance.
- **Quality -** It means the correctness of information. For example, an over-optimistic manager may give too high estimates of the profit of product which may create problem in inventory and marketing.
- **Transparency -** It is essential in decision and policy making. For example, total amount of advance does not give true picture of utilization of fund for decision about future course of action; rather deposit-advance ratio is perhaps more transparent information in this matter.
- **Value of Information -** It is defined as difference between the value of the change in decision behavior caused by the information and the cost of the information. In other words, given a set of possible decisions, a decision-maker may select one on basis of the information at hand. If new information causes a different decision to be made, the value of the new information is the difference in value between the outcome of the old decision and that of the new decision, less the cost of obtaining the information.

6. Different Information Systems that serve different organizational levels are as given:

(i) Operational Level Systems - These support operational managers by keeping track of the elementary activities and transactions of the enterprises e.g. sales, payroll, receipts etc. These are primarily needed to answer routine questions and keep track of flow of transactions though the enterprises. For example - it gives answer to query like how many books are in the inventory, what happens to the payment of the customer? And how many hours a particular employee works in office. To get answer of these types of queries; the information should be accurate, current and easily available.

(ii) **Knowledge Level Systems -** These systems support the business to integrate new knowledge into the business and control the flow of paperwork. These help the organization's knowledge and data workers.

(iii) **Management Level Systems -** These support the middle managers in monitoring, decision-making and administrative activities and are helpful in answering questions like - Are things working well and in order? These provide periodic reports rather than instant information on operations. For example - a college control system gives report on the number of leaves availed by the staff, salary paid to the staff, funds generated by the fees, finance planning etc. These type of systems mainly answers "what if" questions.

(iv) **Strategic Level Systems -** These support the senior level management to tackle and address strategic issues and long term trends, both inside organization and the outside world. These answer questions like what products should be launched to increase the profit and capture the market and help in long term planning.

7. **Information System Security:** Information System Security refers to the protection of valuable assets against loss, disclosure, or damage. Securing valuable assets from threats, sabotage or natural disaster with physical safeguards such as locks, perimeter fences and insurance is commonly implemented by most of the organizations. However, security must be expanded to include logical and other technical safeguards such as user identifiers, passwords, firewalls, etc.

   The valuable assets are the data or information recorded, processed, stored, shared, transmitted, or retrieved from an electronic medium. The data or information is protected against harm from threats that will lead to its loss, inaccessibility, alteration, or wrongful disclosure. The protection is achieved through a layered series of technological and non-technological safeguards such as physical security and logical measures.

   Information System Security Objective: The objective of Information System Security is "the protection of the interests of those relying on information, and protect the information systems and communications that deliver the information from harm resulting from failures of confidentiality, integrity, and availability".

   For any organization, the security objective comprises three universally accepted attributes:

   - **Confidentiality:** Prevention of the unauthorized disclosure of information;
   - **Integrity:** Prevention of the unauthorized modification of information; and
   - **Availability:** Prevention of the unauthorized withholding of information.

8. Following are the major techniques to commit cyber frauds:

   - **Hacking:** It refers to unauthorized access and use of computer systems, usually by means of personal computer and a telecommunication network. Normally, hackers do not intend to cause any damage.

- **Cracking:** Crackers are hackers with malicious intentions which mean un-authorized entry. Un-ethical hacking is classified as Cracking.
- **Data Diddling:** Changing data before, during, or after it is entered into the system in order to delete, alter, or add key system data is referred as Data Diddling.
- **Data Leakage:** It refers to the unauthorized copying of company data such as computer files.
- **Denial of Service (DoS) Attack:** It refers to an action or series of actions that prevents access to a software system by its intended/authorized users; causes the delay of its time-critical operations; or prevents any part of the system from functioning.
- **Internet Terrorism:** It refers to using Internet to disrupt electronic commerce and to destroy company and individual communications.
- **Logic Time Bombs:** These are the program that lies idle until some specified circumstances or a particular time triggers it. Once triggered, the bomb sabotages the system by destroying programs, data or both.
- **Masquerading or Impersonation:** In this case, perpetrator gains access to the system by pretending to be an authorized user.
- **Password Cracking:** Intruder penetrates a system's defence, steals the file containing valid passwords, decrypts them and then uses them to gain access to system resources such as programs, files and data.
- **Piggybacking:** It refers to the tapping into a telecommunication line and latching on to a legitimate user before s/he logs into the system.
- **Round Down:** Computer rounds down all interest calculations to 2 decimal places. Remaining fraction is placed in account controlled by perpetrator.
- **Scavenging or Dumpster Diving:** It refers to the gaining access to confidential information by searching corporate records.
- **Social Engineering Techniques:** In this case, perpetrator tricks an employee into giving out the information needed to get into the system.
- **Super Zapping:** It refers to the unauthorized use of special system programs to bypass regular system controls and performs illegal acts.
- **Trap Door:** In this technique, perpetrator enters in the system using a back door that bypasses normal system controls and perpetrates fraud.

9. Some of the common techniques for controlling physical access is an organization are discussed below:

(a) Locks on Doors: These are discussed below:

- **Cipher Locks** in which on entering a four digit number, the door will unlock for a predetermined period of time, usually ten to thirty seconds;
- **Bolting Door Locks** to avoid illegal entry; and
- **Electronic Door Locks** which has a special code that is internally stored within the card and is used to activate the door locking mechanism.

(b) Physical Identification Medium: These are discussed below:

- **Personal Identification Numbers (PIN):** A secret number assigned to an individual, in conjunction with some means of identifying the individual, serves to verify the authenticity of the individual;
- **Plastic Cards:** Used for identification purposes. Customers should safeguard their card so that it does not fall into unauthorized hands.
- **Identification Badges:** Special identification badges with different colors and photo Ids can be issued to personnel as well as visitors for easy identification purposes.

(c) Logging on Facilities: These are given as under:

- **Manual Logging:** All visitors should be prompted to sign a visitor's log indicating their name, company represented, their purpose of visit, and person to see. A valid and acceptable identification such as a driver's license, business card or vendor identification tag may also be asked for; before allowing entry inside the company.
- **Electronic Logging:** This feature is a combination of electronic and biometric security systems. The users logging can be monitored and the unsuccessful attempts being highlighted.

(d) Other means of Controlling Physical Access: Other important means of controlling physical access are given as follows:

- **Video Cameras:** Refined video cameras should be placed at specific locations and monitored by security guards. The video supervision recording must be retained for possible future play back.
- **Security Guards:** Extra security can be provided by appointing guards aided with CCTV feeds. Guards supplied by an external agency should be made to sign a bond to protect the organization from loss.
- **Controlled Visitor Access:** A responsible employee should escort all visitors that may be friends, maintenance personnel, computer vendors, consultants and external auditors.

- **Bonded Personnel:** All service contract personnel such as cleaning people and off-site storage services should be asked to sign a bond. This may to a certain extent can limit the financial exposure of the organization.
- **Dead Man Doors:** These systems encompass a pair of doors that are typically found in entries to facilities such as computer rooms and document stations. The first entry door must close and lock, for the second door to operate, with only one person permitted in the holding area.
- **Non–exposure of Sensitive Facilities:** There should be no explicit indication such as presence of windows of directional signs hinting the presence of facilities such as computer rooms. Only the general location of the information processing facility should be identifiable.
- **Computer Terminal Locks:** These locks ensure that the device to the desk is not turned on or disengaged by unauthorized persons.
- **Controlled Single Entry Point:** All incoming personnel can use controlled Single Entry Point. A controlled entry point is monitored by a receptionist. Multiple entry points increase the chances of unauthorized entry. Unnecessary or unused entry points should be eliminated or deadlocked.
- **Alarm System:** Illegal entry can be avoided by linking alarm system to inactive entry point and the reverse flows of enter or exit only doors, so as to avoid illegal entry. Security personnel should be able to hear the alarm when activated.
- **Perimeter Fencing:** Fencing at boundary of the facility may also enhance the security mechanism.
- **Control of out of hours of employee-employees:** Employees who are out of office for a longer duration during the office hours should be monitored carefully. Their movements must be noted and reported to the concerned officials frequently
- **Secured Report/Document Distribution Cart:** Secured carts, such as mail carts, must be covered and locked and should always be attended.

10. The primary objective of a Business Continuity Planning (BCP) is to minimize loss by minimizing the cost associated with disruptions and enable an organization to survive a disaster and to reestablish normal business operations. In order to survive, the organization must assure that critical operations can resume normal processing within a reasonable time frame. The key objectives of the contingency plan are to:

- Provide the safety and well-being of people on the premises at the time of disaster;
- Continue critical business operations;

- Minimize the duration of a serious disruption to operations and resources (both information processing and other resources);
- Minimize immediate damage and losses;
- Establish management succession and emergency powers;
- Facilitate effective co-ordination of recovery tasks;
- Reduce the complexity of the recovery effort; and
- Identify critical lines of business and supporting functions.

The goals of the Business Continuity Plan should be to:

- Identify weaknesses and implement a disaster prevention program;
- minimize the duration of a serious disruption to business operations;
- facilitate effective co-ordination of recovery tasks; and
- reduce the complexity of the recovery effort.

11. There are eight phases involved in a methodology for developing a Business Continuity Plan (BCP). These are as follows:

Phase 1 – Pre-Planning Activities (Project Initiation): This Phase is used to obtain an understanding of the existing and projected computing environment of the organization. This enables the project team to refine the scope of the project and the associated work program; develop project schedules; and identify and address any issues that could have an impact on the delivery and the success of the project.

During this phase, a Steering Committee should be established that has the overall responsibility for providing direction and guidance to the Project Team. The committee should also make all decisions related to the recovery planning effort. The Project Manager should work with the Steering Committee in finalizing the detailed work plan and developing interview schedules for conducting the Security Assessment and the Business Impact Analysis. The development of a policy to support the recovery programs; and an awareness program to educate management and senior individuals who will be required to participate in the project are the other two key deliverables of this phase.

Phase 2 – Vulnerability Assessment and General Definition of Requirements: Security and controls within an organization are continuing concern. This phase addresses measures to reduce the probability of occurrence. A thorough Security Assessment of the computing and communications environment including personnel practices; physical security; operating procedures; backup and contingency planning; systems development and maintenance; database security; data and voice communications security; systems and access control software security; insurance; security planning and administration; application controls; and personal computers. The

phase further defines the scope of the planning effort analyze, recommend and purchase recovery planning and maintenance software required to support the development and maintenance of the plans.

Phase 3 – Business Impact Assessment (BIA): A Business Impact Assessment (BIA) of all business units that are part of the business environment enables the project team to identify critical systems, processes and functions; assess the economic impact of incidents and disasters that result in a denial of access to systems services and other services and facilities; and assess the "pain threshold," that is, the length of time business units can survive without access to systems, services and facilities.

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

Phase 4 – Detailed Definition of Requirements: During this phase, a profile of recovery requirements is developed that is used as a basis for analyzing alternative recovery strategies. This profile should include hardware (mainframe, data and voice communications and personal computers), software (vendor supplied, in-house developed, etc.), documentation (DP, user, procedures), outside support (public networks, DP services, etc.), facilities (office space, office equipment, etc.) and personnel for each business unit. Recovery Strategies will be based on short term, intermediate term and long term outages. Another key deliverable of this phase is definition of the plan scope, objectives and assumptions.

Phase 5 – Plan Development: During this phase, recovery plan components are defined and plans are documented. This phase also includes the implementation of changes to user procedures, upgrading of existing data processing operating procedures required to support selected recovery strategies and alternatives, vendor contract negotiations (with suppliers of recovery services) and the definition of Recovery Teams, their roles and responsibilities. Recovery standards are also be developed during this phase.

Phase 6 – Testing/Exercising Program: The plan Testing/Exercising Program is developed during this phase. Testing/exercising goals are established and alternative testing strategies are evaluated. Testing strategies tailored to the environment should be selected and an on-going testing program should be established.

Phase 7 – Maintenance Program: Maintenance of the plans is critical to the success of an actual recovery. The plans must reflect changes to the environments that are supported by the plans. It is critical that existing change management processes are revised to take recovery plan maintenance into account. In areas, where change management does not exist, change management procedures will be recommended and implemented.

Phase 8 – Initial Plan Testing and Implementation: Once plans are developed, initial tests of the plans are conducted and any necessary modifications to the plans are made based on an analysis of the test results. Specific activities of this phase include Defining the test purpose/approach; Identifying test teams; Structuring the test; Conducting the test; Analyzing test results; and Modifying the plans as appropriate.

12. An audit or self-assessment of the enterprise's Business Continuity Management (BCM) program should verify the following factors:

- All key products and services and their supporting critical activities and resources have been identified and included in the enterprise's BCM strategy;
- The enterprise's BCM policy, strategies, framework and plans accurately reflect its priorities and requirements (the enterprise's objectives);
- The enterprise' BCM competence and its BCM capability are effective and fit-for-purpose and will permit management, command, control and coordination of an incident;
- The enterprise's BCM solutions are effective, up-to-date and fit-for-purpose, and appropriate to the level of risk faced by the enterprise;
- The enterprise's BCM maintenance and exercising programs have been effectively implemented;
- BCM strategies and plans incorporate improvements identified during incidents and exercises and in the maintenance program;
- The enterprise has an ongoing program for BCM training and awareness;
- BCM procedures have been effectively communicated to relevant staff, and that those staff understand their roles and responsibilities; and
- Change control processes are in place and operate effectively.

13. User Related Issues refer to those issues where user/customer is reckoned as the primary agent. Some of the user related issues that may come in achieving the system development objectives are given below:

- **Shifting User Needs:** User requirements for IT are constantly changing. As these changes accelerate, there will be more requests for Information systems development and more development projects. When these changes occur during a development process, the development team faces the challenge of developing systems whose very purpose might change since the development process began.
- **Resistance to Change:** People have a natural tendency to resist change and information systems development projects signal changes - often radical - in the workplace. When personnel perceive that the project will result in personnel cutbacks, threatened personnel will dig in their heels, and the development project is doomed to failure.

- **Lack of User Participation:** Users must participate in the development efforts to define their requirements, feel ownership for project success, and work to resolve development problems. User participation also helps to reduce user resistance to change.
- **Inadequate Testing and User Training:** New systems must be tested before installation to determine that they operate correctly. Users must be trained to effectively utilize the new system.

14. **Strengths of Waterfall Model:** The fundamental strength of the Waterfall Model are given as below:
    - It is ideal for supporting less experienced project teams and project managers or project teams, whose composition fluctuates.
    - The orderly sequence of development steps and design reviews help to ensure the quality, reliability, adequacy and maintainability of the developed software.
    - Progress of system development is measurable.
    - It enables to conserve resources.

    Weaknesses of Waterfall Model: Though it is highly useful model, it suffers from various weaknesses too. Experts and practitioners identify a number of weaknesses including the following:
    - It is criticized to be inflexible, slow, costly, and cumbersome due to significant structure and tight controls.
    - Project progresses forward with only slight movement backward.
    - There is a little to iterate, which may be essential in situations.
    - It depends upon early identification and specification of requirements, even if the users may not be able to clearly define 'what they need early in the project'.
    - Requirement inconsistencies, missing system components and unexpected development needs are often discovered during design and coding.
    - Problems are often not discovered until system testing.
    - System performance cannot be tested until the system is almost fully coded, and under capacity may be difficult to correct.
    - It is difficult to respond to changes, which may occur later in the life cycle, and if undertaken it proves costly and are thus discouraged.
    - It leads to excessive documentation, whose updation to assure integrity is an uphill task and often time-consuming.
    - Written specifications are often difficult for users to read and thoroughly appreciate.
    - It promotes the gap between users and developers with clear vision of responsibility.

15. **System Testing:** It is a process in which software and other system elements are tested as a whole. System Testing begins either when the software as a whole is operational or when the well-defined subsets of the software's functionality have been implemented. The purpose of system testing is to ensure that the new or modified system functions properly. These test procedures are often performed in a non-production test environment. The types of testing that might be carried out are as follows:

- **Recovery Testing:** This is the activity of testing 'how well the application is able to recover from crashes, hardware failures and other similar problems'. Recovery testing is the forced failure of the software in a variety of ways to verify that recovery is liable to be properly performed, in actual failures.
- **Security Testing:** This is the process to determine that an Information System protects data and maintains functionality as intended or not. The six basic security concepts that need to be covered by security testing are – confidentiality, integrity, availability, authentication, authorization and non-repudiation. This testing technique also ensures the existence and proper execution of access controls in the new system.
- **Stress or Volume Testing:** Stress testing is a form of testing that is used to determine the stability of a given system or entity. It involves testing beyond normal operational capacity, often to a breaking point, in order to observe the results. Stress testing may be performed by testing the application with large quantity of data during peak hours to test its performance.
- **Performance Testing:** Software performance testing is used to determine the speed or effectiveness of a computer, network, software program or device. This testing technique compares the new system's performance with that of similar systems using well defined benchmarks.

16. Information System Audit has been categorized into five types:

(i) **Systems and Application:** It is an audit to verify that systems and applications are appropriate, are efficient, and are adequately controlled to ensure valid, reliable, timely, and secure input, processing, and output at all levels of a system's activity.

(ii) **Information Processing Facilities:** This is an audit to verify that the processing facility is controlled to ensure timely, accurate, and efficient processing of applications under normal and potentially disruptive conditions.

(iii) **Systems Development:** It refers to an audit to verify that the systems under development meet the objectives of the organization and to ensure that the systems are developed in accordance with generally accepted standards for systems development.

(iv) **Management of IT and Enterprise Architecture:** It is an audit to verify that IT management has developed an organizational structure and procedures to ensure a controlled and efficient environment for information processing.

(v) **Telecommunications, Intranets, and Extranets:** This refers to an audit to verify that controls are in place on the client (end point device), server, and on the network connecting the clients and servers.

17. **Audit Trail:** Audit Trail are logs that can be designed to record activity at the system, application and user level. When properly implemented, audit trails provide an important detective control to help accomplish security policy objectives. Audit trail controls attempt to ensure that a chronological record of all events that have occurred in a system is maintained. This record is needed to answer queries, fulfill statutory requirements, detect the consequences of error and allow system monitoring and tuning. The accounting audit trail shows the source and nature of data and processes that update the database. The operations audit trail maintains a record of attempted or actual resource consumption within a system.

Audit Trail Objectives: Audit trails can be used to support security objectives in three ways:

- **Detecting Unauthorized Access:** Detecting unauthorized access can occur in real time or after the fact. The primary objective of real-time detection is to protect the system from outsiders who are attempting to breach system controls. A real-time audit trail can also be used to report on changes in system performance that may indicate infestation by a virus or worm. Depending upon how much activity is being logged and reviewed; real-time detection can impose a significant overhead on the operating system which can degrade operational performance. After-the-fact, detection logs can be stored electronically and reviewed periodically or as needed. When properly designed, they can be used to determine if unauthorized access was accomplished, or attempted and failed.
- **Reconstructing Events:** Audit analysis can be used to reconstruct the steps that led to events such as system failures, security violations by individuals, or application processing errors. Knowledge of the conditions that existed at the time of a system failure can be used to assign responsibility and to avoid similar situations in the future. Audit trail analysis also plays an important role in accounting control. For example - by maintaining a record of all changes to account balances, the audit trail can be used to reconstruct accounting data files that were corrupted by a system failure.
- **Personal Accountability:** Audit trails can be used to monitor user activity at the lowest level of detail. This capability is a preventive control that can be used to influence behavior. Individuals are likely to violate an organization's security policy if they know that their actions are not recorded in an audit log.

18. ***[Section 68]*** **Power of Controller to give directions**

(1) The Controller may, by order, direct a Certifying Authority or any employee of such Authority to take such measures or cease carrying on such activities as specified in

the order if those are necessary to ensure compliance with the provisions of this Act, rules or any regulations made there under.

(2) Any person who intentionally or knowingly fails to comply with any order under sub-section (1) shall be guilty of an offence and shall be liable on conviction to imprisonment for a term not exceeding two years or to a fine not exceeding one lakh rupees or with both.

19. The Power of a Police Officer is given in the Section 80 of the IT Act (Amendment) 2008 which is as follows:

***[Section 80]* Power of Police Officer and Other Officers to Enter, Search, etc.**

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any police officer, not below the rank of a Inspector or any other officer of the Central Government or a State Government authorized by the Central Government in this behalf may enter any public place and search and arrest without warrant any person found therein who is reasonably suspected of having committed or of committing or of being about to commit any offence under this Act

Explanation

For the purposes of this sub-section, the expression "Public Place" includes any public conveyance, any hotel, any shop or any other place intended for use by, or accessible to the public.

(2) Where any person is arrested under sub-section (1) by an officer other than a police officer, such officer shall, without unnecessary delay, take or send the person arrested before a magistrate having jurisdiction in the case or before the officer-in-charge of a police station.

(3) The provisions of the Code of Criminal Procedure, 1973 shall, subject to the provisions of this section, apply, so far as may be, in relation to any entry, search or arrest, made under this section

20. Cloud Computing Architecture: The Cloud Computing Architecture (CCA) of a cloud solution is the structure of the system which comprises of on-premise and cloud resources, services, middleware, and software components, their geo-location, their externally visible properties and the relationships between them. Cloud architecture typically involves into multiple cloud components communicating with each other over a loose coupling mechanism, such as a messaging queue. Elastic provisioning implies intelligence in the use of tight or loose coupling of cloud resources, services, middleware, and software components.

A cloud computing architecture consists of **Front End** and a **Back End.** They connect to each other through a network, usually the Internet. The Front End is the side, the computer user sees and interacts through, and the Back End is the “cloud” section of the system, truly facilitating the services. The details are given as follow:

- **Front End Architecture:** The Front End of the cloud computing system comprises of the client's devices (or computer network) and some applications needed for accessing the cloud computing system. All the cloud computing systems do not give the same interface to users. Web services like electronic mail programs use some existing web browsers such as Firefox, Microsoft's Internet Explorer or Apple's Safari. Other types of systems have some unique applications which provide network access to its clients.
- **Back End Architecture:** Back End refers to some service facilitating peripherals. In cloud computing, the Back End is cloud itself, which may encompass various computer machines, data storage systems and servers. Groups of these clouds make up a whole cloud computing system. Theoretically, a cloud computing system can include any type of web application program such as video games to applications for data processing, software development and entertainment. Usually, every application would have its individual dedicated server for services.

  A central server is established to be used for administering the whole system. It is also used for monitoring client's demand as well as traffic to ensure that everything of system runs without any problem. There are some protocols that are followed by this server and it uses a special type of software known as Middleware that allows computers that are connected on networks to communicate with each other. If any cloud computing service provider has many customers, then there's likely to be very high demand for huge storage space. The cloud computing system must have a redundant back-up copy of all the data of its client's.

21. (a) **Segregation of Duties:** Segregation of duties means that in the processing of a transaction, there are split between different people, such that one person cannot process a transaction right from start to finish. Various stages in the transaction cycle are spread between two or more individuals. However, in a computerized system, the auditor should also be concerned with the segregation of duties within the IT department. Within an IT environment, the staff in the IT department of an enterprise will have a detailed knowledge of the interrelationship between the source of data, how it is processed and distribution and use of output. IT staff may also be in a position to alter transaction data or even the financial applications which process the transactions.

(b) **Corrective Controls:** Corrective controls are designed to reduce the impact or correct an error once it has been detected. Corrective controls may include the use of default dates on invoices where an operator has tried to enter the incorrect date. A Business Continuity Plan (BCP) is considered to be a corrective control. The main characteristics of the corrective controls are as follows:

- Minimizing the impact of the threat;
- Identifying the cause of the problem;

- Providing Remedy to the problems discovered by detective controls;
- Getting feedback from preventive and detective controls;
- Correcting error arising from a problem; and
- Modifying the processing systems to minimize future occurrences of the incidents.

Examples of Corrective Controls are given as follows:

- Contingency planning;
- Backup procedure;
- Rerun procedures;
- Change input value to an application system; and
- Investigate budget variance and report violations.

(c) **Cryptography:** It deals with programs for transforming data into cipher text that are meaningless to anyone, who does not possess the authentication to access the respective system resource or file. A cryptographic technique encrypts data (clear text) into cryptograms (cipher text) and its strength depends on the time and cost to decipher the cipher text by a cryptanalyst. Three techniques of cryptography are Transposition (permute the order of characters within a set of data), Substitution (replace text with a key-text) and Product Cipher (combination of transposition and substitution).

(d) **Schedule Feasibility:** Schedule feasibility or Time Feasibility involves the design team's estimating how long it will take a new or revised system to become operational and communicating this information to the steering committee. For example, if a design team projects that it will take 16 months for a particular system design to become fully functional, the steering committee may reject the proposal in favor of a simpler alternative that the company can implement in a shorter time frame.

(e) **System Control Audit Review File (SCARF):** The SCARF technique involves embedding audit software modules within a host application system to provide continuous monitoring of the system's transactions. The information collected is written onto a special audit file- the SCARF master files. Auditors then examine the information contained on this file to see if some aspect of the application system needs follow-up. In many ways, the SCARF technique is like the snapshot technique along with other data collection capabilities.

22. **(a)** **Asset:** Asset can be defined as something of value to the organization; e.g., information in electronic or physical form, software systems, employees. Irrespective of the nature of the assets themselves, they all have one or more of the following characteristics:

- They are recognized to be of value to the organization.
- They are not easily replaceable without cost, skill, time, resources or a combination.
- They form a part of the organization's corporate identity, without which, the organization may be threatened.
- Their data classification would normally be Proprietary, Highly confidential or even Top Secret.

It is the purpose of Information Security Personnel to identify the threats against the risks and the associated potential damage to, and the safeguarding of Information Assets.

Threat: Any entity, circumstance, or event with the potential to harm the software system or component through its unauthorized access, destruction, modification, and/or denial of service is called a Threat. A Threat is an action, event or condition where there is a compromise in the system, its quality and ability to inflict harm to the organization.

Threat has capability to attack on a system with intent to harm. Every system has a data, which is considered as a fuel to drive a system, data is nothing but assets. Assets and threats are closely correlated. A threat cannot exist without a target asset. Threats are typically prevented by applying some sort of protection to assets.

(b) **Abstract System:** Also known as Conceptual System, it can be defined as an orderly arrangement of interdependent ideas or constructs. For example, a system of theology is an orderly arrangement of ideas about God and the relationship of humans to God.

Physical System: It is a set of tangible elements which operate together to accomplish an objective e.g. Computer system, University system etc.

(c) **Full Backup:** A Full Backup captures all files on the disk or within the folder selected for backup. With a full backup system, every backup generation contains every file in the backup set. However, the amount of time and space such a backup takes, prevents it from being a realistic proposition for backing up a large amount of data.

Incremental Backup: An Incremental Backup captures files that were created or changed since the last backup, regardless of backup type. This is the most economical method, as only the files that changed since the last backup are backed up. This saves a lot of backup time and space. Normally, incremental backup are very difficult to restore. One will have to start with recovering the last full backup, and then recovering from every incremental backup taken since.

(d) **Platform as a Service** (**PaaS):** Cloud providers deliver a computing platform including operating system, programming language execution environment,

database, and web server. Application developers can develop and run their software solutions on a cloud platform without the cost and complexity of acquiring and managing the underlying hardware /software layers. In PaaS, one can make applications and software on other's database. Thus, it gives us the platform to create, edit, run and manage the application programs we want.

Software as a Service (SaaS): SaaS provides users to access large variety of applications over internets that are hosted on service provider's infrastructure. For example, one can make his/her own word document in Google docs online, s/he can edit a photo online on pixlr.com so s/he need not install the photo editing software on his/her system- thus Google is provisioning Software as a Service.

23. (a) The popular implementation strategies that may be used to convert an old system into new system are described as follows:

- **Direct Implementation / Abrupt Change-Over:** This is achieved through an abrupt takeover – an all or no approach. With this strategy, the changeover is done in one operation, completely replacing the old system in one go. This usually takes place on a set date, often after a break in production or a holiday period so that time can be used to get the hardware and software for the new system installed without causing too much disruption.
- **Phased Changeover:** With this strategy, implementation can be staged with conversion to the new system taking place gradually. For example, some new files may be converted and used by employees whilst other files continue to be used on the old system i.e. the new is brought in stages (phases). If a phase is successful then the next phase is started, eventually leading to the final phase when the new system fully replaces the old one.
- **Pilot Changeover:** With this strategy, the new system replaces the old one in one operation but only on a small scale. Any errors can be rectified or further beneficial changes can be introduced and replicated throughout the whole system in good time with the least disruption. For example - it might be tried out in one branch of the company or in one location. If successful then the pilot is extended until it eventually replaces the old system completely.
- **Parallel Changeover:** This is considered as the most secure method with both systems running in parallel over an introductory period. The old system remains fully operational while the new systems come online. With this strategy, the old and the new system are both used alongside each other, both being able to operate independently. If all goes well, the old system is stopped and new system carries on as the only system.

(b) ***[Section 7]*** **Retention of Electronic Records**

(1) Where any law provides that documents, records or information shall be retained for any specific period, then, that requirement shall be deemed to

have been satisfied if such documents, records or information are retained in the electronic form, -

(a) the information contained therein remains accessible so as to be usable for a subsequent reference;

(b) the electronic record is retained in the format in which it was originally generated, sent or received or in a format which can be demonstrated to represent accurately the information originally generated, sent or received;

(c) the details which will facilitate the identification of the origin, destination, date and time of dispatch or receipt of such electronic record are available in the electronic record:

However,

this clause does not apply to any information which is automatically generated solely for the purpose of enabling an electronic record to be dispatched or received.

(2) Nothing in this section shall apply to any law that expressly provides for the retention of documents, records or information in the form of electronic records, publication of rules, regulation, etc. in Electronic Gazette.

24. (a) **Feasibility Study:** After possible solution options are identified, project feasibility i.e. the likelihood that these systems will be useful for the organization is determined. A feasibility study is carried out by the system analysts, which refers to a process of evaluating alternative systems through cost/benefit analysis so that the most feasible and desirable system can be selected for development. The Feasibility Study of a system is evaluated under following dimensions described briefly as follows:

- **Technical:** Is the technology needed available?
- **Financial:** Is the solution viable financially?
- **Economic:** Return on Investment?
- **Schedule/Time:** Can the system be delivered on time?
- **Resources:** Are human resources reluctant for the solution?
- **Operational:** How will the solution work?
- **Behavioural:** Is the solution going to bring any adverse effect on quality of work life?
- **Legal:** Is the solution valid in legal terms?

(b) **Fact Finding:** Every system is built to meet some set of needs, for example, the need of the organization for lower operational costs, better information for

managers, smooth operations for users or better levels of services to customers. To assess these needs, the analysts often interact extensively with people, who will be benefited from the system in order to determine 'what are their actual requirements'. Various fact-finding techniques/tools used by the system analyst for determining these needs/requirements are briefly discussed below:

(i) **Documents:** Documents mean manuals, input forms, output forms, diagrams of how the current system works, organization charts showing hierarchy of users and manager responsibilities, job descriptions for the people, who work with the current system, procedure manuals, program codes for the applications associated with the current system, etc. Documents are a very good source of information about user needs and the current system.

(ii) **Questionnaires:** Users and managers are asked to complete questionnaire about the information systems when the traditional system development approach is chosen. The main strength of questionnaire is that a large amount of data can be collected through a variety of users quickly. Also, if the questionnaire is skilfully drafted, responses can be analyzed rapidly with the help of a computer.

