PAPER – 5: STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION

*Question No.**1** is compulsory.*

*Answer any **four** questions from the remaining **five** questions.*

Working notes should form part of the answer.

No statistical or other table will be provided with this question paper.

Question 1

Cure Hospital is running under private-public-partnership (PPP) model - providing treatment for non-communicable diseases. ABCO Hospitals Limited is the private partner which runs a chain of hospitals on profit basis in major cities in India. The public partner is the State Government. Cure Hospital is a "not- for-profit" hospital.

Private partner is to invest in Upgrading and equipping the facility and responsible for operational management and service delivery. Government to provide physical space and other infrastructure in "as is where is" condition, provide support facilities and hospital amenities. Private partner assumes the entire responsibility, for a full range of investment operation and maintenance functions. Private partner has the authority to make daily management decisions.

The hospital is funded to a great extent by the State Government and a fixed level of funding is received from the government each year out of the State budgetary allocation. It is up to the hospital to allocate this fund to different areas such as doctors' and other staff salaries, medicines and all other costs required to run a hospital.

Cure Hospital's objectives are:

- *to give prompt access to high quality medical treatment for patients.*
- *to provide free treatment to poor patients in line with government policy of inclusive development.*
- *to provide value for money for the taxpayer-measured by the 3 Es framework of Economy, Efficiency and Effectiveness.*
- *to contribute to medical science by developing innovative ways to deliver treatment to patients.*

Except select surgeries, all services are free for poor patients that are below poverty line (BPL) card holders. 40% beds are reserved for poor patients. Free out patient department (OPD) services to poor. CT Scan and MRI diagnostics are free for poor patients, subsidised rates for others. Cure Hospital also runs a generic medicine shop inside the hospital premises which sells medicines to all patients at discount ranging from 40% to 56% - the only shop of this kind in the city.

WHO has agreed to provide financial and technical support to the neonatal care unit. The hospital enabled it to obtain five accreditation certificates from various leading authorities on different aspects of hospital management.

Feedback is taken from each in-patient about the quality of service provided by the hospital and the satisfaction level is taken in 1 to 10 point scale. 1 being the least satisfied and 10 represents totally satisfied.

In a recent meeting of the managing committee of the hospital, discussions were held about inadequate performance measurement systems in place to assess whether the hospital is achieving its objectives and that insufficient attention is given to the importance of non-financial performance indicators.

A four member team consisting of a performance management expert and three senior doctors was created to give their advice in these aspects.

The four member team met with doctors, staff and other stakeholders at length and breadth. Some of the conversations were as below:

Doctor A: I think the hospital always deliver value for money. We have always achieved our total financial budgets.

Doctor B: We work here much longer hours than doctors in other hospitals, often without being paid for working overtime.

Doctor C: There is not enough government and private partner funding to recruit more doctors and paramedic staff.

Doctor D: Number of out-patients has increased considerably. Earlier an out-patient had to wait for an average period of 2 hours 20 minutes and now the same has increased to 3 hours.

Senior Doctor K: I do not know how much time we spend developing innovative ways to deliver treatment to patients though, as most of the performance data we doctors receive relates to financial targets.

In-patient H: Incompetent paramedic staff, poor quality of food and bed linen.

Staff M: Management undermines our role in running the hospital.

Recent performance data of the hospital vis-a-vis national average are as follows:

	Cure Hospital	**National average of other PPP run hospitals**
Number of doctors	80	76
Average doctors' salaries per month including overtime	₹ 1,20,000	₹ 1,60,000
Average doctors' salaries including overtime as per budget	₹ 1,20,000	₹ 1,25 000
Number of in-patients treated	8,360	6,369
Average satisfaction rating of in- patients	6	9

Number of patients readmitted for treatment of the same ailment within short period of time after discharge from the hospital	*627*	*128*
Average staff satisfaction rating (0% represents totally dissatisfied and 100% represents totally satisfied)	*16%*	*86%*
Number of out-patients treated	*76,212*	*63,318*

Required

(a) *EXPLAIN why non-financial performance indicators are particularly important to measure the performance of "not-for-profit" organisations such as Cure Hospitals.* ***(4 Marks)***

(b) *EVALUATE whether Cure Hospital is delivering value for money for each of the components of the value for money framework.* ***(12 Marks)***

(c) *The CEO of the hospital intends to introduce a nominal fee for out-patient treatment given to poor patients and remove subsidised rate of CT Scan and MRI diagnostic for other patients in order to achieve its objectives in a better way. EVALUATE the proposal of the CEO.* ***(4 Marks)***

Answer

(a) Cure Hospital has been formed in a public-private partnership to provide quality healthcare to the public, with *focus on the poorer sections of the society*. Healthcare service is provided for free, except for select surgeries. A sufficient portion of its capacity (hospital beds) is reserved entirely for Below Poverty Line (BPL) patients. Generic medicines are provided at a discounted price, to make them more affordable. World Health Organization (WHO) has decided to fund its neo-natal unit. With all this information, it can be summarized that Cure Hospital has been formed "not-for-profit" objective, attending to a social cause of providing quality healthcare to the economically poorer sections of the society.

Cure Hospital has been formed in partnership with ABCO Hospitals Ltd. and the State Government. The State Government has provided physical space, infrastructure, other support facilities and hospital amenities. ABCO Hospital, the private partner has the entire responsibility of taking care of allocation of funds, investment, operations, and maintenance functions. Daily management decisions are also handled by the private partner.

Since the Government has provided substantial funding and facilities to Cure Hospital, it owes a fiduciary responsibility of reporting the financial measures to its stakeholders, the government in this case. At the same time, financial measures alone are not enough to assess the performance of not-for-profit organizations. Due to its objective of public service, measurement of appropriate non-financial metrics are equally important. The reasons are:

(i) **Benefits cannot be quantified:** Cure Hospital essentially provides public healthcare service to the economically weaker sections of the society. Due to political, legal, and social reasons, not-for-profit organizations like Cure Hospital cannot be shut down merely for not being economically / financially viable. Therefore, financial measures are less relevant. Due to its non-financial objective, appropriate non-financial measures become more important. For example, the benefits of saving lives cannot be quantified in financial terms.

(ii) **Benefits may accrue over long term:** The expenditure incurred in one year may yield benefits over several years. For example, the investment in an Intensive Care Unit (ICU) facility may accrue of multiple years. Neonatal care unit have been given financial and technical support from WHO which will give long term benefits to hospital.

(iii) **Measurement of utilization of funds and expenditure:** In the case of Cure Hospitals, many hospital services are free, allocation of capacity is aimed at providing free service to the BPL section of the society, medicines are provided at discounted rates. Therefore, Cure Hospital does not have a substantial revenue stream to earn from its patients. It gets a fixed budget allocation from the State Government, while ADCO Hospital allocates these funds for various investments and expenditures. *The assessment whether the spending have been appropriate is a key challenge.* Defining cost per unit would be subjective since it could be cost of patients arriving at the hospital or cost of patients successfully treated at the hospital. Either figure could be tweaked to make it seem that the objectives are being met. The management may resort to rampant spending simply to meet the expenditure targets. Therefore, non-financial measure need to be put in place help stakeholders scrutinize whether the objectives for which funds have been given are being met.

(iv) **Multiple objectives:** Not-for-profit organizations have multiple objectives. It may be unclear which are the most important. Cure Hospital aims at providing high quality treatment to its patients while also developing innovative ways to deliver treatment to its patients. Both objectives are equally important and inter-related. Non-financial measures provide better information about how each of these objectives have been met.

The benefits of organizations like Cure Hospital are non-financial in nature. Except for providing fiduciary information to the stakeholders, all other objectives of Cure Hospital can be measure only using non-financial measures.

(b) Value for money for Cure Hospital would comprise of the 3Es: Economy, Efficiency and Effectiveness.

(i) Economy: Has the desired output (and quality of service) been achieved at the lowest cost?

The medical resource at Cure Hospital in terms of doctors is 80, higher than the national average of 76 at other centers. Doctor's salaries would be a significant expenditure for Cure Hospital. **The average doctor's salary at Cure Hospital (including overtime) is ₹120,000 per month, this is within the budget figure as pointed out by Doctor A. The salary is lower than the national average at other PPP run hospitals, where doctors earn ₹160,000 per month.** Therefore, *economy of money is being achieved at Cure Hospital*.

The relatively lower levels of salary could be due to differences in levels of experience or that the doctors at Cure Hospital work overtime without getting paid (as pointed out by Doctor B). **This may be one of the reasons why staff satisfaction is only 16% compared to 86% in other centers.**

(ii) Efficiency: Has maximum output been achieved with the minimum resources?

Treating patients is the key objective of Cure Hospitals, while doctors are the main resource to deliver it. The number of patients treated per year is a good measure of efficiency achieved.

Cure Hospital treats 84,572 patients (in house patient 8,360 + outpatient 76,212) while the national average at other centers is only 69,687 (in house patient 6,369 + outpatient 63,318). Cure Hospital has 80 doctors as compared to 76 national average. Therefore, each doctor at Cure Hospital **treats 1,057 patients (84,572 patients/ 80 doctors) as compared to 917 patients** (69,687 patients / 67 doctors) at other centers. *Resource utilization of its pool of doctors is higher in Cure Hospital.*

Doctor C mentions that there is not enough funding to hire more doctors and para-medic staff. Therefore, there is a constraint on the limited resources of doctors and support staff. This might be the reason, why each doctor at Cure Hospital works longer than colleagues at other centers.

Therefore, while efficiency in terms of number of patients treated by each doctor is high, there are other *hidden costs* that need to be taken into account**. Few such costs could be low employee morale, higher waiting time of patients to receive treatment.** This impacts the effectiveness of service provided.

(iii) Effectiveness: Has Cure Hospital achieved its mission or objective?

Cure Hospital has the objective of providing high quality medical service to its patients. Better quality of treatment would ensure that re-admission for treatment of the same ailment within a short span of time would be minimal. **Number of such re-admitted patients in much higher at 627 at Cure Hospital as compared to 128 at other centers.** Assuming all such re-admissions to be in-house patients, this return of patients for medical care for the same ailment within a short span of time is **7.50%** compared to the national average of **2.01%**.

Prompt medical treatment can also be questioned since the **waiting time of patients to receive treatment has increased from 2 hours 20 minutes to 3 hours.**

Senior Doctor K points out the time spent on delivering innovative care to patients may be limited due to financial constraints and overwork staff.

All this would have resulted in dissatisfaction among patients, whose **survey indicates a score of 6 against a national average of 9.** This shows that *objective of Cure Hospital is not being met effectively*.

To summarize, *Cure Hospital is achieving economy by maintaining lower salaries for doctors. Out-reach to patients is also high as compared to national average. However, due to limited availability of resources, doctors and staff are* ***overworked****. While it does well on the efficiency aspect, it comes with a hidden cost in terms of* ***dissatisfaction among patients and employees and low quality of medical care.*** *Therefore, medical treatment is not effective, which is an important aspect in the value for money framework.*

(c) Proposal to introduce nominal fee for out-patient treatment given to poor people and remove subsidized rate of CT scan and MRI for other patients.

Cure Hospital is a not-for-profit organization that aims at providing quality health care to the economically weaker sections of the society. It gets its primary funding from the State Government. It does not generate and is not aimed at generating substantial revenue from its patients. The CEO has proposed to introduce nominal fee for out-patient treatment given to poor people and remove subsidized rate of CT scan and MRI for other patients. However, this would not help Cure Hospital achieve its objective.

The given problem seems to suggest severe constraint in the resources available to meet its objectives thus impacting effectiveness of treatment. Each doctor treats 1,057 patients in a month as compared to the national average of 917 in a month. Number of patients, especially the out-patients is much more than national average. **Overworked doctors combined with limited staff resources is the main hurdle that Cure Hospital faces in effectively achieving its objectives.**

Cure Hospital is a not-for-profit organization. **Therefore, generating nominal fees to achieve its objectives would not help its purpose. Instead, it** ***can apply for higher budget allocation from the government*****.** This can help it procure good quality resources such as experienced doctors by paying them higher salaries including overtime. Better qualified doctors can help provide not just better treatment but also innovative ways of treatment to patients. Improved / enhanced facilities could reduce the waiting time for medical care, enabling prompt medical service.

Improved service would result in better treatment, lowering the cases for re-admissions for same ailment within a short span of time. This improves the effectiveness of medical care provided at Cure Hospital. Better service would improve patient satisfaction. Quality medical care would provide a better case for Cure Hospital to sustain its operations in the long- run. The State Government may also more favorably consider any justifiable future budgetary increments.

Overall, the management of the hospital seems to be indifferent to the opinions and needs of the staff. ***The CEO's decision has a very short term outlook that does not co-relate with the organization's objectives.*** By trying to off-set a limited revenue stream to achieve its objectives shows that the management's style of working needs improvement.

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Conceptually correct *brief explanation* is sufficient for each step.

Question 2

Pixel Limited is a toy manufacturing company. It sells toys through its own retail outlets. It purchases materials needed to manufacture toys from a number of different suppliers. Recently, due to the entity of few reputed foreign brands in the toy market and particularly in the segment in which Pixel Ltd. is doing business, it is facing a threat to operate profitably.

Each toy requires 4 kg. of materials at ₹ 19 per kg. and 5% of all materials supplied by the suppliers are found to be substandard. Labour hour requirement for each toy is 0.4 hour at ₹ 120 per hour.

Market research has determined that the selling price will be ₹ 240 per toy. The company requires a profit margin of 15% of the selling price. Expected demand for toy in the coming year will be 50,000 toys. Sales and variable overhead per unit for the four quarters of the year will be as follows:

	Q1	***Q2***	***Q3 (Festive season)***	***Q4 (Festive season)***
Sales (units)	*7,500*	*9,000*	*15,500*	*18,000*
Variable overhead per unit (₹)	*22*	*22*	*24*	*25*

Total fixed overheads are expected to be ₹ 6,25,000 for each quarter.

The production manager has decided to produce 12,500 units in each quarter. Inventory holding costs will be ₹ 18 per unit of average inventory per quarter. Inventory holding costs are not included in above.

Normal production capacity per quarter is 15,000 toys. The company can produce further up to 6,000 units per quarter by resorting to overtime working. Overtime wages will be at 150% of normal wage rate.

Assume zero opening inventory.

Required

(a) (i) CALCULATE the cost gap that exists between the total cost per toy as per the production plan and the target cost per toy. ***(9 Marks)***

(ii) *DISCUSS how just-in-time purchasing and just-in-time production will remove the cost gap calculated in (i) above. Show calculations in support of your answer.* ***(7 Marks)***

(b) *EXPLAIN, how implementation of JIT production method can be a major source of competitive advantage and success of the company.* ***(4 Marks)***

Answer

(a) (i) Cost gap between Total Cost *per toy* as per the production plan and the Target Cost *per toy*

Target Cost *per toy*

Sr. No.	Particulars	₹ per unit	For Annual Sales of 50,000 units
1	Selling Price *per toy*	240	1,20,00,000
2	Required Profit Margin (15% of selling price =15% ×₹240 *per unit*)	36	18,00,000
3	Target Cost *per annum* (Step 1 - 2)		1,02,00,000
4	Target Cost *per toy* (Step 3 / 50,000 units)		**204.00**

Therefore, Target Cost is **₹204** *per toy*.

Total Cost as per production plan

Pixel Ltd. has an annual production requirement of 50,000 toys, which is also its annual sales. Given that opening inventory for the first quarter is nil. The production manager wants to produce 12,500 units *per quarter* irrespective of the sales demand for the quarter. This implies that during some quarters, there might be unsold inventory, for which inventory holding cost has to be borne. This type of production is called "produce to stock".

Production Schedule and Inventory Holding Cost *for the year*

Sr. No.	Particulars	Q1	Q2	Q3	Q4	Total for the year
1	Opening Stock (units)	-	5,000	8,500	5,500	
2	Production (units)	12,500	12,500	12,500	12,500	50,000
3	Sales (units)	7,500	9,000	15,500	18,000	50,000
4	Closing Stock (units) (Step 1 + 2 – 3)	5,000	8,500	5,500	-	
5	Average Inventory = (Step 1+ Step 4)/ 2	2,500	6,750	7,000	2,750	

6	Inventory Holding Cost (Average Inventory × ₹18 *per unit* of Average Inventory)	₹45,000	₹1,21,500	₹1,26,000	₹49,500	**₹3,42,000**

Total Cost of Production *per toy* as per production plan

Sr. No.	Particulars	Q1	Q2	Q3	Q4	Total for 50,000 units
1	Direct Material Cost *per unit* (Note 1)	₹80	₹80	₹80	₹80	₹40,00,000
2	Direct Labour Cost *per unit* (Note 2)	₹48	₹48	₹48	₹48	₹24,00,000
3	Variable Overhead Cost *per unit*	₹22	₹22	₹24	₹25	₹11,62,500
4	Total Variable Cost *per unit* for the quarter (other than inventory holding cost) [Steps 1+ 2+3]	₹150	₹150	₹152	₹153	
5	Production (units) for the quarter (refer production schedule above)	12,500	12,500	12,500	12,500	50,000
6	Total Variable Cost for the quarter (other than inventory holding cost) [Step 4 × Step 5]	₹18,75,000	₹18,75,000	₹19,00,000	₹19,12,500	₹75,62,500
7	Inventory Holding Cost for the quarter	₹45,000	₹1,21,500	₹1,26,000	₹49,500	**₹3,42,000**

	(refer to the production schedule above)					
8	Fixed Overheads	₹6,25,000	₹6,25,000	₹6,25,000	₹6,25,000	₹25,00,000
9	Total Cost [Step 6 + Step 7+Step 8]	₹25,45,000	₹26,21,500	₹26,51,000	₹25,87,000	₹1,04,04,500
10	Total Cost per toy as per production schedule (Step 9 / 50,000 units)					**₹208.09**

Note 1

Each toy requires 4kg of material, 5% of all materials is substandard. Therefore, procurement should factor this substandard quality.

Material required *per unit* = 4 kg / 95% = 4.21 kg

Material Cost *per toy* produced = 4.21 kg ×₹19 per kg = ₹80 *per unit*

Note 2

Each toy requires 0.40 hours. Rate per hour is ₹120 *per hour*.

Therefore, Cost *per toy* = 0.40 × ₹120 = ₹48 *per unit*

Cost Gap

= Total Cost *per toy* as per production schedule – Target Cost *per toy*

= ₹208.09 - ₹204.00 *per toy*

= ₹4.09 per toy

JIT System

(ii) Just in Time Purchasing and Just in Time Production is aimed at eliminating inventory holding of raw material and finished goods respectively. Components are purchased only when there is a requirement in the production process. Similarly, finished goods are produced only when there is a demand for them. This type of production is called "produce to order". Hence, there is neither any opening inventory nor any closing inventory, thereby no inventory holding cost.

In the given problem, this savings is off-set by the extra payment to be made to labor for overtime. Production capacity is 15,000 toys per quarter. This can be increased by 6,000 toys per quarter by incurring additional overtime cost.

