PRIME ACADEMY

35TH SESSION PROGRESS TEST – ADVANCED MANAGEMENT ACCOUNTING

No. of pages – 4

Total Marks – 75
Time allowed – 2 Hours

PART– A.

Answer all the questions

1. Following is the data regarding X Ltd

Month	Sales	Total Cost
	`.	`
January	140,000	112,000
February	154,000	120,000
March	170,000	127,000

Calculate the Break-even Sales value and the profit for the month of April if the sales value is `160,000.

2. X Ltd produced 2,000 units of a product and the following is the profitability statement.

	`
Sales	120,000
Variable Cost	81,000
Fixed Cost	26,400

It was noticed for the second block of 1,000 units Variable cost increased by `11 per unit and Fixed Cost increased by `1,400. Compute the breakeven point.

3. The present turnover of a company is `15000 its variable costs is `9000 and fixed costs is `3000, calculate the percentage increase in selling price that would be needed over the sale value for the Year to earn a margin of safety of 60%.

4. A machinery which originally cost `12,000 has an estimated life of 10 years and is depreciated at a rate of `1200 per year. It has been unused for some time, however, as expected production orders did not materialize. A special order has now been received which would require the use of the machine for two months. The current net realizable value of the machine is `8,000. If it is used for the job, its value is expected to fall to `7,500. The net book value of the machine is `8,400. Routine maintenance of the machine currently costs `40 per month. With use, the cost of maintenance and repairs would increase to `60 per month, what would be the relevant cost of using the machine for the order so that it can be charged as the minimum price for the order?

5. A company is currently operating at 40% capacity. It sells a product at a rate of `100 per product. One of its chain stores has offered the company that it would take an additional 40% capacity and has quoted a price of `75 per unit. List down any 5 factors that you would consider on this proposal.

6. Illustrate with suitable examples sunk cost and opportunity cost.

(6 * 5 = 30 Marks)

PART – B.

Answer all the questions

1. The following budgeted profit statement has been prepared using absorption costing principles:

Particulars		January To June `000s	July To December `000s
Sales		540	360
Opening Stock		100	160
Production cost	Direct Material	108	36
	Direct Labour	162	54
	Overheads	90	30
		460	280
Closing Stock		160	80
		300	200
Gross Profit		240	160
Prodn OH (over) / under absorption		(12)	12
Selling costs		50	50
Distribution Costs		45	40
Administrative costs		83	83
		166	185
Net Profit / (Loss)		74	(25)
Sales Units		15000	10000
Production Units		18000	6000

The Members of the Management team are concerned by the significant change in the profitability between the two six-month periods. As management accountant, you have analyzed the date upon which the budgeted statement has been produced, with the following results.

1. The production overheads cost comprises both a fixed and a variable element, the latter appears to be dependent on the number of units produced. The

fixed element of the cost is expected to be incurred at a constant rate through out the year.

2. The selling costs are fixed.
3. The distribution cost compromises is both the fixed and variable element, the latter appears to be dependent on the number of units sold. The fixed element of the cost is expected to be incurred at a constant rate through out the year
4. The Administrative costs are fixed.

You are required to:

a. Present the above budgeted profit statement in Marginal costing Format.
b. Reconcile each of the six-monthly profit/loss values reported respectively under Marginal and Absorption costing system
c. Reconcile the six months profit to January to June from the absorption costing systems with the six monthly losses for July to December from the absorption costing statements.
d. Calculate the annual value of units required to break even

2. F Ltd manufactures cosmetic products that are sold through a network of sales agents. The agents are paid a commission of 15% of sales. The income statement for the year ending 31st March 2011 is as follows.