(iii) **Interviews:** Users and managers may also be interviewed to extract information in depth. The data gathered through interviews often provide system developers with a larger picture of the problems and opportunities. Interviews also give analyst the opportunity to observe and record first-hand user reaction and to probe for further information.

(iv) **Observation:** In general and particularly in prototyping approaches, observation plays a central role in requirement analysis. Only by observing how users react to prototypes of a new system, the system can be successfully developed.

(c) Some of the weaknesses of Rapid Application Development (RAD) model identified by the experts and practitioners include the following:

- Fast speed and lower cost may affect adversely the system quality.
- The project may end up with more requirements than needed (gold-plating).
- Potential for feature creep where more and more features are added to the system over the course of development.
- It may lead to inconsistent designs within and across systems.
- It may call for violation of programming standards related to inconsistent naming conventions and inconsistent documentation,
- It may call for lack of attention to later system administration needs built into system.

- Formal reviews and audits are more difficult to implement than for a complete system.
- Tendency for difficult problems to be pushed to the future to demonstrate early success to management.
- Since some modules will be completed much earlier than others, well–defined interfaces are required.

25. If Mr. B wants to file an FIR against Mr. A, then he may file the same under the following Section of Information Technology (Amendment) Act, 2008:

- Section 66A: Punishment for sending offensive messages through communication service, etc.; and
- Section 66B: Punishment for dishonestly receiving stolen computer resource or communication device.

All these applicable sections in this case are given as follows:

***[Section 66A]* Punishment for sending offensive messages through communication service, etc.**

Any person who sends, by means of a computer resource or a communication device,-

(a) any information that is grossly offensive or has menacing character; or

(b) any information which he knows to be false, but for the purpose of causing annoyance, inconvenience, danger, obstruction, insult, injury, criminal intimidation, enmity, hatred, or ill will, persistently by making use of such computer resource or a communication device,

(c) any electronic mail or electronic mail message for the purpose of causing annoyance or inconvenience or to deceive or to mislead the addressee or recipient about the origin of such messages shall be punishable with imprisonment for a term which may extend to three years and with fine.

Explanation: For the purposes of this section, terms "Electronic mail" and "Electronic Mail Message" means a message or information created or transmitted or received on a computer, computer system, computer resource or communication device including attachments in text, image, audio, video and any other electronic record, which may be transmitted with the message.

***[Section 66B]* Punishment for dishonestly receiving stolen computer resource or communication device**.

Whoever dishonestly receives or retains any stolen computer resource or communication device knowing or having reason to believe the same to be stolen computer resource or communication device, shall be punished with imprisonment of either description for a term which may extend to three years or with fine which may extend to rupees one lakh or with both.

PAPER – 7 : DIRECT TAX LAWS

PART – III : QUESTIONS AND ANSWERS

QUESTIONS

Basic Concepts

1. Discuss, with the aid of case laws, whether the following receipts are revenue or capital in nature:

   (a) Liquidated damages received by A Ltd. from supplier of plant and machinery for failure to supply machinery within the stipulated time.

   (b) Power subsidy received by B Ltd., a cement manufacturing company, from the State Government, year after year, on the basis of actual power consumption.

   (c) One-time subsidy, equivalent to 60% of sales tax paid, received by C Ltd. from the State Government under the scheme of industrial promotion for expansion of its capacities and modernisation.

Income which do not form part of total income [Charitable Trusts]

2. (a) Ramji charitable trust, registered under section 12AA, earned income from mutual funds specified under section 10(23D) to the tune of ₹ 2 lakh in the P.Y. 2014-15 and claims exemption under section 10(35) in respect of such income. It also earned dividend income of ₹ 1 lakh and agricultural income of ₹ 5 lakh in the same year, and claims exemption under section 10(34) and 10(1), respectively, in respect of such income, without complying with the conditions laid down under section 11. Discuss the correctness of the claim of the Ramji charitable trust.

   (b) Shivji charitable trust purchased a building for ₹ 25 lakh in March, 2014 for the purposes of the trust and claimed the same as application of income in the P.Y.2013-14. It also claims depreciation@10% on buildings for P.Y.2014-15, while computing income for the purpose of application. Discuss the correctness of the depreciation claim made by Shivji charitable trust.

   (c) Ganeshji charitable trust, whose main object is relief of the poor, filed an application for registration on 1st April, 2014 and was registered under section 12AA on 1st September, 2014. The trust is in existence since May, 2012. The trust claimed the benefits of sections 11 and 12 in respect of income from property held under trust for A.Y.2013-14 to A.Y.2015-16. Discuss the correctness of the claim of the trust, if assessment proceedings for A.Y.2013-14 and A.Y.2014-15 are pending before the Assessing Officer on 1st September, 2014.

Profits and gains of business or profession

3. Discuss the deductibility of the following expenditure while computing business income –

(a) A Ltd., a manufacturing company, has invested ₹ 35 crore (including ₹ 5 crore in computers installed in office) in new plant and machinery. The said plant and machinery was acquired and installed in April, 2014 and put to use in the same month.

(b) B Ltd. invested ₹ 10 crore in land and ₹ 5 crore in new plant and machinery in April, 2014 for setting up and operating a semi-conductor wafer fabrication manufacturing unit which commences operations on 1st June, 2014.

(c) C Ltd. incurred expenditure of ₹ 42 lakhs on rural development activities qualifying as a CSR activity as per section 135 of the Companies Act, 2013 read with Schedule VII thereto, and claimed the same as deduction under section 37. It also made contribution of ₹ 10 lakhs to Prime Minister's National Relief Fund as part of its CSR obligation.

(d) D Ltd. paid salary of ₹ 25 lakh to its resident employees in the month of March, 2015 without deducting tax at source. Out of the said salary, ₹ 15 lakh is paid to employees falling in the 20% tax slab and the balance to employees falling in the 30% tax slab.

(e) E Ltd. paid fees for professional services to X Inc., a Swedish company, in March, 2015 after deducting tax at source at the rates in force. The tax so deducted was, however, deposited only in September, 2015.

Capital Gains

4. Mr. Ganesh, aged 43 years, working as a General Manager with W Consulting Ltd., furnishes the following particulars of assets transferred by him during the P.Y.2014-15 –

	Particulars	Date of transfer	Net Sale consider-ation ₹
(1)	A residential house in Pune which he had purchased in January, 2000 at a cost of ₹ 31,12,000.	28/2/2015	2,00,00,000
(2)	Listed equity shares of Indian companies purchased in June 2012 at a cost of ₹ 2 lakh.	15/3/2015	4,00,000
(3)	Unlisted shares purchased in June 2012 at a cost of ₹ 75,000.	15/3/2015	1,25,000
(4)	Units of equity oriented fund purchased in June 2012 at a cost of ₹ 50,000	15/3/2015	90,000
(5)	Units of debt oriented fund purchased in February 2010 at a cost of ₹ 63,200	15/3/2015	1,45,000

Mr. Ganesh made the following investments out of the net consideration from sale of residential house at Pune–

	Particulars	₹
(1)	Purchased a residential flat in Nagpur on 30/6/2015	52,00,000
(2)	Purchased a residential flat in Coimbatore on 31/7/2015	40,00,000
(3)	Invested in 3 year bonds of NHAI on 30/3/2015	35,00,000
(4)	Invested in 3 year bonds of RECL on 18/6/2015	50,00,000

Compute the total income and tax liability of Mr. Ganesh for A.Y.2015-16, if his salary income (computed) is ₹ 32 lakh and interest on fixed deposits with banks is ₹ 2 lakh. Assume that he has contributed ₹ 1,50,000 to public provident fund and paid medical insurance premium of ₹ 14,000 to insure his health.

Cost Inflation Index of F.Y.1999-2000: 389; F.Y.2009-10: 632; F.Y.2012-13: 852; F.Y.2014-15: 1024.

Capital Gains & Income from other sources

5. Mr. Vallish has acquired a residential house property in Noida on 23rd May, 2001 for ₹ 36,85,800 and decided to sell the same on 14th August, 2005 to Mrs. Poorna and an advance of ₹ 1,50,000 was taken from her. The balance money was not paid by Mrs. Poorna and hence, Mr. Vallish has forfeited the entire advance sum. In April, 2014, he once again entered into negotiations for sale of the said property to Mr. Sridhar, and received ₹ 3,50,000 as advance, but the transfer did not materialize and hence, the advance was forfeited. On 27th March, 2015, he finally sold this house to Mr. Sundar for ₹ 1,37,00,000. In the meantime, on 3rd January, 2015, he had purchased a residential house in Mathura for ₹ 36,00,000 and made full payment for the same. However, Mr. Vallish does not possess any legal title till 31st March, 2015, as such transfer was not registered with the registration authority.

   Mr.Vallish had purchased another old house in Agra on 22nd September, 2014 from Mr. Yadav, an Indian resident, by paying ₹ 30,00,000 and the purchase was registered with the appropriate authority.

   Determine the taxable capital gain arising from above transactions in the hands of Mr.Vallish for the A.Y. 2015-16 [Cost Inflation Index - 2001-02: 426; 2005-06: 497; 2014-15:1024].

Assessment of various entities

6. A business trust, registered under SEBI (Real Estate Investment Trusts) Regulations, 2014, gives particulars of its income for the P.Y.2014-15:

   (1) Interest income from A Ltd. – ₹ 4 crore;

   (2) Dividend income from A Ltd. – ₹ 2 crore;

   (3) Short-term capital gains on sale of listed shares of A Ltd. – ₹ 3 crore;

   (4) Short-term capital gains on sale of developmental properties – ₹ 2 crore

(5) Interest received from investments in unlisted debentures of real estate companies – ₹ 10 lakh;

A Ltd. is an Indian company in which the business trust holds controlling interest. The business trust holds 62% of the shareholding of A Ltd.

Discuss the tax consequences of the above income earned by the business trust in the hands of the business trust and the unit holders, assuming that the business trust has distributed ₹ 10 crore to the unit holders in the P.Y.2014-15.

7. Mr.Anish, carrying on the business of operating a warehousing facility for storage of food grains, has a total income of ₹ 95 lakh for the P.Y.2014-15. He commenced operations of the business in April, 2014. In computing the total income for the P.Y.2014-15, he had claimed deduction under section 35AD in respect of investment of ₹ 82 lakh in building (on 1.5.2014) for operating the warehousing facility for storage of food grains. Compute his tax liability for A.Y.2015-16.

8. Gamma Ltd., a domestic company, has distributed on 10.12.2014, dividend of ₹ 460 lakh to its shareholders. On 1.10.2014, Gamma Ltd. has received dividend of ₹ 120 lakh from its domestic subsidiary company Beta Ltd., on which Beta Ltd. has paid dividend distribution tax under section 115-O. Compute the additional income-tax payable by Gamma Ltd. under section 115-O.

9. The net profit of Delta Ltd. as per profit and loss account for the previous year 2014-15 is ₹ 170 lakhs after debiting/crediting the following items:

(i) Provision for income-tax: ₹ 14 lakhs

(ii) Dividend Distribution tax: ₹ 2 lakhs

(iii) Securities transaction tax: ₹ 1 lakh

(iv) Transfer to General Reserve: ₹ 6 lakhs

(v) Provision for deferred tax: ₹ 9 lakhs

(vi) Proposed Dividend: ₹ 5 lakhs

(vii) Preference Dividend: ₹ 3 lakhs

(viii) Provision for permanent diminution in value of investments: ₹ 2 lakhs

(ix) Provision for gratuity based on actuarial valuation: ₹ 4 lakhs

(x) Depreciation debited to Profit & Loss Account is ₹ 18 lakhs. This includes depreciation on revaluation of assets to the tune of ₹ 4 lakhs.

(xi) Agricultural income: ₹ 5 lakhs (Expenditure to earn agricultural income : ₹ 2 lakh)

(xii) Long term capital gains exempt under section 10(38) : ₹ 7 lakhs (Expenditure to earn long-term capital gains : ₹ 0.75 lakhs)

(xiii) Transfer from Special Reserve: ₹ 3 lakhs

(xiv) Transfer from Revaluation Reserve: ₹ 5 lakhs

Brought forward losses and unabsorbed depreciation as per books of the company are as follows:

Previous year	Brought forward loss (₹ in lakhs)	Unabsorbed Depreciation (₹ in lakhs)
2011-12	3	4
2012-13	2	-
2013-14	8	5

Compute the book profit of Delta Ltd. under section 115JB for the A.Y. 2015-16. Compute the tax liability of the company for the A.Y.2015-16, if the total income computed as per the provisions of the Income-tax Act, 1961 is ₹ 100 lakhs.

Taxation of non-residents

10. The details given hereunder relate to two non-residents, Mr. Evan Smith, an Australian cricket player and his brother, Mr. Dean Smith, a musician for the A.Y.2015-16–

	Particulars	Mr. Evan Smith	Mr. Dean Smith
(1)	Participation in cricket tournaments in India	₹ 32 lakhs	
(2)	Winnings from lotteries (net)	₹ 55,280	
(3)	Contribution of an article relating to the sport of cricket in a sports magazine in India	₹ 15,000	
(4)	Performance in a music show in India		₹ 2 lakhs

With reference to the provisions of the Income-tax Act, 1961, you are required to –

(i) Compute their tax liability for the A.Y.2015-16.

(ii) Discuss whether the above income are subject to deduction of tax at source.

(iii) Explain whether it is necessary for them to file their return of income for A.Y.2015-16.

Transfer Pricing

11. (i) "In the Indian context, Advance Pricing Agreements entered into for determining arm's length price in relation to an international transaction is valid only for a period, not exceeding 5 years, prospective to the date of agreement and cannot be applied in respect of prior period transactions" – Discuss the correctness or otherwise of this statement.

(ii) XYZ Ltd., an Indian company, has entered into an agreement for sale of product M to Mr.Ganesh, an unrelated party, on 15/3/2015. Mr.Ganesh had entered into an agreement on 10/3/2015 (for sale of product M) with ABC Inc., a non-resident entity, which is a specified foreign company in relation to XYZ Ltd. Would the transaction

between XYZ Ltd. and Mr.Ganesh be deemed as an international transaction entered into between two associated enterprises, if Mr. Ganesh is a resident and ordinarily resident for the P.Y.2014-15?

Income-tax Authorities

12. Elucidate the following statements, with specific reference to the amendments made by the Finance (No.2) Act, 2014, bringing out the cause and effect of the changes:

    (a) "The scope of powers of an income-tax authority under section 133A has been expanded".

    (b) "The period of time for which an income-tax authority acting under section 133A has the power to retain books of account and documents impounded without pre-approval from higher authorities has been increased."

Assessment Procedure

13. The assessment of Mr. Hari for A.Y.2007-08 was made on 28.3.2009 making an addition of ₹ 3,25,000 in respect of certain income received during the P.Y.2006-07. The assessee contested the addition before Commissioner (Appeals) but lost the case. The Appellate Tribunal passed an order on 26.2.2014 holding that the said income was not taxable in the P.Y.2006-07 but the same was taxable in the year of accrual, being P.Y.2001-02 relevant to A.Y.2002-03. The Assessing Officer issued notice under section 148 for A.Y.2002-03 in March 2014 bringing to tax the sum of ₹ 3,25,000. Is the notice for reassessment valid?

    Would your answer change if, in the said case, the assessment order for A.Y.2007-08 was made on 4.4.2009 instead of 28.3.2009?

Appeals and Revision

14. Does the Appellate Tribunal, under section 254(2), have the power to review or re-appreciate the correctness of its earlier decision on merits? Also, discuss whether the Tribunal has the power thereunder to recall an order in entirety, to rectify a mistake apparent from record. In this context, distinguish between the power to review and power to recall, with the aid of recent case laws.

Settlement Commission

15. "The scope of definition of "case" in respect of which an assessee can make an application to the Settlement Commission has been expanded" – Discuss the correctness or otherwise of this statement, in the context of the definition as amended by the Finance (No.2) Act, 2014.

Miscellaneous Provisions/Penalties

16. Discuss the correctness or otherwise of the following statements –

(i) Acceptance of loan or deposit of ₹ 20,000 or more from any person through electronic clearing system would attract penalty under section 271D;

(ii) The Assessing Officer and Commissioner (Appeals) are the only authorities competent to levy penalty under section 271G.

17. Biotech Ltd. filed its return of income for A.Y.2014-15 on 30th September, 2014. In computing its business income, it had claimed a weighted deduction@200% of the expenditure of ₹ 22 lakhs (including cost of building ₹ 10 lakhs) on in-house scientific research under section 35(2AB). The assessee had clearly disclosed the bifurcation of expenditure of ₹ 22 lakhs in its return of income. The Assessing Officer, disallowed ₹ 10 lakhs, being the excess 100% of cost of building which was claimed as weighted deduction under section 35(2AB), since the same was eligible only for deduction@100% under section 35(1)(iv) read with section 35(2). He also levied penalty under section 271(1)(c). Biotech Ltd. agreed with the disallowance made but contended that there no concealment of particulars of income so as to attract penalty under section 271(1)(c), since it has disclosed all the particulars of income, including the bifurcation of expenditure in respect of which deduction was claimed under section 35(2AB). Discuss the correctness of the Biotech Ltd.'s contention.

Provisions for deduction and collection of tax at source

18. Examine the applicability of the provisions for tax deduction at source under section 194DA in the following cases -

(i) Mr. Anand, a resident, is due to receive ₹ 7 lakhs on 31.3.2015, towards maturity proceeds of LIC policy taken on 1.4.2009, for which the sum assured is ₹ 6 lakhs and the annual premium is ₹ 80,000.

(ii) Mr. Aarav, a resident, is due to receive ₹ 2.25 lakhs on 31.3.2015 on LIC policy taken on 1.4.2012, for which the sum assured is ₹ 2 lakhs and the annual premium is ₹ 50,000.

(iii) Mr. Avnish, a resident, is due to receive ₹ 98,000 on 15.12.2014 towards maturity proceeds of LIC policy taken on 15.12.2010 for which the sum assured is ₹ 90,000 and the annual premium was ₹ 19,000.

Wealth-tax

19. ABC Constructions Ltd. furnishes the following particulars of its wealth for the valuation date as on 31.3.2015:

Assets:		**₹ (in lakhs)**
(i)	Land in urban area (held as stock in trade since 1997).	67
(ii)	Motor cars (including one imported car, worth ₹ 25 lakhs used for hiring)	46

(iii)	320 acres agricultural land acquired at Faridabad on 15.6.2014 for construction of residential flats/commercial complex. However, Faridabad Authority has reserved 32 acres land as green belt.	320
(iv)	Residential flats of 1200 sq feet each provided to 5 employees (salary of two employees exceeded ₹ 10 lakhs per annum)	45
(v)	Farm house of 3 acres at a remote village beyond 25 kms from the local limits of Municipality	11
(vi)	Cash in hand as per cash book	2
	Liabilities:	
	(i) Loan for purchase of land at Urban area	42
	(ii) Loan for purchase of land at Faridabad	200
	(iii) Wealth-tax liability for Assessment year 2014-15	8
	(iv) Loan for construction of residential flats	20

Compute the net wealth of the company as on valuation date 31.03.2015.

20. State with reasons whether the following assets are chargeable to wealth tax under the Wealth-tax Act, 1957:

(i) Silver and gold in the jewellers shop

(ii) Jewellery purchased by Mr. Shankar out of balance lying in his Non Resident External Account on the date of his return to India. Mr. Shankar, who was living in the USA for 15 years, returned to India two years back on permanent basis.

(iii) Aircraft owned and used by a company for transportation of its goods.

(iv) Jeep of the company given to the Director for official use.

(v) Farm house situated 40 kms outside the municipal limits of Jaipur, but within 23 kms of Niwai Municipal Corporation.

SUGGESTED ANSWERS/HINTS

1. (a) Liquidated damages received from supplier of plant and machinery

The issue as to whether liquidated damages received from supplier of plant and machinery for failure to supply machinery within the stipulated time is a capital receipt or revenue receipt came up before the Supreme Court in *CIT v. Saurashtra Cement Ltd. (2010) 325 ITR 422 (SC).*

In that case, it was observed that the damages were directly and intimately linked with the procurement of a capital asset i.e., the cement plant, which lead to delay in coming into existence of the profit-making apparatus. It was not a receipt in the

course of profit earning process. The Supreme Court, therefore, held that the amount received by the assessee towards compensation for sterilization of the profit earning source, is not in the ordinary course of business; hence, it is a capital receipt in the hands of the assessee.

Applying the rationale of the Apex Court ruling to the case on hand, the liquidated damages received by A Ltd. from supplier of plant and machinery for failure to supply machinery within the stipulated time is a capital receipt, not chargeable to tax.

(b) Power subsidy received year after year on the basis of actual power consumption

The issue as to whether power subsidy received by a company from the State Government, year after year, on the basis of actual power consumption is a capital receipt or revenue receipt came up before the Andhra Pradesh High Court, in *CIT v. Rassi Cement Ltd. (2013) 351 ITR 169.*

The Andhra Pradesh High Court referred to the decision of the Supreme Court in *Sahney Steel & Press Works Ltd. v CIT (1997) 228 ITR 253,* where incentives (including power subsidy) granted year after year were treated as supplementary trade receipts. In that case, the Supreme Court had observed that the power subsidy, given as a part of an incentive scheme after commencement of production, is linked to production. Therefore, the same has to be treated as a revenue receipt, since such assistance is given for the purpose of carrying on of the business of the assessee.

Accordingly, the Andhra Pradesh High Court, in *Rassi Cement Ltd.'s* case, held that power subsidy received by the assessee from the State Government on the basis of actual power consumption has to be treated as a revenue receipt and not as a capital receipt.

Applying the rationale of the above ruling to the case on hand, power subsidy received by B Ltd. from the State Government, year after year, on the basis of actual power consumption is a revenue receipt and hence, chargeable to tax.

(c) One-time subsidy [received as a percentage of sales tax paid] for capacity expansion and modernisation

The issue as to whether one-time subsidy (received as a percentage of sales tax paid) for capacity expansion and modernisation would constitute a revenue receipt or capital receipt came up before the Calcutta High Court in *CIT v. Rasoi Ltd. (2011) 335 ITR 438,* where the subsidy received by the company was a one-time receipt, equivalent to 90% of the amount of sales tax paid.

The Calcutta High Court, applying the rationale of Supreme Court in *CIT v. Ponni Sugars & Chemicals Ltd. (2008) 306 ITR 392*, observed that if the object of the subsidy is to enable the assessee to run the business more profitably, the receipt would be a revenue receipt. On the other hand, if the object of the assistance is to enable the assessee to set up a new unit or to expand an existing unit, the receipt

would be a capital receipt. Therefore, the object for which subsidy is given determines the nature of the subsidy and not the form or the mechanism through which the subsidy is given.

In *Rasoi Ltd.*'s case, since the company received subsidy by way of financial assistance, in the period of crisis, for expansion of the capacities and modernization of its manufacturing units in West Bengal, the Calcutta High Court observed that merely because the subsidy was equivalent to 90% of the sales tax paid, it cannot be construed that the same was in the form of refund of sales tax paid. Therefore, the Court held that the subsidy received has to be treated as a capital receipt and not as a revenue receipt.

Applying the rationale of the above ruling, the one-time subsidy, equivalent to 60% of sales tax paid, received by C Ltd. from the State Government under the scheme of industrial promotion for expansion of its capacities and modernization is a capital receipt.

2. (a) Section 11(7) provides that where a trust has been granted registration under section 12AA and the registration is in force for a previous year, then, such trust cannot claim any exemption under any provision of section 10 [other than exemption of agricultural income under section 10(1) and exemption available under section 10(23C)].

Therefore, Ramji Charitable trust cannot claim exemption under section 10(35) in respect of income from mutual funds and exemption under section 10(34) in respect of dividends, since it has voluntarily opted for the special dispensation under sections 11 to 13, and consequently has to be governed by the provisions of these sections. However, it can claim exemption under section 10(1) in respect of agricultural income, since section 11(7) provides an exception in respect of such income.

Therefore, the claim of Ramji charitable trust, as regards exemption under section 10(34) and section 10(35), is not correct.

(b) Section 11(6) provides that income for the purposes of application shall be determined without allowing any deduction for depreciation or otherwise in respect of any asset, the cost of acquisition of which has been claimed as an application of income under section 11 in the same or any other previous year.

Accordingly, in this case, since the cost of building (i.e., ₹ 25 lakh) has been claimed and allowed as application of income under section 11 while computing the income of the trust for the P.Y.2013-14, depreciation on building will not be allowed for the purpose of determining income for the purposes of application in the P.Y.2014-15.

Therefore, the depreciation claim made by Shivji charitable trust is not correct.

(c) Section 12A(2) provides that the provisions of section 11 and 12 shall apply in relation to the income of a trust from the assessment year immediately following the financial year in which the application for registration is made. Accordingly, by

virtue of this provision, the exemption provisions would apply from A.Y.2015-16 since the charitable trust made an application for registration in April, 2014.

However, the first proviso to section 12A(2) provides that in case where a trust or institution has been granted registration under section 12AA, the benefit of sections 11 and 12 shall be available in respect of any income derived from property held under trust of any assessment year preceding the aforesaid assessment year, for which assessment proceedings are **pending before the Assessing Officer as on the date of such registration, provided the objects and activities of the trust remain the same for such preceding year.**

In this case, since the assessment proceedings for A.Y.2013-14 and A.Y.2014-15 are pending before the Assessing Officer on the date of registration of the trust, the claim of Ganeshji charitable trust is correct and the benefit of exemption under sections 11 and 12 would be available in respect of those years, provided the objects and activities of the trust were the same during those years.

3. (a) A Ltd. is eligible for deduction @ 15% under section 32AC(1A), since the investment in new plant and machinery (excluding computers installed in office) acquired and installed during the P.Y.2014-15 exceeds ₹ 25 crore. The deduction under section 32AC(1A) would be ₹ 4.50 crore (i.e., 15% of ₹ 30 crore). This deduction would be in addition to deduction under section 32 in respect of depreciation of ₹ 7.5 crore (i.e., 15% of ₹ 30 crore ***plus*** 60% of ₹ 5 crore) and additional depreciation of ₹ 6 crore (i.e., 20% of ₹ 30 crore).

(b) B Ltd. would be eligible for investment-linked tax deduction under section 35AD@100% in respect of amount of ₹ 5 crore invested in new plant and machinery in April, 2014 for setting up and operating a semi-conductor wafer fabrication manufacturing unit which commences operation on 1st June, 2014, being a date falling on or after 1st April, 2014. However, such unit must be notified by the CBDT in accordance with the prescribed guidelines and the expenditure must be capitalized in the books of account of B Ltd. on 1st June, 2014. ₹ 10 crore, being the cost of land, would not qualify for investment-linked tax deduction under section 35AD.

(c) For the purposes of section 37(1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall not be allowed as deduction under section 37.

Accordingly, the expenditure of ₹ 42 lakhs incurred by C Ltd. on rural development activities, being an activity qualifying as a CSR activity as per section 135 of the Companies Act, 2013 read with Schedule VII thereto, is not allowable as deduction under section 37.

₹ 10 lakhs, being contribution to Prime Minister's National Relief Fund, though not eligible for deduction while computing business income, would be eligible for 100% deduction under section 80G from gross total income

Note : *The Explanatory Memorandum to the Finance (No.2) Bill, 2014 clarifies that expenditure on CSR activities, which is of the nature described in sections 30 to 36, shall be allowed as deduction under those sections subject to fulfillment of conditions, if any, specified therein.*

Under section 35AC, 100% deduction is eligible in respect of the expenditure incurred on eligible projects/schemes specified under Rule 11K, which includes, inter alia, any programme for uplift of the rural poor as the Central Government may, by notification in the Official Gazette, specify in this behalf on the recommendation of the National Committee, being a committee constituted by the Central Government, from amongst persons of eminence in public life.

Therefore, if the expenditure of ₹ 42 lakhs on rural development activities are incurred for the uplift of the rural poor and the other conditions mentioned under section 35AC are fulfilled by C Ltd., it can claim deduction of such expenditure under section 35AC.

(d) Non-deduction of tax at source on any payment on which tax is deductible as per the provisions of Chapter XVII-B would attract disallowance under section 40(a)(ia). Under section 192, forming part of Chapter XVII-B, obligation is cast on every person responsible for paying any income chargeable under the head "Salaries" to deduct tax at source. 30% of expenditure would be disallowed under section 40(a)(ia) for failure to deduct tax at source. Accordingly, ₹ 7.50 lakhs, being 30% of ₹ 25 lakhs paid as salary to its resident employees without deduction of tax at source, would be disallowed under section 40(a)(ia).

(e) Disallowance under section 40(a)(i) is not attracted in this case since the tax deducted at source under section 195 in the P.Y.2014-15 has been deposited on or before the due date of filing of return under section 139(1).

4. Computation of total income of Mr. Ganesh for A.Y.2015-16

Particulars		₹
Salaries		32,00,000
Capital gains *[See Working Note below]*		17,00,600
Interest on fixed deposits		2,00,000
Gross Total Income		**51,00,600**
Less: Deductions under Chapter VI-A		
Under section 80C – PPF	1,50,000	
Under section 80D – Mediclaim premium	14,000	1,64,000
Total Income		**49,36,600**

Tax on total income:	**₹**
Tax on long-term capital gains [20% of ₹ 16,50,600]	3,30,120
Tax on other income of ₹ 32,86,000 [₹ 49,36,600 - ₹ 16,50,600]	8,10,800
	11,40,920
Add: Education cess@2% and SHEC@1%	34,228
	11,75,148

Working Note – Computation of Capital Gains chargeable to tax for A.Y.2015-16

	Particulars	**₹**
(1)	**Residential house**	
	Gross Sale consideration	2,00,00,000
	Less: Indexed cost of acquisition [31,12,000 × 1024/389]	81,92,000
		1,18,08,000
	Less: **Exemption under section 54**	
	Investment in one residential house [**See Note 1]**	52,00,000
	Investment in bonds of NHAI/RECL [**See Note 2]**	50,00,000
	Long-term capital gains taxable@20% under section 112	**16,08,000**
(2) & (4)	**Listed equity shares and units of equity oriented fund** Capital gains on sale of listed equity shares and units of equity oriented fund held for more than 12 months is a long-term capital gain exempt under section 10(38).	Nil
(3)	**Unlisted shares**	
	Sale consideration	1,25,000
	Less: Cost of acquisition	75,000
	Short-term capital gains taxable at normal rates of tax **[See Note 3]**	50,000
(5)	**Units of debt-oriented fund**	
	Sale consideration	1,45,000
	Less: Indexed cost of acquisition [₹ 63,200 × 1024/632]	1,02,400
	Long-term capital gains taxable at 20% u/s 112 **[See Notes 3 & 4]**	42,600

Taxable Capital Gains:	**₹**
Long-term capital gains taxable@20% u/s 112 [(1) + (5)]	16,50,600
Short-term capital gains taxable at normal rates [3]	50,000
	17,00,600

Notes:

(1) Section 54 has been amended by the Finance (No.2) Act, 2014 to provide that the exemption thereunder is available in respect of investment made in **one residential house** situated in India. In this case, it is more beneficial for Ganesh to avail the exemption under section 54 in respect of residential flat at Nagpur, since the cost of the Nagpur flat is higher than the cost of the Coimbatore flat.

(2) Section 54EC provides for exemption of capital gains invested in bonds of NHAI and RECL within a period of six months from the date of transfer. The maximum deduction thereunder in respect of investment in such bonds, out of capital gains arising from transfer of one or more capital assets during a financial year, would be restricted to ₹ 50 lakhs, irrespective of whether the investment is made in the same financial year or in the subsequent financial year or both. Therefore, in this case, the deduction under section 54EC would be restricted to ₹ 50 lakhs, even though the aggregate investment in eligible bonds within a period of six months is ₹ 85 lakhs.