The Production Plan under the Just in Time System

Sr. No.	Particulars	Q 1	Q 2	Q 3	Q 4	Total for the year
1	Opening Stock (units)	-	-	-	-	
2	Production (units)	7,500	9,000	15,500	18,000	50,000
3	Sales (units)	7,500	9,000	15,500	18,000	50,000
4	Closing (units)	-	-	-	-	
5	Inventory Holding Cost	-	-	-	-	
6	Production Beyond Capacity of 15,000 Toys *per quarter* (units)	-	-	500	3,000	

Total Cost of Production under JIT System

Sr. No.	Particulars	Q1	Q2	Q3	Q4	Total for 50,000 units
1	Direct Material Cost *per unit* (Note 1)	₹76	₹76	₹76	₹76	38,00,000
2	Direct Labour Cost *per unit*	₹48	₹48	₹48	₹48	24,00,000
3	Variable Overhead Cost *per unit*	₹22	₹22	₹24	₹25	11,85,000
4	Total Variable Cost *per unit* (Steps 1+ 2+3)	₹146	₹146	₹148	₹149	
5	Production (units) for the quarter (Refer JIT production schedule above)	7,500	9,000	15,500	18,000	50,000
6	Total Variable Cost for the quarter (Step 4 × Step 5)	₹10,95,000	₹13,14,000	₹22,94,000	₹26,82,000	₹73,85,000
7	Production (units) for the quarter in excess of capacity (Refer JIT production schedule above)	-	-	500	3,000	3,500

8	Overtime Labour Cost for production in excess of capacity (Note 2) [Step 7 × 0.40 × 50% ×₹120 per hour]	₹0	₹0	₹12,000	₹72,000	**₹84,000**
9	Fixed Overheads	₹6,25,000	₹6,25,000	₹6,25,000	₹6,25,000	₹25,00,000
10	Total Cost for production under the JIT System (Step 6 + Step 8+ Step 9)	₹17,20,000	₹19,39,000	₹29,31,000	₹33,79,000	₹99,69,000
11	Total Cost *per toy* as per production schedule (Step 10 / 50,000 units)					**₹199.38**

Note 1

Carefully selected suppliers of delivering high quality materials in a timely manner directly at the shop floor, reducing the material receipt time and loss due to sub-standard material.

Note 2

Overtime wages are 150% of normal wage rate. Therefore, for every toy produced over the quarterly production capacity of 15,000 toys, 50% extra wage over and above the hourly rate has to be paid as overtime wages. Each toy needs 0.40 hours for production. Therefore, overtime cost for excess production = excess production units × 0.40× 50% ×₹120 per hour.

Cost Gap

The cost of production *per toy* under the JIT system is ₹199.38 per toy as compared to the target cost of ₹204 *per toy and* ***save ₹ 4.62 per toy***.

The savings *primarily* comes from eliminating the inventory holding cost of ₹3,42,000 per annum and sub- standard material cost of ₹2,00,000 per annum under the previous production system. This is slightly offset by the additional cost of ₹84,000 per annum that has to be paid towards overtime labor charges and ₹22,500 towards additional variable overheads. However, by switching to the JIT system, Pixel Ltd. could reduce its production cost below the target cost per toy.

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This question can also be solved by assuming "***continued*** material wastage" due to ***sub-standard material*** **from suppliers**.

(b) JIT system aims at:

- Meeting customer demand in a timely manner.
- Providing high quality products and
- Providing products at the lowest possible price.

The main features of the JIT production system are:

- **Material handling cost is reduced –** materials move from one machine to another in an organized sequence. The production process is grouped into to manufacturing cells. These can be managed with *minimal labor*. This reduces material handling costs as also any pile up of inventory in the form of work-in-progress. In JIT procurement process, the raw material is received only when needed. *Due to significant reduction in inventory, inventory holding costs, normal wastage cost and spoilage can be avoided. Optimum arrangement of cells can lead to lesser floor space requirement, thereby reducing factory rental and overhead cost.*
- **Multi-skilled labor:** Hire and retain multi-skilled workers who are capable of performing a variety in operations including repairs and maintenance. Therefore, a worker is not confined to only one process in the production process. He can contribute towards other processes as well. This reduces the workforce requirement and labor idle time. The company can have a *more efficient workforce, with lesser number of workers*. There is potential to reduce labor cost on account of this.
- **Minimizing defects rework and scrap**: Each stage of the production process is tightly linked in a sequential manner. Defective output from one stage will stop the work at the next stage. Due to this, workers can identify and correct errors or defects instantaneously. JIT creates urgency for eliminating defects as quickly as possible since the downstream work also stops due to error in any workstation. *Production process efficiency improves and reduces rework or scrap.* The overall quality of production improves. There are other benefits to streamlining production process: *lesser need for inspection of final output and lesser sales returns due to defects. This would contribute to the product's brand value*.
- **Reduced set-up time:** Streamlined production process under JIT *reduces set-up time at the workstations*. When the production process has to change to make the product per the customers' demands, set-up time is incurred at the workstation. By streamlining operations, JIT system aims at reducing the set-up time, so that production can continue with the least possible interruption. This brings flexibility in the operations since the company can quickly change the production requirement, to make products to meet the customer's demand. Quick turnover improves productivity of the machine, thereby increasing the production capacity. Lesser time is spent on set-up which is not a value adding activity.

- **Reduces lead time for receiving materials** since the suppliers of raw material are capable of delivering high quality materials in a timely manner directly at the shop. Proper selection of such suppliers is imperative for the JIT system to be successful. If this can be achieved, then it is beneficial for the company since inventory holding of material is eliminated along with receiving *better quality of raw material in a timely manner*.

Eliminating inventory holding, scrap, material wastage, flexibility in operations by reducing set-up time, better response time to customer's demands, better skilled workforce, better quality of production, lower workforce requirement, lower floor space requirement all of these contribute towards lowering working capital requirements. These contribute to a company's competitive edge and success.

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Conceptually correct brief explanations are sufficient.

Question 3

AKG Limited has three autonomous divisions. The divisions are evaluated on the basis of ROI, with year end bonuses given to divisional managers who have the highest ROI. Operating results of Division II for the last year are given below:

	₹
Sales	*2,10,00,000*
Less: Variable Expenses	*1,26,00,000*
Contribution margin	*84,00,000*
Less: Fixed Expenses	*67,20,000*
Net Operating Income	*16,80,000*
Divisional Operating Assets	*52,50,000*

The company's overall ROI for the last year was 18% (considering all divisions). Division II has an opportunity to add a new product line that would require an investment of ₹30,00,000. Other details of the new product line are as follows:

	₹
Sales	*₹90,00,000 per annum*
Variable Expenses	*65% of sales*
Fixed Expenses	*₹25,20,000 per annum*
Life cycle of the product line	*5 years*

Though Division II is performing well, but many a times, the customers complained that they had to wait for long after placing the orders. The company is interested in cutting the amount of time between when a customer places an order and when the order is completed. For the last year, the following data were reported in respect of Division II:

Inspection time	=	*0.5 days per batch*
Process time	=	*2.8 days per batch*
Wait time	=	*16.0 days per batch*
Queue time	=	*4.0 days per batch*
Move time	=	*0.7 days per batch*

In addition to financial performance measures, the company wishes to introduce a variety of non-financial performance measures.

The company has set aggressive targets in both sales growth and ROI for the coming year. The company's strategy for achieving these goals includes a campaign aimed at building brand recognition, customer retention, improvement in product quality, on time delivery to customers, expansion of eco-friendly product line and introduction of limited edition items.

Required:

(a) *(i)* *CALCULATE last year's ROI of Division II.* ***(1 Mark)***

(ii) *DISCUSS whether the manager of Division II would accept or reject the new product line, if he takes his decision based solely on divisional ROI.* ***(2 Marks)***

(iii) *ADVISE how residual income approach can be used as an alternative financial measure for evaluation of managerial performance in the best interest of the company.* ***(2 Marks)***

(iv) *CALCULATE Manufacturing Cycle Efficiency (MCE) and interpret the result.* ***(3 Marks)***

(v) *STATE what percentage of the production time is spent in non-value added activities.* ***(1 Mark)***

(vi) *CALCULATE the delivery cycle time.* ***(1 Mark)***

(vii) *CALCULATE the new MCE if by using Lean Production all queue time can be eliminated.* ***(2 Marks)***

(b) Based on the above information and using a Strategy Map TABULATE two objectives and two measures for each perspective across the four dimensions of a balanced scorecard in the following format :

Perspective	*Strategic Objective*	*Measure*

(8 Marks)

Answer

(a) (i) Calculation of last year ROI of Division II

= Controllable Profit/ Controllable Net Asset

= ₹16,80,000/ ₹52,50,000

= 32%

(ii) Calculation of ROI of New Product Line

Particulars	**Amount (₹)**
Sales	90,00,000
Less: Variable Cost	58,50,000
Controllable Contribution	31,50,000
Less: Fixed Cost	25,20,000
Controllable Profit	6,30,000
Investment Available	30,00,000
Return on the Proposed Line (ROI)	**21%**

The manager of Division II would be unwilling to invest the additional ₹30 lacs because this would decrease the Division II's ROI of 32% to 28%.

[₹16,80,000+₹6,30,000/ (₹52,50,000+₹30,00,000)]

(iii) Generally, a manager who is evaluated based on ROI will reject any project whose rate of return is below the Division's current ROI even if the rate of return of the project is above the company's minimum required rate of return. In contrast, managers who are evaluated using residual income will pursue any project whose rate of return is above the minimum required rate of return, because it will increase their residual income. So, in the best interest of the company as a whole, residual income approach can be used for evaluation of managerial performance.

Alternative

To overcome some of the dysfunctional consequences of ROI, the residual income approach can be used. For the investment decision for Divisions II, the residual income calculations are as follows:

Proposed Investment	₹ 30,00,000
Controllable Profit	₹6,30,000
Cost of Capital (18%)	₹5,40,000
Residual Income(RI)	**90,000**

Advise

This calculation indicates that the residual income of Division II will increase if manager accept the project. However, it is important to note that Residual Income does not always point to the right decision, because notional interest on accounting capital employed is not the same as IRR on cash investment. This Project has 1.65% IRR.

Overall, Residual Income is more likely than ROI to improve when managers make correct investment decisions, and so is probably a 'safer' basis than ROI on which to measure performance.

(iv) Manufacturing Cycle Efficiency (MCE)

$$= \frac{\text{Processing Time}}{\text{Inspection Time + Process Time + Queue Time + Move Time + Wait Time}}$$

$$= \frac{2.8 \text{ days}}{0.5 \text{ days} + 2.8 \text{ days} + 4.0 \text{ days} + 0.7 \text{ days} + 16.0 \text{ days}}$$

= 11.67%

Interpretation

In AKG, the MCE is 11.67%, which means that 88.33% of the time a unit is in process is spent on the activities that do not add value to the product. Monitoring the MCE helps companies to reduce non -value added activities and thus get products into the hands of customers more quickly and at a lower cost.

(v) Percentage of Time Spent on Non- Value Added Activities

= 100% -11.67%

= 88.33%

(vi) Delivery Cycle Time

= 0.5 days + 2.8 days + 4.0 days + 0.7 days + 16 days

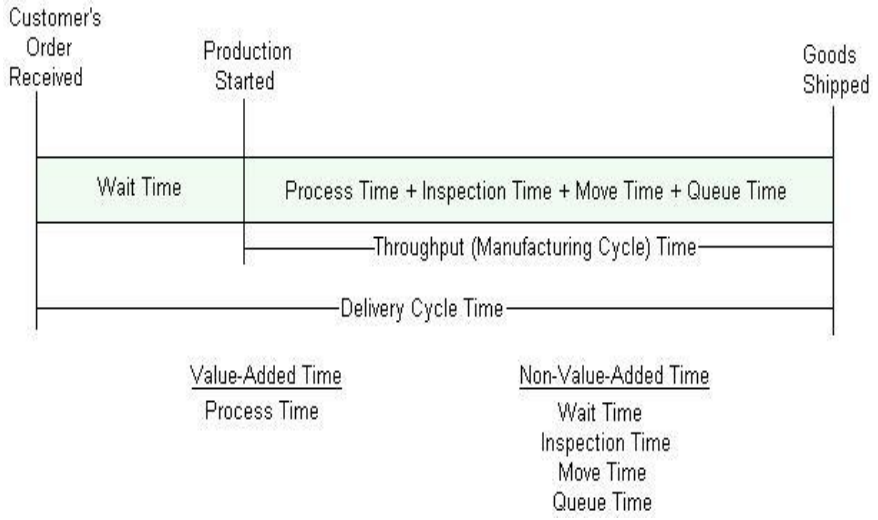
= 24 days

(vii) Revised MCE

$$= \frac{2.8 \text{ days}}{0.5 \text{ days} + 2.8 \text{ days} + 0 \text{ days} + 0.7 \text{ days} + 16 \text{ days}}$$

= 14%

Alternative (iv) to (vii)



(iv) Manufacturing Cycle Efficiency (MCE)

$$= \frac{\text{Value Added Time (Processing Time)}}{\text{Throughput (Manufacturing Cycle) Time}}$$

$$= \frac{2.8 \text{ days}}{0.5 \text{ days} + 2.8 \text{ days} + 4.0 \text{ days} + 0.7 \text{ days}}$$

= 35%

Interpretation

In AKG, the MCE is 35%, which means that 65% of the time a unit is in process is spent on the activities that do not add value to the product. Monitoring the MCE helps companies to reduce non -value added activities and thus get products into the hands of customers more quickly and at a lower cost.

(v) Percentage of Time Spent on Non- Value Added Activities

= 100% -35%

= 65%

(vi) Delivery Cycle Time

= 0.5 days + 2.8 days + 4.0 days + 0.7 days + 16 days

= 24 days

(vii) Revised MCE

$$= \frac{2.8 \text{ days}}{0.5 \text{ days} + 2.8 \text{ days} + 0 \text{ days} + 0.7 \text{ days}}$$

= 70%

(b)

Perspective	Strategic Objective	Measure
Financial	▪ Improve ROI ▪ Increase Sales	▪ % increase in ROI ▪ % increase in sales
Customer Perspective	▪ Improve brand recognition ▪ Customer retention	▪ % of target audience who recognize brand ▪ %of suggestions/ complaints responded ▪ % increase in repeat customers/ Number of repeat customers
Internal Perspective	▪ Improve in product quality ▪ Improve on time delivery to customers ▪ Reduction in time spent in non-value added activities	▪ % reduction in defect rate ▪ % of orders on time ▪ % increase in MCE
Learning & Innovation	▪ Expansion of eco-friendly product line ▪ Introduction of limited edition items	▪ No of eco-friendly products developed. ▪ No of limited editions introduced.

☞

Other measures are also possible.

Question 4

(a) A chemical company produces two chemicals SX and ZX. Environmental activities and costs associated with the two chemicals are as follows :

	SX	***ZX***
Unit produced (kg.)	*6,00,000*	*15,00,000*
Packing Materials (kg.)	*80,000*	*40,000*
Energy Usage (KWH)	*60,000*	*30,000*
Toxin releases (Pounds into air)	*2,00,000*	*40,000*
Pollution control machine hours	*32,000*	*8,000*

Cost of environmental activities :	
Packing material Costs	*₹ 3,60,000*
Energy Costs	*₹ 96,000*
Fines for release of toxins into air	*₹ 48,000*
Operating costs of pollution control equipments	*₹ 1,12,000*

Required

CALCULATE the environmental cost per kilogram for each chemical produced by the company. ***(5 Marks)***

OR

The triple bottom line recognises that a company's performance should not only be viewed in terms of its ability to generate economic profits for its owners, but also by its impact on people and the planet for its long term economic and social viability. XYZ Limited has recently undertaken initiatives towards sustainability as below :

(i) Reduced the amount of plastic usage in the peanut butter jars.

(ii) Provided financial support to hospital run by local authority in the vicinity of the factory.

(iii) Constructed solar powered warehouse.

(iv) Generate profit for the company's shareholders.

(v) Started child care unit for the benefit of women employees as well as for the neighborhood community.

Required

IDENTIFY whether this initiative would primarily impact people, planet or profit. ***(5 Marks)***

(b) The President of Automation Limited, a 150 persons engineering company, decided it was time to fire the company's biggest client. Although the client provided close to 60% of the company's annual revenue, Automation Limited decided that dropping this client was necessary. The client was profitable.

The President of Automation Limited stated "We cannot be a great place to work without employees, and this client was bullying my employees. Its demands for turnaround were impossible to meet even with people working seven days a week. No client is worth losing my valued employees".

The initial impact on revenues was significant. However, Automation Limited was able to cut costs and obtain new customers to fill the void. Moreover, the dropped client later gave Automation Limited two projects on more equitable terms.

Required

(i) DISCUSS the reasons behind dropping of a profitable client by Automation Limited.

(2 Marks)

(ii) STATE three qualitative factors that management should consider in outsourcing and make or buy decisions. ***(3 Marks)***

(c) APC Ltd. has two divisions- Division X and Division Y with full profit responsibility. Division X produces components 'Gex' which is supplied to·both division Y and external customers.

Division Y produces a product called 'Gextin' which incorporates component 'Gex'. For one unit of 'Gextin' two units of component 'Gex' and other materials are used.

Till date, Division Y has always bought component 'Gex' from division X at ₹ 50 per unit since the lowest price at which the component 'Gex' could have been bought by Division Y was ₹ 52 per unit.

Division X charges the same price for component 'Gex' to both division Y and external customers. However, it does not incur selling and distribution costs when transferring internally.

Division Y has received a proposal from a new supplier who has offered to supply component 'Gex' for ₹ 47 per unit at least for the next three years.

Manager of Division Y requests the manager of Division X to supply component 'Gex' at or below, ₹ 47 per unit. Manager of Division X is. not ready to reduce· the transfer price since the divisional performance evaluation is done based on profit margin ratio of the division.

The following additional information is made available to you :

	Component 'Gex' ₹	Product 'Gextin' ₹
Selling Price per unit	50	180
Less: Variable Costs		
Direct Materials		
Component 'Gex'	-	100
Other materials	12	22
Direct labour	16	13
Manufacturing Overhead	2	5
Selling and Distribution Costs	4	2
Contribution per unit	16	38
Annual fixed costs	₹ 40,00,000	₹ 20,00,000
Annual external demand (units)	3,00,000	1,20,000
Capacity of plant (units)	5,00,000	1,50,000

Required

(i) CALCULATE the present profit of each division and the company as a whole. ***(2 Marks)***

(ii) ANALYSE the impact on the total annual profits of each division and the company as a whole if Division Y accepts the offer of the new supplier. ***(4 Marks)***

(iii) In the changed scenario, DISCUSS why the top management should intervene and advise a suitable transfer price for component 'Gex' for resolving transfer pricing conflict which promotes goal congruence through efficient performance of the concerned division. ***(4 Marks)***

Answer

(a) Environment Cost Allocation

Allocation of environment costs incurred by the company can be allocated to products using (i) Input-Out analysis (ii) Flow Cost Accounting (iii) Life cycle costing and (iv) Activity Based Costing

Environment costs can be allocated to Chemicals SX and ZX using Activity Based Costing.

S. No.	Type of Environment cost	Allocation Basis	Cost Allocation ₹		
			Chemical SX	Chemical ZX	Total
1	Packing Material Costs	*Packing Materials(kg.)* SX 80,000 kg. ZX 40,000 kg.	2,40,000	1,20,000	3,60,000
2	Energy Cost	*Energy Usage (KWH)* SX 60,000 kwh ZX 30,000 kwh	64,000	32,000	96,000
3	Fines for Release of Toxins into Air	*Toxins Released (Pounds into air)* SX 200,000 pounds ZX 40,000 pounds	40,000	8,000	48,000
4	Operating Costs of Pollution Control Equipment	*Pollution Control Machine Hours* SX 32,000 hrs ZX 8,000 hrs	89,600	22,400	1,12,000
5	Total Cost Allocation	Sum of Steps 1 to 4	4,33,600	1,82,400	6,16,000
6	Units Produced (kg.)		6,00,000	15,00,000	21,00,000
7	Environment Cost *per unit* produced (Step 5 / Step 6)		**₹0.7227**	**₹0.1216**	₹0.2933

The environment cost allocation per kilogram for Chemical SX is ₹0.72 per kg and Chemical ZX is ₹0.12 per kg.

The average environment cost per kg for overall production is ₹0.2933 per kg.

Or

Triple Bottom Line

Identification of initiatives undertaken by XYZ Ltd. into categories it would impact based on the Triple Bottom Line Model – People, Planet or Profit.

Reduced the amount of plastic usage in peanut butter jars.	Planet
Provided financial support to hospital run by local authority in the vicinity of the factory	People
Constructed solar powered warehouse	Planet
Generated profit for the company's shareholders	Profit
Started child care unit for the benefit of women employees as well as for the neighboring community	People

(b) Decision Making – Automation Ltd.