F Ltd

Income Statement for the year ended 31st March, 2011

Particulars	`	`
Sales		117,000,000
Cost of goods sold		
Variable	52,650,000	
Fixed	12,915,000	65,565,000
Gross Margin		51,435,000
Selling and Marketing Expenses		
Commissions	17,550,000	
Fixed Costs	12,825,000	30,375,000
Operating Income		21,060,000

The company is considering hiring its own sales staff to replace the network of agents. It will pay its salespeople a commission of 10% and incur additional fixed costs of `11.7 million. You are required:

a. Is it advisable to employ own sales staff?

b. Under the current policy of using a network of sales agents, calculate the F Ltd breakeven point in sales values for 2011.
c. Calculate the company's breakeven point in sales values for the year 2011 if it hires its own sales force to replace the network of agents
d. Calculate the estimated sales values in Rupees that would generate an identical net income for the year ending 31st March 2011, regardless of whether the F Ltd employ its own sales staff and pays them a 10% commission as well as incurring additional fixed costs of `11.7 million, or continues to use the independent network of agents?

3. Fancy Apple Mart specializes in gift packs of Apples. Each gift pack consist 100 apples. It employs 5 labourers in its Mart and each of them works for 8 hours a day and 25 days in a month. The general fixed cost per month is ` 30,000. The Mart obtains a special order for 250 gift packs of apples. Each gift pack would consist of the following: Red apples 50, Green apple 30, Yellow apple 20, and a gift box. The Mart normally sells the gift pack at a profit of 10% on the selling price.
It is estimated that each gift pack would require 30 minutes of packing labour. Fancy Apple Mart provides the following information:

Apples & Gift box	**Stock on hand Quantity Nos**	**Actual Purchase Price/ apple `**	**Current market price/ apple `**
Red	15,000	20	25
Green	5,000	16	18
Yellow	6,000	30	40
Light red	5,000	20	(Salvage Value)
Gift box	500 nos	20	20

Red, Green, yellow apples are regularly used by the stores in the normal course of business. The stock of light red apples represent purchases of another order which was cancelled. They can be substituted for red apples without any objection from the purchaser. Otherwise with no alternative use they can be sold in the market for `20,000/-. The boxes has been already acquired for an earlier order. It is the residue which is in stock. The stores can sell the same in the market for 50% of its value. Variable overheads are 50% of the packing labour. The current cost of this labour is `400 per hour. The shop estimates that it will have 50 hours as idle time when the special order is carried out.

You are required:

(a) To compute the minimum price per gift pack assuming the special order is a one time order.
(b) Would your answer to Part A differ if the orders are continuous?

(3 * 15 = 45 Marks)

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35TH SESSION PROGRESS TEST- ADVANCED MANAGEMENT ACCOUNTING

SUGGESTED ANSWERS

PART- A

1. Applying High Low method, the variable cost % will be as follows:
(127000 – 112000) / (170000-140000) = 15000 / 30000 = 50%

Hence fixed cost = (112000- 50% of 140000) or (127000 – 50% of 170000) = `42,000

Break even sales value = Fixed cost / PV Ratio = 42000 / 50% = `84,000.

When Sales Value is `160000, Contribution equals `80000 and

Profit = Contribution – Fixed Cost = `80000 – `42000 =`38000

2. Since cost structure varies for block of 1000 units the BEP is analysed as such

Particulars	**1-1000**	**1001-2000**
Selling Price / unit - 120000 / 2000	`60	`60
Variable cost / unit	---	--
1000x + 1000(x+11) = 81000	---	--
2000x + 11000 = 81000, x = 35	`35	`46
Contribution per unit	`25	`14
Fixed Cost	`25000	`26400 (`25000+`1400)
BEP	1000 UNITS	1000 + (1400 / 14) = 1100 UNITS

3.

Particulars	**Proposed (`)**
Sales	15000+x
Variable Cost	9000

Contribution	6000+x
Fixed Cost	3000
Profit	3000+x
Desired Margin of Safety	60%
	i.e. (3000+x) / (6000+x / 15000+x) = 60% of 15000+x
	= (3000+x = 60% of 6000+x)
	= (3000+x = 3600 + 0.6x) = 0.4x = 600
	Therefore x = `1500
	% increase = (1500 / 15000) = 10%

4.