(3) With effect from A.Y.2015-16, units of debt oriented fund and unlisted shares would qualify as a long-term capital asset only if they are held for a period of more than 36 months. Since unlisted shares are held for a period of less than 36 months, the gain arising therefrom is a short-term capital gain chargeable to tax at normal rates. Since the units of debt-oriented fund are held for more than 36 months, the gain arising therefrom is a long-term capital gain chargeable to tax@20%.

(4) Further, the benefit of concessional rate of 10% on long-term capital gains (without indexation) would not be available to units of a debt-oriented fund and unlisted shares with effect from A.Y.2015-16.

5. Computation of taxable capital gain of Mr. Vallish for the A.Y.2015-16

Particulars	₹
Sale proceeds	1,37,00,000
Less: Indexed cost of acquisition **(See Notes 1 & 2)**	84,99,200
Long-term capital gain	52,00,800
Less: Exemption under section 54 in respect of investment in house at Mathura **(See Notes 3 & 4)**	36,00,000
Taxable long-term capital gain	**16,00,800**

Notes:

(1) Computation of indexed cost of acquisition

Particulars	₹
Cost of acquisition	36,85,800
Less: Advance taken in the previous year 2005-06 and forfeited	1,50,000

Cost for the purpose of indexation	35,35,800
Indexed cost of acquisition (₹ 35,35,800 x 1024/426)	84,99,200

(2) Advance of ₹ 3,50,000 taken by Mr. Vallish from Mr. Sridhar in April, 2014, which was forfeited due to the transaction not materializing, is taxable under section 56(2)(ix). Hence, such amount would not be reduced to compute the indexed cost of acquisition while computing capital gains on sale of the property in March, 2015.

(3) In order to avail exemption of capital gains under section 54, one residential house should be purchased within 1 year before or 2 years after the date of transfer or constructed within a period of 3 years after the date of transfer. In this case, Mr. Vallish has purchased the residential house in Mathura within one year before the date of transfer and paid the full amount as per the purchase agreement, though he does not possess any legal title till 31.3.2015 since the transfer was not registered with the registration authority. However, for the purpose of claiming exemption under section 54, holding of legal title is not necessary. If the taxpayer pays the full consideration in terms of the purchase agreement within the stipulated period, the exemption under section 54 would be available. It was so held in *Balraj v. CIT(2002) 254 ITR 22 (Del.) and CIT v. Shahzada Begum (1988) 173 ITR 397 (A.P.).*

(4) The Finance (No.2) Act, 2014 has clarified that exemption under section 54 can be availed only in respect of one residential house. It would be more beneficial for Mr. Vallish to claim exemption in respect of the Mathura house since the cost of the same is higher than the cost of the Agra house.

6. Tax consequences in the hands of the business trust and its investors

(1) **Interest income of ₹ 4 crore from A Ltd.:** There would be no tax liability in the hands of business trust due to pass-through status enjoyed by it under section 10(23FC) in respect of interest income from A Ltd., being the special purpose vehicle **[See Notes 2 & 3 below]**. Therefore, A Ltd. is not required to deduct tax at source on interest payment to the business trust.

However, the business trust has to deduct tax at source under section 194LBA –

- @10%, on interest component of income distributed to resident unit holders; and
- @5%, on interest component of income distributed to non-corporate non-resident unit holders and foreign companies.

Interest component of income distributed to unit holders is taxable in the hands of the unit holders – @5%, in case of unit holders, being non-corporate non-residents or foreign companies; and at normal rates of tax, in case of resident unit holders.

The interest component of income received from the business trust in the hands of each unit-holder would be determined in the proportion of 4/11.1, by virtue of section 115UA(1) **[See Notes 1 & 4 below]**.

(2) **Dividend income of ₹ 2 crore from A Ltd.:** There would be no tax liability in the hands of the business trust since dividend is subject to dividend distribution tax under section 115-O in the hands of A Ltd; Hence, the dividend income is exempt under section 10(34) in the hands of the business trust.

Any distributed income referred to in section 115UA, to the extent it does not comprise of interest referred to in section 10(23FC) received by unit holders, is exempt in their hands under section 10(23FD). Therefore, by virtue of section 10(23FD), there would be no tax liability on the dividend component of income distributed to unit holders in their hands.

(3) **Short-term capital gains of ₹ 3 crore on sale of listed shares of A Ltd.:** As per section 115UA(2), the business trust is liable to pay tax@15% under section 111A in respect of short-term capital gains on sale of listed shares of special purpose vehicle **[See Note 6]**. There would, however, be no tax liability on the capital gain component of income distributed to unit holders, by virtue of the exemption contained in section 10(23FD) **[See Note 5]**.

(4) **Short-term capital gains of ₹ 2 crore on sale of developmental properties:** It is taxable at maximum marginal rate of 33.99% in the hands of the business trust as per section 115UA(2) **[See Note 6]**. There would be no tax liability in the hands of the unit holders on the capital gain component of income distributed to them, by virtue of the exemption contained in section 10(23FD) **[See Note 5]**.

(5) **Interest of ₹ 10 lakh received in respect of investment in unlisted debentures of real estate companies:** Such interest is taxable@33.99%, being the maximum marginal rate, in the hands of the business trust, as per section 115UA(2) **[See Note 6].** However, there would be no tax liability in the hands of the unit holders on the interest component of income distributed to them, by virtue of section 10(23FD) **[See Note 5]**.

Notes:

(1) New Chapter XII-FA, containing the special provisions relating to business trusts, has been inserted w.e.f. A.Y.2015-16. Section 115UA(1) provides that any income distributed by a business trust to its unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder, as it had been received by, or accrued to the business trust.

(2) Section 10(23FC) exempts any income of a business trust by way of interest received or receivable from a Special Purpose Vehicle (SPV). Thus, the business trust enjoys a pass-through status in respect of interest received or receivable from a SPV.

(3) SPV means any company or LLP in which the business trust holds controlling interest and any specified percentage of shareholding or interest, as may be required by the regulations under which such trust is granted registration [not less than 50% as per the current SEBI (Real Estate Investment Trusts) Regulations, 2014]. Since A Ltd. is an

Indian company in which the business trust holds controlling interest and 62% of shareholding, it is a special purpose vehicle. It is presumed that A Ltd. fulfills the other conditions specified in the regulations to qualify as an SPV.

(4) The distributed income of the business trust, to the extent it comprises of interest referred to in section 10(23FC), is deemed to be the income of the unit holder in the previous year of distribution and subject to tax in the hands of the unit holder in that year. Accordingly, the business trust is required to deduct tax at source on interest component of income distributed to its unit holders.

(5) Any distributed income referred to in section 115UA, to the extent it does not comprise of interest referred to in section 10(23FC), received by unit holders is exempt in their hands under section 10(23FD).

(6) Section 115UA(2) provides that subject to the provisions of sections 111A and 112, the total income of a business trust shall be chargeable to tax at the maximum marginal rate.

7. Computation of tax liability of Mr. Anish for A.Y.2015-16

Particulars		₹ in lakh
Tax liability on total income of ₹ 95 lakhs under the normal provisions of the Income-tax Act, 1961 [₹1.25 lakhs (tax on income upto ₹ 10 lakhs) + 30% of ₹ 85 lakhs (₹ 95 lakhs – ₹ 10 lakhs)]		26.75
Add: Education cess and SHEC@3%		0.80
Total tax liability		**27.55**
Adjusted Total Income	**₹ in lakh**	
Total Income		95.00
Add: Deduction under section 35AD [150% of ₹ 82 lakhs]	123.00	
Less: Depreciation under section 32 [10% of ₹ 82 lakhs]	8.20	114.80
Adjusted Total Income		**209.80**
Alternate Minimum Tax (AMT)@18.5%		38.81
Add: Surcharge@10% (since adjusted total income > ₹ 100 lakh)		3.88
		42.69
Add: Education cess@2% and SHEC@1%		1.28
Tax liability under section 115JC		**43.97**
Since the regular income-tax payable is less than the AMT payable, the adjusted total income of ₹ 209.80 lakhs shall be deemed to be the total		

income of Mr.Anish and tax is payable@18.5% thereof plus surcharge@10% and cess@3%. Therefore, the tax liability is ₹ 43.97 lakhs.	
AMT Credit to be carried forward under section 115JD	
Tax liability under section 115JC	43.97
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	27.55
	16.42

Notes:

(1) The Finance (No.2) Act, 2014 has brought the investment-linked tax deduction claimed under section 35AD within the scope of AMT. Accordingly, section 115JC has been amended to provide that total income shall be increased by the deduction claimed under section 35AD, as reduced by the depreciation allowable under section 32, as if no deduction under section 35AD was allowed in respect of the asset for which such deduction is claimed.

(2) The specified business of operating a warehousing facility for storage of food grains is eligible for weighted deduction@150% of capital expenditure under section 35AD, if operations were commenced on or after 1.4.2012.

(3) AMT Credit can be carried forward for a maximum period of ten assessment years immediately succeeding the assessment year for which the tax credit becomes allowable. Such credit is allowed to be set-off against the tax payable on total income in an assessment year in which the tax is computed in accordance with the regular provisions of the Income-tax Act, 1961, to the extent of excess of such tax payable over the AMT of that year.

8. Computation of additional income-tax payable by Gamma Ltd.

Particulars	₹ in lakh
Dividend distributed by Gamma Ltd. [referred to in section 115-O(1)]	460
Less: Dividend received from domestic subsidiary Beta Ltd. [referred to in section 115-O(1A)]	120
Net distributed profits	**340**
Add: Increase for the purpose of grossing up of dividend $\left\{\frac{15}{(100-15)}\times 340\right\}$	60
Gross dividend	**400**

Additional income-tax payable by Gamma Ltd. u/s 115-O [15% of ₹ 400 lakhs]	60.00
Add: Surcharge@10%	6.00
	66.00
Add: Education cess@2% and SHEC@1%	1.98
	67.98

Notes:

(1) Sub-section (1B) has been inserted in section 115-O by the Finance (No.2) Act, 2014 to provide that for the purposes of determining the tax on distributed profits payable in accordance with the section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115-O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115-O(1), be equal to the net distributed profits.

(2) As per section 115-O(1B), for the purpose of grossing up, the rate specified in sub-section (1) of section 115-O has to be considered. The rate specified in sub-section (1) of section 115-O is 15%. Accordingly, in the above solution, the rate of 15% has been considered for the purpose of grossing up.

Note *- It is also possible to take a view that grossing up should be done at the rate of 16.995% (that is, 15% plus surcharge@10% plus education cess and SHEC@3%), which is the effective rate of dividend distribution tax.*

9. Computation of Book Profit of Delta Ltd. under section 115JB

Particulars		₹	₹
Net Profit as per Profit & Loss Account			1,70,00,000
Add: **Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB**			
Income-tax paid or payable or provision therefor			
Provision for income-tax	₹ 14,00,000		
Dividend distribution tax	₹ 2,00,000	16,00,000	
Provision for deferred tax		9,00,000	
Transfer to General Reserve		6,00,000	
Provision for diminution in the value of investment		2,00,000	
Dividend paid or proposed			
Proposed dividend	5,00,000		

Preference dividend	3,00,000	8,00,000	
Expenditure to earn income exempt u/s 10 [except section 10(38)]			
Expenditure to earn agricultural income [Exempt u/s 10(1)]		2,00,000	
Depreciation		18,00,000	61,00,000
			2,31,00,000
Less: **Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB**			
Amount credited to profit and loss account from Special Reserve		3,00,000	
Depreciation (excluding depreciation on account of revaluation of fixed assets) (i.e., ₹ 18,00,000 – ₹ 4,00,000)		14,00,000	
Amount credited to profit and loss account from revaluation reserve (to the extent of depreciation on revaluation)		4,00,000	
Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less taken on cumulative basis		9,00,000	
Income exempt u/s 10 [except section 10(38)]			
Agricultural Income [since it is exempt under section 10(1)]		5,00,000	35,00,000
Book Profit			**1,96,00,000**

Computation of tax liability of Delta Ltd. for A.Y.2015-16

18.5% of book profit		36,26,000
Add: Surcharge@5% (since total income > ₹ 1 crore but less than ₹ 10 crore)		1,81,300
		38,07,300
Add: Education cess @ 2%	76,146	
Secondary and higher education cess @ 1%	38,073	1,14,219
Tax liability on book profit under section 115JB		**39,21,519**
Total income computed as per the provisions of the Income-tax Act, 1961	**1,00,00,000**	
Tax payable @ 30%		30,00,000
Add: Education cess @ 2%	60,000	
Secondary and higher education cess @ 1%	30,000	90,000
Tax Payable as per the Income-tax Act, 1961		**30,90,000**

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 18.5% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 18.5% thereof *plus* surcharge, if applicable, *plus* education cess @2% and secondary and higher education cess @1%. Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 18.5% of book profit, the book profit of ₹ 1,96,00,000 is deemed to be the total income and income-tax is payable @ 18.5% thereof *plus* surcharge@5% *plus* education cess @ 2% and secondary and higher education cess @1%. The tax liability, therefore, works out to ₹ 39,21,519.

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, 1961, will be allowed as tax credit in the subsequent years. The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act.

Particulars	₹
Tax on book profit under section 115JB	39,21,519
Less: Tax on total income computed as per the other provisions of the Act	30,90,000
Tax credit to be carried forward	**8,31,519**

This tax credit is allowed to be carried forward for ten assessment years succeeding the assessment year in which the credit became allowable. Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Notes:

(1) Securities transaction tax does not form part of income-tax and hence, should not be added back to net profit for computing book profit.

(2) Provision for gratuity based on actuarial valuation is a provision for meeting an ascertained liability. Therefore, it should not be added back for computing book profit.

(3) Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which is credited to profit and loss account, would be deducted in arriving at the book profit. However, deduction of such long-term capital gains is not allowed for computing book profit. Consequently, expenditure to earn such income should not be added back to arrive at the book profit. Section 10(38) also provides that such long term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under section 115JB.

10. (i) Computation of tax liability of Mr. Evan Smith for the A.Y.2015-16

	Particulars	₹	₹
	Income taxable under section 115BBA		
	Income from participation in cricket tournaments in India	32,00,000	
	Contribution of article in a magazine in India	15,000	
		32,15,000	
	Tax @ 20% under section 115BBA on ₹ 32,15,000		6,43,000
	Tax@30% under section 115BB on income of ₹ 80,000 (₹ 55,280 + ₹ 24,720) by way of winnings from lotteries		24,000
			6,67,000
	Add: Education cess@2% and Secondary and higher education cess @1%		20,010
	Total tax liability of Mr. Evan Smith		**6,87,010**

Mr. Dean Smith is a non-resident entertainer, whose income of ₹ 2 lakh from a music show in India is taxable@20% under section 115BBA. Therefore, his tax liability is ₹ 41,200 (being 20% of ₹ 2 lakh plus education cess@2% and secondary and higher education cess@1%)

(ii) Yes, the above income are subject to deduction of tax at source.

Income referred to in section 115BBA is subject to deduction of tax at source@20% under section 194E.

Income referred to in section 115BB (i.e., winnings from lotteries) is subject to deduction of tax at source@30% under section 194B.

Since Mr. Evan Smith and Mr. Dean Smith are non-residents, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by education cess@2% and secondary and higher education cess@1%.

(iii) Section 115BBA provides that if the total income of the non-resident sportsman or non-resident entertainer comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income.

In this case, although Mr. Evan Smith is a non-resident sportsman, he has winnings from lotteries as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he has to file his return of income for A.Y.2015-16.

However, since Mr. Dean Smith's income comprises of only income referred to in section 115BBA, in respect of which tax is deductible under section 194E, he need not file his return of income for A.Y.2015-16, if tax has been so deducted.

11. (i) The statement is not correct.

Under section 92CC, the CBDT may, with the approval of the Central Government, enter into an advance pricing agreement with any person for determining the Arm's Length Price or specifying the manner in which the arm's length price is to be determined in relation to an international transaction to be entered into by that person.

The agreement entered into is valid for a period, not exceeding five previous years, as may be mentioned in the agreement. Once the agreement is entered into, the arm's length price of the international transaction, which is subject matter of the advance pricing agreement, would be determined in accordance with such an advance pricing agreement, except where there is a change in law or facts having a bearing on the agreement so entered.

In order to reduce current pending as well as future litigation in respect of the transfer pricing matters, sub-section (9A) has been inserted in section 92CC by the Finance (No.2) Act, 2014 to provide roll back mechanism in the advance pricing agreement scheme.

The "roll back" provisions refer to the applicability of the methodology of determination of arm's length in relation to the international transactions which have already been entered into in a period prior to the period covered under an advance pricing agreement.

Accordingly, the advance pricing agreement may, subject to such prescribed conditions, procedure and manner, provide for determining the arm's length price or for specifying the manner in which arm's length price is to be determined in relation to an international transaction entered into by a person during any period not exceeding four previous years preceding the first of the previous years for which the advance pricing agreement applies in respect of the international transaction.

(ii) Section 92B(2) extends the scope of the definition of international transaction given in section 92B(1) by deeming a transaction entered into with a person other than an associated enterprise as a transaction with an associated enterprise, if the following conditions are satisfied:

- there exists a prior agreement in relation to the relevant transaction between the other person and the associated enterprise **or**,
- where the terms of the relevant transaction are determined in substance between such other person and the associated enterprise; **and**
- either the enterprise or the associated enterprise or both of them are non-residents.

In such a case, a transaction entered into between the enterprise and the other person shall be deemed to be an **international transaction** entered into between two associated enterprises, **whether or not such other person is a non-resident.**

In this case, the agreement between the Indian company, XYZ Ltd. and unrelated party, Mr. Ganesh for sale of product M was entered into on 15/3/2015. Prior to that date (i.e., on 10/3/2015), Mr. Ganesh has entered into an agreement, for sale of product M, with ABC Inc., a non-resident entity. ABC Inc. is deemed to be an associated enterprise of XYZ Ltd. since it is a specified foreign company in relation to XYZ Ltd., which implies that XYZ Ltd. holds 26% or more in the nominal value of the equity share capital of ABC Inc.

In this case, there exists a prior agreement in relation to the transaction for sale of product M between the unrelated party, Mr.Ganesh and the associated enterprise, ABC Inc., which is a non-resident entity. Hence, the transaction entered into between XYZ Ltd., an Indian company and Mr. Ganesh for sale of product M is deemed to be an international transaction entered into between two associated enterprises, irrespective of the residential status of Mr. Ganesh.

12. (a) The statement is correct.

Sub-section (2A) has been inserted in section 133A to provide that an income-tax authority may, for the purpose of verifying that tax has been deducted or collected at source in accordance with the provisions of Chapter XVII-B or Chapter XVII-BB, as the case may be, enter-

(1) any office, or a place where business or profession is carried on, within the limits of the area assigned to him, or

(2) any such place in respect of which he is authorised for the purposes of this section by such income-tax authority who is assigned the area within which such place is situated, where books of account or documents are kept.

The income-tax authority may for this purpose enter an office, or a place where business or profession is carried on after sunrise and before sunset.

Further, such income-tax authority may require the deductor or the collector or any other person who may at the time and place of survey be attending to such work,—

(1) to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place, and

(2) to furnish such information as he may require in relation to such matter.

An income-tax authority may -

(1) place marks of identification on the books of account or other documents inspected by him and take extracts and copies thereof;

(2) record the statement of any person which may be useful for, or relevant to, any proceeding under the Act.

However, while acting under sub-section (2A), the income-tax authority shall **not** impound and retain in his custody, any books of account or documents inspected by him or make an inventory of any cash, stock or other valuable articles or thing checked or verified by him.

(b) The statement is correct.

Section 133A empowers an income-tax authority to enter any premises in which business or profession is carried out for the purposes of survey.

An income-tax authority acting under this section may impound and retain in his custody any books of account or documents inspected by him during the course of survey, after recording his reasons for doing so. However, so far, he did not have the power to retain in his custody any such books of account or document for a period exceeding ten days (exclusive of holidays) without obtaining the approval of the Chief Commissioner or Director General therefor, as the case may be.

An income-tax authority acting under section 133A has the powers as conferred upon it under section 131(1), i.e., it has the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely, -

(1) discovery and inspection;

(2) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

(3) compelling the production of books of account and other documents; and

(4) issuing commissions.

Under section 131(3), an extended time limit of 15 days (exclusive of holidays) has been provided upto which an income-tax authority may retain in his custody, books of account or other documents impounded, without obtaining the approval of the higher authorities specified thereunder i.e., Principal Chief Commissioner or Chief Commissioner, Principal Director General or Director General etc.

In order to align the time period under section 133A with the time period under section 131(3), section 133A(3) has been amended by the Finance (No.2) Act, 2014 to provide that an income-tax authority shall not retain in his custody any such books of account or other documents for a period exceeding **fifteen days** (exclusive of holidays) without obtaining the approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Commissioner or Commissioner or Principal Director or Director therefor, as the case may be.

13. Section 149(1) provides the time limit for issue of notice under section 148 for assessment, reassessment or recomputation where income has escaped assessment. The time limit prescribed under section 149(1) in a case where income escaping assessment exceeds ₹ 1 lakh is 6 years from the end of the relevant assessment year. In

this case, the relevant assessment year is A.Y.2002-03, being the year in respect of which the income exceeding ₹ 1 lakh has escaped assessment. The six year time limit under section 149(1) for issuing notice under section 148 relating to A.Y.2002-03 expires on 31.3.2009. In this case, the notice under section 148 is issued in March, 2014, which is outside the six year time limit prescribed under section 149(1).

The restriction of time limit under section 149(1) is, however, not applicable where notice under section 148 is issued for making an assessment, reassessment or recomputation to give effect to any finding or direction contained in an order passed by any authority in any proceeding by way of appeal, reference or revision or by a Court in any proceeding under any other law. This relaxation is contained in section 150(1).

However, such relaxation will not apply where any such assessment or reassessment relates to an assessment year in respect of which an assessment or reassessment could not have been made at the time the order which was the subject matter of appeal, reference or revision, as the case may be, was made on account of such assessment or reassessment having become time-barred at that point of time itself. This restriction is contained in section 150(2). The relaxation contained in section 150(1) is, therefore, subject to the restriction contained in section 150(2).

In this case, since the notice under section 148 was issued for the purpose of making reassessment to give effect to an appellate order, the restriction contained in section 149(1) does not apply. The relaxation under section 150(1) will apply in this case, since the order which was the subject matter of appeal was passed on 28.3.2009, which is within the six year time limit from the end of the relevant assessment year, i.e., A.Y.2002-03. Therefore, since the original order which was the subject matter of appeal was passed on 28.3.2009, the relaxation contained in section 150(1) will apply. Consequently, the notice issued under section 148 by the Assessing Officer in March 2014, in this case, would be valid.

However, if the original order was passed on 4.4.2009, it falls outside the six year time limit in relation to A.Y.2002-03, which expires on 31.3.2009. The operation of section 150(1) would then be subject to the restriction contained in section 150(2). According to section 150(2), if on the date of passing of the order which was the subject-matter of appeal (i.e., on 4.4.2009), the reassessment could not have been made on account of the same having become time-barred, then, notice for reassessment cannot be issued now by availing the relaxation given in section 150(1). Therefore, if the original order was passed on 4.4.2009, the notice issued under section 148 by the Assessing Officer in March 2014 would not be valid.

14. Section 254(2) specifically empowers the Appellate Tribunal to amend any order passed by it, either *suo motu* or on an application made by the assessee or Assessing Officer, with a view to **rectifying any mistake apparent from record**, at any time within 4 years from the date of passing the order sought to be amended.

The powers of the Tribunal under section 254(2) relating to rectification of its order are very limited. Such powers are confined to rectifying any mistake apparent from the

record. The mistake has to be such that for which no elaborate reasons or inquiry is necessary. **Accordingly, the re-appreciation of evidence placed before the Tribunal during the course of the appeal hearing is not permitted. It cannot re-adjudicate the issue afresh under the garb of rectification.** This issue came up for consideration before the Punjab & Haryana High Court in the case of *CIT vs. Vardhman Spinning (1997) 226 ITR 296,* wherein it was observed that the jurisdiction to review or modify orders passed by the authorities under the Act cannot be inferred on the basis of a supposed inherent right.

The Delhi High Court, in *Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243 (Delhi)(FB),* observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in *Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466,* dealing with the Tribunal's power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. **While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.**

When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then it is the duty of the Tribunal to set it right. The Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.

Thus, while the Tribunal does not have the power to review or reappreciate the correctness of its earlier decision on merits under section 254(2), it, however, has the power to recall its order in entirety to rectify a mistake apparent from record.

15. The statement is correct.

Prior to 1st October, 2014, section 245A(b) defining "case" in respect of which an assessee may make an application to the Settlement Commission, specifically excluded from its scope –

(1) a proceeding for assessment or reassessment or recomputation under section 147;

(2) a proceeding for making fresh assessment in pursuance of an order under section 254 by the Appellate Tribunal or an order of revision under section 263 or section 264 by Commissioner, setting aside or cancelling an assessment.

This exclusion has now been removed by the Finance (No.2) Act, 2014 with effect from 1st October, 2014. Therefore, the proceedings mentioned in (1) and (2) above would now fall within the definition of "case" in respect of which an assessee can make an application to the Settlement Commission under section 245C.

16. (i) The statement is incorrect.

Under section 269SS, prior to amendment by the Finance (No.2) Act, 2014, no person shall accept any loan or deposit of ₹ 20,000 or more from any other person otherwise than by an account payee cheque or account payee bank draft. Thus, prior to amendment by the Finance (No.2) Act, 2014, account payee cheque and account payee bank draft were the only permissible modes of acceptance of loan or deposit to avoid penalty under section 271D.

In order to enable payment by way of internet banking facilities or by use of payment gateways, sections 269SS has been amended by the Finance (No.2) Act, 2014 to provide that use of electronic clearing system through a bank account shall also be a permissible mode of acceptance of any loan or deposit thereunder.

Thus, acceptance of loan or deposit exceeding the prescribed limit of ₹ 20,000 through electronic clearing system would **not** be treated as contravention of the provisions of sections 269SS. **Hence, penalty under section 271D would not be attracted.**

(ii) The statement is incorrect.

Penalty under section 271G is leviable if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by section 92D(3).

Section 271G has been amended by the Finance (No.2) Act, 2014 with effect from 1st October, 2014, to include a Transfer Pricing Officer, as referred to in section 92CA, as an authority competent to levy the penalty under section 271G in addition to the Assessing Officer and the Commissioner (Appeals).

17. The issue under consideration in this case is whether making an incorrect claim in the return of income would tantamount to concealment of particulars or furnishing of inaccurate particulars for attracting the penal provisions under section 271(1)(c) when no information given in the return of income is found to be incorrect.

This issue came up before the Supreme Court in *CIT v. Reliance Petro Products Pvt. Ltd. (2010) 322 ITR 158*. The Supreme Court observed that in order to attract the penal provisions of section 271(1)(c), there has to be concealment of the particulars of income or furnishing inaccurate particulars of income. Where no information given in the return is found to be incorrect or inaccurate, the assessee cannot be held guilty of furnishing inaccurate particulars. Making an incorrect claim (i.e. a claim which has been disallowed) would not, by itself, tantamount to furnishing inaccurate particulars.

The Apex Court held that where there is no finding that any details supplied by the assessee in its return are incorrect or erroneous or false, there is no question of imposing penalty under section 271(1)(c). A mere making of a claim, which is not sustainable in law, by itself, will not amount to furnishing inaccurate particulars regarding the income of the assessee.

Applying the rationale of the above Supreme Court ruling to the case on hand, penalty under section 271(1)(c) cannot be imposed on Biotech Ltd. merely for making an incorrect claim which is not sustainable in law, since the company had furnished all the details and no information given by the company was found to be incorrect or erroneous or false.

The contention of Biotech Ltd. is, therefore, correct.

18. (i) Since the annual premium is less than 20% of sum assured in respect of a policy taken before 1.4.2012, the maturity proceeds of ₹ 7 lakhs are exempt under section 10(10D) in the hands of Mr. Anand. Hence, no tax is required to be deducted at source under section 194DA on such sum payable to Mr. Anand.

(ii) Since the annual premium exceeds 10% of sum assured in respect of a policy taken on 1.4.2012, the sum of ₹ 2.25 lakhs due to Mr.Aarav would not be exempt under section 10(10D) in his hands. Therefore, tax is required to be deducted@2% under section 194DA on the maturity proceeds of ₹ 2.25 lakhs payable to Mr.Aarav.

(iii) Even though the annual premium exceeds 20% of sum assured in respect of a policy taken before 1.4.2012, and consequently, the maturity proceeds of ₹ 98,000 would not be exempt under section 10(10D) in the hands of Mr.Avnish, the tax deduction provisions under section 194DA are not attracted since the maturity proceeds are less than ₹ 1 lakh.

19. Computation of Net Wealth of M/s ABC Constructions Ltd. as on valuation date 31.03.2015

Particulars		₹ (in lakhs)	₹ (in lakhs)
Assets [as per the definition of assets under section 2(ea)]			
(i)	Land in urban area (held as stock in trade since 1997) – taxable, under section 2(ea)(v), since it is held as stock-in-trade for more than 10 years		67
(ii)	Motor cars (excluding imported car not being an asset since it is used for hiring) is an asset under section 2(ea)(ii) [₹ 46 lakhs – ₹ 25 lakhs]		21
(iii)	Agricultural land acquired for construction of residential and commercial complex [is a stock-in-trade in the hands of a construction company – hence, not an asset under section 2(ea)(v)]		Nil

(iv) (a) Residential flats provided to three employees drawing salary less than ₹ 10 lakhs per annum – not an asset, since covered under the exclusion contained in section 2(ea)(i)(1)		Nil
(b) Residential flat provided to two employees drawing salary exceeding ₹ 10 lakhs per annum is an asset since it is not covered under the exclusion contained in section 2(ea)(i)(1) [45 × 2/5]		18
(v) Farm house – not included within the scope of asset under section 2(ea)(i) since it is situated beyond 25 kms from the local limits of a municipality		Nil
(vi) Cash in hand as per cash book is not an asset, since it represents cash recorded in the books. Hence, it is not covered under section 2(ea)(vi)		Nil
		106
Less: **Liabilities**		
(i) Loan for purchase of land in urban area – deductible, since it is incurred in relation to land in urban area, which is an asset chargeable to wealth-tax.	42	
(ii) Loan for purchase of agricultural land - not deductible, since land held as stock-in-trade is not an asset	Nil	
(iii) Wealth tax liability for Assessment year 2014-15 – wealth tax liability is not deductible	Nil	
(iv) Loan for construction of residential flats - the portion relating to taxable asset (2/5th) is deductible i.e., $\frac{2}{5} \times 20$	8	50
Net Wealth		**56**

20. (i) Silver and gold used in the jewellers' shop: Jewellery is an asset within the meaning of section 2(ea)(iii) of the Wealth-tax Act, 1957. However, if jewellery is used as stock-in-trade, the same shall be excluded from the assets chargeable to wealth-tax, by virtue of proviso to section 2(ea)(iii). Silver and gold used in the jewellers' shop represent his stock-in-trade and would, therefore, not be chargeable to wealth-tax.