(i) With increasing completion, dynamic market changes, changing needs of customers, *non-financial* and *ethical considerations* have gained relevance in the decision-making process. A company may face the dilemma of meeting customers' needs while protecting employees' rights. While there are no clear-cut parameters to measure the impact of such decisions, they have a *long-term impact* on the company's operations that ensures profitability and sustainability of an organization.

In the given scenario, a customer who contributes close to 60% of Automation Ltd.'s profits has been making turnaround demands that are unreasonable for the company employees to meet. Automation Ltd. has to decide whether to continue doing business with the customer based on the current terms or protecting the work environment of its employees. In the current scenario, *it is in Automation's long term interests to protect its employees' rights (a non-financial consideration). Keeping this approach in mind, Automation Ltd. decided to terminate business with the profitable client. While this had a significant impact on revenues in the short term, in the long run Automation Ltd. was able to get business from new clients.* Also, realizing the *value of service* provided, the dropped client came back with projects on equitable terms. Therefore, even though it did not make financial sense in the short run, decisions based on non-financial metrics played an important role in ensuring Automation Ltd.'s long term sustainability.

☞

Conceptually correct brief explanation is sufficient.

(ii) Qualitative factors to consider while making the outsourcing and make or buy decisions:

(a) Quality of goods produced outside vs. in-house production of the component. Outsourcing or buying a component from the external market, should not impact the overall quality of the product. Therefore, *any component critical for a product would generally not be outsourced unless its supplier gives quality assurance*.

(b) *Reliability of suppliers* in the outsourcing arrangement. Assurance must be given by the supplier in terms of both quality and timely delivery of components for the given price. Also, there must be a sufficient pool of suppliers from whom the company can buy the product. If one supplier closes shop, there must be alternate suppliers available.

(c) *Availability of skilled labor and infrastructure* to make the component in-house. If not available, then the component may have to be bought from the external market.

(d) *Regularity of demand for the product* – If made in-house, seasonal demand for a product may result in the risk of holding high inventories (including that of raw materials) or making high capital investments that will prove unproductive during off-season. Therefore, *outsourcing or buying from external market may be more viable when the demand for the final product is seasonal*.

(e) *Risk of technological obsolescence for the component* – when the risk is higher company may favor outsourcing.

(f) *Confidentiality of process or patent of process* – Confidential processes or critical components may not be outsourced.

(g) The shutting down of company's manufacturing facility might have a negative impact on the morale of remaining employees.

(c) APC Ltd. Transfer Pricing

(i) Profitability of each division and the company as a whole when Division X supplies 240,000 units of Gex annually to Division Y.

Division Y produces 1,20,000 units of Gextin. Each component of Gextin requires 2 components of Gex that it currently procures from Division X. Therefore, it procures 2,40,000 units of Gex from Division X annually.

Division X has an overall capacity of 5,00,000 units annually to produce Gex. Of this it produces 2,40,000 units for Division Y, which it must first cater to. The remaining 2,60,000 units of Gex is sold to external customers.

Divisional and Overall Profitability of APC Ltd.

Sr. No.	Particulars	Division X				Division Y		Total APC Ltd
		Per unit of Gex	External Sales	Internal Sales	Total Division X	Per unit of Gextin	External Sales	
			2,60,000 units	2,40,000 Units	5,00,000 Units		1,20,000 units	
1	Selling Price	50	1,30,00,000	1,20,00,000	2,50,00,000	180	2,16,00,000	4,66,00,000
2	*Less:* Variable Cost							
a	Direct Material							
b	Component Gex	---	---	---	---	100	1,20,00,000	1,20,00,000
c	Other materials	12	31,20,000	28,80,000	60,00,000	22	26,40,000	86,40,000
d	Direct Labour	16	41,60,000	38,40,000	80,00,000	13	15,60,000	95,60,000
e	Manufacturing Over-head	2	5,20,000	4,80,000	10,00,000	5	6,00,000	16,00,000
f	Selling and Distribution Costs	4	10,40,000	----	10,40,000	2	2,40,000	12,80,000
	Total	34	88,40,000	72,00,000	1,60,40,000	142	1,70,40,000	3,30,80,000
3	Contribution (Step 1 - 2)	16	41,60,000	48,00,000	89,60,000	38	45,60,000	1,35,20,000
4	Annual Fixed Cost				40,00,000		20,00,000	60,00,000
5	Annual Profit (Step 3 - 4)				**49,60,000**		**25,60,000**	**75,20,000**

Note

Division X does not incur marketing costs on internal sales. Therefore, cost not incurred on transfer of 240,000 units to Division Y.

(ii) Impact if Division Y accepts to buy 240,000 units of Gex annually from the external supplier at ₹47 per unit of Gex.

Sr. No.	Particulars	Division X				Division Y		Total
		Per unit of Gex	External Sales	Internal Sales	Total Division X	Per unit of Gextin	External Sales	
			3,00,000 units	0 Units	3,00,000 units		1,20,000 units	
1	Selling Price	50	1,50,00,000	-	1,50,00,000	180	2,16,00,000	3,66,00,000
2	*Less:* Variable Cost							
a	Direct Material							
b	Component Gex	-	-	-	-	94	1,12,80,000	1,12,80,000
c	Other Materials	12	36,00,000	-	36,00,000	22	26,40,000	62,40,000
d	Direct Labour	16	48,00,000	-	48,00,000	13	15,60,000	63,60,000
e	Manufacturing Overhead	2	6,00,000	-	6,00,000	5	6,00,000	12,00,000
f	Selling and Distribution Costs	4	12,00,000	-	12,00,000	2	2,40,000	14,40,000
	Total	34	1,02,00,000	-	1,02,00,000	136	1,63,20,000	2,65,20,000
3	Contribution (Step 1 - 2)	16	48,00,000	-	48,00,000	44	52,80,000	1,00,80,000
4	Annual Fixed Cost				40,00,000		20,00,000	60,00,000
5	Annual Profit (Step 3 - 4)				8,00,000		32,80,000	40,80,000

Analysis

APC Ltd

Overall profitability of APC Ltd. reduces from ₹75,20,000 per annum to ₹40,80,000 per annum. The reduction in profit is therefore ₹34,40,000 per annum. Reasons are:

(a) The cost of manufacturing Gex is only ₹30 per unit while Division Y is procuring this at ₹47 per unit from an external supplier. Annually this results in a loss of ₹40,80,000 (240,000 units of Gex×₹17 per unit).

(b) Since Division X no longer makes Gex for internal sales, it can ramp up its external sales to meet the full annual demand of 300,000 units. This results in extra external sales of 40,000 units annually. Each unit gives a contribution of ₹16 per unit. Therefore, additional contribution from sale of 40,000 units of Gex to external customers is ₹640,000 per annum.

(c) Therefore, netting both (a) and (b) above, the net loss to the company is **₹34,40,000** per annum.

Division Y

Impact on profit of Division Y, increase from ₹25,60,000 per annum to ₹32,80,000 per annum that is **₹7,20,000** per annum increase. This is due to the savings in procurement cost of Gex for Division Y. Instead of procuring Gex at ₹50 per unit Division Y proposes to buy it at ₹47 per unit externally. For its annual demand of 2,40,000 units of Gex**, it translates to savings of ₹7,20,000 annually in procurement cost for Division Y.**

Division X

Impact on profit of Division X, reduction from ₹49,60,000 per annum to ₹8,00,000 per annum. A substantial reduction of **₹41,60,000** in its divisional profit per year. Division X earns a contribution of ₹20 per unit of Gex from its internal transfer to Division Y. (Selling price ₹50 per unit less variable cost of manufacturing ₹30 per unit). If Division Y procures Gex externally, this would result in an annual loss of ₹48,00,000 in contribution for Division X (240,000 units ×₹20 per unit). However, due to additional external sales of 40,000 units of Gex, Division X can earn an additional contribution of ₹6,40,000 per year (40,000 units of Gex × ₹16 contribution per unit of external sale). Offsetting, this results in a lower contribution **of ₹41,60,000 per annum for Division X.**

This also results in excess capacity of 2,00,000 units per annum in Division X.

(iii) APC Ltd. can suffer a loss of ₹34,40,000 per annum if Division Y decides to procure Gex from the external supplier. It costs on ₹30 per unit to manufacture Gex internally as compared to ₹47 per unit that Division Y is willing to pay to the external supplier. However, Division X is unwilling to reduce the price from ₹50 per unit since divisional performance is done based on the profit margin ratio of the division. Therefore, the management of the company has to step in to promote goal congruence. If Division Y buys GEX from the external supplier, not only is it costly for the company, it also results in a lot of unused capacity lying idle in Division X.

In the current scenario, one possible way of arriving at an acceptable transfer price range could be:

Division X is currently working at full capacity of 5,00,000 units per annum. Of this production, 2,40,000 units is supplied internally to Division Y while the balance is supplied to external market. The marginal cost of production of Gex is ₹30 per unit. If this were sold externally, it would earn a contribution of ₹16 per unit. **Therefore, the minimum transfer price the Division X would demand = marginal cost of production per unit + opportunity cost per unit = ₹30 + ₹16 = ₹46 per unit of Gex.**

(The other way of looking at this could also be that Division X does not incur any selling and distribution costs on internal transfers. To outside clients it needs to spend ₹4 per unit towards the same. Therefore, to make its price more competitive with the

external market, Division X can reduce the price by ₹4 per unit, which it has been recovering from Division Y for a cost it does not incur in internal transfers. Thus, based on its cost structure and the competitive profit margin it earns from external sales, it can price its internal transfers at ₹46 per unit.)

Division Y will be willing to pay the lower of net marginal revenue or the external buy-in price.

The Net Marginal Revenue per unit of Gextin = Selling price per Gextin – (marginal cost for Division Y other than the cost of Gex) = ₹180 - ₹42 = ₹138 per unit of Gextin. This translates that Division Y will be willing to pay upto ₹69 per unit of Gex, that it can incur without incurring a divisional loss. Meanwhile, the external buy-in price is ₹47 per unit.

Therefore, the maximum price Division Y will be willing to pay = lower of Net Marginal Revenue or external buy-in price = lower of ₹69 or ₹47 per unit of Gex. Therefore, Division Y will be willing to pay maximum ₹47 per unit of Gex to Division X.

Therefore, the transfer price range can be set between **₹46 - ₹47** per unit of Gex. Division X would then have to compete with the external supplier to retain its internal sales. This would promote more efficient working between Division X and Y. **By selling it at ₹46 per unit, the contribution of Division X would be maintained at ₹16 per unit. For Division Y. the procurement of Gex at ₹46 per unit would be beneficial since it is lower than the external market price. If transfer price set at external market rate ₹47 per unit, Division Y would still be able to improve its profit margin as compared to the original transfer price of ₹50 per unit.**

Given that the marginal cost of manufacturing Gex is only ₹30 per unit, the management has to ensure that production of Gex is made in-house. Performance measure at a divisional level should then not be restricted to financial performance alone (full profit responsibility) and should be accordingly modified to include non-financial / operational measures as well.

☞

Conceptually correct brief explanation is sufficient.

Question 5

(a) *APZ Company Ltd. manufactures spare parts and can be called "high volume based" manufacturing environment. The company is using the system of Total Productive Maintenance for maintaining and improving the integrity of manufacturing process. There are several different automated manufacturing machines located in the plant, through which manufacturing of spare parts are done and supplied to cater the demand in the market.*

A 12 hour shift is scheduled to produce a spare part in APZ Company Ltd. as shown in the schedule below. The shift has three 15 minute breaks and a 10 minute clean up period.

Production Schedule for Automated machine A 10:

Cycle: 10 (seconds),

Spare parts Manufactured: 3,360,

SCRAP: 75,

Unplanned Downtime: 36 minutes

Required

(i) CALCULATE OEE (Overall Equipment Effectiveness) and comment on it. ***(6 Marks)***

(ii) The management of company has decided to ensure that things are done right the first time and that the defects and waste are eliminated from operations. Thus, they are planning to implement Total Quality Management (TQM) also.

SUMMARIZE the connection between Total Quality Management (TQM) and Total Productive Maintenance (TPM). ***(4 Marks)***

(b) SPS Limited uses activity based costing to allocate variable manufacturing overhead costs to products. The company identified three activities with the following information for last quarter :

Activity	Standard Rate	Standard Quantity per unit produced	Actual Costs	Actual Quantity
Indirect Materials	₹ 20 per kilogram	0.5 kilogram per unit	₹ 9,40,000	48,000 kilogram
Product Testing	₹ 3 per test minute	10 minutes per unit	₹ 22,50,000	7,40,000 test minutes
Energy	₹ 0.20 per minute of machine time	4 minutes of machine time per unit	₹ 70,000	3,60,000 minutes of machine time

The company produced 80,000 units in the last quarter. Company policy is to investigate all variances above 5% of the flexible budget amount for each activity.

Required

(i) CALCULATE variable overhead expenditure variance and variable overhead efficiency variance for each of the activities using activity based costing. Clearly indicate each variance as favourable or unfavourable / adverse. ***(6 Marks)***

(ii) INTERPRET the results of variable overhead efficiency variance as calculated in (i) above in respect of indirect materials and product testing activity. ***(2 Marks)***

(iii) IDENTIFY the variances that should be investigated according to company policy. Show calculations to support your answer. ***(2 Marks)***

Answer

(a) (i) Calculation of Loss of Time Per Shift

	Mins.
Break	45
Clean up Period	10
Unplanned Downtime	36
Total Time Loss Per Shift	91

Availability Ratio *per shift* = $\left\{\frac{720 \text{ mins.} - 91 \text{ mins.}}{720 \text{ mins.}}\right\} \times 100\%$

= **87.36 %**

Actual Production = 3,360parts

Standard time = 10seconds

Standard Time Required = 3,360parts × 10seconds/ 60

(Ideal Time) = 560 minutes

Actual Time Taken = 720 mins. – 91 mins.

= 629 minutes

Performance Ratio = $\left\{\frac{560 \text{ mins.}}{629 \text{ mins.}}\right\} \times 100\%$

= **89.03%**

Quality Ratio = $\left\{\frac{3{,}360 \text{ parts} - 75 \text{ parts}}{3{,}360 \text{ parts}}\right\} \times 100\%$

= **97.77%**

Thus, **OEE** = 0.8736 × 0.8903 × 0.9777

= **76.04%**

Comment

Since OEE of APZ Company Ltd. is lesser than 85 % i.e. World Class Performance Level, Company is advised to improve its each ratio i.e. availability ratio, performance ratio and quality ratio by collecting information related to all downtime and losses on machines, analyzing such information through graphs and charts, making improvement decisions thereon like autonomous maintenance, preventive maintenance, reduction in set up time etc. and implementing the same.

Alternative

1. Scheduled Time = 12 hours = 720 Minutes (12 × 60)
2. Planned Down Time = 3 breaks × 15 minutes + clean- up 10 minutes = 55 minutes
3. Net Available Time (NAT) = 720 – 55 = 665 minutes

Automated Machine A

1. Unplanned Downtime = 36 minutes
2. Net Operating Time (NOT) = Net Available Time – Unplanned Downtime
3. NOT = 665 – 36 = 629 minutes
4. Ideal Operating Time (IOT): 3,360 Total Parts × 10 seconds = 33,600 / 60 = 560 minutes
5. Lost Operating Time (LOT): 75 Scrap Parts × 10 seconds = 750 / 60 = 12.50 minutes

Automated Machine A: OEE Factors are calculated as follows

1. Availability: NOT / NAT = (629 / 665) × 100 = **94.59 %**
2. Performance: IOT / NOT = (560 / 629) × 100 = **89.03%**
3. Quality: (IOT – LOT) / IOT = (560 – 12.50) / 560 × 100 = **97.77%**
4. OEE = A × P × Q = 94.59% × 89.03% × 97.77% = **82.34%**

Comment

Since the OEE of APZ Company Ltd is very close to 85% i.e. world class performance level, company should take measures to improve it and strive to attain 85% level. Availability Ratio of machine A10 is 94.59% exceeding the ideal value of > 90% which is good but the Performance and Quality Ratios need attention as they are below their ideal values of 95% and 99% respectively.

☞

OEE *can also be computed directly as under:*

1) *(Good Counts × Ideal Cycle Time)/ Planned Production Time* ***Or***
2) *(Ideal Operating Time – Loss Operating Time)/ Net Available Time*

(ii) The connection between TQM and TPM are summarized below:

- TQM and TPM make company more competitive by reducing costs, improving customer satisfactions and slashing lead times.

- Involvement of the workers into all phases of TQM and TPM is necessary.
- Both processes need fundamental training and education of participants.
- TPM and TQM take long time to notice sustained tangible benefits.
- Commitment from top managements is necessary for success of the implementation.

(b) (i) **Indirect Materials**

Efficiency Variance	=	Cost Impact of *undertaking activities* more/ less than *standard*
	=	(0.50kg. × 80,000units – 48,000 kg.) × ₹20
	=	₹1,60,000 (A)
Expenditure Variance	=	Cost impact of paying more/ less than standard for actual activities undertaken
	=	48,000kg. × ₹20 – ₹9,40,000
	=	₹20,000 (F)

Product Testing

Efficiency Variance	=	Cost Impact of *undertaking activities* more/ less than *standard*
	=	(10 mins. × 80,000 units – 7,40,000 mins.) × ₹3
	=	₹1,80,000 (F)
Expenditure Variance	=	Cost impact of paying more/ less than standard for actual activities undertaken
	=	7,40,000mins × ₹3 – ₹22,50,000
	=	₹30,000 (A)

Energy

Efficiency Variance	=	Cost Impact of *undertaking activities* more/ less than *standard*
	=	(4 mins. × 80,000 units – 3,60,000 mins.) × ₹0.20
	=	₹8,000 (A)
Expenditure Variance	=	Cost impact of paying more/ less than standard for actual activities undertaken
	=	3,60,000mins × ₹0.20 – ₹70,000
	=	₹2,000 (F)

(ii) Indirect Materials

SPS actually spent 48,000 kg. or 8,000 kg. more than the standard allows. At a predetermined rate of ₹ 20 per kg., efficiency variance is 1,60,000 (A). Since actual quantity were higher than the standard, the variance is unfavorable. This adverse variance, could have been caused by the inferior quality, result of carelessness handling of materials by production workers or could as a result of change in methods of production, product specifications or the way in which quality of the product is checked or controlled.

Product Testing

Favorable efficiency variance amounting to ₹1,80,000 indicates that fewer testing minutes were expended during the quarter than the standard minutes required for the level of actual output. This may be due to employment of a higher skilled labor or improvement of skills of existing workforce through training and development leading to improved productivity etc.

(iii) Flexible Budget

Indirect Materials	= (0.50 kg. × 80,000 units) × ₹20 = ₹8,00,000	= ₹8,00,000× 5% **= ₹40,000**
Product Testing	= (10 mins. × 80,000 units) × ₹3 = ₹24,00,000	= ₹24,00,000 × 5% **= ₹1,20,000**
Energy	= (4 mins. × 80,000) × ₹0.20 = ₹64,000	= ₹64,000 × 5% **= ₹3,200**

Efficiency Variance for all the three activities are more than 5% of their flexible budget amount. So, according to the company policy, efficiency variances should be investigated.