Nature of Cost	Relevancy	Amount in `
Original Cost of the Machine	Sunk Cost	0
Depreciation	Non Cash charge	0
Net Realisable Value of the Machine	Relevant Cost (8000-7500)	500
Routine maintenance of the machine	Incremental Cost ((60-40) x 2)	40
Relevant Cost of using the machine		540

5.

i. Impact on the existing sales
ii. Nature of the order
iii. Changes in cost structure
iv. Increase in investment
v. Is it a one time order or continuous order?
vi. Tax consideration
vii. Customer reaction
viii. Competition

6.

Opportunity Cost:

Opportunity cost may be as defined as prospective change in cost following the adoption of an alternative machine, process, raw materials, specification or operation. In other words, it is the cost of opportunity lost by diversion of an input factor from one use to another. It is the measure of the benefit of opportunity foregone. The opportunity cost of the value of opportunity foregone is taken into consideration when alternatives are compared. The introduction of opportunity cost concept is helpful to the management in making profitability calculations when one or more of the inputs required by one or more of the alternative courses of action is already available. These inputs may nevertheless have a cost and this is measured by the sacrifice made by the alternative action chosen or the cost that is given up in order to make them available for the current proposal.

Eg. Product A yields a profit of `1000 whereas product B yields a profit of `1500. If product A is chosen the opportunity cost is `1500.

Sunk Costs

Costs which do not change under given circumstance and do not play any role in decision making process are known as sunk costs. They are historical costs incurred in the past. In other words, these are the costs which have been incurred by a decision made in the past and cannot be changed by any decision made in the future. These costs are however, best basis of predicting future costs. Amortisation of past expenses is the clearest kind of sunk cost.

Eg. A Ltd purchased a machine costing `1,00,000/- on 01-04-2010 and has a life period of 5 yea` As on 01-04-2012, the WDV represents the sunk cost.

PART – B

1. (a).

The unit cost structure is the same in each six months period

	`	`
Selling Price		36
Direct Material	6	
Direct Labour	9	
Variable Overheads	3	
Distribution Cost	1	19
Contribution		17

	January – June		July – December	
	`000s	`000s	`000s	`000s
Sales		540		360
Variable Costs		285		190
Contribution		255		170
Fixed Costs				
Production Costs	24		24	
Selling Costs	50		50	
Distribution Costs	30		30	
Administration	83	187	83	187
		68		(17)

(b) Stock Valuation - Marginal Cost per unit `18 Absorption Cost per unit `20

	January – June	July – December
	`000s	`000s
Absorption Profit	74	(25)
C / fwd of Fixed Overheads in Stock		
3000*`2	6	
4000* `2		(8)

Marginal Profit	68	(17)

(c) Absorption based Profit per unit is `4,00,000 / 25000 = `16

	` 000s
Profit from January – June	74
Reduction in Sales Volume (5000 * 16)	(80)
Difference in Overhead Recovery	(24)
Reduction in Distribution Cost	5
Profit / (loss) from July-December	(25)

(d) Fixed Costs = `1,84,000 * 2 = `3,74,000 Contribution per unit = `17

Annual Break Even Sales in units = `3,74,000 / 17 = 22,000 Units

2.

Particulars	**Hire agents**	**Hire Own workforce**
	Amount ` in '000	
Sales	117,000	117,000
Variable Costs	70,200	64,350
Contribution Margin	46,800	52,650
Less: Fixed Costs	25,740	37,440
Operating Income	21,060	15,210
Contribution Margin Ratio	40%	45%
Breakeven point	64350	83200

F Ltd should not hire its own sales force since it reduces the operating Income by `5850 / -

The sales level at which operating incomes will be identical is called the point of in difference. This would be when the cost of the network of agents (15% of sales) is exactly equal to the cost of paying employees 10% commission along with additional fixed costs of `11.7 million. None of the other costs is relevant, because they will not change between alternatives.