(ii) Jewellery purchased by Mr. Shankar out of balance lying in his NRE A/c on the date of his return to India on permanent basis: Any asset acquired by Mr. Shankar out of money brought by him into India, within one year immediately preceding the date of his return or at any time thereafter, would be exempt for a

period of seven successive assessment years following the year of his arrival in India on a permanent basis. Money standing to the credit of such person in a NRE Account on the date of his return to India shall be deemed to be money brought by him into India on that date. Therefore, the jewellery acquired by Mr. Shankar out of balance lying in his NRE A/c on the date of his return to India would not be chargeable to wealth-tax for the A.Y.2015-16, since Mr.Shankar has come to India on a permanent basis only two years back.

(iii) Aircraft owned and used by a company for transportation of its goods: The definition of asset under section 2(ea)(iv) includes, *inter alia*, aircrafts, other than those used by the assessee for commercial purposes. Aircraft owned and used by a company for transportation of its goods can be construed as used for "commercial purposes", since it is used for the business of the company. Hence, such aircraft is not chargeable to wealth-tax [*Garware Wall Ropes Ltd. vs. Additional CIT (2004) 89 ITD 221 (Mum)]*

(iv) Jeep of the company given to Director for official use: In the context of the Wealth-tax Act, 1957, the term "Motor Car" is meant to be an inclusive term encompassing all vehicles (other than heavy vehicles) which can be regarded as "motor car" in a broad sense. Hence, "Motor Car" includes a Jeep. Since the jeep is not used for the business of running on hire or as stock-in-trade, it is an asset as per section 2(ea)(ii) *[Southern Roadways Ltd. v. CWT (2001) 251 ITR 213 (Mad.)]*

(v) Farm house situated within 25 kilometers from the local limits of municipality: Section 2(ea) of the Wealth-tax Act, 1957 defines the term "asset". According to the said definition, asset means, *inter alia,* any building including farm house situated within 25 kilometers from the local limits of any municipality. Therefore, the farmhouse situated within 23 kilometers from Niwai Municipal Corporation shall be an asset chargeable to wealth-tax.

Applicability of Legislative Amendments/Circulars etc. for May, 2015 – Final Examination

Paper 7 : Direct Tax Laws & Paper 8 : Indirect Tax Laws

Applicability of the Finance Act, Assessment Year etc. for May, 2015 Examination

The provisions of direct and indirect tax laws, as amended by the Finance (No.2) Act, 2014, including notifications and circulars issued up to 31st October, 2014. The applicable assessment year for Direct Tax Laws is A.Y.2015-16.

Part – I: Statutory Update – Direct Tax Laws

Significant Notifications and Circulars issued between 1st May, 2014 and 31st October, 2014

Study Material for Direct Tax Laws [November, 2014 edition] contains all the relevant amendments made by the Finance (No.2) Act, 2014 and circulars/notifications issued up to 30.04.2014. However, for students appearing in May, 2015 examination, amendments made by notifications, circulars and other legislations made between 01.05.2014 and 31.10.2014 are also relevant. Such amendments are given hereunder:-

I. NOTIFICATIONS

1. Notification of Cost Inflation Index for F.Y.2014-15 (Notification No. 31/2014, dated 11-6-2014)

The Central Government has, in exercise of the powers conferred by *clause (v) of Explanation to section 48*, vide this notification specified the Cost Inflation Index for the financial year 2014-15 as 1024.

S. No.	Financial Year	Cost Inflation Index	S. No.	Financial Year	Cost Inflation Index
1.	1981-82	100	18.	1998-99	351
2.	1982-83	109	19.	1999-2000	389
3.	1983-84	116	20.	2000-01	406
4.	1984-85	125	21.	2001-02	426
5.	1985-86	133	22.	2002-03	447
6.	1986-87	140	23.	2003-04	463
7.	1987-88	150	24.	2004-05	480
8.	1988-89	161	25.	2005-06	497
9.	1989-90	172	26.	2006-07	519
10.	1990-91	182	27.	2007-08	551
11.	1991-92	199	28.	2008-09	582
12.	1992-93	223	29.	2009-10	632
13.	1993-94	244	30.	2010-11	711
14.	1994-95	259	31.	2011-12	785
15.	1995-96	281	32.	2012-13	852
16.	1996-97	305	33.	2013-14	939
17.	1997-98	331	**34.**	**2014-15**	**1024**

2. Increase in ceiling limit for investment in Public Provident Fund [Notification No. G.S.R. 588 (E), dated 13-8-2014]

In exercise of the powers conferred by Section 3(4) of the Public Provident Fund Act, 1968, the Central Government has increased annual ceiling limit for deposit in PPF A/c from ₹ 1 lakh to ₹ 1.50 lakhs by amending the Public Provident Fund Scheme, 1968.

3. Rate of depreciation in respect of windmills installed on or after 01.04.2014 (Notification No. 43/2014, dated 16-9-2014)

The Central Board of Direct Taxes has, vide this notification amended the rate of depreciation on certain renewable energy devices. Accordingly, the following renewable energy devices would be eligible for depreciation @80% from A.Y. 2015-16, if they are installed on or after 1st April 2014 –

(a) Wind mills and any specially designed devices which run on wind mills;

(b) Any special devices including electric generators and pumps running on wind energy

This implies that if the aforesaid renewable energy devices were installed on or before 31st March 2014, they would be eligible for depreciation @ 15% from A.Y. 2015-16.

The applicable rate of depreciation for A.Y. 2014-15 and A.Y. 2015-16, based on date of installation of such renewable energy devices, have been tabulated hereunder for a better understanding of the amendment made vide this notification.

Date of installation	Rate of depreciation	
	A.Y. 2014-15	A.Y. 2015-16
On or before 31.03.2012	80%	15%
Between 1.04.2012 to 31.03.2014	15%	15%
On or after 01.04.2014	N.A	80%

II. CIRCULARS

1. Eligibility of deduction under section 80-IA for unexpired period, in case of an undertaking or enterprise developing an infrastructure facility, industrial park, SEZ and transferring the same to another enterprise or undertaking for operation and maintenance [Circular No. 10/2014 dated 06-05-2014]

Under section 80-IA, deduction is available in respect of profits & gains derived by an undertaking or enterprise engaged in developing, operating and maintaining any infrastructure facility, industrial park etc. The undertakings or enterprises eligible for availing deduction under this section have been specified under sub-section (4) of section 80-IA and can broadly be classified as under:

(i) enterprise carrying on the business of developing or operating & maintaining or developing, operating & maintaining infrastructure facilities [80-IA(4)(i)];

(ii) undertaking providing basic or cellular telecommunication services [80-IA(4)(ii)];

(iii) undertaking which develops, develops & operates or maintains & operates an industrial park or SEZ [80-IA(4)(iii)];

(iv) undertaking set up for generation / generation & distribution of power or laying of network / renovation or modernization of network of transmission / distribution lines [80-IA(4)(iv)] or

(v) set up for reconstruction or revival of power generation plant [80-IA(4)(v)].

The provisions of section 80-IA also contain the conditions to be satisfied for being eligible for deduction. As per section 80-IA(3), undertakings mentioned in (ii) and (iv) above **should <u>not</u> be formed by splitting up or reconstruction of an existing business**.

The proviso to clause (i) and clause (iii) of sub-section (4) of section 80-IA deal with the situation where operation and maintenance of infrastructure facility or operation and maintenance of industrial park / SEZ, respectively, is transferred to another enterprise in the manner provided therein and **the transferee undertaking <u>can</u> avail deduction for the unexpired period**.

Section 80-IA(12A) provides that where the enterprise or undertaking of an Indian Company entitled to the deduction under the said section is transferred on or after 01.04.2007 in a scheme of amalgamation or demerger, **<u>no</u>** deduction shall be available to the amalgamated or the resulting company.

The vital factor in determining the eligibility criteria for availing deduction u/s 80-IA would be verification of factual issues so as to ascertain whether

(a) there has been splitting up or reconstruction of a business already in existence,

(b) transfer is in accordance with the proviso to clause (i) or clause (iii) of sub-section (4) of section 80-IA, or

(c) transfer of an enterprise or undertaking is in a scheme of amalgamation or demerger.

The CBDT has, through this circular, clarified that if –

(i) an enterprise or undertaking develops an infrastructure facility, industrial park or special economic zone, as the case may be; **and**

(ii) transfers it to another enterprise or undertaking for operation and maintenance in accordance with the proviso to clause (i) or clause (iii) of sub-section (4) of section 80-IA; **and**

(iii) this transfer is **<u>not</u>** by way of amalgamation or demerger,

(iv) the transferee **shall be eligible** for the deduction for the unexpired period.

The profit for the purposes of deduction in the case of transferee shall be computed in accordance with sub-sections (5) to (10) of section 80-IA.

2. Taxation of Alternative Investment Funds having status of Non-charitable trusts under Income-tax Act, 1961 [Circular No. 13/2014, dated 28-07-2014]

The SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations), aims at regulating all forms of private pool of funds in India. These regulations divide AIFs into three broad categories – Category I, Category II and Category III AIFs, on the basis of the operational strategies, objectives and fund structure. Category I AIFs include Venture Capital Funds which are established as a trust and Venture Capital Companies. Category I AIFs are eligible for "pass through status" under section 10(23FB) read with section 115U, in respect of income which arises to the fund from investment in venture capital undertaking (VCU), provided they comply with the additional conditions laid down under the Income-tax Act, 1961. Such income accruing or arising or received by a person out of investment made in a Category I AIF fulfilling the prescribed conditions under the Income-tax Act, 1961 shall be taxable in the like manner as if the person had made a direct investment in the VCU. In effect, the VCF (falling under Category I AIF) enjoys a pass through status in respect of such income under section 10(23FB).

A large number of AIF's registered with SEBI have been set up in the form of non-charitable trusts. In this regard, clarification was sought from the CBDT about tax treatment in cases of AIFs being non-charitable trusts where the name of investor and beneficial interest are not explicitly known on the date of its creation owing to such information becoming available only when the fund starts accepting contributions from the investors. The issue is whether the income of such funds would be taxable in the hands of the trustees of the AIF in the capacity of a 'Representative assessee as defined in section 160(1)(iv) or in the hands of investors.

In this regard, the CBDT has clarified that where the trust deed does not specify the name of investors or their beneficial interests, the provisions of section 164(1) would apply and the entire income of fund shall be liable to be taxed at Maximum Marginal Rate of income tax in the hands of the trustees of such AIF's in their capacity as 'Representative Assessee'. Consequently, the provisions of section 166 need not be invoked in the hands of the investor, as the income has already been subject to the tax in the hands of the Representative Assessee in accordance with section 164(1).

However, in case of funds, where the name of beneficiaries and their interest in the Fund are determined i.e., stated in the trust deed, the tax on whole of the income of the fund - consisting of or including profit and gains of business, would be leviable upon the trustees of such AIF, being 'Representative Assessee' at maximum marginal rate in accordance with the provisions of section 161(1A).

The Circular further clarifies that the tax treatment given above will not be operative in the area falling in the jurisdiction of a High Court which has taken or takes a contrary decision on the issue.

3. Allowability of deduction under section 10AA on transfer of technical manpower in the case of software industry [Circular No. 14/2014, dated 8-10-2014]

The CBDT had earlier clarified *vide* Circular No.12/2014 dated 18th July, 2014 that mere transfer or re-deployment of existing technical manpower from an existing unit to a new

SEZ unit in the first year of commencement of business will not be construed as splitting up or reconstruction of an existing business, provided the number of technical manpower so transferred does not exceed 20% of the total technical manpower actually engaged in developing software at any point of time in the given year in the new unit.

The limit of 20% was considered inadequate and restrictive and it impacted the competitiveness of Indian Software Industry in global market. Consequently, the matter was re-examined by the CBDT, and in supersession of Circular No.12/2014 dated 18th July, 2014, it has now been decided that the transfer or re-deployment of technical manpower from existing unit to a new unit located in SEZ, in the first year of commencement of business, shall not be construed as splitting up or reconstruction of an existing business, provided the number of technical manpower so transferred as at the end of the financial year should not exceed 50% of the total technical manpower actually engaged in development of software or IT enabled products in the new unit. Alternatively, if the assessee-enterprise is able to demonstrate that the net addition of the new technical manpower in all units of the assessee-enterprise is at least equal to the number that represents 50% of the total technical manpower of the new SEZ unit during such previous year, deduction under section 10AA would not be denied provided the other prescribed conditions are also satisfied. The assessee-enterprise will have the choice of complying with any one of the two alternatives given above to avail the benefit of deduction under section 10AA.

The Circular also clarifies that:

(a) it shall be applicable only in the case of assessees engaged in the development of software or in providing IT enabled services in SEZ units eligible for deduction under section 10AA. .

(b) it shall not apply to the assessments which have already been completed. Further, no appeal shall be filed by the Department in cases where the issue is decided by an appellate authority in consonance with this circular.

4. Approval of long-term bonds and rate of interest for the purpose of section 194LC of the Income-tax Act, 1961 [Circular No. 15/2014, dated 17-10-2014]

Section 194LC, inserted by the Finance Act, 2012, provides for a concessional rate of withholding tax @ 5% on interest payment by an Indian company to a non-corporate non-resident or a foreign company. The concessional rate of tax and TDS was applicable if the borrowing is made in foreign currency between 1.7.2012 and 30.6.2015, from a source outside India, *inter alia,* by way of issue of long-term infrastructure bonds, as approved by the Central Government in this behalf.

This year, the Finance (No.2) Act, 2014 has expanded the scope of deduction of tax at a concessional rate of 5% under section 194LC to cover interest payable to a non-corporate non-resident or a foreign company by an **Indian company or a business trust** on money borrowed by it in foreign currency from a source outside India **by issue of any long-term bond, including long-term infrastructure bond, as approved by the Central Government in this behalf, at any time between 1.10.2014 and 30.6.2017.** It may be noted that the concessional rate of tax deducted at source would continue to be

applicable in respect of long term infrastructure bonds issued during the period 1.7.2012 to 30.9.2014.

Considering the fact that a large number of bond issues have to be undertaken by Indian companies, the Government is providing an approval mechanism to avoid approval for each and every specific case, which would lead to avoidable compliance burden on the borrower/issuer of bond. Accordingly, the CBDT conveys the approval of Central Government for issue of long-term bonds including long-term infrastructure bonds by Indian companies which satisfy the following conditions:

(a) The bond shall be issued at any time on or after 1st October, 2014 but before 1st July, 2017.

(b) The bond issue shall comply the relevant provisions of Foreign Exchange Management Act, 1999, read with relevant ECB regulations, either under automatic route or approval route.

(c) The bond issue should have Loan Registration Number issued by Reserve Bank of India.

(d) The term "long term" means that the bond to be issued should have original maturity term of three years or more.

Further, the Central Government has also approved the interest rate for the purpose of section 194LC in respect of borrowing by way of issue of long term bond including long term infrastructure bond, as any rate of interest which is within the All-in-cost ceilings specified by the RBI under ECB regulations as is applicable to the borrowing through a long term bond issue having regard to the tenure thereof.

Any bond issue satisfying the above conditions would be treated as approved by the Central Government for the purpose of section 194LC. Further, it has also been clarified that consequent to the amendment to section 194LC, the approval of Central Government contained in Circular No. 7/2012, in so far as they apply to borrowings by way of a loan agreement, shall be valid for the borrowings made on or before 30/06/2017 instead of 30/06/2015 as mentioned in the said Circular.

Part II : Judicial Update – Direct Tax Laws

Significant Recent Legal Decisions

"Select Cases in Direct and Indirect Tax Laws – An Essential Reading for the Final Course" is a compilation of the significant decisions of Supreme Court, High Court and Authority for Advance Rulings. October, 2014 edition of the said publication is relevant for May, 2015 examination. Students may note that in addition to the cases reported in the said publication, following significant recent legal decisions are also relevant for May, 2015 examination:-

Basic Concepts

1. What is the nature of subsidy given to enable the assessee to set up new unit - a capital receipt or revenue receipt?

CIT v. Kirloskar Oil Engines Ltd (2014) 364 ITR 88 (Bom)

Facts of the case : The assessee-company was engaged in the business of manufacture of internal combustion engines of three horse power. The predecessor-in-title of the assessee applied for special capital incentive in the form of loan of ₹ 20 lakhs from State Industrial Corporation of Maharashtra (in short, SICOM) in the year 1992. The actual disbursement was to take place after the receipt of funds from the Government of Maharashtra. The predecessor-in-title took bridge loan from SICOM. Later, the bridge loan together with outstanding interest of ₹ 5 lakhs was converted into special capital incentive by the SICOM, and the receipt was directly credited to capital reserve account of the assessee. The assessee-company claimed that the receipt was capital in nature, which was not accepted by the Assessing Officer.

High Court's Observations : The High Court observed that whenever new industries are to be set up in the State, there are incentives offered by the State Government. They are offered directly or through some canalizing agencies like SICOM. Initially, they are termed as a loan but later on they are converted into an incentive and offered with a view to enable the assessee to set up a new unit. The character of receipt in the hands of recipient is to be determined with respect to the purpose for which the subsidy is given.

The point of time at which the subsidy is given is immaterial. The source is also immaterial. The purpose test is to be applied. If the object of the subsidy is to enable the assessee to run the business more profitably, then the receipt is on the revenue account. If the object was to enable the assessee to set up a new unit, then, the receipt of subsidy is on capital account.

High Court's Decision: Accordingly, in this case, the High Court held that the subsidy received by the assessee-company for setting up a new unit is a capital receipt not chargeable to tax.

Charitable Trusts

2. In a case where properties bequeathed to a trust could not be transferred to it due to ongoing court litigation and pendency of probate proceedings, can violation of the provisions of section 11(5) be attracted?

DIT (Exemption) v. Khetri Trust (2014) 367 ITR 723 (Del)

Facts of the case: As per the 'will' of Late Raja Bahadur Sardar Singh, the entire property, including immovable property and shares in foreign companies, were bequeathed to the trust. However, the properties could not be transferred to or acquired by the trust because of ongoing litigation in the Court. In the probate proceedings, the 'will' was challenged and the probate proceedings are still pending.

The trustees paid ₹ 1,10,000 for raising a memorial for late Raja Bahadur Sardar Singh and the said amount was given to a business entity for this purpose, but due to the ongoing dispute, such project was not completed. The business entity, however, paid interest on the said amount. The Assessing Officer denied the benefit of exemption under section 11, on the ground that the asset held in the form of shares of foreign company and the advance given to business entity were contrary to the mandate of section 11(5) and thus, the condition specified in section 13(1)(d) has been violated.

Appellate Authorities' views: The Commissioner (Appeals) observed that the validity of the will has been challenged in the probate proceedings; therefore, till the 'will' is probated and affirmed as genuine, the trust would not acquire the legal right on the property for the purpose of Income-tax Act, 1961. In case the probate is denied, the properties would not devolve on the trust. The shares in foreign company were still in the name of the donor, Late Raja Bahadur Sardar Singh, and its acquisition by the trust is dependent upon the adjudication of the probate.

Further, with regard to the advance given to the business entity, the Commissioner (Appeals) found that the said amount cannot be treated as an investment which was covered and regulated by section 11(5), since the intent and purpose behind the payment was not investment.

These views of the Commissioner (Appeals) were confirmed by the Tribunal.

High Court's Decision: Based on the above factual findings, elucidated and affirmed by the Commissioner (Appeals) and the Tribunal, the High Court held that there was no violation of section 11(5) in this case.

3. Is the approval of Civil Court mandatory for amendment of trust deed, even in a case where the settler has given power to the trustees to alter the trust deed?

DIT (Exemptions) v. Ramoji Foundation (2014) 364 ITR 85 (AP)

Facts of the case: The settler gave power to the trustees to amend, alter, change or modify the objects of the trust deed with the approval of two-third majority. Such additional or altered object, however, must be of charitable nature falling within the definition thereof under the relevant provisions of the Income-tax Act, 1961. Based on

these provisions of the trust deed and referring to the Supreme Court decision in *CIT v. Kamla Town Trust (1996) 217 ITR 699,* the Tribunal held that the trust deed can be amended without approaching the Civil Court. Therefore, the Tribunal directed the DIT (Exemptions) to grant registration to the assessee-trust under section 12AA on the basis of the amended trust deed.

Issue: The issue under consideration before the High Court is whether the Tribunal was correct in holding that the amendment to the trust deed can be made without approaching the Civil Court, on the basis of the decision in the case of *Kamla Town Trust (Supra)*.

High Court's Observations: The High Court observed that the power has been given to the trustees by the settler to amend the trust deed without approaching the Civil Court, provided all the conditions laid down by the settler are fulfilled. The sanction of Civil Court is required only when there is no such power. When the power has been specifically given to the trustees by the settler, no further power from the Civil Court is required.

The High Court made reference to the *Kamla Town Trust's* case and observed that it has not been stated anywhere in the Supreme Court's decision that in spite of the power given to them by settler to amend the trust deed, the trustees have to approach the Civil Court to get the trust deed rectified.

High Court's Decision: Accordingly, in this case, the High Court held that the Tribunal has correctly dealt with the matter and the trust deed amended by the trustees can be relied upon by the Revenue authorities for the purpose of granting registration under section 12AA.

Profits and gains from business or profession

4. Is the expenditure on replacement of dies and moulds, being parts of plant and machinery, deductible as current repairs?

CIT v. TVS Motors Ltd (2014) 364 ITR 1 (Mad)

Facts of the case: The assessee company, engaged in manufacture of motor cycles and spares, filed its return of income for the relevant assessment year. It later filed a revised return in which it claimed deduction under section 31 in respect of expenditure incurred on replacement of dies and moulds in the place of worn out dies and moulds. The claim was rejected by the Assessing Officer on the ground that the assessee had claimed depreciation in respect of such expenditure in the earlier years.

Assessee's contention: The assessee contended that dies and moulds are not plant and machinery but are attachments to make plant and machinery function as per the requirements of the business. The assessee relied on the Madras High Court decision in the case of *Super Spinning Mill Ltd v. Asstt.CIT (2013) 357 ITR 720,* where expenditure on replacement of machinery parts was allowed as revenue expenditure.

High Court's Observations: The High Court referred to the Supreme Court ruling in *CIT v. Mahalakshmi Textile Mills Ltd. (1967) 66 ITR 710* and observed that as long as there was no change in the performance of the machinery and the parts that were replaced were performing precisely the same function, the expenditure has to be considered as current repairs of plant and machinery. In that case, the Supreme Court also observed that if grant of relief to an assessee is justified on another ground, the Revenue is bound to consider such claim of granting the relief. Accordingly, in this case, even though the assessee has claimed depreciation in the earlier years, the claim of the assessee for deduction of expenditure on replacement of moulds and dies as 'current repairs" is justified on the ground that there was no change in the performance of the machinery on account of such replacement.

The High Court also referred to its decision in the case of *CIT v. Machado Sons (2014) 2 ITR – OL 385* holding that **when the object of the expenditure was not for bringing into existence a new asset or to obtain a new advantage, the said expenditure qualifies as 'current repairs' under section 31.**

High Court's Decision: Applying the rationale of above decisions, the High Court held that "moulds & dies" are not independent of plant and machinery but are parts of plant and machinery. Once the dies are worn out, they had to be replaced so that the machine can produce the product according to business specifications. Thus, the expenditure incurred by the assessee towards replacement of parts of machinery to ensure its performance without bringing any new asset or advantage, is eligible for deduction as 'current repairs' under section 31.

5. Is guarantee commission paid by a company to its employee directors deductible as its business expenditure, where such guarantee was given by the employee directors to the bank for enabling credit facility to the company?

Controls & Switchgear Contractors Ltd v. Dy.CIT (2014) 365 ITR 312 (Del)

Facts of the case: The assessee, a listed company, wanted some credit facilities from the bank for its business purpose. The banker insisted on personal guarantee of the directors as a pre-condition for providing financial assistance to the company. The directors were employees of the company who were drawing salary from the company. A resolution was passed for paying commission to the directors and a sum of ₹ 24.37 lakhs each was paid as commission calculated at the rate of 1.5% of the principal sum, in respect of which personal guarantee was furnished by the directors to the bank.

Assessing Officer's Contention: The Assessing Officer applied section 36(1)(ii) and held that if the amount was not paid to them as commission, the same would have been payable as profits or dividend. Accordingly, the Assessing Officer contended that the assessee-company avoided dividend distribution tax under section 115-O which was otherwise payable. The appellate authorities also confirmed the disallowance of expenditure.

High Court's Observations and Decision: The High Court observed that the directors of the company are employees of the company and are entitled to remuneration for the services rendered as employees. The assessee-company passed a resolution resolving that the directors be paid commission for providing their personal guarantees for the financial assistance availed by the assessee-company from the bank. This act of providing personal guarantee was clearly beyond the scope of their services as employees of the company. The assessee-company, in its commercial wisdom, had agreed to pay a commission for furnishing of such guarantees by the director employees, which cannot be faulted. In such a case, the Assessing Officer only has to determine whether the transactions are real and genuine. It is not within his jurisdiction to impose his views as regards the necessity or the quantum of expenditure undertaken by the assessee. As regards section 36(1)(ii) the recipient directors were not entitled to receive the amount as commission in lieu of bonus or dividend. Dividend is paid to all the shareholders and the recipient directors were not the only shareholders of the company. The payment of commission, hence, cannot be taken as payment of dividend, since payment of dividend would result in payment to all the shareholders and not to select shareholders.

The High Court, therefore, set aside the Tribunal's order and directed rectification of the disallowance of amount paid as commission to directors.

6. Can employees contribution to Provident Fund and Employee's State Insurance be allowed as deduction where the assesssee-employer had not remitted the same on or before the "due date" under the relevant Act but remitted the same on or before the due date for filing of return of income under section 139(1)?

CIT v. Gujarat State Road Transport Corpn (2014) 366 ITR 170 (Guj)

Facts of the case: The assessee collected employees' contribution to Provident Fund and ESI which were remitted, after the due date under the relevant Acts but before the 'due date' for filing the return specified in section 139(1). The assessing authority held that the amount collected by way of employees' contribution to PF and ESI are income under section 2(24)(x) and their remittance is governed by section 36(1)(va). The time limit prescribed for remitting the contribution is the 'due date' prescribed under the Provident Funds Act, Employees' State Insurance Act, rule, order or notification issued thereunder or under any standing order, award, contract or service or otherwise.

Issue: The issue under consideration is whether extended time limit upto the due date of filing the return contained in section 43B would be available in respect of remittances which are governed by section 36(1)(va).

High Court's Observations: The High Court noted that section 43B(b) pertaining to employer's contribution cannot be applied with respect to employees' contribution which is governed by section 36(1)(va). So far as the employee's contribution is concerned, the *Explanation* to section 36(1)(va) continues to remain in the statute and there is no provision for applying the extended time limit provided under section 43B for remittance of employee's contribution. The amount of employee's contribution to PF and ESI is an

income upon recovery from salary and its remittance within the 'due date' as specified in *Explanation* to section 36(1)(va) makes it eligible for deduction. Employees' contribution recovered by the employer is not eligible for extended time limit upto the due date of filing of return, which is available under section 43B in the case of employer's own contribution.

High Court's Decision: The High Court, accordingly, held that the delayed remittance of employees' contribution beyond the 'due date' prescribed in section 36(1)(va), is not deductible while computing the business income, even though such remittance has been made before the due date of filing of return of income under section 139(1).

Note: *A contrary view was expressed by Uttrakhand High Court in the case of CIT v. Kichha Sugar Co. Ltd. (2013) 356 ITR 351 holding that the employees' contribution to provident fund, deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer-assessee with the provident fund authority on or before the due date of filing the return for the relevant previous year.*

7. Where the assessee-company came into existence on bifurcation of a Joint Venture Company (JVC), can the amount paid by it to the JVC for use of customer database and transfer of trained personnel be claimed as revenue expenditure?

CIT v. IBM Global Services India P Ltd (2014) 366 ITR 293 (Karn)

Facts of the case: The assessee-company came into existence on the bifurcation of a joint venture company floated earlier by two other companies. The assessee-company paid ₹ 530 lakhs for use of domestic customer database to the joint venture company, which gave information about various customers who patronized the company in the past and who continued to have service maintenance contract. This enabled the assessee to provide maintenance support services and effectively run its software business. Also, certain skilled and trained employees of the joint venture company were transferred to the assessee-company for which it made a payment of ₹ 938.58 lakhs to the joint venture company. The assessee claimed both the payments viz. payment for use of domestic customer database and absorption of trained employees, as revenue expenditure. The claim of the assessee was disallowed by the Assessing Officer.

Assessing Officer's Contentions: The Assessing Officer contended that domestic customer database is a capital asset which provides an enduring advantage or benefit to the assessee, since by utilizing the same, the assessee can successfully run its business activities over a considerable period of time. Hence, he treated the payment made for acquisition of domestic customer database as the payment made towards acquisition of capital asset. The Assessing Officer also contended that compensation paid by the assessee to the joint venture company for transfer of human skill is a capital expenditure, since the expenditure incurred on recruitment and training of transferred personnel would provide an enduring benefit.

High Court's Observations and Decision: The High Court observed that the expenditure incurred for use of customer database did not result in acquisition of any capital asset. The assessee got the right to use the database and the company which provided the database was not precluded from using such database. Therefore, the expenditure incurred was for use of data base and not for acquisition of such data base and, hence, is deductible as revenue expenditure.

As regards payment for obtaining trained and skilled employees, it was held that the joint venture company spent a lot of money to give training to employees who were transferred to the assessee-company. They were trained in the field of software. They have opted for employment with the assessee, and for their past services with the joint venture company, expenditure has been incurred. In effect, the payment made by the assessee-company was towards expenditure incurred for their training and recruitment. Such expenditure was in the revenue field, and therefore, the payment made by the assessee-company as per agreement to save such expenditure was also revenue in nature. Therefore, the expenditure incurred for obtaining trained and skilled employees cannot be termed as capital expenditure though the benefit may be of enduring nature. The High Court, thus, held that both the expenditures claimed were allowable as revenue expenditure.

8. Is release of retention money to the assessee-contractor on the basis of furnishing bank guarantee taxable as income of the assessee, where the assessee's right to receive retention money is subject to certain conditions including certification by the engineer in-charge?

Amarshiv Construction P Ltd v. Dy.CIT (2014) 367 ITR 659 (Guj

Facts of the case: The assessee-company was engaged in the business of civil construction. It was awarded a construction contract by Sardar Sarovar Narmada Nigam Ltd for construction of a part of the Sardar Sarovar Dam. Out of the bills raised by the assessee for such construction work, a certain portion was retained by the payer as retention money. This would be released only upon being certified by the engineer in-charge that the construction was carried out without any defects. The contract agreement was subsequently modified to permit greater liquidity to the assessee-contractor by allowing release of retention money where the contractor provides a matching bank guarantee for the sum to be released. Such bank guarantee would be encashed to the extent of dues or any defect found in the construction carried out or discharged at the end of the warranty period.

Issue: The issue before the High Court was whether the release of retention money based on bank guarantee results in accrual of income to the assessee-contractor.

High Court's Observations: The High Court observed that the crucial question is the point of time at which the assessee gets the right to receive such sum as his income. The High Court referred to the various decisions holding that **whenever the retention money of a contractor for performance of guarantee was held back by the employer of the contract, it cannot be taxed at that point of time and would accrue**

only when the release of retention money becomes an enforceable right to the contractor. The moot point was a change in terms of the contract for release of retention money based on furnishing of bank guarantee by the contractor.