Alternative

Statement Showing Identification of Variances to be investigated

	Calculation	Variance % of Flexible Budget	Criteria	Investigate Y or N
Indirect Materials				
Efficiency Variance	$\left(\frac{1,60,000}{8,00,000}\times 100\right)$	**20%**	5%	**Y**
Expenditure Variance	$\left(\frac{20,000}{8,00,000}\times 100\right)$	2.5%	5%	**N**
Product Testing				

Efficiency Variance	$\left(\frac{1,80,000}{24,00,000}\times 100\right)$	**7.5%**	5%	**Y**
Expenditure Variance	$\left(\frac{30,000}{24,00,000}\times 100\right)$	1.25%	5%	**N**
Energy				
Efficiency Variance	$\left(\frac{8,000}{64,000}\times 100\right)$	**12.5%**	5%	**Y**
Expenditure Variance	$\left(\frac{2,000}{64,000}\times 100\right)$	3.125%	5%	**N**

Question 6

(a) *SEZ Limited produces three products S, Q and L which use the same resources but in varying quantities. Product S uses one unit of component P which is purchased from outside suppliers at, ₹ 120 per unit. Details of the three products are as follows :*

	S	*Q*	*L*
Annual Demand (units)	*9,000*	*5,700*	*7,800*
	Per unit ₹	*Per unit ₹*	*Per unit ₹*
Selling Price	*310*	*275*	*224*
Component P	*120*	*-*	*-*
Direct materials (₹ 8 per kg.)	*24*	*32*	*24*
Skilled labour (₹ 40 per hour)	*20*	*60*	*40*
Unskilled labour (₹ 24 per hour)	*18*	*24*	*36*
Variable Overhead (₹ 6 per machine hour)	*18*	*24*	*24*
Annual fixed costs are ₹ 15,00,000			

Maximum availability of skilled labour is 16,200 hours. Other resources are sufficient to meet the annual demand/sales.

Engineering division of the company came forward with a proposal to make the component 'P' in house with the following costs break up :

Direct materials (₹ 8 per kg.)	*₹ 24*
Skilled labour (₹ 40 per hour)	*₹ 40*
Unskilled labour (₹ 24 per hour)	*₹ 8*
Variable Overhead (₹ 6 per machine hour)	*₹ 18*
	₹ 90

For in-house making of the component 'P' there will not be any change in the annual fixed costs of the company. The company can either buy the component 'P' or make it in house.

Required

RECOMMEND the optimum production plan and profit for the year. Show calculation in support of your answer. ***(10 Marks)***

(b) *SW & Co is a firm of Chartered Accountants having head office at Delhi and four branches in different parts of Northern region. They are providing wide range of services to their esteemed clients. Their core services include Taxation, Corporate Audits, Bank Audits, Management Audits and Project financing. The firm is preparing its budgets for the financial year 2019-2020.*

The senior partners of the firm have stated that they would like to pay off the firm's loan taken from a public sector bank two years back for the renovation of their office premises this year and to have a positive cash reserve of ₹ 2,00,000 by the end of the year.

While comparing the actual cost with the budgeted data of last year, it was revealed that travelling costs were much higher than the budgeted costs. Fees receivable from some clients were so pending for more than three years thus distorting the expectations of cash budget.

DISCUSS the differences between feedforward control and feedback control using the above information about the cash budget of SW & Co. ***(10 Marks)***

Answer

(a) Option-1

SEZ Ltd. produces 3 products Product S, Product Q and Product L. Each unit of Product S requires one unit of component P, which is currently procured from the external market at ₹120 per unit. There is a constraint in terms of skilled hours available for production, the maximum available is 16,200 hours. Given this constraint, the production plan should be based on the contribution derived per skilled labor hour spent on each product.

Calculation of skilled hour requirement for each of the products and component P

Skilled Hour Requirement

Sr. No.	Particulars	S	Component P	Q	L
1	Skilled Labour Cost *per unit*	20	40	60	40
2	Skilled Labour Rate *per hour*	40	40	40	40
3	Skilled Hours *per unit* (Step 1 / Step 2)	0.5	1	1.5	1

Note: When component P is manufactured, in-house Product S would require 1.5 hours of skilled labor hour per unit.

Contribution per unit and contribution per skilled hour (when component P is purchased)

Sr. No.	Particulars	S Per unit ₹	Q Per unit ₹	L Per unit ₹
1	Selling Price	310	275	224
	Variable Cost			
i	Component P (purchased)	120	0	0
ii	Direct Materials	24	32	24
iii	Skilled Labor	20	60	40
iv	Unskilled Labor	18	24	36
v	Variable Overhead	18	24	24
2	Total Variable Cost (Sum of steps i to v)	200	140	124
3	Contribution *per unit* (Step 1 - Step 2)	110	135	100
4	Skilled Hour *per unit* (refer skilled hour table - Step 3)	0.5	1.5	1
5	Contribution per *skilled hour* (Step 3 / Step 4)	220	90	100
	Ranking Based on Contribution *per skilled hour*	1	3	2

Based on this, SEZ Ltd. would first produce Product S, then Product L and then Product Q. The constraint of 16,200 hours of skilled labor has to be taken into account while drawing up the production plan. Production plan as per above ranking will be as below:

Product	Annual Demand (units)	Skilled Hour *per unit* (refer skilled hour table - Step 3)	Skilled hour utilized for production	Number of skilled hours remaining post production
	A	B	C = A × B	
S	9,000	0.5	4,500	11,700
L	7,800	1.0	7,800	3,900
Q	5,700	1.5	3,900	-

First, 9,000 units Product S is produced, this requires 4,500 hours of skilled labor. After production of Product S, 11,700 hours of skilled labor remain. (16,200 hours – 4,500 hours). Next 7,800 units of Product L can be produced, for which the skilled hours used are 7,800 hours. The remaining 3,900 hours would be used to produce Product Q.

Volume of Product Q that can be produced in 3,900 hours = **3,900 / 1.5 hours per unit = 2,600** units.

Therefore, profitability of SEZ Ltd. when component P is purchased:

Sr. No	Particulars	S	Q	L	Total ₹
1	Production (units)	9,000	2,600	7,800	
2	Contribution *per unit* (refer to contribution table - Step 3)	₹110.00	₹135.00	₹100.00	
3	Total Contribution (Step 1 × Step 2)	9,90,000	3,51,000	7,80,000	21,21,000
4	Fixed Cost				15,00,000
5	Total Profit (Step 3 - Step 4)				6,21,000

Option-2

Contribution when component P is manufactured in-house.

Note that Product S requires 0.5 hours and component P would require 1 hour of skilled labor per unit. If component P, a part of Product S is manufactured in-house, then Product S would in all require 1.5 hours of skilled labor per unit.

Based on this, contribution per unit and contribution per skilled hour if component P is manufactured is:

Sr. No.	Particulars	S Per unit ₹	Q Per unit ₹	L Per unit ₹
1	Selling Price	310	275	224
	Variable Cost			
i	Component P (made in house) refer note 1	90	0	0
ii	Direct Materials	24	32	24
iii	Skilled Labor	20	60	40
iv	Unskilled labor	18	24	36
v	Variable Overhead	18	24	24
2	Total Variable Cost (sum of steps i to v)	170	140	124
3	Contribution *per unit* (Step 1 - Step 2)	140	135	100
4	Skilled Hours *per unit* (refer skilled hour table - Step 3)	1.5	1.5	1
5	Contribution *per skilled hour* (Step 3 / Step 4)	93.33	90.00	100.00
6	Ranking Based on Contribution *per skilled hour*	2	3	1

Note 1

Component P has a variable cost, sum of direct material + skilled labor + unskilled labor + variable overhead, given to be ₹90 per unit

Each unit of Product S requires 1 more hour of skilled labor to manufacture component P. Skilled labor is a limited resource that costs ₹40 per hour. The savings SEZ Ltd. earns by manufacturing component P in-house is only ₹30 (external purchase cost is ₹120 per unit – cost of manufacturing component P in-house is ₹90 per unit). Therefore, it is profitable to purchase component P from the external market.

For further analysis, the impact of producing component P in-house would be:

Based on the revised ranking, SEZ Ltd. would first produce Product L, then Product S and then Product Q. The production plan is component P is made in-house would be

Product	Annual Demand (units)	Skilled Hour *per unit* (refer skilled hour table - Step 3)	Skilled hour utilized for production	Number of skilled hours remaining post production
	A	B	C = A × B	
L	7,800	1	7,800	8,400
S	9,000	1.5	8,400	0
Q	5,700	1.5	0	0

First, 7,800 units Product L is produced, this requires 7,800 hours of skilled labor. After production of Product L, 8,400 hours of skilled labor remain. (16,200 hours – 7,800 hours). The remaining 8,400 units would be used to produce Product S. Volume of Product S that can be produced in 8,400 hours = 8,400 / 1.5 hours per unit = 5,600 units. In this constraint, Product Q cannot be produced.

The profitability of SEZ Ltd. if component P is manufactured in-house:

Sr. No	Particulars	S	Q	L	Total ₹
1	Production (units)	**5,600**	-	**7,800**	
2	Contribution *per unit* (refer to contribution table - Step 3)	₹140.00	₹135.00	₹100.00	
3	Total Contribution (Step 1 × Step 2)	7,84,000	-	7,80,000	15,64,000
4	Fixed Cost				15,00,000
5	Total Profit (Step 3 - Step 4)				64,000

Recommendation

When component P is purchased, annual profits would be ₹6,21,000. When component P is manufactured in-house, annual profits would be ₹64,000, a reduction of ₹557,000 per year. Therefore, component P has to be bought externally. Optimum production plan would be

Product S – 9,000 units

Product Q – 2,600 units

Product L – 7,800 units

The decision to outsource make or buy decision might have strategic implications for the SEZ and should be formulated from strategic perspective with senior management's involvement.

(b) Feed forward control systems are the comparison of draft plans with the objectives of the company.

In the scenario provided the consultancy firm has a number of objectives, two of which are related to their cash flow. The first of these is to pay off the loan by the year end and the second is to have a positive cash reserve of ₹ 2,00,000 by the year end.

An initial draft of the cash budget will be produced based on the expected receipts and payments and other costs of the firm. Cash budgets to be prepared showing the cash inflows and outflows for each month so that the firm can identify its expected monthly cash balance. This can be compared with the company's objectives to see if their cash balance objectives are being achieved. It is this comparison that is the process of feed forward control.

It is also referred to as a preventive control. The rationale behind feed forward control is to foresee potential problems and take corrective action to ensure that the final output is as expected. Feed forward controls are desirable because they allow management to prevent problems rather than having to cure them later. Feed forward controls are costly to implement as it requires additional resources and investments.

Feedback control systems are the comparison of actual results against the budget that has been approved. Thus, in the context of the SW & Co., actual travelling costs comparison made against the budgeted costs and overdue fees receivables are also the process of feedback control.

As with any budget and actual comparison there may be an adverse or favorable variance. If this is significant then further analysis may be required to determine its cause. This comparison process is feedback control. It is also known as post action control. If any problem is identified after a process is complete, a corrective action is taken to rectify the problem. Feedback based system have the advantage of being simple and easy to implement.

Thus, initially the difference between feed forward control and feedback control systems is that feed forward occurs in the budget setting stage whereas feedback control occurs during the year. This means that feed forward identifies potential problems before they occur whereas feedback identifies problems after they have happened.

PAPER – 7: DIRECT TAX LAWS & INTERNATIONAL TAXATION

Part - II

*Question No.**1** is compulsory.*

*Answer any **four** questions from the remaining **five** questions.*

Working notes should form part of the respective answers

All questions relate to Assessment Year 2019-20, unless stated otherwise in the question.

Question 1

Anamika Builders and Constructions Ltd., a company resident in India is engaged in the business of construction and real estate. Net profit as per profit and loss account is ₹ 54,80,000 (prepared in accordance with ICDS) after debiting/crediting the following items:

(i) Depreciation debited to books ₹ 8,47,000.

(ii) Gross revenue includes ₹ 5,00,000 in respect of a service contract for maintenance of the office building for Nitup Ltd. for the period from 1st March, 2019 to 30th April, 2019. The expenses incurred on the project till 31-3-2019 amounts to ₹ 1,27,000 which is included in other expenses.

(iii) The amount of employee benefits include a sum of ₹ 4,41,000 in respect of bonus payable to employees. In the previous year 2018-19, the company and its employee's union had a dispute over payment of bonus. In order to avoid late payment of bonus, the company formed a trust and transferred the amount of bonus payable to employees to the said trust. The dispute was settled in the month of November, 2019 and the trust paid the amount of bonus to the employees on 30th December, 2019;

(iv) Capital gains on sale of shares in Yara Ltd. ₹ 3,77,500.

(v) In respect of one of its on-going projects, the assessee had made some structural changes contrary to what was earlier approved by the municipal authorities. Assessee hence paid a sum of ₹ 98,000 as regularization fee in respect of such changes made in the construction plan.

(vi) Other expenses include ₹ 1,45,000 as expenditure incurred on CSR.

(vii) During the previous year 2018-19, the assessee company decided to expand its business and open a retail petrol out let. Accordingly, a sum of ₹ 1,75,000 was deposited with the concerned authority. However, the assessee could not start this operation and the deposit with the authority was forfeited. Amount paid for advertisement in political parties' brochure ₹ 48,000.

The Suggested Answers for Paper 7:- Direct Tax Laws and International Taxation are based on the provisions of direct tax laws as amended by the Finance Act, 2018, which is relevant for November, 2019 examination. The relevant assessment year is A.Y.2019-20.

(viii) During the previous year 2018-19, the assessee entered into an agreement with Bat Ltd. As per the agreement, Bat Ltd. has agreed to not to engage in the business of real estate trading. The assessee paid ₹ 11 lakhs without deduction of tax at source on 1-6-2018 as non-compete fee.

Additional Information:

(i) Depreciation as per Income-tax Act, 1961 ₹ 5,14,000. This includes an amount of ₹ 78,000 in respect of fire fighting equipments installed in various business premises/ offices of the assessee. During the year, as there were no incidence of fire, these equipments were not used.

(ii) On 26th October, out of 5 unsold office spaces in a mall, the assessee converted one such space into its own office. The fair market value of that space as on that date was ₹ 15,00,000. The cost incurred originally to construct such space was ₹ 10,00,000.

(iii) In respect of ongoing construction contracts, there was a claim for escalation of prices, to the tune of ₹ 8,50,000. The company had filed a lawsuit in the year 2017. In the previous year 2018-19, the court gave its judgement in favour of the company. The company has received ₹ 2,00,000 till 31-03-2019. Gross receipt in the profit and loss account includes ₹ 2,00,000 in respect of such claims.

(iv) The assessee held 250 shares in Yara Ltd. On 1-4-2017, Y Ltd. allotted bonus shares in the ratio of 1 : 1. The company sold all the shares in Yara Ltd. on 24th September 2018 for ₹ 2,050 per share. The company had acquired the original shares for ₹ 540 on 23-06-2015. The fair market value of the shares as at 31st January 2018 was ₹ 1,980 per share.

You are required to compute the total income chargeable to tax in the hands of Anamika Builders and Constructions Ltd., for the Assessment Year 2019-20 giving a brief explanation to each item of additions or deletions. Ignore provisions of MAT. ***(14 Marks)***

Answer

Computation of Total Income of M/s Anamika Builders and Construction Ltd. for the A.Y. 2019-20

	Particulars	Amount in ₹	
I	**Profits and gains of business and profession**		
	Net profit as per profit and loss account		54,80,000
	Add: **Items debited but to be considered separately or to be disallowed**		
	(i) Depreciation as per books of account	8,47,000	
	(iii) Bonus transferred to the trust for making payment to the employees after settlement of the dispute	4,41,000	

		[The bonus would be allowable as deduction u/s 36(1)(ii), even though the amount of bonus payable was initially remitted to the trust created for the purpose of avoiding late payment of bonus, provided actual payment of bonus is made to the employees on or before the due date[1]. However, since in the present case, actual payment of bonus to employees is made on 30th December 2019, after due date of filing return of income i.e., after 31st October 2019, deduction u/s 36(1)(ii) would not be allowable merely because the amount was remitted to the trust before the stipulated due date. Since the same has been debited to the profit and loss account, it has to be added back]		
	(v)	**Regularization fee paid to Municipal Authorities**	98,000	
		[Regularization fee paid to Municipal authorities to regularize the deviation from the earlier approved construction plan in its on-going projects is in the nature of penalty as it is paid to compound an offence[2]. Hence, it does not qualify for deduction u/s 37. As the same has been debited to the profit and loss account, it has to be added back]		
	(vi)	**Expenditure incurred on CSR**	1,45,000	
		[Under section 37(1), only expenditure not covered under sections 30 to 36, and incurred wholly and exclusively for the purposes of the business is allowed as a deduction while computing taxable business income. 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. As the same has been debited to the profit and loss account, it has to be added back]		
	(vii)	**Expenditure on expansion of new business of retail petrol out let** [Where expenditure is incurred on project not related to the existing business and the project was abandoned without creating a new asset,	1,75,000	

[1] *Shasun Chemicals & Drugs Ltd v. CIT (2016) 388 ITR 1 (SC)*
[2] *It was so held in Millennia Developers (P) Ltd. v. DCIT (2010) 322 ITR 401 (Kar.)*

		the expenses are capital in nature[3]. Retail petrol outlet is not related to the existing business of construction and real estate, the expenditure incurred on setting up such business would not be allowed as deduction. As the same has been debited to the statement of profit and loss, it has to be added back]		
	(vii)	**Amount paid for advertisement in political parties brochure [Section 37(2B)** prohibits allowance of any expenditure incurred by an assessee on advertisement in any souvenir, brochure, pamphlet or the like published by a political party. Since the same has been debited to the profit and loss account, it has to be added back]	48,000	
	(viii)	**Non-compete fees to Bat Ltd.**	3,30,000	
		[On account of the payment of non-compete fee, the company does not acquire any business, the profit-making apparatus remains the same and there is no new business or new source of income and therefore, the expenditure has to be treated as revenue in nature. Since company has not deducted tax at source u/s 194J on such non-compete fees during the previous year 2018-19, 30% of expenditure i.e., ₹ 3,30,000 would be disallowed]		
		Note - The above treatment is based on the Madras High Court ruling in *M/s. Asianet Communications Ltd vs CIT, 174/2005 on 26.6.2018*		
		Alternate treatment is possible based on the Gujarat High Court ruling in *PCIT vs Ferromatic Milacron India Pvt, Ltd 1233/2018 on 9.10.2018,* as briefed hereunder:		
		Rights acquired under a non-compete agreement gives enduring benefit and protects the assessee's business against competition. The expression "or any other business or commercial rights of similar nature" used in *Explanation 3* to sub-section 32(1)(ii) is wide enough to include non-compete rights. Hence, such expenditure would be capital expenditure and it would be treated as intangible asset and be eligible for depreciation @25%. In such case, the expenditure which is debited to the profit and loss account, i.e.,		

[3] *as per McGaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.)*

	₹ 11,00,000, has to be added back and depreciation of ₹ 2,75,000 i.e., 25% would be allowed as deduction. Further, disallowance of 30% of expenditure on account of non-deduction of tax at source would also not be attracted.		20,84,000
			75,64,000
	Add: **Amount taxable but not credited to profit and loss account**		
	AI(ii) Business income on conversion of stock-in trade into capital asset		15,00,000
	[Fair market value of inventory on the date of its conversion or treatment as capital asset, would be chargeable to tax as business income. Since cost of construction of one unsold office space in a mall i.e., ₹ 10,00,000 has already been debited to profit and loss account, the FMV of ₹ 15,00,000 would be chargeable to tax. Hence, such amount has to be included in business income]		
	AI(iii)Claim for Escalation price in respect of ongoing construction contracts		6,50,000
	[As per section 145B, claim for escalation of a price of ₹ 8,50,000 would be deemed to be income of P.Y. 2018-19 i.e., the previous year in which reasonable certainty of its realization is received, being the year in which the judgment in the favour of the company was given. Since only the sum of ₹ 2,00,000 received by the company till 31.3.2019 is included in the profit and loss account, balance ₹ 6,50,000 has to be included in business income]		
			97,14,000
	Less: **Items credited to profit and loss account, but not includible in business income/permissible expenditure and allowances**		
	(ii) Revenue from service contract for maintenance of the office building of Nitup Ltd.	3,73,000	
	[Since the service contract for maintenance of office building is for a period of 61 days i.e., from 1st March 2019 to 30th April 2019 (less than 90 days), the revenue from such contract would be determined on		

		the basis of project completion method. Consequently, the income from contract and the expenditure would also be chargeable/ allowable in the P.Y. 2019-20. Since the revenue of ₹ 5,00,000 is credited and expenditure of ₹ 1,27,000 has been debited to statement of profit and loss, the net amount of ₹ 3,73,000 (₹ 5,00,000 – ₹ 1,27,000) has to be deducted while computing business income of the P.Y. 2018-19]		
	(iv)	**Capital gains on sale of shares in Yara Ltd.**	3,77,500	
		[Capital gains on sale of shares in Yara Ltd. is chargeable to tax under the head "Capital Gains". As the same has been credited to the profit and loss account, it has to be reduced]		
	AI(i)	**Depreciation as per Income-tax Rules, 1962**	5,14,000[4]	
		[One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". Courts have held that, in certain circumstances, such as in the case of stand-by equipments, an asset can be said to be in use even when it is "kept ready for use". Since fire-fighting equipments, being stand by equipments, are kept ready for use, the depreciation on these equipments would be allowable, even though they are not actually used. Since the said amount is already included in the figure of depreciation allowable under the Income-tax Act, 1961, no separate adjustment is required]		
	Business Income			**84,49,500**
II	**Capital Gain**			
	In respect of Original Shares			
	Sale Consideration [250 shares x ₹ 2,050]	5,12,500		
	Less: Cost of acquisition, being higher of	4,95,000	**17,500**	
	- Actual cost [250 x ₹ 540]	1,35,000		
	- Lower of	4,95,000		

[4] Since this is stated to be the amount of depreciation as per Income-tax Act, it is presumed that the same also includes the depreciation on converted office space.