Let the sales volume = S
15% X S = (10% X S) + `11,700

.15S = .10S + `11,700
.05S = `11,700 therefore  S = `23400

3.

ITEM OF COST	RELEVANT / OR NOT	Reason	One time order Amount `	Continuous Order Amount `
Red Apple	Relevant	Apples required for additional order	207,500 12500	312,500
		Less: Stock of light Red Apples	5000	
		Balance red Apples to be replaced	7500	
Green Apple	Relevant	Replacement cost - Opportunity cost	135,000	135,000
Yellow Apples	Relevant	Replacement cost - Opportunity cost	200,000	200,000
Gift Box	Relevant	Opportunity cost – Salvage value	2,500	5,000
Labour	Relevant	Total hours required 125 Idle hours – now 50 Additional hours required 75	30,000	50,000
Variable overhead	Relevant	Incremental cost(125hrs * `200 / - per hr)	25,000	25,000
Fixed cost	Irrelevant	Sunk cost	-	3,750
TOTAL COST			**600,000**	**731,250**
Cost per unit			2400	2925
Profit on the above			NIL	325
Price to be quoted.			2400	3250

<u>WORKINGS:</u>

Total fixed cost for the period `30000

Fixed cost per hour 30000 / 1000 = 30

Fixed cost for 250 packs `30*250*0.5hrs = 3,750

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35TH SESSION PROGRESS TEST

INFORMATIONS SYSTEMS CONTROL & AUDIT

No. of Pages: 3 Total Marks: 75

Time Allowed: 2Hrs

PART -A

1. **Fill in the blanks .**

a. _____________Basically means that the stages in the processing of a transaction are split between different people, such that one person cannot process a transaction through from start to finish.
b. ____________ is a global standard issued by ISO and IEC in October 2005, to establish and maintain an effective information management system, using a continual improvement approach
c. ____________ are potential losses due to threats materializing
d. __________controls are designed to reduce the impact or correct an error once it has been detected.
e. _____________ deals with "meaningless to anyone who does not possess the authentication to access the respective system resource or file."
f. A __________document needs to specify the acceptable requirements (functional, technical, and contractual) as well as the evaluation criteria used in the vendor selection process.
g. Specific reports and other documentation, called __________ must be produced periodically during system development to make development personnel accountable for faithful execution of system development tasks.
h. Structured English, also known as____________, is the use of the English language with the syntax of structured programming.
i. A ________ is a computer file that contains descriptive information about the data items in the files of a business information system.
j. A _______ is a manageable unit containing data and instructions to perform a well-defined task

(10X1=10 Marks)

2. Match the following

1	Modularity	A	Corrective control
2	Structured walkthrough	B	Black-box testing
3	Dynamic analysis testing	C	Cohesion and coupling
4	Contingency planning	D	ICMP 'Ping'
5	Hacking	E	Static Analysis testing

(5x1=5 Marks)

3. State true or false with reasons

    i. The COBIT framework address the issue of control from three vantage points, or dimensions

    ii. Access control mechanism processes the user request for resources in four steps.

    iii. DSS, MIS and expert systems are developed using traditional waterfall approach of systems development.

    iv. Decision tree is commonly used to help identify a strategy most likely to reach a goal and to calculate conditional probabilities.

    v. While designing a database, data modelling precedes conceptual modelling.

(5x2=10 Marks)

PART- B

1. a) To cope with the new technology usage in an enterprise the Auditor is to be competent to provide independent evaluation as to whether the business process activities are recorded and reported according to established standards or criteria.