All the amounts received would not mean receipt of income. Whether income did accrue or not would depend on the fact of whether the right to receive the same had accrued to the payee or not. The fact that tax was deducted at source by the payer would also be of no consequence. The contractor i.e., the payee, has no control over tax deduction by the payer. Mere tax deduction will not decide the taxability of receipt. The manner in which the recipient has accounted the receipt in the books is also not a criterion for deciding the character of receipt. The amount was released based on furnishing of bank guarantee which cannot be equated or interpreted as conferring a right on the contractor-assessee to seek release of funds and to tax the same as income. The amount received is not a free entitlement and the bank guarantee could be invoked for recovery of dues for the defects in the work performed. Accordingly, the amount released based on bank guarantee with pending procedural formalities for approval of the work performed could not be taxed as income. This is because the income did not accrue when the funds were released as the release is based on bank guarantee and not on approval of performance appraisal.

There was no material change in the terms of contract, since both before and after the amendment of the agreement, the right to receive the amount was subject to the vital conditions of recoveries and adjustments against the amounts found due or defects in the work completed by the contractor. The right to receive the amount is also subject to certification by the engineer-in-charge that no liability was attached to the contractor. Therefore, the character of the amount received on furnishing of bank guarantee did not undergo any change. It still retained the character of retention money

High Court's Decision:

The High Court, therefore, held that the release of retention money against furnishing of bank guarantee was a receipt not chargeable to tax.

9. Is interest income on margin money deposited with bank for obtaining bank guarantee to carry on business, taxable as business income?

CIT v. K and Co. (2014) 364 ITR 93 (Del)

Facts of the case: The assessee running a lottery, deposited certain funds with a bank in order to obtain bank guarantee to be furnished to the State Government of Sikkim. Such guarantee enabled the assessee to carry on the business of printing lottery tickets and for conducting lotteries on behalf of the State Government of Sikkim. The funds which were held as margin money, earned some interest.

Issue: The issue under consideration is whether such interest income would be taxable under the head 'Profits and Gains from Business or Profession' or under the head 'Income from other sources'.

High Court's Observations: The High Court noted that the interest income from the deposits made by the assessee is inextricably linked to the business of the assessee and such income, therefore, cannot be treated as income under the head 'Income from other sources'. The margin money requirement was an essential element for obtaining the bank guarantee which was necessary for the contract between the State Government of Sikkim and the assessee. If the assessee had not furnished bank guarantee, it would not have got the contract for running the said lottery

High Court Decision: The High Court, accordingly, held that the interest income received on funds kept as margin money for obtaining the bank guarantee would be taxable under the head "Profits and gains of business or profession".

Income from Other Sources

10. Does repair and renovation expenses incurred by a company in respect of premises leased out by a shareholder having substantial interest in the company, be treated as deemed dividend?

CIT v. Vir Vikram Vaid (2014) 367 ITR 365 (Bom)

Facts of the case: The assessee holds more than 75% of equity shares in a company and is the executive director of the company. In his personal capacity, he is the owner of certain premises in which he was carrying on a proprietary business. Subsequently, the assessee ceased to carry on the business of proprietary concern and hence, let out the premises to the company. The company incurred ₹ 2.51 crores towards construction and improvement of factory premises, which it continued to use otherwise than as the owner of the premises. The Assessing Officer held that the amounts spent by the company towards repair and renovation is taxable as deemed dividend in the hands of the assessee. In the alternative, the said amount was to be treated as a perquisite taxable in the hands of the assessee.

Appellate Authorities' Views: The Commissioner (Appeals) noted the assessee's submission that he had leased out the said premises for a rent lower than the prevailing market rate with an understanding that all expenditure for its upkeep and maintenance would be spent by the company on account of the assessee having stopped business activities. According to the Commissioner (Appeals), the assessee failed to substantiate his claim. The Commissioner (Appeals) was of the view that all the conditions provided under section 2(22)(e) for deemed dividend were satisfied. On the other hand, the Tribunal concluded that the payment was neither a deemed dividend nor a perquisite chargeable to tax.

High Court's Observations: The challenge before the High Court by the Revenue was only with regard to applicability of section 2(22)(e) in this case. The High Court observed that no money had been paid by way of advance or loan to the shareholder who has substantial interest in the company. Further, the amount spent was towards repairs and renovation of the premises owned by the assessee but occupied by the company as lessee. There is no dispute that the company had taken on rent the aforesaid premises.

The High Court observed that the expenditure incurred by virtue of repairs and renovation on the premises cannot be brought within the definition of advance or loan given to the shareholder having substantial interest in the company, though he is the owner of the premises. It cannot be treated as payment by the company on behalf of the shareholder or for the individual benefit of such shareholder. If held in such manner, it is a mere assumption not tenable in law.

High Court's Decision: The High Court, accordingly, held that the repair and renovation expenses in respect of premises occupied by the company cannot be treated as deemed dividend in the hands of shareholder being the owner of the building.

Assessment of various entities

11. Where land inherited by three brothers is compulsorily acquired by the State Government, whether the resultant capital gain would be assessed in the status of "Association of Persons" (AOP) or in their individual status?

CIT v. Govindbhai Mamaiya (2014) 367 ITR 498 (SC)

Facts of the case: Three brothers inherited a property consequent to demise of their father. A part of this bequeathed land was acquired by the State Government and compensation was paid for it. On appeal, compensation was enhanced and the enhanced compensation was paid with interest.

Issue: The issue under consideration is regarding the status in which capital gain arising on transfer of property would be assessed. The assessees' offered income in their status as "individual" but the Revenue sought to tax the same in their status as "Association of Persons" (AOP).

High Court's Observations: The High Court found that the parties inherited the property and there was no material on record to suggest consensus *ad idem* between the brothers for formation of AOP. It referred to *CWT v. Chander Sen (1986) 161 ITR 370 (SC)* to hold that as per section 4 of the Hindu Succession Act, 1956, income from the asset inherited by a son from his father has to be assessed as income of the son individually. Further, as per section 8 of the Hindu Succession Act, 1956, the property of the father devolves on his son in his individual capacity and not as karta of HUF. Thus, it was held that the income is chargeable to tax in their individual status and not as AOP.

Supreme Court's Observations: The Supreme Court referred to its earlier decision in the case of *Meera & Co v. CIT (1997) 224 ITR 635* in which the earlier precedent in the case of *CIT v. Indira Balakrishna (1960) 39 ITR 546 (SC)* was followed. The Apex Court noted that "Association of Persons" means an association in which two or more persons join in a common purpose or common action.

The Supreme Court also referred to its judgment in *G. Murugesan & Bros. v. CIT (1973) 4 SCC 211*. In that case, it was held that an association of persons could be formed only when two or more persons voluntarily combined together for certain purposes.

In this case, the property in question came to the assessees' possession through inheritance i.e., by operation of law. It is not a case where any 'association of persons" was formed by volition of the parties. Further, even the income earned in the form of interest is not because of any business venture of the three assessees, but is the result of the act of the Government in compulsorily acquiring the said land. Thus, the basic test to be satisfied for making an assessment in the status of AOP is absent in this case.

Apex Court's Decision: The Apex Court, accordingly, held that the income from asset inherited by the legal heirs is taxable in their individual hands and not in the status of AOP.

Income-tax Authorities

12. Can the assessee's application, for adjustment of tax liability on income surrendered during search by sale of seized gold bars, be entertained, where assessment has not been completed?

Hemant Kumar Sindhi & Another v. CIT (2014) 364 ITR 555 (All)

Facts of the case: Consequent to a search in the premises of the assessee, some gold bars were seized from the locker. The assessee voluntarily disclosed some income during the course of search. The assessee filed an application for sale of the gold bars and adjustment of tax liability on undisclosed income out of the sale proceeds. This would obviate his liability to pay interest under sections 234B and 234C. The Assessing Officer dismissed the application on the reasoning that only when the assessment is completed and tax demand is crystallized, can recovery be initiated by the sale of gold bars. The assessee filed a writ contesting the dismissal of application by the Assessing Officer.

High Court's Observations: The High Court observed that section 132B(1)(i) uses the expression "the amount of any existing liability" and "the amount of the liability determined". The words "existing liability" postulates a liability that is crystallized by adjudication; Likewise, "a liability is determined" only on completion of the assessment. **Until the assessment is complete, it cannot be postulated that a liability has been crystallized.**

As per the first proviso to section 132B(1)(i), the assessee may make an application to the Assessing Officer for release of the assets seized. However, he has to explain the nature and source of acquisition of the asset to the satisfaction of the Assessing Officer. It is not the *ipse dixit* of the assessee but the satisfaction of the Assessing Officer on the basis of the explanation tendered by the assessee which is material.

High Court's Decision: The High Court, accordingly, held that the Assessing Officer was justified in his conclusion that it is only when the liability is determined on the completion of assessment that it would stand crystallized and in pursuance of which a demand can be raised and recovery can be initiated. Therefore, in the present case, the first proviso to section 132B(1)(i) would not be attracted. The High Court, thus, dismissed the writ petition.

Assessment Procedure

13. Can the Assessing Officer reassess the issues other than the issues in respect of which proceedings were initiated under section 147, when the original "reasons to believe" on the basis of which the notice was issued ceased to exist?

CIT v. Mehak Finvest P Ltd (2014) 367 ITR 769 (P&H)

Facts of the case: In the present case, reassessment proceedings were initiated against the assessee on the reason that various finance companies managed and controlled by certain persons were engaged in accommodation entries and the assessee-company was one among them. However, during the reassessment proceedings, the Assessing Officer noticed that fresh share application money amounting to ₹ 47 lakhs could not be explained by the assessee and hence invoked section 68 to bring to tax such sum. There was no addition on the basis of the original reason for which reassessment proceedings were initiated.

Issue: The issue under consideration is whether an addition can be made in reassessment when the original reasons on the basis of which notice for reassessment was issued did not survive.

Assessee's Contention vis-a-vis Revenue's Contention: The assessee contended that when the original reason prompting the initiation of reassessment proceedings did not survive, the question of making addition on some other fresh grounds was not possible. The basis of the assessee's contention was the Bombay High Court ruling in case of *CIT v. Jet Airways (I) Ltd (2011) 331 ITR 236 and Delhi High Court ruling in Ranbaxy Laboratories Ltd v. CIT (2011) 336 ITR 136*.

On the other hand, the Revenue placed reliance on the jurisdictional High Court decision in the case of *Majinder Singh Kang v. CIT (2012) 344 ITR 358* holding that reassessment can be made on the basis of additional grounds, even though the original reason forming the basis of issue of notice did not survive.

High Court's Observations: The High Court noted that *Explanation 3 to section 147* nowhere postulates or contemplates that the Assessing Officer cannot make any additions on any other ground unless some addition is made on the basis of the original ground for which reassessment proceeding was initiated. It cited the dismissal of special leave petition (SLP) against the High Court ruling in *Majinder Singh Kang's* case by the Supreme Court on 19.08.2011 as the binding precedent.

High Court's Decision: The High Court, accordingly, held that even though no addition is made on the original grounds which formed the basis of initiation of reassessment proceedings, the Assessing Officer is empowered to make additions on another ground for which reassessment notice might not have been issued but which came to his notice subsequently during the course of proceedings for reassessment.

Note : *A contrary view expressed by the Delhi High Court in Ranbaxy Laboratories Ltd.'s case has been reported in the October, 2014 edition of the publication "Select Cases in Direct and Indirect Tax Laws"*

Appeals and Revision

14. Should the four year time limit for rectification of order by the Tribunal under section 254(2) be reckoned from the date of its order or from the date of receipt of order by the assessee?

Peterplast Synthetics P Ltd v. Asstt. CIT (2014) 364 ITR 16 (Guj)

Facts of the case: The assessee, dissatisfied with the order of Commissioner (Appeals), preferred an appeal before the Appellate Tribunal, which dismissed the appeal vide order dated February 20, 2007. The said order was, however, received by the assessee only on November 19, 2008. The assessee, after receipt of the order, preferred a rectification application against the same on May 9, 2012. The said rectification application was dismissed by the Tribunal on the ground that it is barred by law of limitation as provided under section 254(2) as the time limit of 4 years has to be reckoned from the date of order passed by the Tribunal i.e., from February 20, 2007. The assessee, being aggrieved with the dismissal of rectification application by the Tribunal, preferred a writ before the High Court.

Issue: The issue under consideration before the High Court is regarding the date to be reckoned for computing the period of limitation of four years under section 254(2) - whether the date of the Tribunal's order or the actual date of receipt of order by the assessee?

High Court's Observations: The High Court referred to the Bombay High Court ruling in *Petlad Bulakhidas Mills Co Ltd v. Raj Singh (1959) 37 ITR 264,* in which it was observed that the expression 'order' means an order, of which the affected party has actual or constructive notice. The right to make an application for revision is given to an assessee against an order, and that right can only be effectively exercised if the party affected had knowledge, either actual or constructive, of that order.

In that case, the Bombay High Court had observed that if the 'order' means a unilateral arriving at a decision by the appellate authority without the person affected having any knowledge of that decision, then, undoubtedly, the limitation would begin to run from the date when the authority chooses to pass the order. In such a case, the appellate authority may make the order, put it in a drawer, forget about it and if a year has passed after it, the right of the assessee to go for revision would be barred. Such contention is entirely untenable.

In this case, the Gujarat High Court observed that the effective right to appeal against the order or to seek rectification of the order could be exercised only when the affected party gets to know of the order. Thus, the right of appeal could be exercised only when the party affected by such order has knowledge of the order and hence, the limitation would start only from that date.

High Court's Decision: Applying the rationale of the above Bombay High Court ruling pronounced in relation to an application for revision, to the issue on hand pertaining to the date of reckoning the period of limitation for rectification under section 254(2), the Gujarat High Court held that the period of limitation has to be reckoned from the date of receipt of order by the assessee and not from the date of order. Therefore, the Tribunal had erred in dismissing the rectification application on the ground that it was barred by limitation by computing the time limit from the date of order instead of from the date of receipt of order by the assessee.

Miscellaneous Provisions

15. Can the Assessing Officer *suo moto* assume jurisdiction to declare sale of property as void under section 281?

Dr. Manoj Kabra v. ITO (2014) 364 ITR 541 (All)

Facts of the case: The assessee acquired a property for ₹ 7 lakhs though the stamp duty was paid in accordance with the circle rate which was ₹ 12 lakhs. Pursuant to the sale deed, the assessee took possession of the property. Prior to the sale, the income tax assessment of vendor had been completed and a certain demand was raised against him in respect of the assessment year when the sale of the property was effected. The Assessing Officer issued a notice under section 281 to show cause as to why the sale deed executed in his favour (assessee-buyer) should not be treated as a void document. The assessee-buyer contended that he was a *bona fide* purchaser for adequate consideration and no notice of pendency of proceedings was to known him nor was it brought to his knowledge by the seller.

The assessee placed reliance on the decision of Supreme Court in the case of *TRO v. Gangadhar Vishwanath Ranade (Decd.) (1998) 234 ITR 188,* where it was held that section 281 of the Income-tax Act, 1961 is only a declaratory provision and not an adjudicatory provision entitling the income-tax authority to declare a document as a void document.

High Court's Observation: The High Court observed that the issue in this case was squarely covered by above Apex Court decision which held that the legislature had no intention to confer any exclusive power or jurisdiction upon the income-tax authority to decide any question arising under section 281. The Income-tax Act, 1961, does not prescribe any adjudicatory machinery for deciding any question which may arise under section 281. In order to declare a transfer as fraudulent under section 281, an appropriate proceeding in accordance with law was required to be taken under section 53 of the Transfer of Property Act, 1882. The Assessing Officer is required to file a suit for declaration to the effect that the transaction of transfer was void under section 281 of the Income-tax Act; but he himself cannot assume jurisdiction to declare the sale deed as void.

High Court's Decision: Applying the rationale of the Apex Court ruling, the High Court held that the Assessing Officer has no jurisdiction under section 281 to *suo moto* declare the sale as void.

Deduction, Collection and Recovery of Tax

16. Is payment made for use of passive infrastructure facility such as mobile towers subject to tax deduction under section 194C or section 194-I?

Indus Towers Ltd v. CIT (2014) 364 ITR 114 (Del)

Facts of the case: The assessee owned a network of telecom towers and infrastructure services which were let out to major telecom operators in the country. Under section 197, the assessee sought for lower tax deduction under section 194C for the financial year 2013-14 at 0.5% and whereas the Assessing Officer issued a certificate under section 197 for lower tax deduction at 2.5% under section 194-I. The assessee filed a writ before the Delhi High Court. The Court directed the assessee to prefer a revision petition before the Commissioner of Income-tax.

The Commissioner of Income-tax rejected the contention of the assessee for applying section 194C and upheld the order of the Assessing Officer applying section 194-I, on the ground that the mobile operators had the right to install the equipment on the tower owned by the assessee, which tantamounts to use of the land or telecommunication site and the tower owned by the assessee. The assessee once again preferred a writ before the High Court.

Assessee's Contentions: The assessee explained that its responsibility is to provide the entire passive infrastructure service with the aid of equipment belonging to it which is fully operated, controlled and managed by it. The customers do not have access, control or possession over the towers, sites or designated areas which are limited to rectification or maintenance of any defects in the equipments installed by them. The assessee, further, contended that its customers do not pay for any leasing rights but only for the services. Therefore, the provisions of section 194-I would not be attracted in this case.

High Court's Observations: The High Court observed that it was the intention of the parties to use the technical and specialized equipment maintained by the assessee. The infrastructure was given for the use of mobile operators. The towers were the neutral platform without which the mobile operators could not operate. Each mobile operator has to carryout this activity, by necessarily renting premises and installing the same equipment. The dominant intention was the use of equipment or plant or machinery and the use of premises was only incidental.

High Court's Decision: The High Court held that the submission of the assessee that the transaction is not "renting" is incorrect. Also, the Revenue's contention that the transaction is primarily "renting of land" is also incorrect. The underlying object of the arrangement was the use of machinery, plant or equipment i.e., the passive infrastructure and it is incidental that it was necessary to house the equipment in some premises. It directed that tax deduction be made at 2% as per section 194-I(a), the rate applicable for payment made for use of plant and machinery.

17. Is payment made to an overseas agent, who did not perform any service in India, liable for tax deduction at source?

DIT (International Taxation) v. Wizcraft International Entertainment (P) Ltd (2014) 364 ITR 227 (Bom)

Facts of the case: The assessee, an event management company, engaged the services of an agent to bring artistes to India. The assessee-company (i) paid commission to overseas agent; (ii) reimbursed the expenses in connection with the visit of the artistes in India; and (iii) paid fees to the artistes in India. The assessee-company deducted tax at source on the fees paid to the international artistes in India but did not deduct tax at source on the commission paid to the agent and on the reimbursement of expenses incurred in India by the artistes.

Assessing Officer's view *vis-à-vis* Commissioner (Appeals) view: The Assessing Officer contended that the payments made by the assessee including the payment made by way of commission to the agent and payment for reimbursement of expenses in connection with the visit of the artistes to India are liable for tax deduction at source. The Commissioner (Appeals) was of the view that expenses incurred and reimbursed do not constitute income derived by the artistes from their personal activities, so as to be taxable under Article 18 of the Double Taxation Avoidance Agreement between India and UK; and hence, the same is not liable for deduction of tax at source.

Issue: The issue under consideration before the High Court was with regard to deduction of tax on commission paid to overseas agent who never took part in the events organized in India and amount paid as reimbursement of expenses incurred on travelling of artistes.

High court's Observations: The High Court observed that the assessee has deducted tax on the payments made to artistes for the services rendered in India. In so far as reimbursement of expenses is concerned, it has been verified with supporting documents that it was towards their air travel on which no tax was required to be deducted. With regard to the payment of commission, the agent did not act as a performing artist or entertainer. He was concerned only with the services rendered outside India. Thus, the Tribunal had recorded the finding of fact that the income of the agent did not arise from the personal activities in the contracting status of an entertainer or artist. He only contacted the artistes and negotiated with them for performance in India in terms of the authority given by the assessee. Hence, the commission paid to the overseas agent was not liable to tax in India. Consequently, there was no obligation for deducting tax at source at the time of making payment to the overseas agent.

High Court's Decision: The High Court, therefore, affirmed the decision of the Tribunal and Commissioner (Appeals) holding that the service rendered by the agent was outside India and hence, was not chargeable to tax in India. Thus, the requirement for deducting tax at source under section 195 on such payment does not arise.

18. Can incentives given to stockists and distributors by a manufacturing company be treated as "commission" to attract –

(i) the provisions for tax deduction at source under section 194H; and

(ii) consequent disallowance under section 40(a)(ia) for failure to deduct tax at source?

CIT v. Intervet India P Ltd (2014) 364 ITR 238 (Bom)

Facts of the case: The assessee-company engaged in manufacture of biological vaccines and animal health care pharmaceutical products, sold the same either through consignment or commission agents or directly through distributors or stockists. During the relevant financial year, it introduced a sales promotion scheme to boost sales by way of product discounts and product campaign. It passed on the incentives to distributors through consignment agents by way of sales credit notes. The Assessing Officer held that as the assessee was paying the stockists/distributors for the services rendered by them for buying and selling goods, on the basis of quantum of sales effected, such payment has to be considered as commission, on which tax was deductible at source under section 194H. Consequently, disallowance under section 40(a)(ia) was attracted for failure to deduct tax at source.

High Court's Observations: The High Court observed that the assessee had undertaken sales promotion by way of product discount scheme under which it offered incentive to the stockists / distributors and dealers. **The relationship between the assessee and the distributors / stockists was that of principal to principal.** The products were firstly sold to distributors / stockists who in turn resold the goods in the market. No service was offered by the assessee to them except a discount under the product discount scheme/product campaign scheme to buy the assessee's product.

High Court's Decision: The High Court, accordingly, held that the stockists and distributors were not acting on behalf of the assessee and most of the credit was by way of goods on meeting the sales target which could not be said to be a commission within the meaning of the *Explanation (i)* to section 194H. Accordingly, the High Court affirmed the order of the Tribunal which held that such payment does not attract deduction of tax at source. Consequently, disallowance under section 40(a)(ia) would not be attracted.

PAPER – 8 : INDIRECT TAX LAWS

PART – III : QUESTIONS AND ANSWERS

QUESTIONS

Valuation of Excisable Goods

1. M/s. Fresh Bakery manufactures biscuits named as "Choconuts". Biscuits are notified under section 4A of the Central Excise Act, 1944 with an abatement of 30%. The following information has been furnished by M/s. Fresh Bakery with regard to clearances of packs of "Choconuts":

   (i) 2,500 packs having MRP ₹ 70 per pack were sold in retail packages, but buyer is charged for 2,400 packs only at ₹ 50 per pack (100 packs have been given free as quantity discount).

   (ii) 50 packs were given away as free samples, without any MRP on the pack.

   (iii) 400 packs manufactured on job work basis for Modern Bakers, another bakery company, were cleared after putting MRP of ₹ 70 each. Each such pack is sold by Modern Bakers at ₹ 60 to individual customers. Cost of raw material supplied by Modern Bakers is ₹ 12,000, job charges including profit of M/s. Fresh Bakery is ₹ 6,000, transportation charges of raw material to M/s. Fresh Bakery and biscuits to Modern Bakers is ₹ 2,000.

   (iv) 80 packs of biscuits having MRP ₹ 70 each were packed in a single package for protection and safety during transportation and cleared at ₹ 5000. 500 of such packages were cleared.

   Determine the central excise duty payable, if rate of duty is 12%, education cess is 2% and secondary and higher education cess is 1%.

   Note: Turnover of M/s. Fresh Bakery in the previous financial year is ₹ 450 lakh.

CENVAT credit

2. "The CENVAT credit of duties, other than National Calamity Contingent Duty (NCCD) can be used to pay NCCD."

   Examine the correctness of the statement with the help of a decided case law, if any.

Export Procedures under Central Excise

3. Soft Textile Mills manufactures M.M. Yarn by using duty paid inputs and clears the same for export on payment of duty. It wants to claim rebate of duty paid by it on inputs as well as of duty paid on finished goods under rule 18 of the Central Excise Rules, 2002.

   Rule 18 of the Central Excise Rules, 2002 provides that *"where any goods are exported, the Central Government may, by notification, grant rebate of duty paid on such excisable goods* ***OR*** *duty paid on materials used in the manufacture or processing of such goods*

and the rebate shall be subject to such conditions or limitations, if any, and fulfilment of such procedure, as may be specified in the notification."

Soft Textile Mills contends that it is eligible to claim the dual benefit i.e., rebate of duty on both inputs and finished products under rule 18 on account of following reasons:

(i) Word "or" used in rule 18 should be read as "and" as there is a combined Form ARE-2 for claiming the rebate on the manufactured goods as well as rebate on materials used in the manufacture or processing of such goods.

(iii) Since whole of the duty paid on manufactured goods is exempted under rule 19 of the Central Excise Rules, 2002, the assessee opting for rule 18 cannot be put at a disadvantageous situation in the matter of claiming such rebate.

You are required to examine the contention of the Soft Textile Mills with the help of a decided case law, if any.

Pre-deposit under Central Excise

4. An order has been issued to M/s. Shankar & Sons in which the Joint Commissioner of Central Excise has confirmed a duty demand of ₹ 12,50,000 and imposed a penalty of equal amount under section 11AC of the Central Excise Act, 1944 plus a penalty of ₹ 1,50,000 under rule 26 of Central Excise Rules, 2002.

M/s Shankar & Sons intends to file an appeal with the Commissioner (Appeals) against the said adjudication order. Compute the quantum of pre-deposit required to be made by M/s. Shankar & Sons for filing the appeal with the Commissioner (Appeals).

In the above case, what would be the quantum of pre-deposit, if the adjudication order imposed only the penalties under section 11AC of the Central Excise Act, 1944 and rule 26 of Central Excise Rules, 2002 (no duty is demanded)?

Answer with reference to the position of law as amended by Finance (No. 2) Act, 2014.

SSI Exemption

5. Saatvik Pvt. Ltd., which is engaged in the manufacture of excisable goods, started its business in July, 2014. The following details are provided by Saatvik Pvt. Ltd. for finished product manufactured by it:

Particulars	(₹)
9,000 kg of input 'A' purchased @ ₹ 497.75 per kg (inclusive of central excise duty @ 12.36%)	44,79,750
13,500 kg of input 'B' purchased @ ₹ 995.50 per kg (inclusive of central excise duty @ 12.36%)	1,34,39,250
Capital goods purchased on 02.08.2014 (inclusive of excise duty at 12.36%)	45,10,000
Finished goods sold at uniform transaction value (exclusive of excise duty) throughout the year	3,00,00,000

Calculate the total amount of excise duty payable by Saatvik Pvt. Ltd. in cash, if any, during the year 2014-15. Rate of duty on finished goods may be taken at 12.36%. There is neither any processing loss nor any closing inventory of inputs and output.

Note: Saatvik Ltd. avails all the exemptions, whichever are applicable in its case.

Basic Concepts of Service Tax

6. "Services provided by a person to another are taxable under service tax law."

Is there any exception(s) to this general rule whereby services provided by a person to oneself are taxable? Discuss by giving example.

Basic Concepts of Service Tax

7. 'Z' has entered into an agreement with XY Ltd. for running a canteen in XY Ltd.'s premises for its employees. XY Ltd. has provided the place on rent and reimburses certain expenses for maintenance and running the canteen.

'Z' charges cash from individual customers for food, eatables and beverages supplied according to rates stipulated in the menu card. 'Z' is of the view that since it is not providing any service to XY Ltd. but only selling goods in its canteen to individual customers, it is not liable to pay any service tax. Furthermore, since it is paying VAT on the sale of food and beverages, there should not be any service tax liability on the activity undertaken by him.

Examine the situation and discuss if 'Z' is liable to pay service tax with the help of a decided case law, if any.

Negative List of Services

8. "Collection charges or service charges paid to any toll collecting agency are not liable to service tax."

Explain the validity of the statement with reference to the provisions of Finance Act, 1994.

Place of Provision of Service

9. With reference to the position of service tax law as applicable on or after 01.10.2014, what would be the place of provision of service in the following independent cases?

(i) PQ Trade Links of Hyderabad are appointed as commission agent by a foreign company for sale of its goods to Indian customers. In lieu of their services, PQ Trade Links receive a fixed percentage of commission from the concerned foreign company.

(ii) ST Fabricators of Mysore has temporarily imported certain goods from its customer located in Egypt for repairs. The said goods have been re-exported to Egypt after carrying out the necessary repairs without being put to any use in Mysore.

Valuation of Taxable Service

10. SNSP Pvt. Ltd. furnishes the following information pertaining to various services provided by it and the considerations received therefor:

Particulars	(₹)
Services provided to Municipal Corporation by way of repairs of a water tank	20,000
Services provided to a NGO by way of construction of a school for imparting education to poor students	7,00,000
Construction services provided to International Labour Organisation (ILO)	1,00,000
Construction of roads in a factory	4,00,000
Repair and maintenance of a Railway Station	1,00,000
Renovation of a historical monument located in Delhi specified under Ancient Monuments and Archaeological Sites and Remains Act, 1958	50,000
Renting of residential dwelling for use as residence	60,000
Services provided to Government by way of construction of residential complex meant for use of Government employees	2,00,000

Compute the value of taxable services and the service tax liability of SNSP Pvt. Ltd. The turnover of taxable services of SNSP Pvt. Ltd. in the preceding financial year was ₹ 9,50,000.

Note: Assume that no works contract service is involved in any of the services provided by SNSP Pvt. Ltd. Service tax has been charged separately, wherever applicable. SNSP Pvt. Ltd. avails all the exemptions, whichever are applicable in its case.

Exemptions and abatements

11. Triksha Pvt. Ltd. commenced its business on 15th October, 2014 in Delhi. It has provided following services upto 31st March, 2015. Determine its service tax liability for the Financial Year 2014-15:

S. No.	Particulars	(₹)
(i)	Services provided by way of plastering of walls (₹ 8,00,000 represents total amount charged for the works contract)	8,00,000
(ii)	Service provided in the execution of a works contract for construction of a new building (₹ 13,50,000 represents total amount charged for the works contract)	13,50,000
(iii)	Taxable services (not in the nature of works contract) provided under brand name of other person–not eligible for any abatement	4,00,000

Services provided at (i) and (ii) above are under the brand name owned by Triksha Pvt. Ltd. Triksha Pvt. Ltd. has paid ₹ 1,50,000 as excise duty on the inputs used by it for provision of services at (i) and (ii). ₹ 40,000 has been paid as excise duty on inputs used for provision of services at (iii).

Triksha Pvt. Ltd. cannot determine the value of taxable services provided by it in terms of rule 2A(i) of Service Tax (Determination of Value) Rules, 2006.

Note: Triksha Ltd. avails small service provider's exemption under Notification No. 33/2012 ST dated 20.06.2012.

12. Harbhajan Travels Pvt. Ltd., located in Gujarat, is engaged in providing services of renting of motorcab and discharges its service tax liability by availing abatement granted under *Notification No. 26/2012 ST dated 20.06.2012*. Amount charged for the services rendered by the company during the month of October, 2014 is ₹ 6,00,000. The invoices for such services have been issued by Harbhajan Travels Pvt. Ltd. in the month of October, 2014.

The company has sub-contracted a part of its services to Ramchandra Cabs Pvt. Ltd., which is also engaged in providing services of renting of motorcab. Ramchandra Cabs Pvt. Ltd. has raised an invoice for ₹ 1,12,360 dated 25.10.2014 (value of services is ₹ 1,00,000 and service tax payable thereon is ₹ 12,360) on Harbhajan Travels Pvt. Ltd. for the services sub-contracted to it during the month of October, 2014. Harbhajan Travels Pvt. Ltd. has received the invoice raised by Ramchandra Cabs Pvt. Ltd. on 25.10.2014.