	• ₹ 4,95,000 (₹ 1,980 x 250), being fair market value as on 31.1.2018; and • ₹ 5,12,500, being full value of consideration on transfer		
	Long-term capital gain under section 112A [Since shares held for more than 12 months, the gain is a LTCG. Benefit of indexation is, however, not available on LTCG taxable u/s 112A].		
	In respect of Bonus Shares		
	Sale Consideration [250 shares x ₹ 2,050] 5,12,500 Less: Cost of acquisition, being higher of 4,95,000		
		17,500	
	- Actual cost Nil - Lower of 4,95,000 • ₹ 4,95,000 (₹ 1,980 x 250), being fair market value as on 31.1.2018; and • ₹ 5,12,500, being full value of consideration on transfer		
	Long-term capital gain u/s 112A [Since shares held for more than 12 months, the gain is LTCG. Benefit of indexation is, however, not available on LTCG taxable u/s 112A].		35,000
	Gross Total Income		**84,84,500**
	Less: **Deduction under Chapter VI-A**		
	Under section 80GGB		48,000
	Advertisement in souvenir published by a political party is deemed to be a contribution of such amount to the political party and is, therefore, allowable as deduction in the hands of the company assuming that payment is made otherwise than by way of cash		
	Total Income		**84,36,500**

Question 2

(a) Ram Manufactures LLP., engaged in manufacturing activity which is liable for GST@18%. The firm consists of 4 equal partners who contributed ₹ 15 lakhs each as capital. The

partnership deed authorises interest on capital@9% per annum besides working partner salary of ₹ 25,000 per month to each partner, as all of them are working partners.

A survey under section 133A was conducted in the premises of the firm on 23-01-2019 and during the course of survey (a) bills and vouchers (each below ₹ 10,000) aggregating to ₹ 2,50,000 were found in the premises which were not recorded in the books of account; and (b) unaccounted stock of ₹ 10,50,000 was found in the premises on 23-01-2019.

Note: *No effect was given in the books of account of the firm for the above said items even after the conclusion of survey.*

The following issues are presented to you:

(i) Depreciation debited in the profit and loss account includes ₹ 3,00,000 representing depreciation on non-compete fee of ₹ 30,00,000 being the amount paid to a retired partner on 30-4-2016.

(ii) The firm allowed ₹ 4,00,000 as discount on goods sold to A & Co, a proprietary concern owned by one of the partners.

(iii) Depreciation debited to profit and loss account does not include depreciation on the following:

(a) Plant & Machinery (new) acquired in November, 2018 and used during the year cost ₹ 23,60,000 (including GST@18%).

(b) Construction of one factory building was completed on 31st December, 2018 and it was put to use w.e.f. 1-1-2019. The cost of construction admitted in the books was ₹ 40,90,000.

The firm availed loan from a bank for construction of the above said factory building on 20th October, 2017. Interest payable details are as under:

Period	₹
From 20-10-2017 to 31-03-2018	2,00,000
From 01-04-2018 to 31-12-2018	7,00,000
From 01-01-2019 to 31-03-2019	4,20,000

No amount by way of loan interest was paid till 'due date' of filing the return of income prescribed under section 139(1). The loan interest is not debited to profit and loss account and also not included in the cost of construction of the factory building.

(iv) The net profit of the firm for the year ended 31-03-2019 was ₹ 17,21,375 after deducting interest on capital and working partner salary.

You are requested to compute the total income of the firm by giving brief reasons for each of the item given above. ***(8 Marks)***

(b) *Mr. Bhist, a non-resident individual, earned an interest income of ₹ 12 lakhs on an investment made in a notified Infrastructure Debt Fund set up in India eligible for exemption under section 10(47) during the financial year 2018-19. Further, he incurred an expenditure of ₹ 15,000 for earning such interest income. Examine the tax implications in the hands of both Fund and Mr. Bhist and justify your conclusions with relevant provisions of Income-tax Act, 1961 in two situations, when (i) Mr. Bhist is residing in Notified Jurisdictional Area; and (ii) Mr. Bhist is stationed outside India, in a place other than NJA.*

Will there be any change in tax liability of Mr. Bhist, if the income received is fee for technical services from an Indian Company instead of interest income from Infrastructure Debt Fund? ***(6 Marks)***

Answer

(a) Computation of total income of Ram Manufacturers LLP for A.Y.2019-20

Particulars	₹	₹
Profits and gains of business or profession		
Net profit of the firm after deducting interest on capital and salary		17,21,375
***Add:* Items debited but to be considered separately or to be disallowed**		
- **Interest on capital**	Nil	
[no adjustment is required since interest@9% p.a. is authorized by the partnership deed and the rate does not exceed 12%]		
- **Salary to working partners** [to be considered separately] [₹ 25,000 x 12 x 4]	12,00,000	
- **Depreciation on non-compete fee**	3,00,000	
[Since no new asset is created by payment of ₹ 30,00,000 as non-compete fee to a retired partner and the expenditure does not result in enduring benefit in the capital field, it is not capital in nature. Hence, depreciation is not allowable on such expenditure in P.Y. 2018-19]		
Note - The above treatment is based on the Madras High Court ruling in *M/s. Asianet Communications Ltd vs CIT, 174/2005 on 26.6.2018*.		
Alternate answer based on the Gujarat High Court ruling in *PCIT vs Ferromatic Milacron India Pvt.*		

Ltd. 1233/2018 on 9.10.2018 is given hereunder: *Rights acquired under a non-compete agreement gives enduring benefit and protects the assessee's business against competition. The expression "or any other business or commercial rights of similar nature" used in Explanation 3 to section 32(1)(ii) is wide enough to include non-compete rights. Hence, it would be treated as intangible asset and is eligible for depreciation of ₹ 4,21,875 i.e., 25% on WDV as on 1.4.2018.* *Cost [2016-17] ₹ 30,00,000* *Less: Depreciation @25% [2016-17] ₹ 7,50,000* *WDV as on 1.4.2017 ₹ 22,50,000* *Less: Depreciation @25% [2017-18] ₹ 5,62,500* *WDV as on 1.4.2018 ₹ 16,87,500* *Decpreciation@25% [2018-19] ₹ 4,21,875* *Since depreciation of ₹ 3,00,000 is already debited to profit and loss account, the difference of ₹ 1,21,875 is to be deducted from business income.*		
- Discount to A & Co., a related party - disallowance u/s 40A(2) is not attracted in this case, since the transaction is a sale transaction with a related party. Also, the question does not mention that the discount given to A & Co. is excessive.	Nil	15,00,000
		32,21,375
Add: **Amount taxable but not credited to profit and loss account**		
- **Unexplained expenditure** [Expenditure not recorded in the books of account to be treated as unexplained expenditure and would be deemed to be the income of Ram Manufactures LLP as per section 69C. It would be taxable @60% *plus* surcharge @25% *plus* health and education cess@4%]	2,50,000	
- **Unaccounted stock** detected on survey under section 133A on 23.01.2019 chargeable as income	10,50,000	13,00,000
		45,21,375

Less: **Permissible expenditure and allowances**		
- **Unexplained expenditure of ₹ 2,50,000** [As per section 69C, unexplained expenditure would not be allowed as deduction under any head of income]	Nil	
- **Depreciation allowable as per Income-tax Rules, 1962**		
(a) Plant & Machinery acquired in November, 2018		
50% of 15% of ₹ 20,00,000 since it is put to use for less than 180 days. [As per *Explanation 9* to section 43(1), GST paid on acquisition of P & M would not form part of actual cost where GST input credit has been availed by the firm. Therefore, the actual cost of the P & M would be ₹ 20 lakhs [₹ 23,60,000 x100/118] ***Note*** *- Alternatively, if it is assumed that input credit on machinery has not been availed under GST law, then, depreciation has to be calculated treating actual cost as ₹ 23,60,000. In such case, permissible normal depreciation will be ₹ 23,60,000 x 15% x 50% i.e., ₹ 1,77,000.*	1,50,000	
(b) Factory building@50% of 10% on ₹ 49,90,000 [₹ 40,90,000 being, construction cost + ₹ 9,00,000 being interest from 20.10.2017 to 31.12.2018 i.e., the date of borrowing upto the date of put to use] since it is put to use for less than 180 days	2,49,500	
- **Additional depreciation**@50% of 20% on plant and machinery used, since it was put to use for less than 180 days=10% x ₹ 20 lakhs ***Note*** *- Alternatively, if it is assumed that input credit on machinery has not been availed under GST law, then, permissible additional depreciation will be ₹ 23,60,000 x 20% x 50% i.e., ₹ 2,36,000.*	2,00,000	5,99,500
- **Interest on loan borrowed for construction of building** [As per section 36(1)(iii), interest for the period after the asset is put to use is allowable as		Nil

deduction, provided such interest is actually paid on or before due date of filing of return of income as required u/s 43B. Since interest of ₹ 4,20,000 for the period after the asset is put to use is not paid till the due date of filing of return of income, it would not be allowed as deduction].		
Book Profit		**39,21,875**
***Less:* Remuneration to working partners**		
Maximum permissible amount u/s 40(b):		
On first ₹ 3 lakh of book profit at 90% [₹ 3,00,000 × 90%]	2,70,000	
On balance of book profit at 60% [₹ 36,21,875 × 60%]	21,73,125	
	24,43,125	
Remuneration actually paid fully allowable as deduction, since it is lower than the specified limit		12,00,000
Total Income		**27,21,875**
Total income (rounded off)		27,21,880

(b) I. <u>If Mr. Bhist has received interest on investment made in notified Infrastructure Debt Fund</u>

The interest income received by Mr. Bhist, a non-resident, from a notified infrastructure debt fund u/s 10(47) would be subject to a concessional tax rate of 5% (*plus* health and education cess@4%) i.e., 5.2% under section 115A on the gross amount of such interest income.

Accordingly, the tax liability of Mr. Bhist in respect of such income would be ₹ 62,400 (being 5% of ₹ 12 lakhs *plus* health and education cess@4%).

(i) If Mr. Bhist is residing in a Notified Jurisdictional Area (NJA)

Under section 194LB, tax is deductible @ 5% (plus health and education cess@4%) i.e. 5.2% on interest paid by notified infrastructure debt fund u/s 10(47) to a non-resident.

However, since Mr. Bhist is a resident of a NJA, tax would be deductible@30% (plus health and education cess@4%) i.e. 31.2% being the highest of the following rates –

(a) at the rate or rates in force;

(b) at the rate specified in the relevant provision of the Act i.e., 5%;

(c) at the rate of 30%.

Tax to be deducted by notified infrastructure debt fund would be ₹ 3,74,400 (being 30% of ₹ 12 lakhs *plus* health and education cess@4%).

(ii) If Mr. Bhist is stationed outside India, in a place other than a NJA

Tax would be deductible@5% under section 194LB (plus health and education cess@4%) i.e. 5.2% on interest paid by notified infrastructure debt fund u/s 10(47) to Mr. Bhist.

Tax to be deducted by notified infrastructure debt fund would be ₹ 62,400 (being 5% of ₹ 12 lakhs *plus* health and education cess @ 4%).

II. If Mr. Bhist has received fee for technical services (FTS) from an Indian company

If Mr. Bhist, a non-resident, has received FTS from an Indian company instead of interest income from Infrastructure Debt Fund assuming that the agreement for FTS is approved by the Central Government, the same would be subject to tax@10% (*plus* health and education cess@4%) i.e. 10.4% under section 115A on the gross amount of such FTS, irrespective of the residing place of Mr. Bhist.

The tax liability of Mr. Bhist, in such a case, would be ₹ 1,24,800 (being 10% of ₹ 12 lakhs *plus* health and education cess@4%).

Question 3

(a) *GVB Charitable Trust engaged in the activities of running a charitable hospital and medical college since 8 years, has been merged with a Corporate hospital on 31st March, 2019. The said Corporate Hospital is not eligible for registration under section 12AA of the Act. The position of assets and liabilities of the Charitable trust as on the date of merger are furnished as under:*

A:	**Properties and Assets :**		**₹**
	(a)	*Shares and securities held by Trust acquired out of agricultural income exempt u/s 10(1) of the Act:*	*25 lakhs*
	(b)	*Book value of Quoted shares and securities:*	*35 lakhs*
		Market value (Average of lowest and highest price of such shares as on date of merger quoted on recognised stock exchange)	*40 lakhs*
	(c)	*Book value of Land and Buildings held by Trust:*	*60 lakhs*
		Value of Immovable Properties (Land & Buildings) as per valuation report from Registered Valuer:	*40 lakhs*
		Stamp Duty value:	*38 lakhs*
		The Trust was created on 1st January, 2013 and obtained registration under section 12AA on 31st March, 2013.	
	(d)	*The Trust holds 40% of equity shares in an unlisted company and the financial position of said unlisted company as on date of merger is as under :*	*₹*
		Book value of assets (other than immovable property)	*25 lakhs*

Fair Market value of Immovable Property	*45 lakhs*
Reserves and Surplus	*15 lakhs*
Provision for taxation	*5 lakhs*
Total amount of Paid-up Equity Share Capital	*25 lakhs*

B: Liabilities:

(a)	*Liability in respect of shares and securities (unlisted)*	*8 lakhs*
(b)	*Bank Liability in respect of quoted shares and securities*	*15 lakhs*
(c)	*Advance Tax paid*[5]	*12 lakhs*

Compute the tax liability, if any, of Charitable Trust, arising out of above merger, giving explanation for treatment of each item in the context of relevant provisions contained in the Act. Assume that the trust has no tax liability in respect of other activities undertaken during previous year 2018-19. ***(8 Marks)***

(b) Miss Sapna, a resident of India and a salaried employee employed with a private co., aged 30 years, received the following sums during the previous year 2018-19.

Basic Salary	*₹ 45,000 p.m.*
DA	*10% of basic salary*
Transport Allowance	*₹ 8,000 p.m.*
Medical Allowance	*₹ 3,500 p.m.*

She contributed ₹ 25,000 to approved Pension Fund of LIC. She also paid ₹ 1,75,000 by account payee cheque for mediclaim premium to insure the health of her father, aged 65 years, who is not dependent on her as a lumpsum payment for 5 years including the current previous year.

Apart from this, she also provided guest lecture to a foreign university during the year. She received ₹ 7,92,000 from such university after deduction of tax of ₹ 1,08,000 in the country in which such university is located. India does not have any double taxation avoidance agreement under section 90 of the Income-tax Act, 1961, with that country. Compute the tax liability of Ms. Sapna for the A.Y. 2019-20. ***(6 Marks)***

Answer

(a) Computation of exit tax payable by GVB Charitable Trust

As per section 115TD, the accreted income of "GVB Charitable Trust", registered u/s 12AA, would be chargeable to tax at maximum marginal rate@34.944% [30% *plus* surcharge@12% *plus* cess@4%] on its merger with another entity not registered u/s 12AA.

[5] Should have been shown under A: Properties and assets

Particulars		Amount (₹)
Aggregate FMV of total assets as on 31.3.2019, being the specified date (date of merger) **[See Working Note 1]**		1,08,00,000
Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**		23,00,000
Accreted Income		**85,00,000**
Tax Liability@34.944% of ₹ 85,00,000		29,70,240
Working Note 1		
Aggregate fair market value of total assets on the specified date		
Share and securities held by the trust, which are acquired out of agricultural income exempt u/s 10(1) shall be ignored by virtue of proviso to section 115TD(2).		Nil
Quoted shares and securities		40,00,000
[The fair market value of quoted shares would be average of the lowest and highest price of such shares quoted on the recognized stock exchange on the specified date i.e., 31.3.2019]		
Land and building, being immovable property		40,00,000
[The fair market value of land and building would be higher of ₹ 40,00,000 i.e., price that it would ordinarily fetch if sold in the open market as per registered valuer's certificate and ₹ 38,00,000, being stamp duty value as on the specified date i.e., 31.3.2019]		
Equity shares in an unlisted company:		
Book value of assets (other than immovable property)	25,00,000	
Fair market value of immovable property	45,00,000	
	70,00,000	
Less: Book value of liabilities in the balance sheet: [Provision for taxation not to be included in the liabilities; total amount of paid up share capital and reserves and surplus would also not be included in liabilities]	Nil	
	70,00,000	
Value of unlisted shares held by GVB Charitable trust [70,00,000 x 40%]		28,00,000
		1,08,00,000

Working Note 2

Particulars	Amount (in ₹)
Total liability	
Liability in respect of unlisted shares and securities	8,00,000

Bank liability in respect of quoted shares and securities	15,00,000
Total liability of Charitable Trust	**23,00,000**

(b) Computation of total income of Miss Sapna for A.Y.2019-20

Particulars	₹	₹
Salaries [Indian Income]		
Basic Salary (₹ 45,000 x 12 months)	5,40,000	
Dearness Allowance (10% of basic salary of ₹ 5,40,000)	54,000	
Transport Allowance (₹ 8,000 x 12) [Fully taxable]	96,000	
Medical Allowance (₹ 3,500 x 12) [Fully taxable]	42,000	
Gross Salary	7,32,000	
Less: Standard deduction u/s 16 Lower of actual salary or ₹ 40,000	40,000	
Net Salary		**6,92,000**
Income from Other Sources [Foreign Income]		
Income from lectures in foreign university [₹ 7,92,000 plus tax deducted at source of ₹ 1,08,000]		9,00,000
Gross Total Income		**15,92,000**
***Less:* Deduction under Chapter VIA**		
Under section 80CCC – Contribution to approved Pension Fund of LIC	25,000	
Under section 80D – Medical insurance premium of her father, being a resident senior citizen for the year 2018-19, ₹ 35,000 [being 1/5th of the lumpsum premium of ₹ 1,75,000 paid for 5 years] fully allowable, even though he is not dependent on her, since the same does not exceed ₹ 50,000	35,000	
		60,000
Total Income		**15,32,000**

Computation of tax liability of Miss. Sapna for A.Y.2019-20		
Particulars		**₹**
Tax on total income [₹ 1,59,600 (i.e., 30% of ₹ 5,32,000) *plus* ₹ 1,12,500 (Tax on income of ₹ 10 lakh)]		2,72,100
Add: Health and education cess @4%		10,884
Tax Liability		2,82,984

Average rate of tax in India [i.e., ₹ 2,82,984 / ₹ 15,32,000 x 100]	18.47%	
Tax rate in foreign country [1,08,000 /9,00,000] x 100	12%	
Deduction under section 91 on ₹ 9,00,000, being the doubly taxed income@ 12% [being the lower of Indian rate of tax (18.47%) and foreign tax rate (12%)]		1,08,000
Tax Payable		**1,74,984**
Tax Payable (rounded off)		1,74,980

Question 4

(a) (i) Nath Ltd., an Indian company, pays ₹ 8,40,000 to its Chief Financial Officer Mr. Raman as gross salary including taxable allowances and bonus. Besides that, it also provides non-monetary perquisites which cost the company ₹ 1,50,000.