Explain the two basic function that are carried out by the auditor to examine these changes (7 Marks)

b) Give any six examples for preventive controls (3 Marks)

2.. a) Explain the different types of IT audit (5Marks)

b) There are many reasons why organizations fail to achieve their systems development objectives. Explain any five of them (5 Marks)

3. a) Write short notes on the following: (2 Marks each)

- Logical Access Controls
- Audit Trail Objectives

b) It is essential to protect the integrity of a database when application software acts as an interface to interact between the user and the database. Explain the controls to be considered at the time of database updation and database reporting. (6 Marks)

4. a) Explain the stages involved in prototype modelling (4 Marks)

b) A survey of existing methods & procedures is essential in order to fully understand the present system and its related problems. Explain the various areas/aspects that are to be studied whiledoing an analysis of present system in a systems development process. (6 Marks)

5.. You are the IS auditor of ABC& Co. You decide to call on the IS facilities to review the physical and environmental controls. Draft a checklist covering the areas & points which you would be reviewing during the course of the audit.
(Note: You may cover a minimum of 15 points)
(10 Marks)

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35th SESSION - PROGRESS TEST

INFORMATION SYSTEMS CONTROL & AUDIT

SUGGESTED ANSWERS

PART- A

1.

k. Segregation of duties
l. ISO 27001 Information Security Management-Specification with Guidance for Use
m. Exposures
n. Corrective control
o. Cryptography
p. Request for proposal
q. Deliverables
r. Program Design Language or Pseudo Code
s. data dictionary
t. Module

2. 1-c, 2-e, 3-b, 4-a, 5-d

3.

i. True
The three dimensions talked about are: Business objectives, IT resources and IT processes.

ii False
Access control mechanism processes the user request for resources in three steps. They are User Identification (username), User Authentication (password) and user Authorization (accessing resources on a previously identified need-to-know basis).

iii False
The traditional approach sometimes may take years to analyze, design and implement a system. In order to avoid such delays, organizations are increasingly using prototyping techniques to develop smaller systems such as DSS, MIS and Expert systems.

iv True
A Decision Tree (or tree diagram) is a support tool that uses a tree-like graph or model of decisions and their possible consequences, including chance event outcomes, resource costs, and utility.

v False
A conceptual model defines the application domain via entities/objects, attributes of these entities/objects and their relationships. Conceptual Models need to be translated into data models so that they can be accessed and manipulated by both high-level and low-level programming languages

PART-B

1. a) The usage of computers have impacted the way in which audit needs to be done. The auditor has to
consider the following factors:

- Changes to Evidence Collection; and
- Changes to Evidence Evaluation

Changes to Evidence Collection:
Evidence collection requires existence of an audit trail and involves facing issues relating to the following:

a. *Data retention and storage:* A client's insufficient data retention capacities may restrict the amount of historical data that can be retained on-line and readily accessible to the auditor. Besides the audit trail may exist in machine readable – form and the auditor may have to use specialized audit tools and techniques which allow the data to be converted and interrogated.
b. *Absence of input documents:* Transaction data may be entered into the computer directly without the presence of supporting documentation
c. *Lack of a visible audit trail:* The audit trails in some computer systems may exist for only a short period of time. The absence of an audit trail may call for an audit approach which involves auditing around the computer system by seeking other sources of evidence
d. *Lack of visible output*: The results of transaction processing may not produce a hard copy form of output. In the absence of physical output it may be necessary for the auditor to directly access the electronic data retained on the client's computer. This is normally achieved by having the client provide a computer terminal and being granted "read" access to the required data files.
e. *Audit evidence:* Where transactions are system generated (e.g. interest calculation, depreciation calculation), the process of formal transaction authorization may not have been explicitly provided This may alter the risk that transactions may be irregular or ultra vires.
f. *Legal issues*: Increased use of computers for electronic trading can create problems relating to contracts e.g. when is the contract made, where is it made (legal jurisdiction), what are the terms of the contract and are the parties to the contract. Also the laws relating to the admissibility of computer evidence varies from country to country, and even state to state within a country. Before gathering audit evidence, the auditor should find out the applicable local and national laws relating to the subject.