Determine the net service tax liability of Harbhajan Travels Pvt. Ltd. (to be paid in cash) for the month of October, 2014.

Demand under Service Tax

13. Examine the correctness of the following statements with the help of the decided case laws, if any:

(i) Service tax can be collected, during a search operation, without an assessment order being passed by the concerned authority.

(ii) Extended period of limitation can be invoked for contravention of statutory provisions only if intent to evade service tax is proved.

Adjudication under Service Tax

14. "The time limit for completion of adjudication has not been prescribed under service tax law".

Discuss the veracity of the statement with reference to the provisions of service tax law as amended by Finance (No.2) Act, 2014.

Advance Ruling under Service Tax

15. Basant, a non-resident intends to provide a taxable service under a joint venture in collaboration with a non-resident, but has entertained some doubts about its valuation.

Aarohi, Basant's friend, has obtained an 'Advance Ruling' under Chapter VA of the Finance Act, 1994 from the Authority for Advance Rulings on an identical point. Basant proposes to follow the same ruling in his case. Basant has sought your advice as his consultant whether he could follow the ruling given in the case of Aarohi. Explain with reasons.

Valuation of Imported Goods

16. ABC Industries Ltd. imports an equipment by air. CIF price of the equipment is 6,000 US$, freight paid is 1,200 US$ and insurance cost is 1,800 US$. The banker realizes the payment from importer at the exchange rate of ₹ 61 per US$. Central Board of Excise and Customs notifies the exchange rate as ₹ 60 per US$ while rate of exchange notified by RBI is ₹ 62 per US$. ABC Industries Ltd. expends ₹ 56,000 in India for certain development activities with respect to the imported equipment.

    Basic customs duty is 10%, excise duty leviable on similar goods in India is 12% and education cesses are 3% on duty. Additional duty of customs leviable under section 3(5) of the Customs Tariff Act is exempt.

    You are required to:

    (i) compute the amount of total customs duty payable by ABC Industries Ltd.

    (ii) determine the amount of CENVAT credit available to ABC Industries Ltd. How can such CENVAT credit be utilised by ABC Industries Ltd.?

Appeals under Customs Law

17. "Powers of the Committee of Principal Commissioners/Commissioners and Committee of Principal Chief Commissioners/Chief Commissioners of Customs are one and the same".

    Discuss the correctness of the statement with reference to the provisions of customs law.

Provisions relating to Illegal Import under Customs Law

18. Mr. X is a dealer of smuggled goods. However, he himself does not import the goods. Duty has been demanded from Mr. X under sections 28 and 125(2) of the Customs Act, 1962 although no smuggled goods have been seized from him.

    Discuss, with the help of a decided case law, if any whether such demand of duty is valid in law.

Foreign Trade Policy

19. Tarun Pvt. Ltd., a manufacturer, wants to import capital goods in CKD condition from a foreign country and assemble the same in India. The import of the capital goods will be under Project Imports. The capital goods will be used for pre-production processes. The final products of Tarun Pvt. Ltd. would be supplied in SEZ. Tarun Pvt. Ltd. wishes to sell the capital goods imported by it as soon as the production process starts.

    Tarun Pvt. Ltd. seeks your advice whether it can avail the benefit of EPCG Scheme for

importing the intended capital goods.

Note: Assume that all other conditions required for being eligible to the EPCG Scheme are fulfilled in the above case.

20. With reference to the provisions of Foreign Trade Policy 2009-14, discuss, giving reasons, whether the following statements are true or false:

(i) If any doubt arises in respect of interpretation of any provision of FTP, the said doubt should be forwarded to CBEC. Decision of CBEC thereon would be final and binding.

(ii) Waste generated during manufacture in an SEZ Unit can be freely disposed in DTA on payment of applicable customs duty, without any authorization.

SUGGESTED ANSWERS

1. Computation of central excise duty payable by M/s. Fresh Bakery

Particulars	(₹)	(₹)
Retail sale price of 2,500 packs (2,500 × ₹ 70)	1,75,000	
Less: Abatement @ 30%	52,500	
Assessable value (A) [Note 1]		1,22,500
Retail sale price of 50 packs given as free samples (50 × ₹ 70)	3,500	
Less: Abatement @ 30%	1,050	
Assessable value (B) [Note 2]		2,450
Retail sale price of 400 packs manufactured on job work basis (400 × ₹ 70)	28,000	
Less: Abatement @ 30%	8,400	
Assessable value (C) [Note 3]		19,600
Retail sale price of 500 packages containing 80 packs each packed for safety in transportation (80 x ₹ 70 x 500)	28,00,000	
Less: Abatement @ 30%	8,40,000	
Assessable value (D) [Note 4]		19,60,000
Total assessable value (A) + (B) + (C) + (D)		21,04,550
Excise duty @ 12% of ₹ 21,04,550		2,52,546
Education Cess @ 2% of ₹ 2,52,546		5,050.92
Secondary and higher education cess @ 1% of ₹ 2,52,546		2,525.46
Total excise duty payable (rounded off)		**2,60,122**

Notes:

1. Provisions of section 4A of Central Excise Act, 1944 override the provisions of section 4 of the said Act. Therefore, assessable value will be retail sale price declared on the package less abatement irrespective of the quantity discounts offered to the buyer *[Indica Laboratories v. CCE (2007) 213 ELT 20 (CESTAT 3 Member Bench)].*
2. Free samples of the products covered under MRP based assessment are valued under rule 4 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 by taking into consideration the deemed value under section 4A *[Circular No. 915/05/2010-CX dated 19.02.2010].*
3. Provisions of section 4A override the provisions of section 4. Therefore, assessable value will be retail sale price declared on the package less abatement and not the value as determined under rule 10A of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 [viz. the price at which the principal manufacturer sells the goods].
4. Outer packaging for protection/safety during transportation is not wholesale package. Such packaging does not require details like name/address, cost, month year etc. *[State of Maharashtra v. Raj Marketing (2011) 272 ELT 8 (SC)]*. Therefore, valuation of such package will be done on the basis of section 4A i.e., RSP less abatement.
5. Since the turnover of M/s. Fresh Bakery in the previous financial year is ₹ 450 lakh, it will not be entitled to SSI exemption available under *Notification No. 8/2003 CE dated 01.03.2003* in the current year.

2. As per rule 3(1) of the CENVAT Credit Rules, 2004 [CCR], a manufacturer or producer of a final product is allowed to take CENVAT credit of National Calamity Contingent Duty (NCCD). Rule 3(4) of CCR provides that CENVAT credit may be utilized for payment of any duty of excise on any final product. Therefore, CENVAT credit of NCCD may also be utilized for payment of any duty of excise on any final product in terms of rule 3(4) subject to rule 3(7). Rule 3(7) of CCR limits the utilization of CENVAT credit in respect of NCCD as also other duties mentioned in rule 3(7)(b). Rule 3(7)(b) of CCR provides that CENVAT credit in respect of NCCD and other duties mentioned therein shall be utilized towards payment of duty of excise leviable under various statutes respectively.

However, the issue to be considered in the given problem is the opposite of the above inference i.e., whether CENVAT credit of duties, other than National Calamity Contingent Duty (NCCD), can be used to pay NCCD.

This issue has been dealt by the Guwahati High Court in the case of *CCEx. v. Prag Bosimi Synthetics Ltd. 2013 (295) ELT 682 (Gau.).* The High Court stressed upon the importance of the word "respectively" in rule 3(7)(b) as it confines the utilization of CENVAT credit obtained under a particular statute for payment of duty under that statute

only. The High Court, however, categorically added that the converse does not follow from the above discussion. The High Court, therefore, held that merely because CENVAT credit in respect of NCCD can be utilized only for payment of NCCD, it does not lead to the conclusion that credit of any other duty cannot be utilized for payment of NCCD.

Therefore, in view of the above-mentioned judgement, the given statement is correct.

3. The issue to be considered in the given problem is that whether rule 18 permits grant of rebate of duty paid on exported finished goods simultaneously with the rebate of duty paid on inputs.

This issue has been dealt by Rajasthan High Court in the case of *Rajasthan Textile Mills v. UOI 2013 (298) E.L.T. 183 (Raj.).* In the instant case, the High Court made the following significant observations:-

(i) The word "or" is interpreted as 'and' only when the literal interpretation of the word produces absurd results. However, in rule 18, if word "or" is taken to be disjunctive, no absurd result occurs, rather the intention manifested in rule 18 can be given full effect to, i.e. to give the benefit admissible on one of the item, either on finished goods or inputs used in the manufacture or processing of such goods.

(ii) Rule 19 provides benefit on the finished goods i.e., any excisable goods can be exported without payment of duty from the factory of producer. However, it does not provide for rebate of duty paid on the materials used in manufacture or processing of such goods. Thus, the intention of rule 19 is to provide benefit on finished goods and not on raw materials.

The procedures & stages in rules 18 and 19 are different. The word 'or' used in rule 18 cannot be interpreted as 'and' to provide benefit on both, with the aid of different provision of rule 19.

(iii) It is important to note that *Notification No. 19/2004 CE (NT) dated 06.09.2004* provides rebate of the whole of the duty paid on all "excisable goods" while *Notification No. 21/2004 CE (NT) dated 06.09.2004* provides the rebate of whole of the duty paid on 'materials' *i.e.* inputs used in the manufacture or processing of export goods. Issuance of two different notifications further makes it clear that both the benefits cannot be claimed simultaneously.

(iv) Merely because a combined Form ARE-2 can be used to claim both the benefits, i.e. the rebate on finished goods or on inputs used in manufacture of such goods, it cannot be inferred that the rebate is available on both i.e., finished goods as well as on the inputs.

Based on the above observations, the High Court held that rule 18 of the Central Excise Rules, 2002, allows rebate of duty paid either on excisable goods or on materials used in the manufacture or processing of such goods i.e., on raw material but not on both.

Applying the ratio of the above-mentioned decision to the given situation, it can be concluded that the contention of Soft Textile Mills of claiming rebate of duty paid by it on inputs as well as of duty paid on finished goods, under rule 18 of the Central Excise Rules, 2002, is not valid in law.

4. With effect from 06.08.2014, section 35F of Central Excise Act, 1944 has been substituted with a new section to provide, *inter alia*, that an appeal cannot be filed with the Commissioner (Appeals) unless the appellant has deposited 7.5% of the duty, in case where duty or duty and penalty are in dispute, or penalty, where such penalty is in dispute, in pursuance of a decision or an order passed by an officer of Central Excise lower in rank than the Commissioner of Central Excise. The amount of such pre-deposit, however, will not exceed ₹ 10 crores.

Therefore, in the given case, though both duty and penalty are in dispute, quantum of pre-deposit will be 7.5% of only the disputed duty amount i.e., 7.5% of ₹ 12,50,000 which is ₹ 93,750.

If the adjudication order imposed only the penalties under section 11AC of the Central Excise Act, 1944 and rule 26 of Central Excise Rules, 2002 (no duty is demanded), then as per section 35F of Central Excise Act, 1944, 7.5% of the penalty has to be paid as pre-deposit where such penalty only is in dispute for filing an appeal with the Commissioner (Appeals). Further, *Circular No. 984/08/2014 CX dated 16.09.2014* issued by CBEC has clarified that where penalty alone is in dispute and penalties have been imposed under different provisions of the Act, pre-deposit would be calculated based on the aggregate of all penalties imposed in the order sought to be appealed against.

Thus, in the given case, quantum of pre-deposit will be 7.5% of ₹ 14,00,000 [₹ 12,50,000 under section 11AC plus ₹ 1,50,000 under rule 26] which is ₹ 1,05,000.

5. **Computation of excise duty payable by Saatvik Pvt. Ltd.**

Particulars	**(₹)**	**(₹)**
Finished goods sold during the year		3,00,00,000
Less: Exemption of ₹ 150 lakh available under *Notification No. 8/2003 CE dated 01.03.2003* [Note 1]		1,50,00,000
Dutiable clearances		1,50,00,000
Excise duty payable @ 12.36% (₹ 1,50,00,000 × 12.36%)		18,54,000
Less: CENVAT credit available on inputs [Note 2]		
Proportion of inputs consumed in dutiable clearances - (1,50,00,000/3,00,00,000) = 0.5		
Total value of input 'A' and input 'B' inclusive of excise duty ₹ 1,79,19,000 (₹ 44,79,750 + ₹ 1,34,39,250)		

Excise duty paid on inputs consumed in dutiable clearances = [(₹ 1,79,19,000 x 12.36/112.36) x 0.5]	9,85,577	
Less: CENVAT credit available on capital goods [Note 3] [₹ 45,10,000 x 12.36/112.36]	4,96,116	14,81,693
Excise duty payable in cash		**3,72,307**

Notes:

1. Clearances of excisable goods up to the aggregate value of ₹ 1.5 crore are exempt from excise duty in any financial year if the turnover of the unit does not exceed ₹ 4 crores in previous year. Since Saatvik Ltd. has started the manufacture of excisable goods in the financial year 2014-15, it will be eligible for SSI exemption as the aggregate value of clearances in the preceding financial year 2013-14 is 'Nil' (less than ₹ 4 crore) *[Notification No. 8/2003 CE dated 01.03.2003].*
2. In respect of units availing SSI exemption, no CENVAT credit is available on inputs consumed in exempt clearances of ₹ 150 lakh *[Notification No. 8/2003 CE dated 01.03.2003]*.
3. In respect of units availing SSI exemption, CENVAT credit on capital goods can be availed but utilized only after clearances of ₹ 150 lakh *[Notification No. 8/2003 CE dated 01.03.2003]*. Further, as per third proviso to rule 4(2)(a) of CENVAT Credit, Rules, 2004, entire credit on capital goods can be taken in the same financial year by such units.
4. Since there is neither any processing loss nor closing inventory of inputs and output, it implies that all goods manufactured have been sold and entire quantity of both the inputs has been used in manufacturing these goods.

6. Section 65B(44) of the Finance Act, 1994 defines service, *inter alia,* as any activity for consideration carried out by a person for another. However, two exceptions have been carved out in this general rule. These exceptions, contained in Explanation 3 to section 65B(44) are:

(i) an establishment of a person located in taxable territory and another establishment of such person located in non-taxable territory are treated as establishments of distinct persons.

(ii) an unincorporated association or body of persons and members thereof are also treated as distinct persons.

The implications of these deeming provisions are that *inter-se* provision of services between such persons, deemed to be separate persons, would be taxable. For example, services provided by a club to its members and services provided by the branch office of a multinational company to its headquarters located outside India would be taxable provided other conditions relating to taxability of service are satisfied.

7. Z is liable to pay service tax in the given case. Section 66E(i) of the Finance Act, 1994 provides that service portion in an activity wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as part of the activity, is a declared service and is liable to service tax. Since the activity undertaken by 'Z' involves supply of food, eatables and beverages, the same would fall in the category of declared service as defined under section 66E(i) and would be thus, liable to service tax.

Further, the Allahabad High Court in the case of *Indian Coffee Workers' Co-operative Society Limited v. CCE & ST 2014 (34) STR 546 (All.)* - which involved similar facts - held that the assessee (running the canteen in the premises of a company) was an outdoor caterer because services provided as a caterer were at place other than his own. The High Court clarified that taxability or the charge of tax does not depend on whether and to what extent the person engaging the service consumes the edibles and beverages supplied, wholly or in part. What is material is whether the service of an outdoor caterer is provided to another person.

Further the High Court elaborated that the charge of tax in the cases of VAT is distinct from the charge of tax for service tax. The charge of service tax is not on the sale of goods but on the taxable service provided. Hence, the fact that the assessee had paid VAT on the supply of food and beverages to those who consume them at the canteen, would not exclude the liability of the assessee for the payment of service tax in respect of the taxable service provided by the assessee as an outdoor caterer. Based on the observation made above, the High Court held that the assessee was liable for the payment of service tax as an outdoor caterer.

8. The said statement is not valid. Access to a road or a bridge on payment of toll charges only is covered in the negative list of services under section 66D(h) of Finance Act, 1994. Services of toll collection on behalf of an agency authorized to levy toll are in the nature of services used for providing the negative list of services. Thus, collection charges or service charges paid to any toll collecting agency are liable to service tax.

Further as per the principle laid down in section 66F(1) of the Finance Act, 1994, the reference to a service by nature or description in the Act will not include reference to a service used for providing such service.

9. **(i)** As per rule 9(c) of Place of Provision of Services Rules, 2012 (POPS Rules), place of provision of intermediary services is the location of service provider.

With effect from 01.10.2014, definition of term "intermediary" as provided under rule 2(f) of POPS Rules has been substituted to include the intermediary of goods in its scope. The substituted definition provides that "intermediary" means a broker, an agent or any other person, by whatever name called, who arranges or facilitates a provision of a service (hereinafter called the main 'service) or **a supply of goods,** between two or more persons, but does not include a person who provides the main service or supplies the goods on his account.

Accordingly, commission agent of goods will be covered under rule 9(c) of POPS Rules. Thus, the place of provision of services provided or agreed to be provided by PQ Trade Links (as commission agent of goods) to foreign company will be the location of service provider i.e., Hyderabad.

(ii) Rule 4(a) of POPS Rules provides that the place of provision of services provided in respect of goods that are required to be made physically available by the recipient of service to the provider of service in order to provide the service, is the location where the services are actually performed.

However, with effect from 01.10.2014, second proviso to rule 4(a) has been substituted to lay down that clause (a) of rule 4 will not apply in the case of a service provided in respect of goods that are temporarily imported into India for repairs and are exported after the repairs without being put to any use in the taxable territory, other than that which is required for such repair. Consequently, such a case will be covered under rule 3 of POPS Rules (general rule) and the place of provision of service will be the location of service receiver.

In the given case, goods have been temporarily imported by ST Fabricators and have been re-exported after the repairs without being put to any use in Mysore (taxable territory). Therefore, place of provision of repair services carried out by ST Fabricators will be determined by rule 3 of POPS Rules. Consequently, the place of provision of service will be the location of service receiver i.e. Egypt.

10. Computation of value of taxable service and service tax liability of SNSP Pvt. Ltd.

Particulars	**(₹)**
Services provided to Municipal Corporation by way of repairs of a water tank [Note-1(a)]	Nil
Services provided to a NGO by way of construction of a school for imparting education to poor students [Note-1(b)]	7,00,000
Construction services provided to International Labour Organisation [Note-1(c)])	Nil
Construction of roads in a factory [Note-1(d)]	4,00,000
Repair and maintenance of a Railway Station [Note-1(e)]	1,00,000
Renovation of specified historical monument located in Delhi [Note-1(f)]	Nil
Renting of residential dwelling for use as residence [Note 2]	Nil
Services provided to Government by way of construction of residential complex meant for use of Government employees [Note 1(g)]	Nil

Total value of taxable service	12,00,000
Less: SSP Exemption under *Notification No. 33/2012 ST dated 20.06.2012* [Note 3]	10,00,000
Value of taxable services	2,00,000
Service tax @ 12% [₹ 2,00,000 × 12%]	24,000
Education cess @ 2% [₹ 24,000 × 2%]	480
Secondary and higher education cess @ 1% [₹ 24,000 × 1%]	240
Service tax liability	**24,720**

Notes:

1. Following services are exempt from service tax vide Mega Exemption *Notification No. 25/2012 ST dated 20.06.2012*:-

   (a) Services provided to, *inter alia,* local authority by way of *inter alia* repairs of a civil structure or any other original works meant predominantly for use other than for commerce, industry or any other business or profession – Since water tank is a civil structure which is used for purposes other than for commerce, industry or any other business or profession, services provided to Municipal Corporation (local authority) for repairs thereof would be exempt.

   (b) Construction of educational institutes for the Government, a local authority or a Governmental authority - Since in the given case, construction services are provided to a NGO and not to any Government, local authority or governmental authority, the same would be liable to service tax.

   (c) Any services provided to the specified international organizations – Since ILO is a specified international organization, all services provided to it would be exempt from service tax.

   (d) Services provided by way of construction of roads for use by general public – Since, in the given case, construction of roads is not for use by general public but for the limited purpose of a factory, the same would be taxable.

   (e) Services by way of construction, erection, or installation of original works pertaining to railway – Since in the given case, repair and maintenance is carried out for the railway station and not any original works, the same would be liable to service tax.

   (f) Renovation of a historical monument only if specified under Ancient Monuments and Archaeological Sites and Remains Act, 1958 – Since, historical monument in the given case is specified under said Act, renovation of same is exempt from service tax.

(g) Services provided to, *inter alia,* Government by way of, *inter alia,* construction of residential complex predominantly meant for self use or use of their employees or other persons specified in the Explanation 1 to section 65B(44) of Finance Act, 1994 – Since in the given case, services are provided to Government by way of construction of residential complex meant for use of their employees, the same will be exempt from service tax.

2. Services by way of renting of residential dwelling for use as residence are included in the negative list and hence, are not taxable.

3. Small service provider exemption is available in the current year as turnover of taxable services provided in the preceding financial year is less than ₹ 10 lakh *[Notification No. 33/2012 ST dated 20.06.2012].*

11. Computation of service tax liability of Triksha Pvt. Ltd. for the Financial Year 2014-15

Particulars	(₹)
Services provided under the brand name owned by Triksha Pvt. Ltd.	
Services provided by way of plastering of walls [Note 1]	5,60,000
Services provided in the execution of works contract for construction of a new building [Note 2]	5,40,000
Total value of taxable services	11,00,000
Less: Exemption for small service providers	10,00,000
Value of taxable services liable to service tax	1,00,000
Service tax payable @ 12.36% (including 3% education cesses) [₹ 1,00,000 × 12.36%] (A) [Note 3]	12,360
Services provided under the brand name of other person	
Value of taxable services provided under brand name of other person	4,00,000
Service tax payable @ 12.36% (including 3% education cesses) [₹ 4,00,000 × 12.36%] [Note 4]	49,440
Less: CENVAT credit of excise duty paid on inputs used for provision of services [Note 5]	40,000
Service tax payable in cash in respect of services provided under brand name of other person (B)	9,440
Total service tax liability (A) + (B)	21,800

Notes:

1. With effect from 01.10.2014, rule 2A(ii)(B)(ii) of the Service Tax (Determination of Value) Rules, 2006 provides that in case of works contracts entered into maintenance or repair or completion and finishing services such as glazing or plastering or floor and wall tiling or installation of electrical fittings of immovable

property, service tax shall be payable on 70% of the total amount charged for the works contract. Therefore, for plastering of walls, the value of service portion would be ₹ 5,60,000 [70% x ₹ 8,00,000].

2. As per Explanation 1(a)(i) to rule 2A(ii) of the Service Tax (Determination of Value) Rules, 2006, original works *inter alia* means all new constructions. Further, as per rule 2A(ii)(A), in case of works contracts entered into for execution of original works, service tax is payable on 40% of the total amount charged for the works contract. Therefore, for construction of new building, the value of service portion would be ₹ 5,40,000 [40% x ₹ 13,50,000].

3. As per Explanation 2 to rule 2A(ii) of Service Tax (Determination of Value) Rules, 2006, the provider of taxable service cannot take CENVAT credit of duties paid on any inputs, used in or in relation to the works contract, under the provisions of CENVAT Credit Rules, 2004. Hence, excise duty of ₹ 1,50,000 paid on inputs used for provision of works contract service under rule 2A(ii) of the said rules cannot be availed.

4. Exemption for small service providers is not available in respect of taxable services provided under a brand name of another person *[Notification No. 33/2012 ST dated 20.06.2012]*.

5. Since the services provided under brand name of other person are not in the nature of works contracts, CENVAT credit of excise duty paid on inputs used for provision of such services can be availed.

   Also, since SSP exemption is not available in respect of such services, there would not be any restriction for availment of CENVAT credit on inputs used in provision for such service *[Notification No. 33/2012 ST dated 20.06.2012]*.

12. Computation of net service tax liability (to be paid in cash) of Harbhajan Travels Pvt. Ltd. for October, 2014

Particulars	**(₹)**
Amount charged for the services	6,00,000
Value of taxable service @ 40% of the amount charged for the service [Note 1]	2,40,000
Service tax @ 12.36%	29,664
Less: CENVAT credit [Note 2]	4,944
Net service tax liability to be paid in cash	**24,720**

Notes:

1. *Notification No. 26/2012 ST* provides that value of taxable services in respect of services of renting of motor cabs is 40% of the amount charged by the service

provider. In other words, an abatement of 60% of the amount charged is available in respect of services of renting of motorcab.

2. With effect from 01.10.2014, *Notification No. 26/2012 ST* has been amended to provide that up to 40% CENVAT credit of input service of renting of a motorcab provided by a sub-contractor to the main contractor (providing service of renting of motorcab) could be availed by the main contractor if the sub-contractor is paying service tax on full value i.e., no abatement is being availed by sub-contractor. This credit will be available even if the main contractor pays the service tax on abated value.

   Since Ramchandra Cabs Pvt. Ltd. has paid service tax on full value (₹ 1,00,000 x 12.36% = ₹ 12,360), Harbhajan Travels Pvt. Ltd. can avail credit upto ₹ 4,944 (40% of ₹ 12,360).

3. Since Harbhajan Travels Pvt. Ltd. is a company, reverse charge provisions will not apply in its case. Further, provisions of partial reverse charge will not apply in case of Ramchandra Cabs Pvt. Ltd. also, as in its case services are provided in similar line of business.

13. (i) The statement is not correct. Madras High Court in the case of *Chitra Builders Private Ltd. v. Addl. Commr. of CCEx. & ST 2013 (31) STR 515 (Mad.)* has held that it is a well settled position in law that no tax can be collected from the assessee, without an appropriate assessment order being passed by the authority concerned and without following the procedures established by law.

(ii) The statement is correct. As per proviso to section 73(1), extended period of limitation can be invoked if the service tax has not been levied or paid or has been short-levied or short-paid or erroneously refunded by reason of fraud or collusion or wilful mis-statement or suppression of facts or contravention of any of the provision of Chapter V or of rules made thereunder with an intent to evade the payment of service tax.

The Calcutta High Court in the case of *Infinity Infotech Parks Ltd. v. UOI 2013 (31) STR 653 (Gau.)* has held that mere contravention of provision of Chapter V or rules framed thereunder does not enable the service tax authorities to invoke the extended period of limitation. The contravention necessarily has to be with the intent to evade payment of service tax.

14. The statement is not correct with reference to the service tax law as amended by Finance (No.2) Act, 2014. Prior to the amendment made by Finance (No.2) Act, 2014, unlike central excise law, no time limits for completion of adjudication had been prescribed under section 73 of the Finance Act, 1994. However, with effect from 06.08.2014, Finance (No. 2) Act, 2014 has brought service tax law at par with the central excise law by inserting a new sub-section (4B) in section 73 of the Finance Act, 1994.

As per section 73(4B), the Central Excise Officer, where it is possible to do so, should determine the amount of service tax due within the following time limits from the date of notice:

Cases whose limitation is specified as 18 months in section 73(1) [i.e., cases not involving fraud, collusion, suppression of facts etc.)	6 months
Cases falling under the proviso to section 73(1) [i.e, cases involving fraud, collusion, suppression of facts etc.] or the proviso to section 73(4A) [cases where demand has arisen out of audit/investigation etc.)	1 year

15. According to section 96E of the Finance Act, 1994, an advance ruling is binding only on the applicant who has sought it.

In the given problem, in view of the aforesaid provision, Basant cannot make use of the advance ruling pronounced in the identical case of his friend, Aarohi. Basant should obtain a ruling from the Authority of Advance Ruling by making an application under section 96C along with a fee of ₹ 2,500.

16. Computation of customs duty payable by ABC Industries Ltd.

Particulars	**Amount**
CIF value	6,000 US $
Less: Freight	1,200 US $
Less: Insurance	1,800 US $
FOB value	3,000 US $
Assessable value for customs purpose:	
FOB value	3,000 US $
Add: Freight (20% of FOB value) [Note 1]	600 US $
Add: Insurance (actual)	1,800 US $
CIF for customs purpose	5,400 US $
Add: 1% for landing charges [Note 2]	54 US$
Value for customs purpose	5,454 US $
Exchange rate as per CBEC [Note 3]	₹ 60 per US $
Assessable value = ₹ 60 x 5,454 US $	₹ 3,27,240
Basic customs duty @ 10%	₹ 32,724
Sub-total	₹ 3,59,964
Additional duty of customs u/s 3(1) of the Customs Tariff Act (CVD) @ 12% of ₹ 3,59,964 (rounded off) [Note 5]	₹ 43,196

[Education cess on CVD is exempt]	
Education cesses 3% on [₹ 32,724 + ₹ 43,196] (rounded off)	₹ 2,278
Total customs duty payable [₹ 32,724 + ₹ 43,196 + ₹ 2,278]	₹ 78,198

Notes:

1. If the goods are imported by air, the freight cannot exceed 20% of FOB price [Second proviso to rule 10(2) of the Customs (Determination of Value of Imported Goods) Rules, 2007].
2. Even if there is no information regarding landing charges, still they are charged @ 1% of CIF value [Clause (ii) of first proviso to rule 10(2) of the Customs (Determination of Value of Imported Goods) Rules, 2007].
3. Rate of exchange determined by CBEC is considered [Clause (a) of the explanation to section 14 of the Customs Act, 1962].
4. Rule 10(1)(b)(iv) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 *inter alia* provides that value of development work undertaken elsewhere than in India is includible in the value of the imported goods. Thus, development charges of ₹ 56,000 paid for work done in India have not been included for the purposes of arriving at the assessable value.
5. Since excise duty rate on smiliar goods is 12%, CVD will be levied @ 12%.

₹ 43,196 paid as additional duty of customs under section 3(1) of Customs Tariff Act, 1975 will be available as CENVAT credit and can be utilised for payment of excise duty or service tax as per the CENVAT Credit Rules, 2004. Basic customs duty of ₹ 32,724 and education cesses of ₹ 2,278 paid on imported goods will not be available as CENVAT credit.

17. The said statement is not correct. Powers of the Committee of Principal Commissioners/Commissioners of Customs and Committee of Principal Chief Commissioners/Chief Commissioners of Customs are not one and the same.

As per section 129A(2) of the Customs Act, 1962, the Committee of Principal Commissioner/Commissioners of Customs may direct the proper officer to file an appeal on its behalf to the Appellate Tribunal against the order of Commissioner (Appeals), if it is of the opinion that the order is not legal or proper.

As per section 129D(1) of the Customs Act, 1962, the Committee of Principal Chief Commissioners/Chief Commissioners of Customs may, of its own motion, call for and examine the record of any proceedings in which a Principal Commissioner of Customs or Commissioner of Customs has passed any decision or order for the purpose of satisfying itself as to the legality or propriety of any such decision or order. Thereafter, the Committee of Principal Chief Commissioners/Chief Commissioners of Customs may, by order, direct such Principal Commissioner/Commissioner or any other Principal

Commissioner/Commissioner to apply to the Appellate Tribunal for the determination of such points arising out of the decision or order as may be specified by the Committee of Principal Chief Commissioner/Chief Commissioners of Customs in its order.