Discuss the TDS implication in the hands of Nath Ltd. as well as in the hands of Raman as regards non-monetary perquisite.

(ii) KLS Ltd. gives a multilevel parking building in front of a shopping mall in Delhi to PQR Ltd. on a lease of 90 years. PQR Ltd. is liable to pay ₹ 3 crores as one time lease premium in addition to an annual lease rent of ₹ 26 lakhs. What will be the TDS/TCS liability in the hands of KLS Ltd. as well as in the hand of PQR Ltd.? What will be your answer if PQR Ltd. does not have PAN?

(iii) Ranu Ltd., engaged in ·manufacturing of paper, pays ₹ 4,00,000 to the head of labour union to be distributed to various workmen as per the work done by them. The AO wants the ·assessee to deduct tax on such payment under section 194C. Is the action of AO tenable in law? ***(8 Marks)***

(b) DIY Ltd., a company registered in India and subsidiary of CD Inc., a company registered in Austria. DIY Ltd. engaged in the manufacturing of fabric. To arrive at the arm's length price applicable to its transactions with CD Inc., DIY Ltd. enters into an advance pricing agreement with the Board on 25th November 2018. Accordingly, there will be a substantial change in the income of DIY Ltd. Also, DIY Ltd. wishes to apply for roll back provisions to PY 2014-15, 2015-16, 2016-17 and 2017-18. The AO wants to apply such transfer pricing provisions from the year in which DIY Ltd. became the subsidiary of CD Inc. i.e., A.Y. 2012-13 onwards.

DIY Ltd. had filed its return of income for the A.Y. 2018-19 on 26th August 2018 and for A.Y. 2019-20, on 31st August, 2019. The assessments for the A.Ys 2015-16 to 2018-19 are completed but the assessment of A.Y. 2019-20 is pending on the date of entering into APA.

You are required to answer the following questions:

(i) Whether the AO is correct to apply the transfer pricing provisions from A.Y. 2012-13 onwards?

(ii) In respect of A.Y. 2016-17, the transfer price arrived at by the Board is resulting in reduction in income of the assessee. Discuss whether the roll back provisions can be applied for that assessment year as well.

(iii) What will happen to completed as well as pending assessments? ***(6 Marks)***

Answer

(a) (i) **Tax/TDS implication of non-monetary perquisites**

Particulars	₹
Gross salary	8,40,000
Non-monetary perquisites	1,50,000
	9,90,000
Less: Standard deduction u/s 16	40,000
Net Salary	**9,50,000**
Tax liability	**1,06,600**
Average rate of tax (₹ 1,06,600 x 100 / ₹ 9,50,000)	11.221%

Nath Ltd. can deduct tax of ₹ 1,06,600 at source under section 192 from the salary of Mr. Raman.

Alternatively, the company can pay tax on non-monetary perquisites as under:

Tax on non-monetary perquisites = 11.221% of ₹ 1,50,000 = ₹ 16,832

Balance tax to be deducted at source from salary = ₹ 1,06,600 – ₹ 16,832 = ₹ 89,768

If the company pays tax of ₹ 16,832 on non-monetary perquisites, the same is not a deductible expenditure as per section 40(a)(v)

The amount of tax paid towards non-monetary perquisite by the employer is not chargeable to tax in the hands of the employee due to exemption available under section 10(10CC).

(ii) KLS Ltd., the company granting lease of parking lot, is required to collect tax at source@2% under section 206C from the one-time lease premium of ₹ 3 crores and annual lease rent of ₹ 26 lakhs, i.e. on 3.26 crores at the time of debiting the amount payable by PQR Ltd. (assumed to be resident in India) or at the time of receipt of such amount, whichever is earlier.

In case PQR Ltd. does not have PAN, tax has to be collected by KLS Ltd. at the rate of 5%, being the higher of –

(i) 5% and

(ii) 4%, i.e., twice the TCS rate of 2%

In the hands of PQR Ltd., TDS provisions would not be attracted on the one-time lease premium of ₹ 3 crores paid for acquisition of long-term leasehold rights over land or building, which are not adjustable against periodic payments [*CBDT Circular No.35/2016 dated 13.10.2016].*

(iii) If the workers are employees of Ranu Ltd., TDS provisions under section 192 would be attracted and tax has to be deducted at the average rate of income-tax, if salary payable to an individual worker exceeds the basic exemption limit.

In such a case, the action of the Assessing Officer requiring Ranu Ltd. to deduct tax at source under section 194C is not tenable in law.

If, however, the workers are contractual workers, then TDS provisions u/s 194C would be attracted and tax has to be deducted @ 1%, if payment to a worker exceeds ₹ 30,000 or aggregate payment during the year to a worker exceeds ₹ 1,00,000. The action of the AO would be tenable in law, if the above conditions are satisfied.

(b) (i) No; the Assessing Officer is not correct in applying transfer pricing provisions as per the advance pricing agreement from A.Y.2012-13 itself.

This is so since roll back provisions can be applied only for any previous year, falling within the period not exceeding four previous years, preceding the first of the five consecutive previous years as may be specified in the agreement. Since P.Y.2018-19 is the first of the five consecutive previous years, roll back provisions can be applied only from A.Y.2015-16 (relevant to P.Y.2014-15) and not from A.Y.2012-13.

(ii) No; the rollback provision cannot be applied in respect of an international transaction for a rollback year, if the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year already filed by the assessee prior to the filing of the APA.

Accordingly, the roll back provisions cannot be applied in respect of A.Y.2016-17, since it has the effect of reduction in income of DIY Ltd. for that year.

(iii) DIY Ltd. has to furnish modified return in respect of the assessment years relevant to the previous year to which APA applies (and for which returns have already been furnished before entering into an APA) within a period of 3 months from the end of the month in which the agreement was entered into i.e., on or before 28th February 2019. The modifications therein should arise only because of the APA. Such return would be treated as a return filed under section 139(1).

In case of completed assessments (i.e., assessments made upto A.Y.2018-19 other than A.Y.2016-17), the Assessing Officer would assess or reassess or recompute the total income of the relevant assessment year having regard to the APA. Such order of assessment has to be passed within a period of one year from the end of the financial year in which the modified return was furnished.

In respect of pending assessment (i.e., assessment for A.Y.2019-20), the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the APA taking into consideration the return furnished by the assessee, since the same has been furnished after the date of entering into the APA.

Question 5

*(a) Answer any **two** out of the following **three**:*

(i) An Assessee, who is aggrieved by all or any of the following orders, is desirous to know the remedial recourse and the time limit against each order under the Income-tax Act, 1961 -

(1) Passed under section 153A (except an order passed in pursuance of the direction of the Dispute Resolution Panel) by the Assessing Officer.

(2) Passed under section 263 by the Commissioner of Income-tax.

(3) Passed under section 272A by the Principal Commissioner.

(4) Passed under section 254 by the ITAT.

(ii) ABC Ltd., a developer, is engaged in the business of developing of Special Economic Zones, notified on or after 1st April 2005 under the SEZ Act, 2005. It was established in the previous year 2013-14. It had exercised its option for claiming deduction under section 80-IAB from the Assessment Year 2016-17. It received the following incomes during the previous year 2018-19:

Income from the maintenance of SEZ	*₹ 50,40,000*
Income from lease rent from letting out of buildings along with other amenities in SEZ	*₹ 14,25,000*
Interest received from bank deposits (from the refundable security deposits received from lessees)	*₹ 9,50,000*

(1) Calculate the amount of deduction available to ABC Ltd. for the A.Y.2019-20.

(2) On 1st April, 2019, it transferred the operation and maintenance of the SEZ to another company, DEF Ltd. Now, DEF Ltd. wants to claim deduction under section 80-IAB in respect of the income derived from such maintenance of SEZ as was available for ABC Ltd. Comment whether the contention of DEF Ltd.· is valid in law.

(iii) Rama Cements Ltd. is a company engaged in the manufacturing of cement. The company issued 20 lakh equity shares of ₹ 100 each to the general public. The shares were issued at a premium of ₹ 150 per share. The assessee claimed deduction under section·35D in respect of preliminary expenses at 5% of capital employed and added the amount of share premium to the capital employed to arrive at 5% as eligible amount of deduction under section 35D. The Assessing Officer,

however, disallowed the said expenditure on the basis that capital employed does not include the share premium amount. Is the action of the Assessing Officer tenable in law? ***(2 x 4 Marks = 8 Marks)***

(b) *ABC Ltd, a software giant in India, set up a 100% subsidiary company by name SHD Inc. in Switzerland on 1st April, 2018. The subsidiary company, SHD Inc., is mainly engaged in the software services, hardware services and data backup services in three different countries viz., Switzerland, Sweden and India. The following information is furnished by SHD Inc., for FY 2018-19:*

Particulars	***In Switzerland***	***In Sweden***	***In India***
Value of assets as per books of account (₹ in crores)	*24*	*12*	*24*
Number of employees working (in thousands)	*30*	*10*	*28*
Pay roll expenditure (₹ in crores)	*4*	*2.6*	*5.4*
Total aggregate income earned	*₹ 80 crores*		

Other Information:

I. Break up of total income:

- *₹ 28 crores derived from the transactions where purchases are made from associated enterprises and sold to non-associated enterprises;*
- *₹ 24 crores derived from the transactions where both purchases and sales are made from/to associated enterprises;*
- *₹ 16 crores derived from the transactions where purchases are made from non-associated enterprises and sold to associated enterprises:*
- *₹ 8 crores by way of income from capital gains on trading of shares;*
- *₹ 4 crores by way of interest from non-associated enterprises;*

II. During FY 2018-19, total 5 board meetings were held, 2 in India, 1 in Sweden and 2 in Switzerland.

Based on the above information, determine the residential status of SHD Inc., applying the provisions of POEM for the A.Y.2019-20. ***(6 Marks)***

Answer

(a) (i) Remedial measures against certain orders and time limit

	Order passed u/s	**Remedy available**	**Time limit**
1.	153A	File an appeal before the Commissioner (Appeals)	Within **30 days** of the date of service of the notice of demand relating to the

		u/s 246A(1) (or) Move a revision petition u/s 264 before the Commissioner or Principal Commissioner	assessment. Within a period of **one year** from: (i) the date of on which the order was communicated to him; or (ii) the date on which he otherwise came to know of it, whichever is earlier.
2.	263	File an appeal before the Appellate Tribunal (ITAT) u/s 253(1)(c)	**within 60 days** of the date on which the order sought to be appealed against is communicated to the assessee.
3.	272A	File an appeal before the Appellate Tribunal (ITAT) u/s 253(1)(c)	**within 60 days** of the date on which the order sought to be appealed against is communicated to the assessee.
4.	254	File an appeal before the High Court u/s 260A	**within 120 days** from the date of receipt of order of ITAT

(ii) (1) Since ABC Ltd., a developer, is engaged in the business of developing an SEZ, notified on or after 1.4.2005, it is eligible for a deduction of 100% of profits and gains derived by it from any business of developing a SEZ for 10 consecutive assessment years out of 15 assessment years beginning from the year in which the SEZ has been notified by the Central Government.

ABC Ltd. has exercised its option for claiming deduction u/s 80-IAB from A.Y. 2016-17. Therefore, it is eligible to claim 100% deduction in the A.Y. 2019-20, being the 4th consecutive assessment year.

Amount of deduction available to ABC Ltd. for A.Y. 2019-20

Particulars	Amount in ₹
Income from the maintenance of SEZ	50,40,000
Income from lease rent from letting out of buildings along with other amenities in SEZ [As per CBDT Circular No. 16/2017 dated 25.04.2017, income from letting out of premises/developed space along with other facilities in an SEZ is chargeable to tax under the head 'Profits and Gains of Business or Profession". Hence, considered for deduction u/s 80-IAB]	14,25,000
Interest received from bank deposits [not chargeable to tax under the head 'Profits and Gains of Business or Profession". Hence, not considered for deduction u/s 80-IAB]	Nil
	64,65,000

Deduction u/s 80-IAB for A.Y. 2019-20 [100% of profits derived from business]	64,65,000

(2) As per section 80-IAB, if an undertaking, being a Developer i.e., ABC Ltd., in the present case, who develops a SEZ on or after 1.4.2005, transfers the operation and maintenance of such SEZ to another Developer i.e., DEF Ltd., the deduction shall be allowed to DEF Ltd. for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the DEF Ltd.

Hence, DEF Ltd. can claim deduction u/s 80-IAB for the remaining period i.e., from A.Y.2020-21 to A.Y.2025-26.

(iii) The issue under consideration is whether "premium" on subscribed share capital can be treated "capital employed in the business of the company" under section 35D to be eligible for increased deduction under section 35D.

The share premium collected by Rama Cements Ltd. on its subscribed share capital would not be part of "capital employed in the business of the company" for the purpose of section 35D.

If it were the intention of the legislature to treat share premium as being "capital employed in the business of the company", it would have been explicitly mentioned.

Moreover, [6]the provisions of the Companies Act, 2013[7] dealing with capital structure of the company provides the break-up of "issued share capital" and "subscribed share capital" which does not include share premium at the time of subscription.

Also, section 52 of the Companies Act, 2013 requires a company to transfer the premium amount to be kept in a separate account called "securities premium account".

Hence, in the absence of the reference in section 35D, share premium is not a part of the capital employed and increased amount of deduction due to inclusion of securities premium in capital employed would not be allowed u/s 35D.

However, the contention of the Assessing Officer to disallow the whole of the said expenditure claimed under section 35D is not tenable in law, since only to the extent of 5% of the share premium included by the assessee in capital employed, is not allowable. In other words, the deduction otherwise allowable as per the provisions of section 35D cannot be denied.

Note – *The facts of the case are similar to the facts in Berger Paints India Ltd v. CIT (2017) 393 ITR 113, wherein the above issue came up before the Apex Court. The above answer is based on the rationale of the Supreme Court in the said case.*

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[6] *Sl. No. IV(i) in Form MGT- 7 read with section 92 of the Companies Act, 2013*

[7] *Corresponding to column III of the form of the annual return in Part II of Schedule V to the Companies Act, 1956 u/s 159*

(b) SHD Inc., a foreign company, would be resident in India in the P.Y. 2018-19, if its place of effective management is in India in that year.

For determining the POEM of SHD Inc., the important criteria is whether the company is engaged in active business outside India or not.

A company would be said to be engaged in "Active Business Outside India" (ABOI) for POEM, if

- its passive income is not more than 50% of its total income; **and**
- less than 50% of its total assets are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

SHD Inc. would be regarded as a company engaged in active business outside India for P.Y. 2018-19 for POEM purpose only if it satisfies all the four conditions cumulatively.

Condition 1: The passive income of SHD Inc. should not be more than 50% of its total income

Total income of SHD Inc. during the P.Y. 2018-19 is ₹ 80 crores

Passive income is the aggregate of, -

(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises i.e., ₹ 24 crores; and

(ii) income by way of, *inter alia*, capital gains i.e., ₹ 8 crores and interest i.e., ₹ 4 crores;

Passive Income of SHD Inc. is ₹ 36 crores

Percentage of passive income to total income = ₹ 36 crore/ ₹ 80 crore x 100 = 45%

Since passive income of SHD Inc. i.e., 45% is not more than 50% of its total income, the first condition is satisfied.

Condition 2: SHD Inc. should have less than 50% of its total assets situated in India

Value of total assets of SHD Inc. is ₹ 60 crores [₹ 24 crore + ₹ 12 crore + ₹ 24 crore].

Value of total assets of SHD Inc. in India is ₹ 24 crores

Percentage of assets situated in India to total assets = ₹ 24 crores/₹ 60 crores x 100 = 40%

Since the value of assets of SHD Inc. situated in India is less than 50% of its total assets, the second condition for ABOI test is satisfied.

Condition 3: Less than 50% of the total number of employees of SHD Inc. should be situated in India or should be resident in India

Number of employees working in India is 28,000.

Total number of employees of SHD Inc. is 68,000 [30,000+10,000+28,000].

Percentage of employees working in India to total number of employees is 28,000 x 100/68,000 = 41.176%

Since employees of SHD Inc. working in India are less than 50% of its total employees, the third condition for ABOI test is satisfied.

Condition 4: The payroll expenses incurred on employees situated in India or resident in India should be less than 50% of its total payroll expenditure

Payroll expenditure on employees in India is ₹ 5.40 crores

Total payroll expenditure of SHD Inc. is ₹ 12 crores [4.0 crore + 2.6 crore + 5.4 crore].

Percentage of payroll expenditure on employees in India to total payroll expenditure is ₹ 5.4 crores/₹ 12 crores x 100 = 45%

Since payroll expenditure on employees of SHD Inc. in India is less than 50% of its total payroll expenditure, the fourth condition for ABOI test is satisfied.

Since SHD Inc. satisfies all the above four conditions cumulatively, SHD Inc. has passed the Active Business Outside India (ABOI) test.

Determination of POEM of SHD Inc.

POEM of a company engaged in active business outside India shall be presumed to be outside India, if the majority of the board meetings are held outside India.

Since SHD Inc. is engaged in active business outside India in P.Y. 2018-19 and majority of its board meetings i.e., 3 out of 5, were held outside India, POEM of SHD Inc. would be outside India.

Therefore, SHD Inc. would be non-resident in India for the P.Y. 2018-19.

Question 6

(a) *MNO Ltd. in Mumbai is a wholly owned subsidiary of a holding company located in Low Tax Jurisdiction (LTJ). MNO Ltd. has accumulated profit of ₹ 1,500 lakhs. It deposited ₹ 1,000 lakhs in fixed deposit with a branch of foreign bank located in India. Based on the security of the deposit, the holding company located in ·LTJ availed bank loan of ₹ 800 lakhs. Is this an impermissible arrangement lacking commercial substance? Support your answer with applicable legal provisions.* ***(4 Marks)***

(b) *There is a tax arrear of ₹ 52 lakhs payable by Super Six Traders (P) Ltd. relating to various assessment years. The court appointed a liquidator on 30-06-2018. The liquidator failed to notify his appointment to the Assessing Officer and also omitted to take note of*

the tax arrears. He sold some of the assets of the company and settled the suppliers' dues. What would be the legal consequence of the actions of the liquidator? ***(4 Marks)***

(c) (i) *Explain briefly Jurisdictional double taxation and Economic double taxation. How does the tax law provide for remedial measures?* ***(4 Marks)***

(ii) *Do you agree that the tax treaties are to be interpreted liberally? If so, why?* ***(2 Marks)***

Answer

(a) This is an arrangement whose main purpose is to take money out of reserves available with subsidiary company i.e., MNO Ltd., India without payment of dividend distribution tax under section 115-O.

The dividend distribution tax would be attracted in the hands of MNO Ltd. in both following situations -

- If MNO Ltd. had declared or distributed dividend, tax has to be paid@15% plus surcharge@12% plus health and education cess@4% (i.e., 17.472%) on such distributed income.
- If MNO Ltd. had directly lent money to its holding company, the provisions of section 2(22)(e) would get attracted, on account of deeming such amount of loan as dividend, since the holding company holds substantial interest in its Indian subsidiary, MNO Ltd. In such a case, dividend distribution tax@30% plus surcharge @12% plus health and education cess@4% (i.e. 34.944%) would be levied.

In order to avoid payment of dividend distribution tax, MNO Ltd. had adopted a circuitous route of depositing money with foreign bank's branch in India, so that the bank could loan the amount to the holding company.