Changes to Evidence Evaluation
Evidence evaluation helps to assess control strength and identify system weaknesses. Errors or weaknesses could be identified in the following possible sources/areas:

a. *System generated transactions:* Computer based Financial systems may have the ability to initiate, approve and record financial transactions but the auditor has to gain assurance that a transaction was properly authorized or in accordance with delegated authorities. The auditor may need to look at the application's programming to determine if the programmed levels of authority are appropriate.
b. *Systematic errors*: Computers work on a garbage-in garbage-out basis. Whenever an auditor finds an error in a computer processed transaction, s(he) should be thorough in determining the underlying reason for the error. If the error is due to a systematic problem, the computer may have processed hundreds or thousands of similar transactions incorrectly.

1b) Some examples are:

- Employ qualified personnel
- Segregation of duties
- Access control
- Documentation
- Authorization of transaction
- Validation, edit checks in the application
- Firewalls
- Anti-virus software (sometimes this acts like a corrective control also), etc
- Passwords

2a) *Systems and Applications audit:* An audit to verify that systems and applications are appropriate, are efficient, and are adequately controlled to ensure valid, reliable, timely, and secure input, processing, and output at all levels of a system's activity

Information Processing Facilities audit: An audit to verify that the processing facility is controlled to ensure timely, accurate, and efficient processing of applications under normal and potentially disruptive conditions.

Systems Development audit: An audit to verify that the systems under development meet the objectives of the organization and to ensure that the systems are developed in accordance with generally accepted standards for systems development.

Management of IT and Enterprise Architecture audit: An audit to verify that IT management has developed an organizational structure and procedures to ensure a controlled and efficient environment for information processing.

Telecommunications, Intranets, and Extranets audit: An audit to verify that controls are in place on the client (computer receiving services), server, and on the network connecting the clients and servers.

b)

- Lack of senior management support for and involvement in information systems development.
- Shifting user needs: Constant changes results in more requests for systems development & new project which serves as a challenge to the development team
- Difficulty in defining the requirements, specifications, and objectives for development of strategic systems where the decision making is unstructured
- Personnel are not as familiar with the new technology
- Lack of standard project management and systems development methodologies
- Overworked or under-trained development staff.
- Resistance to change: People have a natural tendency to resist change, when they perceive that the project will result in personnel cutbacks such as downsizing
- Lack of user participation in the development efforts to define their requirements
- Inadequate testing and user training.

3a) (i) **Logical Access Control**

Logical access controls are the system-based mechanisms used to designate who or what is to have access to a specific system resource and the type of transactions and functions that are permitted. Logical access controls restrict users to authorized transactions and functions. The key factors considered in designing logical access controls include confidentiality and privacy requirements, authorization, authentication and access control, user identification and authorization profiles, incident handling, reporting and followup, virus prevention and detection, firewalls, centralized security administration, user training and tools for monitoring compliance, intrusion testing and reporting

(ii) **Audit Trail Objectives**

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

- Detecting unauthorized access to the system which can occur in real time or after the fact.
- Facilitating the reconstruction of events including system failures, security violations by individuals, or application processing errors. This can be used to assign responsibility and to avoid similar situations in the future., and Promoting personal accountability.
- Promoting personal accountability: Individual are not likely to violate an organization's security policy if they know their actions are recorded in an audit log.

3, (b) **Database controls**

Update controls:

- *Sequence check transaction and master files*: Synchronisation and the correct sequence of processing between the master file and the transaction file is critical to maintain the integrity of database during updation, insertion or deletion of records in the master file with respect to the transaction records.
- *Ensure all records on files are processed:* All records in transaction files are to be mapped to respective master file by ensuring that end-of-file of the transaction file and the end-of-file of the master file

- *Process multiple transactions for a single record in the correct order:* Multiple transactions processed against the product master record must be done based on a sorted transaction codes.
- *Maintain a suspense account:* Errors arising due to failure in mapping records in transaction files and master files are maintained in a suspense account. A nonzero balance of the suspense account reflects the errors to be corrected.