The differences in two cases mentioned above can be tabulated as under:

Committee of Principal Commissioners/ Commissioners of Customs	**Committee of Principal Chief Commissioners/ Chief Commissioners of Customs**
Can direct to file an appeal against order of Commissioner (Appeals) who passes order in appeals filed against orders passed by any officer lower in rank than Principal Commissioner/Commissioner of Customs.	Can direct to file a review petition against order of Principal Commissioner/ Commissioner of Customs who passes order as an adjudicating authority.
Regular appeal filed with the Tribunal.	Review application filed with the Tribunal. [Review application treated as appeal filed against the order of the adjudicating authority - section 129D(4) of the Customs Act, 1962.]
Appeal to be filed within three months as specified in section 129A(3) of the Customs Act, 1962.	Review application can be filed within four months; three months for the Committee to issue order for review [delay in filing upto 30 days can be condoned by the Board] and further one month to the Principal Commissioner/ Commissioner to file an application.

18. The issue involved in the given case is whether customs duty can be demanded under section 28 and/or section 125(2) of the Customs Act, 1962 from a person dealing in smuggled goods when no such goods are seized from him. Recently, the Karnataka High Court addressed this issue in the case of *CCus. v. Dinesh Chhajer 2014 (300) ELT 498 (Kar.).* In the instant case, the High Court made the following significant observations:-

(i) Section 28 applies to a case where the goods are imported by an importer and the duty is not paid in accordance with law, for which a notice of demand is issued on the person. In case of notice demanding duty under section 125(2), firstly the goods should have been confiscated and the duty demandable is in addition to the fine payable under section 125(1) in respect of confiscated goods. Thus, notices issued under sections 28 and 125(2) are not identical and fall into completely different areas.

(ii) The material on record disclosed that the assessee did not import the goods but was only a dealer of the smuggled goods. Therefore, there was no obligation cast on him under the Act to pay duty. Thus, the notice issued under section 28 of the Act to the assessee is unsustainable as he is not the person who is chargeable to duty under the Act.

(ii) Since no goods were seized, there could not be any confiscation and in the absence of a confiscation, question of payment of duty by the person who is the owner of the goods or from whose possession the goods are seized, does not arise.

Based on the above observations, the High Court held that no duty is leviable against the assessee as he is neither the importer of the goods nor was in possession of any goods.

In the given case, Mr. X is only a dealer of smuggled goods; he is not the importer of these goods and also no such goods have been seized from him. Therefore, applying the ratio of the above mentioned decision to the given situation, it can be concluded that customs duty under section 28 and/or section 125(2) of the Customs Act, 1962 cannot be demanded from Mr. X.

19. Export Promotion Capital Goods Scheme (EPCG) permits exporters to procure capital goods at concessional rate of customs duty/zero customs duty. In return, exporter is under an obligation to fulfill the export obligation. Export obligation means obligation to export product(s) covered by Authorisation/permission in terms of quantity or value or both, as may be prescribed/specified by Regional or competent authority. Exports to SEZ unit/developer/co-developer will be considered for discharge of export obligation of EPCG Authorisation, irrespective of currency.

The license holder can either procure the capital goods (whether used for pre-production, production or post-production) from global market or domestic market. The capital goods can also be imported in CKD/ SKD to be assembled in India.

An EPCG Authorization can also be issued for import of capital goods under Scheme for Project Imports'. Export obligation for such EPCG Authorizations would be 6 times of duty saved. Duty saved would be difference between the effective duty under Project Imports and concessional duty under the EPCG scheme.

However, import of capital goods is subject to 'Actual User' condition till export obligation is completed.

Therefore, based on the above discussion, Tarun Pvt. Ltd. can import the capital goods under EPCG Scheme. However, it has to make sure that it does not sell the capital goods till the export obligation is completed.

20. (i) False. If any question or doubt arises in respect of interpretation of any provision of the FTP, said question or doubt ought to be referred to DGFT whose decision thereon would be final and binding.

(ii) **True.** Any waste or scrap or remnant including any form of metallic waste & scrap generated during manufacturing or processing activities of an SEZ Unit/ Developer/ Co-developer are allowed to be disposed in DTA freely, without any authorization, subject to payment of applicable customs duty.

Applicability of Legislative Amendments/Circulars etc. for May, 2015 – Final Examination

Paper 7 : Direct Tax Laws & Paper 8 : Indirect Tax Laws

Applicability of the Finance Act, Assessment Year etc. for May, 2015 Examination

The provisions of direct and indirect tax laws, as amended by the Finance (No.2) Act, 2014, including notifications and circulars issued up to 31st October, 2014. The applicable assessment year for Direct Tax Laws is A.Y.2015-16.

Part I : Statutory Update – Indirect Tax Laws

Significant Notifications and Circulars issued between 1st May, 2014 and 31st October, 2014

Study Material for Indirect Tax Laws [November, 2014 edition] contains all the relevant amendments made by the Finance (No.2) Act, 2014 and circulars/notifications issued up to 30.04.2014 as also the budget notifications. However, for students appearing in May, 2015 examination, amendments made by notifications, circulars and other legislations made between 01.05.2014 and 31.10.2014 are also relevant. Such amendments are given hereunder:-

A. CENTRAL EXCISE

I. AMENDMENTS IN THE CENVAT CREDIT RULES, 2004

1. Provider of taxable service now included in Rule 12AAA

Rule 12AAA empowers the Central Government to provide for certain measures to prevent the misuse of the provisions of CENVAT credit including restrictions and to specify, by a notification in the Official Gazette, the nature of restrictions to be imposed, types of facilities to be withdrawn and procedure for issuance of such order.

Earlier, such restrictions could be imposed and facilities could be withdrawn with respect to a manufacturer, first stage dealer, second stage dealer and an exporter.

Now, Central Government has been empowered to impose restrictions and withdraw facilities with respect to **provider of taxable service** also.

[Notification No. 25/2014 CE (NT) dated 25.08.2014]

2. STTG certificate issued by the Indian Railways along with the photocopies of the railway receipts to be the eligible documents for availing CENVAT credit

Rule 9 of the CENVAT Credit Rules, 2004 has been amended to include **Service Tax Certificate for Transportation of Goods** (hereinafter referred to as STTG Certificate) issued by the Indian Railways, along with the photocopies of the railway receipts mentioned in the STTG certificate as a document eligible for taking CENVAT credit. Thus, in case of transport of goods by rail, credit of service tax paid on the said service can be availed on the basis of the STTG certificate.

[Notification No. 26/2014 CE (NT) dated 27.08.2014]

II. CLARIFICATIONS

1. Determination of place of removal

CBEC has clarified that since the definition of palce of removal is now provided in the CENVAT Credit Rules, 2004, wherever CENVAT credit is available upto the place of removal, this definition of place of removal would apply, irrespective of the nature of assessment of duty [*Notification No. 21/2014 CE (NT) dated 11.07.2014* has inserted the definition of place

of removal in the CENVAT Credit Rules, 2004]. The payment of transport, inclusion of transport charges in value, payment of insurance or who bears the risk are not the relevant considerations to ascertain the place of removal.

The place of removal is place where sale takes place. The place where sale takes place is the place where the transfer in property of goods takes place from the seller to the buyer. Determination of place of removal without ascertaining the place where transfer of property in goods has taken place is a deviation from the legal position on the subject.

Place of removal needs to be ascertained in term of provisions of the Central Excise Act, 1944 read with provisions of the Sale of Goods Act, 1930. There are very well laid rules in the Sale of Goods Act, 1930, regarding the time when property in goods is transferred from the seller to the buyer.

(i) **Transfer of property in goods in case of sale of specific or ascertained goods:** Section 19 of the Sale of Goods Act, 1930 provides that where there is a contract for the sale of specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred. Intention of the parties is to be ascertained with reference to the terms of the contract, the conduct of the parties and the circumstances of the case.

(ii) **Transfer of property in goods in case of sale of unascertained or future goods:** Section 23 provides that where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied and may be given either before or after the appropriation is made.

Delivery to carrier: Sub-section (2) of section 23 further provides that where, in pursuance of the contract, the seller delivers the goods to the buyer or to a carrier or other bailee (whether named by the buyer or not) for the purposes of transmission to the buyer, and does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract.

[Circular No. 988/12/2014-CX dated 20.10.2014]

2. Fertilizer subsidy given by the Government to benefit the farmers cannot be considered an additional consideration

Issue: Whether the fertilizer subsidy given by the Government to benefit the farmers can be considered an additional consideration?

Clarification: In case of price-controlled fertilizers, the manufacturers are mandated to sell the goods at the prices notified by the Government. The Government reimburses the differential between the cost of production and the notified price to the manufacturers in the form of subsidy. However, for some specific fertilizer, the price is deregulated and

companies are free to fix the price. They do so after taking into account the subsidy component which is fixed on the basis of nutrient content (i.e per kg subsidy is fixed by the Government for phosphate, potash, nitrogen and sulphur). In both these types of fertilizers, the subsidy is given by the Government to benefit the farmers, as subsidy would reduce the price paid by farmers.

CBEC has clarified that the manufacturers of fertilizers do not gain any extra commercial advantage vis-a-vis other manufacturers because of the subsidy received from the Government. The subsidy paid by the Government to the manufacturer is in larger public interest and not for benefitting any individual manufacturer-seller and it is also not paid on behalf of any individual buyer or entity. In view of the above, it can be concluded that the subsidy component is not an additional consideration and hence, the price at which the fertilizer is sold to buyers by the manufacturers is the sole consideration for its sale. Even though the subsidy component has money value, it cannot be considered as an additional extra-commercial consideration flowing from the buyer to the seller.

Therefore, in respect of fertilizers for which subsidy is provided by the Government, the excise duty will be chargeable on the price charged and subsidy component provided by the Government will not be included in the assessable value.

[Circular No.983/7/2014-CX dated 10.07.2014]

3. Central Excise officer is empowered to conduct audit in Central Excise

Issue: Whether a Central Excise officer is empowered to conduct audit under Central Excise?

Clarification: CBEC has clarified that in Central Excise, there is adequate statutory backing for audit by the Central Excise Officers. The statutory provisions relevant for audit are clause (x) of section 37(2) and rule 22 of the Central Excise Rules, 2002 (CER).

Rule 22 of CER provides that the Commissioner may empower an Officer or depute an audit party for carrying out scrutiny or verification of records of the assessee. The rule also obliges an assessee to make available records for such scrutiny. The statutory backing for rule 22 thus, flows from clause (x) of section 37(2) and the general rule making powers under section 37(1) of the Central Excise Act, 1944. Clause (x) of section 37(2) empowers the Central Government to make rules for verification of records and returns to check the correctness of levy and collection of duty which in the present regime of self-assessment would mean verification of correctness of self-assessment and payment of duty by the assessee. It may be noted that the expression "verification" used in the section is of wide import and would include within its scope, audit by the Departmental officers, as the procedure prescribed for audit is essentially a procedure for verification mandated in the statute.

[Circular No. 986/ 10/ 2014-CX dated 09.10.2014]

B. SERVICE TAX

1. Service provided with respect to Kailash Mansarovar and Haj pilgrimage exempted from service tax

Mega exemption *Notification No. 25/2012 ST dated 20.06.2012* has been amended to exempt the services provided by a specified organisation in respect of a religious pilgrimage facilitated by the Ministry of External Affairs of the Government of India, under bilateral arrangement, from service tax.

Specified organisation shall mean:

(a) Kumaon Mandal Vikas Nigam Limited, a Government of Uttarakhand Undertaking; or

(b) Haj Committee of India and State Haj Committees constituted under the Haj Committee Act, 2002, for making arrangements for the pilgrimage of Muslims of India for Haj.

Thus, the religious pilgrimage organized by the Haj Committee and Kumaon Mandal Vikas Nigam Ltd. will not be liable to service tax.

[Notification No.17/2014 ST dated 20.08.2014]

2. Board/Chief Commissioner empowered to issue supplementary instructions [New rule 12 inserted in the Service Tax Rules, 1994]

With effect from 01.10.2014, Board or the Chief Commissioners of Central Excise may issue instructions for any incidental or supplemental matters for the implementation of the provisions of the Finance Act, 1994.

[Notification No. 19/2014 ST dated 25.08.2014]

3. Clarification regarding levy of service tax on joint venture

CBEC has issued following clarification regarding levy of service tax on joint venture:

(i) Services provided by the members of the Joint Venture (JV) to the JV and *vice versa* or between the members of the JV: In accordance with Explanation 3(a) of the definition of service under section 65B(44) of the Finance Act, 1994, JV (an unincorporated temporary association constituted for the limited purpose of carrying out a specified project) and the members of the JV are treated as distinct persons and therefore, taxable services provided for consideration, by the JV to its members or *vice versa* and between the members of the JV are taxable.

(ii) Cash calls (capital contributions) made by the members to the JV: If cash calls are merely a transaction in money, they are excluded from the definition of service provided in section 65B(44) of the Finance Act, 1994. Whether a 'cash call' is 'merely…. a transaction in money' [in terms of section 65B(44) of the Finance Act, 1994] and hence

not in the nature of consideration for taxable service, would depend on the comprehensive examination of the Joint Venture Agreement, which may vary from case to case. Detailed and close scrutiny of the terms of JV agreement may be required in each case, to determine the service tax treatment of cash calls.

[Circular No. 179/5/2014 ST dated 24.09.2014]

4. Clarification regarding levy of service tax on activities involved in relation to inward remittances from abroad to beneficiaries in India through MTSOs

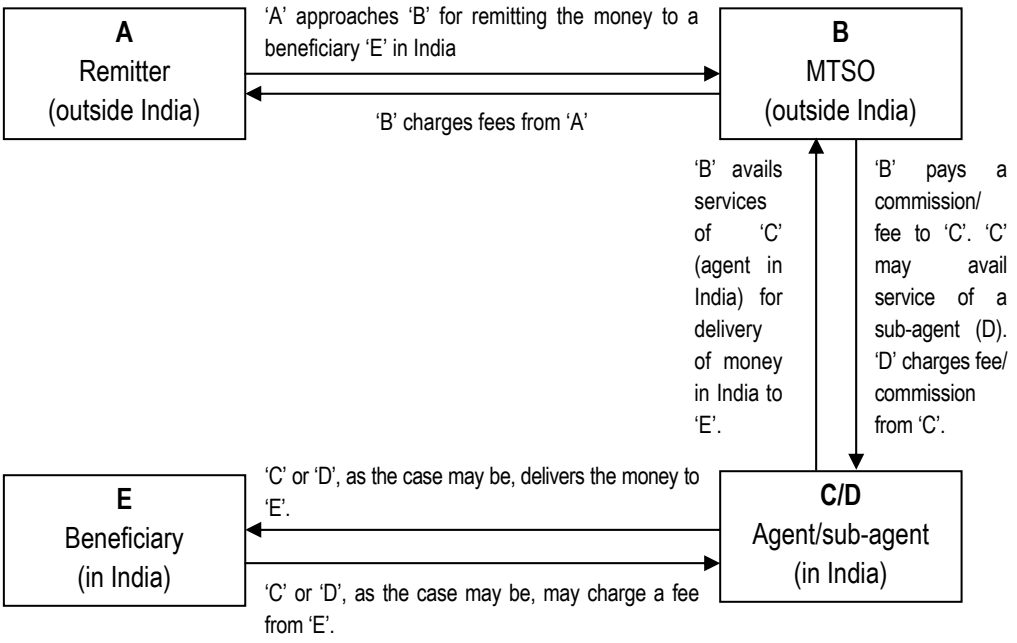
The remittances of money from overseas through the Money Transfer Service Operator (MTSO) route involves the following sequence of transactions:

Step 1: Remitter located outside India (say 'A') approaches a MTSO/bank (say B) located outside India for remitting the money to a beneficiary in India; 'B' charges a fee from 'A'.

Step 2: 'B' avails the services of an Indian entity (agent) (say 'C') for delivery of money to the ultimate recipient of money in India (say 'E'); 'C' is paid a commission/fee by 'B'.

Step 3: 'C' may avail service of a sub-agent (D). 'D' charges fee/commission from 'C'.

Step 4: 'C' or 'D', as the case may be, delivers the money to 'E' and may charge a fee from 'E'.



Circular No. 180/06/2014 ST dated 14.10.2014 has clarified the following issues in this regard:

S. No.	Issues	Clarification
1.	Whether service tax is payable on remittance received in India from abroad?	No service tax is payable per se on the amount of foreign currency remitted to India from overseas. As the remittance comprises money, it does not in itself constitute any service in terms of the definition of 'service' [Section 65B(44)].
2.	Whether the service of an agent or the representation service provided by an Indian entity/ bank to a foreign MTSO in relation to money transfer falls in the category of intermediary service?	Yes. The Indian bank or other entity acting as an agent to MTSO in relation to money transfer, facilitates in the delivery of the remittance to the beneficiary in India. In performing this service, the Indian Bank/entity facilitates the provision of money transfer service by the MTSO to a beneficiary in India. For their service, agent receives commission or fee. Hence, the agent falls in the category of intermediary as defined in rule 2(f) of the Place of Provision of Service Rules, 2012.
3.	Whether service tax is leviable on the service provided, as mentioned in point 2 above, by an intermediary/ agent located in India (in taxable territory) to MTSOs located outside India?	Service provided by an intermediary is covered by rule 9(c) of the Place of Provision of Service Rules, 2012. As per this rule, the place of provision of service is the location of service provider. Hence, service provided by an agent, located in India (in taxable territory), to MTSO is liable to service tax. The value of intermediary service provided by the agent to MTSO is the commission or fee or any similar amount, by whatever name called, received by it from MTSO and service tax is payable on such commission or fee.
4.	Whether service tax would apply on the amount charged separately, if any, by the Indian bank/entity/agent/sub-agent from the person who receives remittance in the taxable territory, for the service provided by such Indian bank/entity/agent/sub-agent	Yes. As the service is provided by Indian bank/entity/agent/sub-agent to a person located in taxable territory, the place of provision is in the taxable territory. Therefore, service tax is payable on amount charged separately, if any.

5.	Whether service tax would apply on the services provided by way of currency conversion by a bank /entity located in India (in the taxable territory) to the recipient of remittance in India?	Any activity of money changing comprises an independent taxable activity. Therefore, service tax applies on currency conversion in such cases in terms of the Service Tax (Determination of Value) Rules. Service provider has an option to pay service tax at prescribed rates in terms of Rule 6(7B) of the Service Tax Rules 1994.
6.	Whether services provided by sub-agents to such Indian Bank/entity located in the taxable territory in relation to money transfer is leviable to service tax?	Sub-agents also fall in the category of intermediary. Therefore, service tax is payable on commission received by sub-agents from Indian bank/entity.

Note: Circular No. 163/14/2012–ST dated 10.07.2012, issued earlier on the aforesaid subject, stands suspended.

Part II : Judicial Update – Indirect Tax Laws

Significant Recent Legal Decisions

"Select Cases in Direct and Indirect Tax Laws – An Essential Reading for the Final Course" is a compilation of the significant decisions of Supreme Court, High Court and Larger Bench of Tribunal. October, 2014 edition of the said publication is relevant for May, 2015 examination. Students may note that in addition to the cases reported in the said publication, following significant recent legal decisions are also relevant for May, 2015 examination:-

SECTION A. CENTRAL EXCISE

Basic concepts of excise

1. Whether contaminated, under or over filled bottles or badly crowned bottles amount to manufactured finished goods which are required to be entered under R.G.-1 register, and which are exigible to payment of excise duty?

Amrit Bottlers Private Limited v. CCE 2014 (306) E.L.T. 207 (All.)

Facts of the Case: The appellant was engaged in manufacturer of aerated water. Revenue alleged that the appellant was draining out manufactured aerated water on account of contaminated, under filled, over filled, badly crowned bottles, without entering them in R.G.1 register [daily stock account] and without payment of excise duty on the same. It issued a demand-cum show cause notice on the appellant for the recovery of said duty. Revenue was of the view that contaminated, under filled, over filled, badly crowned bottles were excisable goods. Further, if such goods were defective/non-marketable, the appellant should have sought remission of duty paid on such goods.

The appellant contended that such aerated water was drained out as certain bottles were found to be defective on account of contamination, under/over filling of the aerated water in bottles or such bottles were badly crowned. Under and over filling of the bottles make them unusable under the erstwhile Weights and Measures Act [now Legal Meteorology Act, 2009] as well as under the Prevention of Food Adulteration Act. Consequently, the aerated water which was drained out was not marketable. Thus, it was not required to be entered in R.G.-1 register. The appellant further submitted that excise duty could not levied on the goods which had not been manufactured and which were not marketable.

Observations of the Court: The Court observed that only a finished product can be entered in RG 1 register. A finished product is a product which is manufactured as well as which is marketable. The law required the appellant to provide a screening test before it could declare the manufactured product as a finished product, which was marketable. In other words, a finished product was required to be accounted for in R.G. 1 register only after undergoing the screening test and having found that they were fit for sale.

Under filled or over filled or badly crowned caps bottles could not be treated as being fully manufactured nor could they be treated as finished goods. Moreover, bottles filled

with less or more aerated water were not marketable under the erstwhile Weights and Measures Act [now Legal Meteorology Act, 2009]. Consequently, such goods could not be entered in R.G. 1 register.

Decision: The Court held that in the instant case, contaminated, under filled, over filled and badly crowned bottles found at the stage of production were not marketable goods. Thus, they were not required to be entered under R.G.-1 register and consequently, no excise duty was payable on them.

Note: *RG-1 register is a daily stock account required to be maintained under rule 10 of the Central Excise Rules, 2002. Rule 10 provides that every assessee shall maintain proper records, on a daily basis, in a legible manner indicating the particulars regarding:*

a. description of the goods produced or manufactured,

b. opening balance, quantity produced or manufactured,

c. inventory of goods,

d. quantity removed,

e. assessable value,

f. the amount of duty payable; and

g. particulars regarding amount of duty actually paid.

Valuation of excisable goods

2. Should a part of sales tax retained by the manufacturer from its customers under a tax concession granted to it, be included in the transaction value of such goods under section 4(3)(d) of the Central Excise Act, 1944?

CCE v. Maruti Suzuki India Limited 2014 (307) E.L.T. 625 (S.C.)

Facts of the Case: The assessee was a prestigious unit manufacturing and selling vehicles in the State of Haryana. Being a prestigious unit, a tax concession was granted to the assessee considered by the High Powered Committee (HPC) under the erstwhile Haryana General Sales Tax Rules, 1975. Therefore, an entitlement certificate was issued to the assessee for implementation of the decision of HPC.

A show cause notice was issued by the Department on the ground that on the sale of its vehicles during the period in question, the assessee had deposited only 50% of the sales tax collected by it from its customers and retained balance 50% availing the tax concession granted to it. The retained sales tax was neither actually paid nor actually payable to the State Government. Therefore, the sales tax retained by the assessee constituted a part of the "transaction value" of the vehicles sold by the assessee to the customers in terms of its definition in section 4(3)(d) of the Central Excise Act, 1944 and excise duty was payable on the same.

The assessee contended that it was not actually exempted from payment of sales tax to the extent of 50% collected from the customers, but that the payment of sales tax was deferred. The 50% sales tax retained for a period of 14 years had to be adjusted against the capital subsidy due to the assessee by the State Government. However, Revenue contended that decision of the HPC did not support the case of the assessee as the entitlement certificate did not mention anything to the effect that it was for the deferment of payment of any sales tax. Thus, the assessee was not supposed to return any amount of sales tax concession to the State Government nor this amount was to be adjusted towards any capital subsidy granted by the State Government.

Observations of the Court: The Supreme Court concurred with the Revenue's contention that there was no mention in the decision of the HPC about adjustment of this amount of sales tax concession against any scheme or any capital subsidy. The entitlement certificate also did not give any indication of deferment of tax or capital subsidy.

Further, referring to CBEC *Circular dated 30th June, 2000,* the Apex Court opined that the assessee retained 50% of the sales tax collected from its customers and it was neither actually paid nor actually payable to the Government. Therefore, the transaction value under section 4(3)(d) shall be calculated by including the amount of sales tax retained by the assessee and they were liable to pay excise duty on such amount.

Decision: The Apex Court, overruling the Tribunal's decision, held that since assessee retained 50% of the sales tax collected from customers which was neither actually paid to the exchequer nor actually payable to the exchequer, transaction value under section 4(3)(d) of the Central Excise Act,1944, would include the amount of such sales tax.

Notes:

(i) The definition of "transaction value" in Section 4(3)(d) of the Excise Act reads as follows:-

"transaction value" means the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter; but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.

(ii) The relevant paragraphs of the CBEC Circular No. 354/81/2000 TRU dated 30th June, 2000 read as follows:-

"As regards exclusion of taxes while working out assessable value, the definition of transaction value itself mentions that whatever amount is actually paid or actually payable to the Government or the relevant statutory authority by way of excise, sale

tax and other taxes, such amount shall be excluded from the transaction value. In other words, if any excise duty or other tax is paid at a concessional rate for a particular transaction, the amount of excise duty or tax actually paid at the concessional rate shall only be allowed to be deducted from price. The assessee cannot claim that the excise duty or tax payable at the "normal rate" should be allowed to be deducted. The words "actually paid" have, therefore, been used to (in) the definition of transaction value to reflect the legislative intention as explained above.

The words "actually payable" in the context of the amount of duty of excise, sales tax and other taxes would normally come into play only in those situations where the amount of excise, sales tax or other taxes is not paid at the time of transaction but paid subsequently, for example, sales tax payable under a deferment scheme."

CENVAT credit

3. Whether CENVAT credit can be availed of service tax paid on customs house agents' (CHA) services, shipping agents' and container services and services of overseas commission agents used by the manufacturer of final product for the purpose of export, when the export is on FOB basis?

Commissioner v. Dynamic Industries Limited 2014 (35) S.T.R. 674 (Guj.)

Facts of the Case: The assessee availed CENVAT credit of service tax paid by it on CHA services, shipping agent and container service and commission paid to overseas agents in respect of finished goods which were exported. The Revenue objected to the CENVAT credit claimed on these services.

Point of Dispute: The Revenue alleged that the CHA services, shipping agent's services, container services and services of overseas commission agent had been availed after the goods were cleared from the place of removal and they were not in relation to the manufacturing activities undertaken by the assessee nor these were pertaining to the activities of clearance of goods from the place of removal. These services, according to the Revenue, did not fall under the definition of the term "input service" and the related CENVAT credit availed was inadmissible.

The assessee contended that the issue was no more *res integra* and in a host of decisions the Tribunal had taken a view that where exports are FOB basis, the place of removal has to be taken as port and, therefore, the service availed by it till the goods reach the port would be admissible; that without the assistance of overseas agents, manufactured goods cannot be sold and, therefore, the services of overseas agents have to be treated as one relating to manufacture.

Observations of the High Court: The High Court referred to definition of 'input service' as also placed reliance on various cases dealing with subject and made the following observations:

(i) In case of all three services in relation to which substantial question of law has been framed there is no specific inclusion of such services in the definition of input service.

(ii) Any service used by the manufacturer directly or indirectly in relation to manufacture of final products and clearing of final products upto the place of removal would certainly be covered within the definition of input service. In the present case, the place of removal would be the port.

(iii) Revenue has not disputed the fact that the services in relation to which the CENVAT credit is claimed by the assessee were availed for the purpose of clearing the goods for the purpose of export.

(iv) As regards customs house agent service and shipping agents and container services, the decision of this Court in *Cadila Healthcare Ltd. 2013 (30) STR 3 (Guj.)* would apply and the definition of input service would cover both these services, considering the nature of services and the place of removal being the 'port' in this case.

(v) With regard to the services of overseas commission agent also, the decision of this Court in *Cadila Healthcare Ltd. 2013 (30) STR 3 (Guj.)* would apply wherein it was held that the CENVAT credit on a service could be availed if that service is used directly or indirectly in the manufacture or clearance of final product. As the services of overseas commission agent have not been used for these purposes, the denial in the referred case shall apply to the present case also. *Consequently, CENVAT credit would not be admissible in respect of the commission paid to foreign agents.*

Decision: The High Court held that CENVAT credit in respect of (i) customs house agents services, (ii) shipping agents and container services and (iii) cargo handling services is admissible, but the CENVAT credit availed for the services of overseas commission agent is not allowed.

Note: *'Place of removal' is a significant concept in the CENVAT Credit Rules, 2004. The services relating to clearance upto place of removal are covered in the definition of input service and services beyond the place of removal are not so covered. The above judgment deals with this concept, and takes a view that in the present case since the property in the goods was passed at port, the port would be considered as place of removal and services of CHA etc. used till port are therefore covered in the definition of input service. Another position taken in this case by the Gujarat High Court is that the services of 'overseas commission agents' are not covered in the definition of input service. This is highly disputable position and there are judgments where a different view has been taken e.g. the judgment of Punjab & Haryana High Court in the case of Ambika Overseas 2012 (25) STR 348 says that the services of commission agent are covered in the definition of input service.*

4. Will rule 6 of the CENVAT Credit Rules, 2004 apply, if the assessee clears an exempted by-product and a dutiable final product?

UOI v Hindustan Zinc Limited. 2014 (303) E.L.T. 321 (S.C.)

Facts of the Case: The respondent assessee was engaged in the manufacture of a dutiable product. During the manufacturing process, a by-product was also being produced which was exempted from the excise duty.

The Department denied CENVAT credit to the assessee saying that since the output products of the assessee were both dutiable and exempted, they were either required to maintain separate records for inputs used in taxable and exempted output or were to pay 8% [now 6%] of the sale price of by-product in terms of rule 6 of the CENVAT Credit Rules, 2004. It was submitted that language of the CENVAT Credit Rules, 2004 needs to be interpreted literally. Since, rule 6 does not provide any distinction between exempted final product and exempted by-product, its provisions would also be applicable to the by-product manufactured and therefore, the assessee was obliged to pay excise duty @ 8% [now 6%] in respect of clearance of exempted by-product.

Decision: The Supreme Court held that since in rule 57CC of the erstwhile Central Excise Rules, 1944 [now rule 6 of the CENVAT Credit Rules, 2004], the term used is 'final product' and not 'by-product', said rule cannot be applied in case of 'by-product' when such by-product emerged as a technological necessity. If the Revenue's argument is accepted, it would amount to equating by-product with final product thereby obliterating the difference, though recognised by the legislation itself.

***Note**: The principle enunciated in the above case by the Supreme Court is that rule 6 of CCR would not apply when manufacture of dutiable final product results in emergence of exempt by-product on account of technological necessity.*

5. Can CENVAT credit availed on inputs (contained in the work-in-progress destroyed on account of fire) be ordered to be reversed under rule 3(5C) of the CENVAT Credit Rules, 2004?

CCE v. Fenner India Limited 2014 (307) E.L.T.516 (Mad.)

Facts of the Case: The respondent assessee was engaged in manufacturing of Oil Seals. On account of fire accident in the factory, the work in progress stocks were burnt and rendered unfit for usage. The assessee had availed CENVAT credit on the raw materials, which were to be used for production of Oil Seals.

A show cause notice was issued to the assessee demanding the CENVAT credit availed on raw materials destroyed along with the interest and penalty though Department did not dispute the fact that inputs on which CENVAT credit had been taken were destroyed by fire when work was in progress. The assessee contended that since inputs were put in use for the manufacture of final products, question of reversing the credit did not arise. However, Revenue, by relying upon rule 3(5C) of the CENVAT Credit Rules, 2004 submitted that the assessee was bound to reverse the credit taken on the inputs.

Observations of the Court: The High Court observed that, it was not in dispute that the inputs on which the CENVAT credit had been availed were destroyed in a fire accident when the work was in progress. Once the fact was not disputed, then the assessee could not be called upon to reverse the credit.

The High Court placed reliance upon the view taken by the Gujarat High Court in the case of *CCE v. Biopac India Corporation Limited 2010 (258) E.L.T.56 (Gujarat H.C.),* wherein it was held that the goods destroyed in fire after being used for many years cannot be said as not used in the manufacture of final product and the assessee need not reverse the credit availed on such inputs.