Tax benefit [of ₹ 279.552 lakhs (₹ 800 lakhs x 34.944%)] is sought to be obtained by way of saving taxes on the amount distributed to the holding company which would be treated as deemed dividend and subject to dividend distribution tax in the hands of MNO Ltd. The arrangement disguises the source of funds by routing it through branch of a foreign bank. The branch of foreign bank may also be treated as an accommodating party.

Hence, the arrangement shall be deemed to be an impermissible arrangement lacking commercial substance.

However, in this case, since the tax benefit of ₹ 279.552 lakhs (₹ 800 lakhs x 34.944%) arising out of such arrangement does not exceed ₹ 3 crore, GAAR provisions cannot be invoked.

(b) As per section 178, the liquidator of Super Six Traders (P) Ltd. has to give notice of his appointment as liquidator within 30 days of his appointment i.e., on or before 30.7.2018 to the Assessing Officer having jurisdiction to assess the income of the company.

He is debarred from parting with the assets of company in his hands until he is notified by the Assessing Officer of the amount of tax arrears (i.e., ₹ 52 lakhs, in this case) except with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

Further, on being so notified, he has to set aside an amount equal to the amount notified.

Since the liquidator has failed to notify the Assessing Officer of his appointment within the time specified and has parted with the assets of the company in his hands in contravention of the above provisions, he shall be personally liable for payment of the tax which the company would be liable to pay.

Failure to comply with the above requirement would be an offence punishable u/s 276A with rigorous imprisonment of two years.

(c) (i) **Jurisdictional double taxation and economic double taxation**

When source rules overlap, double taxation may arise i.e., tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as "jurisdictional double taxation".

This can also be explained with the help of an example. A particular income is taxed in the hands of a person in the country in which it arises (Source State) and also in the country in which such person is a resident (Residence State), by virtue of the domestic tax laws of the respective Contracting States. This gives rise to jurisdictional double taxation.

'Economic double taxation' happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different persons.

For example, in India, income of a firm is subject to tax and partner's share in the income of the firm is exempt. However, if partner is a resident of another country, where share income from firm is taxable, economic double taxation would arise.

In order to avoid jurisdictional double taxation, relief available under the provisions of Double Taxation Avoidance Agreements (DTAAs) with the source country can be utilized, or in the absence of such an agreement, provisions of section 91, providing unilateral relief in the event of double taxation, would be applicable.

Tax treaties generally do not cover instances of economic double taxation. Mutual Agreement Procedure (MAP) provides relief in cases of economic double taxation.

(ii) Yes, I agree with the given statement.

It is a general principle of construction with respect to treaties that they shall be liberally construed so as to carry out the apparent intention of the parties.

[8]Contrary to an ordinary taxing statute, a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated in so far as the particular item under consideration is concerned.

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[8] In John N. Gladden v. Her Majesty the Queen, 85 D.T.C. 5188 at 5190, Source: UOI v. Azadi Bachao Andolan 263 ITR 706 (SC), the principle of liberal interpretation of tax treaties was reiterated by the Federal Court.

PAPER – 8: INDIRECT TAX LAWS

*(i) Question paper comprises of **6** questions. Answer Question No. 1 which is compulsory and any **4** questions out of the remaining **5** questions.*

(ii) Working notes should form part of the answer.

(iii) All questions should be answered on the basis of the position of (i) GST law as amended by significant notifications/circulars issued till 30th April, 2019 and (ii) Customs law as amended by the Finance Act, 2018 and significant notifications/circulars issued till 30th April, 2019.

Question 1

Sukhdev is a mining engineer. He has crossed the threshold limit for registration under the GST law and is duly registered in the State of Maharashtra. He effects the following transactions in the month of March, 2019 and wants you to compute the tax payable in cash. He has filed bond/ LUT to claim benefits from zero-rated supplies. The following are the particulars furnished by him.

Sl. No	Particulars	Value of supply in ₹
(a)	Sukhdev, being an operating member in mining and exploration services at Mumbai High, has provided certain services to the Joint Venture (JV) in which he is also a participant. He believes that the consideration received from the JV is 'Cost Petroleum' and not taxable.	12,00,000
(b)	He has purchased certain machinery from outside the State, to render services to the JV at Mumbai High.	6,00,000
(c)	He has obtained legal opinion from a local firm of advocates to enter into the contract with the JV, for providing services to it.	1,00,000
(d)	He has obtained accommodation from the State Government to locate his office close to the sea shore.	2,00,000
(e)	He gets a portion of the petroleum silt as part of the compensation while exploring the petroleum reserves in the Bombay High- which as per the contract with the Government is part of 'Cost Petroleum'.	6,00,000
(f)	He sells the petroleum silt to a SEZ Developer in Mumbai	6,80,000
(g)	Consideration is received towards transfer of tenancy rights, which according to Sukhdev is not liable to GST as it has suffered stamp duty.	8,00,000
(h)	On violation of the terms in production sharing agreement, Sukhdev has paid liquidated damages to the Government.	3,00,000

(i)	*He has been assigned the right to collect royalty on behalf of Maharashtra Government, as 'Excess Royalty Collection Contractor'. He has noticed that the mining lease holders have short paid 2,00,000 as IGST from what had been exempted to him under the assignment.*	--
(j)	*He has sold self-fabricated machinery through his agent in Mumbai, that has been used for 2 years, the value of which is not available in the open market. The agent sells it immediately to an unrelated customer in Mumbai.*	*10,00,000*
(k)	*Opening Balance and brought forward tax credits are as follows:*	
	- Electronic Cash Ledger - CGST	*12,000*
	- Electronic Credit Ledger - CGST	*18,000*
	- Electronic Credit Ledger - SGST	*12,000*
	- Electronic Credit Ledger - IGST	*60,000*
(l)	*Supply value is exclusive of taxes. Supply of services are taxable at CGST 9%, SGST 9% and IGST 18% and supply of goods are taxable at CGST 2.5%, SGST 2.5% and IGST 5%. Determine the tax payable in cash.* *Provide suitable notes where required.*	

(14 Marks)

Answer

Computation of tax payable in cash

S. No.	Particulars	Amount (₹)	CGST (₹)	SGST (₹)	IGST (₹)
A.	**GST liability on outward supply**				
(i)	Consideration for services provided as an operating member to the Joint Venture [The operating member is providing the mining and exploration service to the joint venture, and thus, the consideration received therefor is not cost petroleum and hence, is liable to tax.]	12,00,000	1,08,000	1,08,000	
(ii)	Compensation received in the form of petroleum silt, which, as per the	6,00,000	Nil	Nil	

	contract with the Government, is part of cost petroleum [Cost petroleum is not a consideration for service to the Government and thus, is not taxable.]				
(iii)	Sale of petroleum silt to a SEZ developer [Supply to SEZ developer is a zero-rated supply and no tax is payable on the same if made under a bond/LUT.]	6,80,000			Nil
(iv)	Consideration for transfer of tenancy rights [Transfer of tenancy rights to a new tenant against consideration in the form of tenancy premium is taxable even though stamp duty has been paid on the same.]	8,00,000	72,000	72,000	
(v)	Sale of self-fabricated machinery[1] [Since open market value of the machine is not available, the value will be 90% of the price charged for the supply of machinery by the agent to his unrelated customer.][2]	9,00,000	22,500	22,500	
Total tax liability on outward supplies			*2,02,500*	*2,02,500*	
B.	GST liability on inward supplies under reverse charge				
(i)	Legal services provided by a firm of advocates to Sukhdev, i.e. a business entity[3]	1,00,000	9,000	9,000	

[1] *It has been assumed that the value of ₹ 10 lakh at which the agent sells the self-fabricated machinery to unrelated customer is known to Sukhdev at the time he sells the machinery to the agent.*

[2] *It has been assumed that the supplier has opted to value the goods at 90% of the value charged by the agent to the unrelated customer.*

[3] *It has been assumed that aggregate turnover of Sukhdev in the preceding financial year exceeds ₹ 20 lakh.*

(ii)	Renting of immovable property provided by the State Government to Sukhdev (a registered person)		2,00,000	18,000	18,000	
(iii)	Assignment, by the State Government, of the right to collect royalty from mining lease holders to the extent the exemption is not available					2,00,000
Total tax liability on inward supplies under reverse charge				*27,000*	*27,000*	*2,00,000*
C.	Input tax credit					
(i)	Opening balance			18,000	12,000	60,000
(ii)	Inter-State purchase of machinery	Since the goods and services are used for effecting taxable supplies including zero rated supplies, full ITC thereon will be allowed.	6,00,000			30,000
(iii)	Legal services		1,00,000	9,000	9,000	
(iv)	Renting of immovable property		2,00,000	18,000	18,000	
(v)	Assignment of right to collect royalty					2,00,000
Total ITC [ITC may be availed for making zero rated supply even if such a supply is an exempt supply. Sale of petroleum silt, being a non-taxable supply, is an exempt supply but since it is also a zero-rated supply, ITC can be availed for making such supply.]				*45,000*	*39,000*	*2,90,000*
D.	**Computation of tax payable in cash**					
	Total tax liability on outward supplies			2,02,500	2,02,500	
	Less: ITC of IGST			1,26,500	1,63,500	

	Less: ITC of CGST and SGST		45,000 (CGST)	39,000 (SGST)	
	Forward charge liability on outward supplies payable in cash after set off of ITC		31,000		
	Reverse charge liability payable in cash without set off of ITC [Tax payable under reverse charge, being not an output tax, cannot be set off against ITC and thus, will have to be paid in cash.]		27,000	27,000	2,00,000
Total tax liability payable in cash [Since ₹12,000 (CGST) is available in Electronic Cash Ledger as opening balance, additional ₹ 46,000 (CGST) needs to be paid in cash.]			**58,000**	**27,000**	**2,00,000**
Payment of liquidated damages to the Government [Services provided by the Government by way of tolerating non-performance of a contract for which consideration in the form of liquidated damages is payable to the Government under such contract, is exempt from GST. Hence, no tax will be payable by Sukhdev on such input service.]		3,00,000	Nil	Nil	

Note: *In terms of section 49B of the CGST Act, 2017, full (100%) IGST credit of ₹ 2,90,000 must be utilised first before using CGST or SGST credit. However, the said IGST credit can be set off against the CGST and SGST liability in any order and in any proportion. Thus, the final answer in each case would vary.*

Question 2

(a) BODMAS Ltd., providing educational services, furnishes you with the following information for the various services provided by it for the month of March, 2019:

Particulars	*₹*
Receipts from running a Boarding School (including receipts for providing residential dwelling service of ₹ 14,00,000)	*30,00,000*

Receipts of 'Gyan Uday' - an Industrial Training Institute (ITI) affiliated to the National Council for Vocational Training (NCVT)	*2,00,000*
Receipts of 'Lakshya', an institute, registered with Directorate General of Employment and Training (DGET), Union Ministry of Labour and Employment, running a Modular Employable Skill Course (MESC) approved by the National Council for Vocational Training (NCVT)	*1,00,000*
Receipts of 'Wizard", a Commercial Coaching Institute providing commercial coaching in the field of arts and science (no certificate was issued on completion of the training)	*80,000*
Fees from prospective employers for campus interview	*4,00,000*
Renting of furnished flats for temporary stay to different persons	*5,00,000*
Receipts of 'Concepts', a Commercial coaching institute providing coaching in the field of commerce (a certificate was awarded to each trainee after completion of the training)	*1,40,000*
Receipts of Gurukul School providing education upto higher secondary	*5,00,000*

Compute the value of taxable supply assuming that all the above receipts are exclusive of GST. ***(9 Marks)***

(b) Mr. X has imported a machine from Japan in June, 2018 for ₹ 50 lakh. However, the machine was exported back in December, 2018 for repairs. The supplier has agreed to carry out the repairs as the machine was still in warranty period, which would normally take 6 months. The fair cost of the repairs will cost ₹10 lakh. In the meantime, Mr. X has requested the supplier to provide him another machine so that he can carry out his operations without hindrance. Acceding to the request, the supplier has provided him with another machine which was imported during February, 2019. The value of the new machine is ₹ 55 lakh. Freight charges incurred were ₹ 2 lakh. You are required to compute the assessable value and total duty payable for the above transaction of replacement.

Customs duty is 10% and IGST is 12%. Social Welfare Surcharge to be taken at 10%.

(5 Marks)

Answer

(a) Services provided by an educational institution to its students, faculty and staff are exempt vide *Notification No. 12/2017 Central Tax (Rate) dated 28.06.2017*. Further, an educational institution means, *inter alia*, an institution providing services by way of-

(i) education up to higher secondary school or equivalent;

(ii) education as a part of a curriculum for obtaining a qualification recognised by any law for the time being in force;

(iii) education as a part of an approved vocational education course.

In view of the aforesaid provisions, value of taxable supply of BODMAS Ltd. for the month of March, 2019 has been computed as follows:

Particulars	**Amount (₹)**
Receipts from Boarding School including receipts for residential dwelling service [Educational institution providing education up to higher secondary school or equivalent]	Exempt
Receipts of Gyan Uday [Educational institution running approved vocational education course (assuming that such courses are run in designated trades)]	Exempt
Receipts of Lakshya running Modular Employable Skill Course [Educational institution running approved vocational education course]	Exempt
Receipts of Wizard - a coaching institute [Taxable since coaching institute is not an educational institution]	80,000
Fees from prospective employers for campus interview [Taxable since such services are not specifically exempt]	4,00,000
Renting of furnished flats for temporary stay to different persons[4] [Not exempt since services by a hotel, inn, guest house, club or campsite, by whatever name called, for residential or lodging purposes, are exempt only when the value of supply of a unit of accommodation is below ₹ 1,000 per day.]	5,00,000
Receipts of Concepts – a coaching institute [Taxable since coaching institute is not an educational institution]	1,40,000
Receipts of Gurukul School providing education upto higher secondary	Exempt
Value of taxable supply	**11,20,000**

(b) Computation of assessable value and total duty payable

Special provisions relating to payment of concessional duty in case of re-importation of goods exported for repairs are not applicable in the given case as the goods exported for repairs and the re-imported goods are not the same.

Therefore, full customs duty will be payable on the machine received as replacement.

[4] *It has been assumed that rent per flat per day ≥ ₹ 1,000.*

	Amount (₹)
Value of new machine (FOB)[5]	55,00,000
Add: Freight charges[6]	2,00,000
Insurance charges @ 1.125% of FOB [₹ 55,00,000 × 1.125%] [Insurance charges have been included @ 1.125% of FOB value since actual charges are not ascertainable]	61,875
Assessable Value	**57,61,875**
Add: Basic customs duty @ 10% of ₹ 57,61,875 (rounded off) **(A)**	5,76,188
Social welfare surcharge @ 10% of ₹ 5,76,188 (rounded off) **(B)**	57,619
Total	63,95,682
Add: Integrated tax @ 12% of ₹ 63,95,682 (rounded off) **(C)**	7,67,482
Total duty payable [(A) +(B) + (C)] (rounded off)	**14,01,289**

Question 3

(a) *Mr. Rajbeer, a registered person at Delhi, is in the business of selling goods relating to interior decoration under the firm name M/s. Rajbeer & Sons. He has opted for composition scheme for the Financial Year (FY) 2018-19.*

His turnover for FY 2018-19 is ₹ 80 lakh and is expected to achieve ₹ 130 lakh in FY 2019-20. Discuss whether M/s Rajbeer & Sons can still enjoy the benefits of composition scheme in FY 2019-20.

His son Karan wants to start business of providing services relating to interior decoration, after completing post-graduation course in interior decoration under same firm name M/s Rajbeer & Sons with effect from 01.04.2019 and wants to enjoy the benefits of composition scheme under GST.

Advise Mr. Rajbeer and his son Karan. ***(5 Marks)***

(b) *Surya Agencies has agreed to supply goods to customer's premises. Goods valued ₹ 80,000 are taxable @ 5% IGST as it is an inter-State supply. It also pays freight and transit insurance of ₹ 12,000. GTA is a registered entity and has charged GST (6% CGST and 6% SGST) under forward charge.*

(i) *Compute the invoice value of supply including IGST.*

(ii) *What will be the invoice value of supply including IGST, if the supply was under ex-factory basis instead of door-delivery basis?* ***(4 Marks)***

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[5] *It has been most logically assumed that value of the machine is its FOB value.*

[6] *It has been most logically assumed that freight charges pertain to transportation of goods from load port to port of importation.*

(c) *During the year 2018, the customs authorities have noticed that there is an increased quantity of Product XYZ being imported, into the country. Determine whether the Central Government should consider levying safeguard duty or anti-dumping duty with appropriate reasons.*

Also enumerate any exemptions/reliefs available from such duty. ***(5 Marks)***

Answer

(a) As per section 10 of the CGST Act, 2017, a registered person, whose aggregate turnover in the preceding financial year did not exceed ₹ 1.5 crore in a State/UT may opt for composition scheme, provided he is, *inter alia,* engaged in supply of goods and/or restaurant service.

However, a person who opts for composition scheme is permitted to supply services other than restaurant service of value not exceeding 10% of turnover in a State/UT in the preceding financial year or ₹ 5 lakh, whichever is higher.

In the given case, M/s. Rajbeer & Sons[7], engaged in business of selling goods relating to interior decoration, is eligible for composition scheme in FY 2019-20 since its aggregate turnover in preceding FY (viz. ₹ 80 lakh) does not exceed ₹ 1.5 crore.

If Karan wishes to start the business of providing services relating to interior decoration under the same firm name M/s Rajbeer & Sons, the sole proprietorship needs to be first converted into a partnership firm. Further, new GST registration under the new PAN is required to be obtained.

In such a case, the firm can provide services relating to interior decoration up to a value of ₹ 5 lakh (10% of zero turnover of last year or ₹ 5 lakh, whichever is higher) to continue enjoying the benefit of composition scheme in FY 2019-20.

(b) Computation of invoice value of supply

(i) When supplier agrees to supply the goods at customer's premises, i.e. freight and transit insurance are paid by the supplier, invoice value of supply will be computed as follows**:**

Particulars	Amount (₹)
Value of goods supplied	80,000
Add: Freight and transit insurance [Since the supplier has agreed to deliver the goods at the customer's premises and to pay for freight and insurance, the	12,000[8]

[7] *It has been assumed that M/s Rajbeer & Sons is a sole proprietorship.*

[8] *Amount of freight and transit insurance (₹ 12,000) given in the question is assumed to be exclusive of 12% GST.*

contract of supply becomes a composite supply, the principal supply being the supply of goods.]	
Total	92,000
Add: IGST @ 5% [Being a composite supply, GST at the rate applicable for principal supply will be charged]	4,600
Invoice value of supply	96,600

(ii) When supplier agrees to supply the goods on ex-factory basis, i.e. the buyer pays the freight and transit insurance, invoice value of supply will be computed as follows**:**

Particulars	Amount (₹)
Value of goods supplied	80,000
Add: IGST @ 5% of ₹ 80,000	4,000
Invoice value of supply	84,000

Note: The above answer is based on the view that part (ii) of the question is an independent case and thus, the information provided in the first paragraph of the question regarding payment of freight and transit insurance by Surya Agencies does not apply to it. Moreover, when the contract is ex-factory, it implies that the freight and insurance will be the buyer's responsibility and seller will have no role, whatsoever, in delivering the goods to the customer's premises.

(c) In the given case, since Product XYZ is being imported into the country in increased quantity, Central Government should consider levying safeguard Duty and not anti-dumping duty.

Anti-dumping duty is imposed when any article is exported from any country to India at less than its normal value, which is not the case here.

However, safeguard duty can be imposed only when Central Government is satisfied that such increased importation is causing/threatening to cause serious injury to the domestic industry.

Exemptions/reliefs:

(a) Safeguard duty shall not be imposed on articles originating from developing country if the share of imports of that article from that country ≤ 3% of the total imports of that article into India.

(b) Safeguard duty shall not be imposed on articles originating from more than one developing country if the aggregate of imports from developing countries each with

less than 3% import share taken together ≤ 9% of the total imports of that article into India.