Report controls:

- *Standing data*: Application program uses many internal tables for calculations. Eg. Income tax slabs table for payroll calculation. Periodic monitoring of these internal tables by means of manual check or by calculating a control total is mandatory.
- *Run-to-Run control* totals help in identifying irregularities like record dropped erroneously from a transaction file, wrong sequence of updating or the application software processing errors.
- *Print Suspense Account Entries* Suspense account entries are to be periodically monitors with the respective error file and action taken on time.
- *Recovery controls*: back-up and recovery strategies together encompass the controls required to restore failure in a database. Backup strategies are implemented using prior version and log of transactions or changes to the database Recovery strategies involve roll-forward (current state database from a previous version) or the rollback (previous state database from the current version) methods.

4 (a)

- *Step 1: Identify Information System Requirements* - the design team needs only fundamental system requirements to build the initial prototype, the process of determining them can be less formal and time-consuming than when performing traditional systems analysis.
- *Step 2: Develop the Initial Prototype* - the designers create an initial base model and give little or no consideration to internal controls, but instead emphasize such system characteristics such as simplicity, flexibility, and ease of use. These characteristics enable users to interact with tentative versions of data entry display screens, menus, input prompts, and source documents.
- *Step 3: Test and Revise*: After finishing the initial prototype, the designers first demonstrate the model to users and then give it to them to experiment. Users must be told that the prototype is incomplete and requires subsequent modifications based on their feedback. Using this feedback, the design team modifies the prototype as necessary and then resubmits the revised model to system users for re evaluation. Thus iterative process of modification and re evaluation continues until the users are satisfied.
- *Step 4: Obtain User Signoff of the Approved Prototype:* At the end of Step 3, users formally approve the final version of the prototype, which commits them to the current design and establishes a contractual obligation about what the system will, and will not, do or provide. Approximately half of these approved prototypes become fully functional systems.

4 (b)

- *Review historical aspects*: A brief history of the organisation and the annual reports should identify the major turning points and milestones that have influenced its growth. The system analyst should investigate what system changes have occurred in the past. These should include operations that have been successful or unsuccessful with computer equipments and techniques.
- *Analyse inputs*: Source documents are used to capture the originating data for any type of system. The system analyst should be aware of the nature of the data and its movement (origination, flow and destination) and other similar considerations to determine how these inputs fit into the framework of the present system.
- *Review data files maintained:* The analyst should investigate the all on-line and off-line files, data files maintained by each department, noting their number and size, where they are located, who uses them and the number of times per given time interval these are used. This information along with the related costs of retrieving and processing the data will influence the new system.
- *Review methods, procedures and data communications*: A procedure review is an intensive survey of the methods by which each job is accomplished. Its basic objective is to eliminate unnecessary tasks or to perceive improvement opportunities in the present information system. A system analyst also needs to review and understand the present data communications used by the organisation so as to identify the need to revamp the network when the new system is installed.

- *Analyse outputs:* The outputs or reports should be scrutinized to determine how well they will meet the organisation's needs. The analysts must understand what information is needed and why, who needs it and when and where it is needed.
- *Review internal controls*: An examination of the present system of internal controls may indicate weaknesses that should be removed in the new system.
- *Model the existing physical system and logical system*: The logical flow of the present information system must be properly documented and may be depicted with the help of system flow charts. The physical flow of the existing system may be shown by employing data flow diagrams. The data flow diagrams are drawn after reviewing or developing system flow charts. Each major operation in the system flow charts is broken down into its lowest-level modules and the data flow diagram is drawn for each one of them.