The High Court further noted that rule 3(5C) can be invoked where on any goods manufactured or produced by an assessee, the payment of duty is ordered to be remitted under rule 21 of the Central Excise Rules, 2002. Thus, only in such case, the CENVAT credit taken on the inputs used in the manufacture of production of said goods shall be reversed.

Decision: The High Court held that CENVAT credit would need to be reversed only when the payment of excise duty on final product is ordered to be remitted under rule 21 of the Central Excise Rules, 2002, which deals with the remission of duty. In the present case, the assessee has not claimed any remission and no final product has been removed, hence, assessee need not reverse the CENVAT credit taken on inputs (contained in the work-in-progress) destroyed in fire.

Appeals

6. Can an appeal be filed before the Supreme Court against an order of the CESTAT relating to clandestine removal of manufactured goods and clandestine manufacture of goods?

CCE v. Fact Paper Mills Private Limited 2014 (308) E.L.T. 442 (SC)

Decision: The Supreme Court held that the appeals relating to clandestine removal of manufactured goods and clandestine manufacture of goods are not maintainable before the Apex Court under section 35L of the Central Excise Act, 1944.

SECTION B. SERVICE TAX

Basic concepts of service tax

7. Whether supply of food, edibles and beverages provided to the customers, employees and guests using canteen or guesthouse of the other person, results in outdoor caterer service?

Indian Coffee Workers' Co-operative Society Limited v. CCE & ST 2014 (34) STR 546 (All.)

Facts of the Case. The assessee entered into agreements with National Thermal Power Corporation Limited (NTPC) for running and maintenance of a guest house and with

Lanco Infratech Limited (LANCO) for running and maintenance of catering services for its Township. The assessee charged amounts in cash from individual customers for food, eatables and beverages supplied according to rates stipulated in the menu card. The assessee did not pay any service tax as it was of the view that it did not provide any service to NTPC or LANCO but only sold goods in their canteens to individual customers (not to NTPC and LANCO). NTPC and LANCO just provided a place for running the canteen on rent and reimbursed certain expenses for maintenance and running. Thus, there should not be any service tax liability on this activity.

However, the Revenue demanded service tax from the assessee by treating the activity of the assessee as outdoor catering services since he was engaged in providing services in connection with catering at a place other than his own. The Revenue was of the opinion that the fact that food, beverages or edibles were consumed by employees of NTPC and LANCO or by those who use the guest house or facility, made no difference to the position that the service was provided by the assessee to NTPC or LANCO, and attracted service tax.

Observations of the Court: The High Court opined that the assessee is a caterer. The assessee is a person who supplies food, edibles and beverages for a purpose. The purpose is to cater to persons who use the facility of a canteen which is provided by NTPC or by LANCO within their own establishments. NTPC and LANCO have engaged the services of the assessee as a caterer. Further, since the assessee provides the services as a caterer at a place other than his own, he is an outdoor caterer.

The High Court clarified that taxable catering service could not be confused with who had actually consumed the food, edibles and beverages which were supplied by the assessee. Taxability or the charge of tax does not depend on whether and to what extent the person engaging the service consumes the edibles and beverages supplied, wholly or in part. What is material is whether the service of an outdoor caterer is provided to another person and once it is, as in the present case, the charge of tax is attracted.

Further the High Court elaborated that the charge of tax in the cases of VAT is distinct from the charge of tax for service tax. The charge of service tax is not on the sale of goods but on a taxable service provided. Hence, the fact that the assessee had paid VAT on the sale of goods on the supply of food and beverages to those who consume them at the canteen, would not exclude the liability of the assessee for the payment of service tax in respect of the taxable service provided by the assessee as an outdoor caterer.

Decision: Based on the observation made above, the High Court held that the assessee was liable for payment of service tax as an outdoor caterer.

Note: *Though the above judgment is based on the definition of 'outdoor caterer' and taxable outdoor catering services as existing prior to 1st July 2012, the principle in the judgment will hold true even for the period beginning from 1st July 2012. Under the current position of law, service portion in an activity wherein goods, being food or any*

other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as part of the activity, is liable to service tax as declared service.

8. **Whether the course completion certificate/training offered by approved Flying Training Institute and Aircraft Engineering Institutes is recognized by law (for being eligible for exemption from service tax) if the course completion certificate/ training/ is only for the purpose of eligibility for obtaining ultimate licence/approval for certifying repair/maintenance/airworthiness of aircrafts?**

CCE & ST v. Garg Aviations Limited 2014 (35) STR 441 (All.)

Facts of the Case: The assessee was running a Flying Training Institute and Aircraft Maintenance Engineering Institute. It was engaged in providing training and coaching to individuals in the field of flying of aircraft for obtaining Commercial Pilot License from the Director Civil Aviation (DGCA), New Delhi. It also provided training for obtaining Basic Aircraft Maintenance Engineering Licence.

Point of Dispute: The Department demanded service tax on this training activity. However, the assessee contended that since the services were leading to the grant of diploma/certificate recognised by the law, the services were exempt and thus, were not chargeable to service tax. The assessee cited the case of *Indian Institute of Aircraft Engineering v. Union of India 2013 (30) STR 689*, in which the Delhi High Court, in the similar matter held that such services were not chargeable to service tax being exempt.

Observations of the Court: The High Court referred to the judgment of the Delhi High Court in *Indian Institute of Aircraft Engineering v. Union of India,* wherein the Delhi High Court made the following observations:

(i) The expression 'recognized by law' is a very wide one. The legislature has not used the expression “conferred by law” or “conferred by statute”. Thus, even if the certificate/degree/diploma/qualification is not the product of a statute but has approval of some kind in 'law', it would be exempt.

(ii) The Aircraft Act, 1934 (the Act) and the Aircraft Rules, 1937 (the Rules) and the Civil Aviation Requirements (CAR) issued by the DGCA under Rule 133B of the Rules, having provided for grant of approval to such institutes and having laid down conditions for grant of such approval and having further provided for relaxation of one year in the minimum practical training required for taking the DGCA examination, have recognized the course completion certificate and the qualification offered by such Institutes.

(iii) The certificate/training/qualification offered by Institutes which are without approval of DGCA would not confer the benefit of such relaxation. Thus, the certificate/training/qualification offered by approved Institutes, has by the Act, Rules and the CAR been conferred some value in the eyes of law, even if it be only for the purpose of eligibility for obtaining ultimate licence/approval for certifying repair/maintenance/airworthiness of aircrafts.

(iv) The Act, Rules and CAR distinguish an approved Institute from an unapproved one and a successful candidate from an approved institute would be entitled to enforce the right, conferred on him by the Act, Rules and CAR, to one year relaxation against the DGCA in a Court of law. The inference can only be one, that the course completion certificate/training offered by such Institutes is recognized by law.

(v) An educational qualification recognized by law will not cease to be recognized by law merely because for practicing in the field to which the qualification relates, a further examination held by a body regulating that field of practice is to be taken.

The Delhi High Court held that the recognition accorded by the Act, Rules and CAR supra to the course completion certificate issued by the institutes as the petitioner cannot be withered away or ignored merely because the same does not automatically allow the holder of such qualification to certify the repair, maintenance or airworthiness of an aircraft and for which authorization a further examination to be conducted by the DGCA has to be passed/cleared.

Decision: The High Court upheld the decision of the Tribunal and held that the Revenue had not been able to persuade the Court to take a contrary view as taken by the Delhi High Court in *Indian Institute of Aircraft Engineering.* The appeal filed by the Revenue would not give rise to any substantial question of law. Hence, the appeal filed was dismissed and the assessee was held not to be liable to pay service tax.

Note: *The above case is in context of the taxable service category of 'commercial coaching or training services' and the related exemption as they stood prior to 1st July 2012. However, as the broad position of the taxable service and the related exemption (which is now covered under the negative list) remains the same, the principle in the judgment may hold true in the present position of law also.*

9. Whether deputation of some staff to subsidiaries/group of companies for stipulated work or for limited period results in supply of manpower service liable to service tax, even though the direction/control/supervision remained continuously with the provider of the staff and the actual cost incurred was reimbursed by the subsidiaries/group companies?

Commissioner of Service Tax v. Arvind Mills Limited 2014 (35) S.T.R. 496 (Guj.)

Facts of the Case: The assessee was engaged in manufacturing of fabrics and ready-made garments. In order to reduce its cost, they deputed some of their employees to their group company. The employees deputed did not work exclusively under the direction or supervision of the subsidiary company and upon completion of the work they were repatriated to the assessee company. The Revenue sought to recover service tax from the assessee for the reimbursement recovered by it from its group/subsidiary companies for the cost of such employees on deputation under the service category of 'manpower supply'.

Observations of the Court: The High Court observed that 'manpower supply services' would not cover the activity of the assessee. The assessee, in order to reduce its cost of

manufacturing, deputed some of its staff to its subsidiaries or group companies for stipulated work or for limited period. All throughout, the control and supervision remained with the assessee. The assessee was not in the business of providing recruitment or supply of manpower. Actual cost incurred by the assessee in terms of salary, remuneration and perquisites was only reimbursed by the group companies. There was no element of profit or finance benefit. The subsidiary companies could not be said to be their clients. The High Court noted that the employee deputed did not exclusively work under the direction or supervision or control of subsidiary company.

Decision: The High Court rejected the contention of the Revenue and held that deputation of the employees by the respondent to its group companies was only for and in the interest of the assessee. There is no relation of agency and client. The assessee company was not engaged in providing any services directly or indirectly in any manner for recruitment or supply of manpower temporarily or otherwise to a client. Therefore, they were not liable to pay service tax.

Note: *Though this judgment is rendered in the context of position of law as it stood prior to 01.07.2012 (pre-negative list regime), the principle enunciated in the above judgement will hold good under the current negative list regime as well.*

10. Whether section 66E(i) of the Finance Act, 1994 which levies service tax on the service portion of activity wherein goods being food or any other article for human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of activity, is *ultra vires* the Article 366(29A)(f) of the Constitution?

Hotel East Park v. UOI 2014 (35) STR 433 (Chhatisgarh)

Questions of Law: The substantial questions of law which arose before the High Court were:

(a) Whether any service tax can be charged on sale of an item or *vice versa*?

(b) Whether in view of Article 366(2A)(f) service is subsumed in sale of foods and drinks and whether such Article is violated by section 66E(i) of the Finance Act, 1994?

Observations of the Court: The High Court observed as under:

(i) With reference to question (a) above, the High Court observed that a tax on the sale and purchase of food and drinks within a State is in exclusive domain of the State. The Parliament cannot impose a tax upon the same. Similarly, there is no entry in List II or List III of the Seventh Schedule to the Constitution under which service tax can be imposed. There is no legislative competence with the States to impose a tax on any service.

(ii) With reference to question (b) above, the High Court observed that Article 366(29A)(f) of the Constitution does not indicate that the service part is subsumed in the sale of the food; it rather separates sale of food and drinks from service. Section 65B(44) as well as section 66E(i) of the Finance Act, 1994, charge service

tax only on the service part and not on the sales part. It indicates that the sale of the food has been taken out from the service part.

(iii) The quantum of services to be taxed is explained under rule 2C of the Service Tax (Determination of Value) Rules, 2006 read with *Notification No. 25/2012 ST* notified by the Central Government. Rule 2C presumes a fixed percentage of bill value as the value of taxable service on which service tax should be charged. However, there is no provision in VAT Act to bifurcate the amount of bill into sale and service.

Decision: The High court held that section 66E (i) of the Finance Act, 1994 is *intra vires* the Article 366(29A)(f) of the Constitution of India.

Further, the High Court held that no VAT can be charged over the amount meant for service and that the amount over which service tax has been charged should not be subject to VAT. The High Court directed the State Government to frame such rules and issue clarifications to this effect to ensure that the customers are not doubly taxed over the same amount. The rules may be in conformity with the bifurcation as provided under the Finance Act, 1994 or ensure that the Commercial Tax authorities do not charge VAT on that part of the value of the food and drink on which service tax is being assessed.

Notes:

(i) Clause 19 of the notification No. 25/2012-ST exempts the service tax in serving food or beverages by the restaurants other than the air-conditioned restaurant or having licence to serve alcoholic beverages i.e. service tax is levied only in those restaurants that have air-conditioning or licence to serve alcoholic beverages.

(ii) Rule 2C of the Service Tax (Determination of Value) Rules, 2006 clarifies that in case of a restaurant, service is presumed to be 40% of the bill value and in case of outdoor catering, it is presumed to be 60% of the bill value. It shows that the value of the food is taken to be 60% of the bill in the case of restaurant and 40% of the bill in case of catering service.

(iii) Article 366 (29A)(f) of the Constitution provides that "tax on the sale or purchase of goods" includes a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration.

Valuation of taxable service

11. Is rule 5(1) of the Service Tax (Determination of Value) Rules, 2006 *ultra vires* the Finance Act, 1994? Can the expression 'suppression of facts' be interpreted to include in its ambit, mere failure to disclose certain facts unintentionally?

Naresh Kumar & Co. Pvt. Ltd v. UOI 2014 (35) STR 506 (Cal.)

Facts of the Case: The petitioner assessee was awarded a contract for carrying out loading, shifting and feeding of coal and gypsum by roads, for which High Speed Diesel (HSD) would be provided free of cost by service recipient. The assessee paid service tax

on the amount charged from the service recipient for the services provided which did not include the cost of the HSD supplied by the service recipient.

A show cause notice was issued to the assessee on the ground that cost of such HSD supplied free of cost by the service recipient should be included in the value of taxable services as the same was used for providing taxable services. The show cause notice invoked extended period of limitation by alleging willful suppression of fact of free supply of HSD.

Point of Dispute: The Revenue contended that the value of free HSD was to be included in the transaction value of service provided by the assessee under rule 5(1) of the Service Tax (Determination of Value) Rules, 2006 (Valuation Rules). The petitioner's major contention was that the value of HSD supplied free by the service recipient does not form part of the gross value of the service provided by them. Also, the petitioner contended that the demand raised by the Revenue under rule 5(1) of the Service Tax (Determination of Value) Rules, 2006 was not sustainable as the said rule has been held *ultra vires* by the Delhi High Court in the case of *Intercontinental Consultants and Technocrats Pvt. Ltd. v. Union of India 2013 (29) STR 9 (Del.).*

Observations of the Court: The High Court observed that in view of the clear exposition of law that the value of the diesel supplied free of cost by the service recipient cannot constitute taxable event (value), the authorities cannot place a contrary stand by placing reliance upon the provision which has been declared *ultra vires* (i.e. rule 5(1) of the Valuation Rules).

The High Court observed that willful suppression cannot be assumed and/or presumed merely on failure to declare certain facts unless it is preceded by deliberate non-disclosure to evade the payment of tax. The High Court elaborated that the extended period of limitation can be invoked on clear exposition that there has been a conscious act on the part of the assessee to evade the tax by non-disclosing the fact which, if disclosed, would attract service tax under sections 66 (now section 66B) & 67 of the Finance Act. The non-disclosure of the fact which, even if, disclosed would not have attracted the charging section cannot be brought within the ambit of suppression of fact for the purpose of extension of limitation period.

Decision: The High Court held that in view of the clear exposition of law that the value of the diesel supplied free of cost by the service recipient cannot constitute taxable event, the authorities cannot place a contrary stand by placing reliance upon the provision which has been declared *ultra vires* (i.e. rule 5(1) of the Valuation Rules).

The High Court held that non-disclosure of free supply of HSD did not constitute willful suppression as same was not a taxable event and thus, the invocation of extended period of limitation by the Revenue is unsustainable.

Exemptions and Abatements

12. Is exemption in relation to service provided to the developer of SEZ or units in SEZ available for a period prior to actual manufacture (which is the authorized operation) of final products considering these services as the services used in authorised operations of SEZ?

Commissioner of Service Tax v. Zydus Technologies Limited 2014 (35) S.T.R. 515 (Guj.)

Facts of the Case: The assessee had manufacturing operations in the SEZ. The Development Commissioner of SEZ granted an extension of one year to the assessee to start manufacturing operations (which were authorised operations of the SEZ). The assessee procured certain services (scientific and technical consultancy) during this period (before beginning of the manufacture) in order to enable it to undertake manufacturing activity.

Later, when the assessee applied for refund of service tax paid on such input services under *Notification No. 9/2009 ST dated 03.03.2009,* the refund was denied on the ground that since the services were received before the authorised operations (i.e., manufacturing) started, the said input services would not be considered to have been used in authorised operations of SEZ unit, and thus, would not get qualified for refund.

Point of Dispute: The Revenue submitted that as per sub-section (2) of section 4 and sub-section (9) of section 15 of the Special Economic Zones Act, 2005 meaning of "authorized operations" can be concluded as "such operation so authorized shall be mentioned in the letter of approval". Thus, since the manufacturing of the goods mentioned in the letter of approval had not started, it could not be said that the authorized operation of SEZ had started.

The assessee contended that it is necessary for SEZ to procure taxable services right from the budding stage and it is only after having obtained such support service of business that the unit would start functioning for production.

When the CESTAT held that the assessee shall be entitled to refund as claimed, the matter was brought before the High Court by the Department.

Observations of the Court: The High Court relied on its decision passed in the case of *Cadila Healthcare Ltd 2013 (30) STR 3 (Guj.)* and held that no error has been committed by the CESTAT in holding that the assessee shall be entitled to refund; as though the operations of the assessee did not reach to the commercial production stage, the input services of scientific and technical consultancy procured by them were in relation to the manufacture which would take place at a later date.

Decision: In the instant case, the High Court referring to their previous decision in case of *CCEx. v. Cadila Healthcare Ltd*. held that the services rendered for a period prior to actual manufacture of final product is commercial activity/production and assessee is entitled to exemption by way of refund claimed.

Note: *Though the above judgment is with reference to SEZ Exemption Notification No. 9/2009 ST, the principle discussed appears to be relevant in context of the present SEZ Exemption Notification No. 12/2013 ST also.*

Demand, adjudication and offences

13. Whether the recipient of taxable service having borne the incidence of service tax is entitled to claim refund of excess service tax paid consequent upon the downward revision of charges already paid, and whether the question of unjust enrichment arises in such situation?

CCus CEx & ST v. Indian Farmers Fertilizers Coop. Limited 2014 (35) STR 492 (All)

The CESTAT answered the above question against the Revenue so this appeal was filed with the High Court by the Revenue. It was the contention of the Revenue that the respondent being recipient of service was not entitled to file a refund claim under section 11B as the expression "any person" in section 11B of the Central Excise Act, 1944 does not include the recipient of the service. The Revenue submitted before the High Court that the principles of unjust enrichment as provided in section 11B were not considered by the CESTAT while allowing the refund claim and that the refund claim filed was not within the period of limitation of one year under section 11B.

Observations of the Court: The High Court relied on the case of *Mafatlal Industries Ltd. v. Union of India 1997 (89) ELT 247* wherein the Supreme Court held that "*Where the burden of the duty has been passed on, the claimant cannot say that he has suffered any real loss or prejudice. The real loss or prejudice is suffered in such a case by the person who has ultimately borne the burden and it is only that person who can legitimately claim its refund."*

The High Court observed that since the respondent, being the recipient of taxable service, had borne the incidence of service tax themselves; there was no question of unjust enrichment. Hence, the respondent was entitled to claim refund of excess service tax paid consequent upon the downward revision of the charges payable by it.

Further, the High Court pointed out that the fact that respondent had not filed the refund claim with the period of limitation was not challenged by the Revenue in the grounds of appeal before the first appellate authority [Commissioner (Appeals)] or in the form of cross objections before the Tribunal. The High Court relied on the Supreme Court's decision in the case of *Commissioner of Customs* v. *Toyo Engineering India Limited 2006 (201) ELT 513 (SC)* wherein it was held that the Revenue could not be allowed to raise submissions for the first time in a second appeal before the Tribunal.

Decision: The High Court upheld the decision of the CESTAT that since the burden of tax has been borne by the respondent as a service recipient, question of unjust enrichment will not arise as per section 11B of the Central Excise Act 1944 (as applicable to service tax under section 83 of Finance Act,1994).

Further, the High Court held that once the finding of the adjudicating authority that the claim for refund was filed within the period of limitation was not challenged by the Revenue before the first appellate authority and CESTAT, Revenue could not assert to contrary and first time urge a point in an appeal before this Court which was not raised in grounds of appeal before authorities below.

Other provisions under service tax

14. Whether sales commission services are eligible input services for availment of CENVAT credit? If there is any conflict between the decision of the jurisdictional High Court and the CBEC circular, then which decision would be binding on the Department? Also, if there is a contradiction between the decision passed by jurisdiction High Court and another High Court, which decision will prevail?

Astik Dyestuff Private Limited v. CCEx. & Cus. 2014 (34) S.T.R. 814 (Guj.)

Facts of the Case: In the present case, the assessee availed CENVAT credit on sales commission services obtained by them. The Revenue, however, denied such credit on the contention that 'sales commission services' do not fit into the definition of 'input services' under rule 2(l) of CENVAT Credit Rules, 2004 in view of the Gujarat High Court decision in the case of *Commissioner v. M/s.Cadila Healthcare Ltd in 2013 (4) STR 3.*

Point of Dispute: The assessee submitted that in view of CBEC Circular dated 29-04-2011, they were entitled to CENVAT credit on sales commission services obtained by them and that the Department, bounded by the CBEC Circular, could not take a contrary decision. They further submitted that since the decision of the Gujarat High Court in case of *Cadila Healthcare Limited* referred by the Revenue is contrary to that of the Punjab & Haryana High court in the case of *Commissioner v. Ambika Overseas 2012 (25) STR 348 (P&H),* wherein the CENVAT credit on such input services was allowed to the assessee, hence the matter should be referred to the Larger bench.

Observations of the High Court: The High Court observed that it is required to be noted that issue involved in the present appeal i.e. whether the appellant would be entitled to CENVAT credit on sales commission services obtained by them is now not *res integra* in view of the decision of this Court in the case of *Cadila Healthcare Limited*. It was elaborated by the High Court that in the case of *Cadila Healthcare Limited,* the jurisdictional High Court did not allow CENVAT credit on sales commission services after interpreting the relevant provisions of law. The High Court clarified that the decision of the jurisdictional High Court is binding to the Department rather than the Circular issued by the C.B.E. & C.

In regard to the request made by the assessee to refer the issue to the Larger Bench, the High Court rejected the same by saying that the appeal against the decision of the jurisdictional High Court (Gujarat H.C) in the case of *Cadila Healthcare Limited* was filed before the Hon'ble Supreme Court and the Apex Court had seized the matter and no stay order was granted in that case. Therefore, the High Court opined that it will not be proper on its part to refer the matter to the Larger Bench in the present case. Even

otherwise, the High Court did not find any reason to take a contrary view than its decision in the case of *Cadila Healthcare Limited*.

Decision: The High Court held that –

(i) if there is any conflict between the decision of the jurisdictional High Court and the CBEC Circular, then decision of the jurisdictional High Court will be binding to the Department rather than CBEC Circular. Therefore, the assessee would not be entitled to CENVAT credit on sales commission services obtained by them.

(ii) merely because there might be a contrary decision of another High Court is no ground to refer the matter to the Larger Bench.

(iii) when there are two contrary decisions, one of jurisdictional High Court and another of the other High Court, then the decision of the jurisdictional High Court would be binding to the Department and not the decision of another High Court.

SECTION C. CUSTOMS

Valuation under the Customs Act, 1962

15. Can the value of imported goods be increased if Department fails to provide to the importer, evidence of import of identical goods at higher prices?

Gira Enterprises v. CCus. 2014 (307) E.L.T.209 (SC)

Facts of the Case: The appellant imported some goods from China. On the basis of certain information obtained through a computer printout from the Customs House, Department alleged that during the period in question, large number of such goods were imported at a much higher price than the price declared by the appellant. Therefore, Department valued such goods on the basis of transaction value of identical goods as per erstwhile rule 5 [now rule 4 of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007] and demanded the differential duty alongwith penalty and interest from the appellant. However, Department did not provide these printouts to the appellant.

The appellant contended that Department's demand was without any basis in law, without any legally admissible evidence and opposed to the principles of natural justice as the computer printout which formed the basis of such demand had not been supplied to them. Resultantly, the appellant had no means of knowing as to whether any imports of comparable nature were made at the relevant point of time.

Observations of the Court: Supreme Court observed that since Revenue did not supply the copy of computer printout, which formed the basis of the conclusion that the appellants under-valued the imported goods, the appellants obviously could not and did not have any opportunity to demonstrate that the transactions relied upon by the Revenue were not comparable transactions.

Decision: The Supreme Court held that mere existence of alleged computer printout was not proof of existence of comparable imports. Even if assumed that such printout did exist and content thereof were true, such printout must have been supplied to the appellant and it should have been given reasonable opportunity to establish that the import transactions were not comparable.

Thus, in the given case, the value of imported goods could not be enhanced on the basis of value of identical goods as Department was not able to provide evidence of import of identical goods at higher prices.

***Note**: This case establishes the principle that the onus to prove that identical goods have been imported at a price higher than the value of the goods declared by the importer, lies with the Department.*

Demand and Appeals

16. Can a writ petition be filed before a High Court which does not have territorial jurisdiction over the matter?

Neeraj Jhanji v. CCE & Cus. 2014 (308) E.L.T. 3 (S.C.)

Facts of the Case: In this case, the assessee filed a writ petition before the Delhi High Court *against the* order in original passed by the Commissioner of Customs of Kanpur. However, the jurisdictional High Court for the petitioner would have been Allahabad High Court. When the Revenue raised objection over the territorial jurisdiction of the High Court, the assessee withdrew the appeal from the Delhi High Court and filed the appeal with the Allahabad High Court with the application for condonation of delay. The Allahabad High Court, however, dismissed the application for condonation of delay and also dismissed the appeal as time barred. Then, the assessee filed a special leave petition with the Supreme Court.

Decision: The Supreme Court observed that the very filing of writ petition by the petitioner in Delhi High Court against the order in original passed by the Commissioner of Customs, Kanpur indicated that the petitioner had taken chance in approaching the High Court at Delhi which had no territorial jurisdiction in the matter. The filing of the writ petition before Delhi High Court was not at all bona fide.

***Note**: In the aforementioned case, the Apex Court has disapproved the practice of Forum Shopping as adopted by the petitioner. Forum Shopping is the practice adopted by the litigants to have their legal case heard in the Court which would provide most favourable decision.*

Provisions relating to illegal import, illegal export, confiscation, penalty & allied provisions

17. Whether mere dispatch of a notice under section 124(a) would imply that the notice was "given" within the meaning of section 124(a) and section 110(2) of the said Customs Act, 1962?

Purushottam Jajodia v. Director of Revenue Intelligence 2014 (307) E.L.T. 837 (Del.)

Facts of the Case: As per section 110(2) of the Customs Act, 1962, a notice under section 124(a) is required to be **"given"** to the person from whose possession they were seized informing him the grounds on which goods are proposed to be confiscated, within 6 months (extendable upto one year) of seizure of the goods. Otherwise, goods need be returned to such person.

However, in the present case, the notice under section 124(a) was dispatched by registered post on the date of expiry of stipulated period under section 110(2) and received by the petitioner after the expiry of such period.

The petitioner contended that since said notice had not been received before the expiry of the said period of six months (extendable upto one year), goods should be returned to him. Relying on Supreme Court's decision in case of *K. Narsimhiah v. H.C. Singri Gowda AIR 1966 SC 330* and Gujarat High Court's decision in case of *Ambalal Morarji Soni v. Union of India AIR 1972 GUJ 126*, it submitted that by the use of the word "given" used in section 110(2), the legislative intent was clear that the notice had to be received by the person concerned or the notice had to be offered/tendered and refused by the person concerned. Mere dispatch by post would not be covered by the word "given" as appearing in the above mentioned provisions of the said Act. Further the expression "given" was distinct and different from the word "issued" or "served".

Revenue, referring to section 153(a), submitted that the moment a notice is tendered or sent by registered post or by an approved courier, that amounts to service of the notice and the actual receipt by the noticee is not a relevant consideration. Since the notice had been sent by registered post within the stipulated period as prescribed under section 110(2) of the said Act, the goods were not liable to be released. They primarily placed reliance on decision of Calcutta High Court in case of *Kanti Tarafdar 1997 (91) ELT 51 (Cal.)* and Madhya Pradesh High Court in case of *Ram Kumar Aggarwal 2012 (280) ELT 13 (M.P.).*

Observations of the Court: The Delhi High Court observed that section 124(a) clearly stipulates that no order confiscating any goods or imposing any penalty on any person shall be made unless the owner of the goods or person from whom goods have been seized is "given a notice" in writing, "informing him of the grounds on which it is proposed to confiscate the goods or to impose a penalty". In case such notice is not given within the stipulated period of six months or the extended period of a further six months, seized goods have to be released.

The object of section 124(a) is that the person from whom the goods have been seized had to be informed of the grounds on which the confiscation of the goods is to be founded. This can happen only when such person receives the notice and is capable of reading and understanding the grounds of the proposed confiscation. On a conjoint reading of section 110(2) and section 124(a) of the said Act, the Court opined that the notice contemplated in these provisions can only be regarded as having been "given"

when it is actually received or deemed to be received by the person from whom the goods have been seized.

The Delhi High Court was in complete agreement with the Supreme Court's decision in case of *K. Narsimhiah* as followed by Gujarat High Court in case of *Ambalal Morarji Soni.* However, it disagreed with the decision of Calcutta High Court in case of *Kanti Tarafdar.* The Delhi High Court pointed out that the decision in the said case was arrived at on the (wrong) premise that section 124 requires that a notice be "issued" as against a notice being "given" when the body of the provision of section 124 nowhere uses the expression "issue of show cause notice". The Delhi Court elaborated that it is only the heading of that section which uses that expression (**issue** of show notice) and the body of section 124(a), on the contrary, uses the exact same expression "given" as used in section 110(2) of the said Act. Therefore, the Delhi High Court was of the view that very basis of the Calcutta High Court's decision in *Kanti Tarafdar* is incorrect. The Delhi High Court also disagreed with the Calcutta High Court's observation that the word "given" used in section 110(2) and section 124(a) is in any manner controlled by section 153. The Delhi High Court opined that in the context of the present cases, section 153 would only define the mode and manner of service and not the time of service or when a notice can be said to have been "given".

Further, Delhi High Court was of the view that Madhya Pradesh High Court, in case of *Ram Kumar Aggarwal,* wrongly concluded that when the legislature had used the words "notice is given" it would "obviously mean that the notice must be issued within six months of the date of seizure". The Delhi High Court, on the other hand, opined that expression "notice is given" does not logically translate to the conclusion that "notice must be issued within the stipulated period".

Decision: The High Court held that since the petitioners did not receive the notice under section 124(a) within the time stipulated in section 110(2) of the Act, such notice will not considered to be "given" by the Department within the stipulated time, i.e. before the terminal date. Consequently, the Department was directed to release the goods seized.

Note: *Section 124(a) of the Customs Act, 1962, inter alia, stipulates that no order confiscating any goods or imposing any penalty on any person shall be made under this Chapter unless the owner of the goods or such person is* ***given*** *a notice in writing informing him of the grounds on which it is proposed to confiscate the goods or to impose a penalty.*

Further, section 110(2) of the Act stipulates that where no such notice is ***given*** *within six months of the seizure of the goods, the goods shall be returned to the person from whose possession they were seized.*