(c) Safeguard duty shall not be applicable on articles imported by a 100% EOU/ SEZ unit unless specifically made applicable;

(d) Safeguard duty shall not be applicable on articles imported by a 100% EOU/ SEZ unit unless the article imported is either cleared as such/ used in the manufacture of any goods that are cleared, into DTA.

(e) Central Government may exempt notified quantity of any article, when imported from any country into India, from whole/part of the safeguard duty.

Question 4

(a) The following particulars are furnished by Delight Exporters, Karnataka, which is duly registered under the GST law. The entity has also filed bond/LUT in order to export goods without payment of any taxes. You are required to calculate the refund amount in respect of input tax credit on inputs and input services relating to goods exported in the relevant tax period.

Sl. No.	***Particulars of supply***	***Value of supply in ₹***
1.	*Turnover - excluding supply of services, but includes exempt supplies of ₹ 8,00,000 and inward supplies of ₹ 2,00,000*	*76,00,000*
2.	*Zero-rated supply of goods under bond/LUT*	*12,00,000*
3.	*Export services under bond/LUT*	*48,00,000*
4.	*Non zero-rated supply of services*	*10,00,000*
5.	*Payments received towards zero-rated supply, which includes ₹ 12,00,000 against which services are yet to be supplied.*	*48,00,000*
6.	*Advance received in the past, against which zero-rated supplies have been made in the current tax period*	*14,00,000*
7.	*Turnover on which suppliers have claimed refund under rule 89(4A) and rule 89(4B)* *-Goods* *-Services*	 *6,00,000* *6,00,000*
8.	*ITC on inputs and input services during the tax period including those under rule 89(4A) and rule 89(4B)*	*12,00,000*
9.	*ITC relating to rule 89(4A) and rule 89(4B)*	*2,40,000*

(5 Marks)

(b) *Dharma Dutta has taken voluntary registration and has not opted for the composition scheme of levy. He is aggrieved by the cancellation of his registration under GST, although he is filing Nil returns, as he has not conducted any business for the past 8 months. He wants to know the circumstances under which the proper officer can cancel registration on his own.* ***(4 Marks)***

(c) *Mr. X imported certain goods from a related person Mr. Q of US and transaction value has been rejected. Rules 4 and 5 of the Import Valuation Rules are found inapplicable as no similar/ identical goods are imported in India. Mr. X furnishes cost related data of imports and requests customs authorities to determine value accordingly as per rule 8. The relevant data are*

1. *Cost of materials incurred by Mr. Q $ 2000*
2. *Fabrication charges incurred by Mr. Q $ 1000*
3. *Other chargeable expenses incurred by Mr. Q $ 400*
4. *Other indirect costs incurred by Mr. Q $ 250*
5. *Freight from Mr. Q 's factory to US port $ 250*
6. *Loading charges at US port $ 100*
7. *Normal net profit margin of Mr. Q is 20% of FOB*
8. *Air freight from US port to Indian port $ 1,500*
9. *Insurance from US port to Indian port $ 50*
10. *Exchange rate ₹ 70 per $*

The customs authorities are of the opinion that since value as per rule 7 can be determined at ₹ 4,00,000, there is no need to apply rule 8.

Can the request of Mr. X be legally acceptable? If so, compute the assessable value under the Customs Act, 1962. ***(5 Marks)***

Answer

(a) In case of zero-rated supply of goods and services without payment of tax under bond/LUT, refund of ITC relating to goods and services exported is granted as per the following formula:

$$\text{Refund Amount} = \frac{\text{(Turnover of zero-rated supply of goods + Turnover of zero-rated supply of services)}}{\text{Adjusted Total Turnover}} \times \text{Net ITC}$$

Accordingly, the amount of refund shall be computed as follows:

Particulars	₹
Net ITC excluding ITC availed for which refund is claimed under rule 89(4A) and 89(4B) (₹ 12,00,000 - ₹ 2,40,000)	9,60,000
Turnover of zero-rated supply of goods excluding turnover of supplies in respect of which refund is claimed under 89(4A) and 89(4B)	6,00,000
Turnover of zero rated supply of services [Aggregate of payments received during the relevant period and services where supply has been completed for which payment had been received in advance in any prior period reduced by advances received for which the supply of services has not been completed during the relevant period] [₹ 48 lakh + 14 lakh - ₹ 12 lakh][9]	50,00,000
Adjusted total turnover = Turnover in a State excluding turnover of services + Turnover of zero-rated supply of services determined as above + Non-zero-rated supply of services – [Exempt supplies other than zero-rated supplies + Turnover of supplies in respect of which refund is claimed under 89(4A) and 89(4B)] [₹ 76 lakh - ₹ 2 lakh + ₹ 50 lakh + ₹ 10 lakh – (₹ 8 lakh[10] + ₹ 6 lakh + ₹ 6 lakh)]	1,14,00,000
Refund of ITC for zero rated supply of goods and zero rated supply of services [₹ 9,60,000 x (₹ 56,00,000/ ₹ 1,14,00,000)]	**4,71,579 (rounded off)**

Note: The above answer is based on the following assumptions made with regard to the information given in the table in the question:

(i) Turnover at Sl. No. 1 [₹ 76 lakh] includes the turnover of zero rated supply of goods given at Sl. No. 2 [₹ 12 lakh].

(ii) Turnover of zero rated supply of goods given at Sl No. 2 [₹ 12 lakh] includes turnover of supplies of goods in respect of which refund has been claimed under rule 89(4A) and 89(4B) [₹ 6 lakh]

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[9] It is assumed that Sl. No. 6. of the table in the question belongs to zero rated supply of service and not for zero rated supply of goods.

[10] The exempt supplies are logically assumed to be other than zero rated supplies.

(ii) Turnover of zero rated supply of services computed as per rule 89(4)(D) [₹ 50 lakh] includes the turnover of supplies of services in respect of which the refund is claimed under rule 89(4A) and 89(4B) [₹ 6 lakh].

However, the above question can also be answered on the basis of alternate assumptions e.g., the turnover of zero rated supply of goods given at Sl. No. 2 [₹ 12 lakh] excludes turnover of supplies of goods in respect of which refund has been claimed under rule 89(4A) and 89(4B) [₹ 6 lakh] or the turnover at Sl. No. 1 [₹ 76 lakh] does not include the turnover of zero rated supply of goods given at Sl. No. 2 [₹ 12 lakh] and turnover of supplies of goods in respect of which refund has been claimed under rule 89(4A) and 89 (4B) [₹ 6 lakh].

(b) GST registration may be cancelled *suo motu* by GST Officer if the registered person: -

(i) does not conduct any business from the place of business

(ii) violates the anti-profiteering provisions

(iii) issues invoice/bill without supply of goods / services

(iv) does not file his GST return for six months

(v) does not file his GST return consecutive tax periods if he has opted for composition levy

(v) has not commenced business within 6 months from date of registration

(vi) has obtained the registration by means of fraud, wilful misstatement or suppression of facts.

Note: Any four points may be mentioned.

(c) The value of the imported goods is determined under rule 8 of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (hereinafter referred to as Import Valuation Rules) if the same cannot be determined under the earlier rules. However, the order of application of rules 7 and 8 can be reversed at the request of the importer and with the approval of the proper officer.

Thus, request of Mr. X for determination of value under rule 8 is legally acceptable if the same is also approved by the proper officer.

Assuming that the request of Mr. X has been approved by the proper officer, the assessable value of the imported goods under rule 8 will be the sum of-

(a) the cost of materials and fabrication or other processing;

(b) an amount for profit and general expenses

(c) the cost or value of all other expenses under rule 10(2) of the said rules.

Computation of assessable value	
Particulars	**Amount ($)**
Cost of materials	2,000

Add: Fabrication charges	1,000
Other chargeable expenses	400
Other indirect costs	250
Cost of the goods at Mr. Q's factory	3,650
Add: Net profit margin @ 20% of FOB, i.e. 25% of total cost Total cost till US port = Cost of the goods at factory + Freight from factory to US port and loading charges at US port = $ 4,000 [$ 3,650 + $ 250 + $ 100] FOB value = Total cost till port + profit = $ 5,000 ($ 4,000 + $ 1,000)	1,000
Add: Freight & loading/unloading charges [In case of import by air, the cost of transport, loading, unloading and handling charges associated with the delivery of the imported goods to the place of importation are restricted to 20% of FOB value]	1,000
Insurance charges	50
Assessable value	5,700
	₹
Assessable value in Indian Rupees (Exchange rate - Rs 70 per $)	3,99,000

Question 5

(a) *A taxpayer has suppressed certain facts resulting in short payment of tax. The mistake is pointed out by the Department, but no show cause notice (SCN) has been issued. As per the taxpayer, suppression is accepted at ₹ 12,00,000 and he agrees that the suppression has taken place in the month of January, 2019. He clears the dues on 20th April, 2019. However, the Department, on verification, identifies additional suppression of ₹ 2,00,000 in the same month of January, 2019. SCN is issued and the taxpayer represents before the proper officer, which results into an adverse order against the taxpayer. The order is passed on 25.05.2019 and the taxpayer complies with the adverse adjudication order on 27.06.2019.*

Determine the tax, interest and penalty payable at each stage. ***(5 Marks)***

(b) *Ganesh Enterprises, a registered supplier under the GST law, has committed an offence that is compoundable. The Department has instituted prosecution against the proprietor of Ganesh Enterprises and he is of the opinion that he shall not be able to apply for compounding of the offence as the prosecution has been launched. He seeks your advice whether he has the opportunity to apply for compounding of the offence and the consequences arising therefrom.* ***(4 Marks)***

(c) *Mrs. X, an Indian resident who was on a visit to China, returned after months. She was carrying with her the following items:*

(i)	*Personal effects*	*₹ 75,000*
(ii)	*Laptop computer*	*₹ 60,000*
(iii)	*Jewellery - 25 grams (purchased in China)*	*₹ 75,000*
(iv)	*Music system*	*₹ 50,000*

Compute the customs duty payable by Mrs. X with reference to the Baggage Rules, 2016.

(5 Marks)

Answer

(a) *Note: In the given question, suppression accepted at ₹ 12 lakh may be assumed to be either the value or the tax amount. Further, where the amount of ₹ 12 lakh is assumed to be the value of suppression, rate for tax payable would also need to be assumed.*

Further, as per explanation 2 to section 74 of the CGST Act, 2017, the expression "suppression" means non-declaration of facts or information which a taxable person is required to declare in the return, statement, report or any other document furnished under this Act or the rules made thereunder, or failure to furnish any information on being asked for, in writing, by the proper officer. Therefore, the question can be answered either by assuming that the information has been suppressed in the return/statement/report filed IN the month of January (interest would become payable from 21st January in this case) or by assuming that suppression activity has taken place in January and the same has been reported in the return/statement/report filed IN the month of February (interest would become payable from 21st February in this case).

In view of the above assumptions, following alternative answers are possible:

Alternative 1- Where amount of ₹ 12 lakh is assumed to be the value of suppression and tax rate assumed to be 18%[11]

Tax, interest and penalty payable before the issue of the SCN: In case of short payment of tax by reason of suppression of facts, if the taxpayer pays such short-paid tax and applicable interest before the issuance of show cause notice, penalty equal to 15% of such tax is payable.

Value suppressed = ₹ 12,00,000

Tax @ 18% = ₹ 2,16,000

Interest = ₹ 2,16,000 × 18% × 90/365 = ₹ 9,587 (rounded off) [From 21st January to 20th April][12]

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[11] *Any other tax rate may also be assumed. Answer will change accordingly.*

[12] *It has been assumed that the information has been suppressed in the return/statement/report filed in the month of January and thus, interest would become payable from 21st January in this case.*

OR

Interest = ₹ 2,16,000 × 18% × 59/365 = ₹ 6,285 (rounded off) [From 21st February to 20th April][13]

Penalty = ₹ 2,16,000 × 15% = ₹ 32,400

Tax, interest and penalty payable after the adjudication order: In case of short payment of tax by reason of suppression of facts, if the taxpayer pays such short-paid tax and applicable interest after 30 days of communication of the adjudication order penalty equal to 100% of such tax is payable.

Value suppressed = ₹ 2,00,000

Tax @ 18% = ₹ 36,000

Interest = ₹ 36,000 × 18% × 158/365 = ₹ 2,805 (rounded off) [From 21st January to 27th June][14]

OR

Interest = ₹ 36,000 × 18% × 127/365 = ₹ 2,255 (rounded off) [From 21st February to 27th June][15]

Penalty = ₹36,000 x 100% **=** 36,000

<u>Alternative 2-</u> Where amount of ₹ 12 lakh is assumed to be the suppressed amount of tax

Tax, interest and penalty payable before the issue of the SCN: In case of short payment of tax by reason of suppression of facts, if the taxpayer pays such short-paid tax and applicable interest before the issuance of show cause notice, penalty equal to 15% of such tax is payable.

Tax payable = ₹ 12,00,000

Interest = ₹ 12,00,000 × 18% × 90/365 = ₹ 53,260 (rounded off) [From 21st January to 20th April] [16]

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[13] It has been assumed that suppression activity has taken place in January and the same has been reported in the return/statement/report filed in the month of February and thus, interest would become payable from 21st February in this case.

[14] It has been assumed that the information has been suppressed in the return/statement/report filed in the month of January and thus, interest would become payable from 21st January in this case.

[15] It has been assumed that suppression activity has taken place in January and the same has been reported in the return/statement/report filed in the month of February and thus, interest would become payable from 21st February in this case.

[16] It has been assumed that the information has been suppressed in the return/statement/report filed in the month of January and thus, interest would become payable from 21st January in this case.

OR

Interest = ₹ 12,00,000 × 18% × 59/365 = ₹ 34,915 (rounded off) [From 21st February to 20th April] [17]

Penalty = ₹ 12,00,000× 15% = ₹1,80,000

Tax, interest and penalty payable after the adjudication order: In case of short payment of tax by reason of suppression of facts, if the taxpayer pays such short-paid tax and applicable interest after 30 days of communication of the adjudication order penalty equal to 100% of such tax is payable.

Tax payable = ₹ 2,00,000

Interest = ₹ 2,00,000 × 18% × 158/365 = ₹ 15,584 (rounded off) [From 21st January to 27th June][18]

OR

Interest = ₹ 2,00,000 × 18% × 127/365 = ₹ 12,526 (rounded off) [From 21st February to 27th June] [19]

Penalty = ₹ 2,00,000

(b) A person accused of an offence is permitted to make an application for compounding of an offence even after the institution of prosecution against him.

Therefore, in the given case, Ganesh Enterprises can apply for compounding of offence even though prosecution has been instituted/launched against him.

On payment of compounding amount determined by the Commissioner, the criminal proceedings which have been initiated against Ganesh Enterprises in respect of the said offence, shall stand abated.

The lower limit for compounding amount is to be the greater of the following amounts: -

- 50% of tax involved, or
- ₹ 10,000.

The upper limit for compounding amount is to be greater of the following amounts: -

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[17] It has been assumed that suppression activity has taken place in January and the same has been reported in the return/statement/report filed in the month of February and thus, interest would become payable from 21st February in this case.

[18] It has been assumed that the information has been suppressed in the return/statement/report filed in the month of January and thus, interest would become payable from 21st January in this case.

[19] It has been assumed that suppression activity has taken place in January and the same has been reported in the return/statement/report filed in the month of February and thus, interest would become payable from 21st February in this case.

- 150% of tax involved or
- ₹ 30,000.

(c) Computation of customs duty payable by Mrs. X

Particulars	₹
Personal effects [Duty free clearance is allowed]	Nil
Laptop computer [One laptop computer is exempt when imported into India by a passenger ≥ 18 years of age]	Nil
Jewellery [Duty free jewellery allowance is not available to Mrs. X since she did not reside abroad for more than 1 year]	75,000
Music system	50,000
Total value	1,25,000
Less: General duty free baggage allowance of ₹ 50,000	50,000
Value of baggage liable to customs duty	75,000
Rate of Duty	38.50%
Customs duty @ 38.50% (including social welfare surcharge)	**28,875**

Question 6

(a) *Mr. Pankaj, an unregistered person under GST, purchases the goods supplied by Mr. Raman, who is a registered person without receiving a tax invoice from Mr. Raman and thus helps in tax evasion by Mr. Raman. What disciplinary action may be taken by tax authorities to curb such type of cases and on whom?* ***(4 Marks)***

(b) *Neurological Systems Private Limited has been subject to confiscation of goods on the ground that it has not accounted for the goods that are liable to tax under the CGST Act, 2017. The directors would like to know from you as to how such goods are to be released from the Department. You are required to advise the directors regarding the provisions of law on this matter.* ***(5 Marks)***

OR

Enumerate any five matters on which the GST Council may make recommendations under Article 279A of the Constitution of India.

(c) *M/s PQR has imported used wearing apparel from USA in April 2019. After receipt, PQR is doubtful that the apparel may not be saleable in India and want to re-export back to USA, without use, which the supplier has accepted. Will PQR be eligible to take drawback of duty paid on imports? Also, list out the conditions for duty drawback.* ***(5 Marks)***

Answer

(a) Supply of goods without issue of any invoice with regard to such supply by a taxable person and the act of aiding or abetting said offence by any person are punishable with penalty and imprisonment.

Penalty would be as follows:

Since Mr. Raman – a taxable person - has supplied goods without invoice, he is punishable with:

Penalty: higher of

(a) ₹ 10,000/- or

(b) 100% of tax evaded

Since Mr. Pankaj helped in tax evasion by Mr. Raman, he is punishable with:

Penalty: up to ₹ 25,000/-

Imprisonment would be as follows:

In case of first time offence, where

(a) tax evaded > ₹ 5 crore, imprisonment upto 5 years and fine

(b) Exceeds ₹ 2 crore tax evaded ≤ ₹ 5 crore, imprisonment upto 3 years and fine

(c) Exceeds ₹ 1 crore tax evaded ≤ ₹ 2 crore, imprisonment upto 1 years and fine

In case of subsequent offence, imprisonment up to 5 years and fine

(b) To get the confiscated goods released from the Department, the directors of Neurological Systems Private Limited are advised as under:-

Neurological Systems Private Limited shall get an option to pay redemption fine in lieu of confiscation.

Such fine should be less than or equal to ≤ [Market value of the goods confiscated – Tax chargeable thereon]

Aggregate of such fine and penalty leviable should be more than or equal to ≥ Amount of penalty leviable under section 129(1) of the CGST Act, 2017.

Neurological Systems Private Limited can get its confiscated goods released on payment of such redemption fine plus the tax, penalty and charges payable in respect of such goods.

(b) Alternative

The matters on which the GST Council may make recommendations under Article 279A of the Constitution of India are as under:-

(i) the taxes, cesses and surcharges levied by the Union, the States and the local bodies which may be subsumed in GST;

(ii) the goods and services that may be subjected to, or exempted from GST;

(iii) model GST Laws, principles of levy, apportionment of GST levied on supplies in the course of inter-State trade or commerce and the principles governing the place of supply;

(iv) the threshold limit of turnover below which goods and services may be exempted from GST;

(v) the rates including floor rates with bands of GST;

(vi) any special rate or rates for a specified period, to raise additional resources during any natural calamity or disaster;

(vii) special provision with respect to Special Category States

(viii) the date on which the GST be levied on petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas and aviation turbine fuel.

(ix) any other matter relating to the GST, as the Council may decide.

Note: Any five points may be mentioned.

(c) Duty drawback is allowed on re-export of imported wearing apparels only when the same has not been used after import.

Since M/s. PQR has re-exported the imported apparels without using the same, it is eligible to take drawback of duty paid on import of apparels provided the following conditions are satisfied:

(a) goods (apparels) are identified to the satisfaction of the proper officer as the goods which were imported and

(b) the goods are entered for export within 2 years [period extendible on sufficient cause being shown]

from the date of payment of duty on import.