5. Secured Physical Access:

1. Whether Physical Access Control Policy is documented and approved?
2. Whether the policy on the following is appropriate and covers:
    - Lay out of facilities
    - Physical Security of the assets
    - Access to the assets
    - Maintenance of the assets
    - Signage on the facilities
    - Labels for assets
    - Visitors' authorization and recording
    - Entrance and exit procedures
    - Legal & regulatory requirements
3. Whether critical IS facilities (like data center) are located appropriately?
    (Verify the location for the following as:-
    - Protection against natural disasters like earthquakes, flooding, extreme weather etc.
    - Not in congested places
    - Not being on ground or top floor
    - Not being below ground level to avoid water leakage etc.
    - Not having a showcase window
    - Not having a direct access from the outside or through a public hallway
    - Place which is not obvious externally)
4. Whether the access to IS facilities is controlled through a secured mechanism?
    (Verify the access control mechanism - e.g. access card, lock and key or manned reception)
5. Whether the access to the IS facilities is limited to approved persons only?
    (Approved persons may include employees, vendors and customers)
6. Whether the physical access control procedures are adequate and appropriate for approved persons?
    (Access should be provided on need to do and need to know basis)
7. Whether the visitor to critical IS facilities are escorted by employees?
    (Records for visitors' access should be maintained)
8. Whether a periodical review of access rights is carried out?
9. Whether the physical security is continually addressed?
10. Whether all access routes are identified and controls are in place?
11. Whether the security awareness is created not only in IS function but also across the organization?
12. Whether the physical security is ensured at suppliers' facilities also in cases where organization's' assets (either physical or data) are processed at supplier's facilities?
13. Whether the usage of any equipment outside the business premises for information processing is authorized by the management?
14. Is the security provided to equipment used outside business premises similar to / same as that offered to equipment used inside the business premises?
15. Whether adequate monitoring equipments are present to monitor the movements of the personnel inside the facility?
16. In case of outsourced software, whether all maintenance work is carried out only in the presence of/ with the knowledge of appropriate IS staff?
17. Whether appropriate access controls like password, swipe card, bio-metric devices etc. are in place and adequate controls exist for storing the data/ information on them? Are there controls to ensure that the issue and re-collection of such access devices are authorized and recorded?

18. Whether access violations are recorded, escalated to higher authorities and appropriate action taken?
19. Whether employees are required to keep the critical / sensitive documents in secured places?
20. Check if facility IS related risks with respect to lighting, building orientation, signage and neighborhood characteristics are identified?
21. Do the network, operating system and application monitoring procedures provide ample information to identify associated risks?
22. Verify that surveillance systems are designed and operating properly?
23. Ensure that physical access control procedures are comprehensive and being followed by security staff.
24. Verify if the security controls in place are appropriate to prevent intrusion into sensitive IS facilities –data centre, communication hubs, emergency power services facilities?
25. Review facility monitoring measures to ensure that alarm conditions are addressed promptly.

. Environmental Controls:

1. Whether the Environmental Control policy is documented and approved?
2. Whether IS facilities are situated in a place that is fire resistant?
   (Verify for wall, floor, false ceiling, furniture and cabling being non combustible / fire resistant / fire retardant)
3. Whether smoking restrictions in IS facilities are in place?
4. Whether adequate smoke / temperature detectors are installed, connected to the fire alarm system and tested?
5. Whether fire instructions are clearly posted and fire alarm buttons clearly visible?
6. Whether emergency power-off procedures are laid down and evacuation plan with clear responsibilities in place?
7. Whether fire prevention and control measures implemented are adequate and tested periodically?
8. Whether fire drill and training are conducted periodically?
9. Whether air-conditioning, ventilation and humidity control procedures are in place, tested periodically and monitored on an ongoing basis?
10. Whether an adequate alternate power arrangement is available? If so, is it covered under maintenance?
11. Whether alternative water, fuel, air-conditioning and humidity control resources are available?
12. Check if heating, ventilation, and air-conditioning systems maintain constant temperatures within a data center and other IS facilities?
13. Evaluate the data center's use of electronic shielding to verify that radio emissions do not affect computer systems or that system emissions cannot be used to gain unauthorized access to sensitive information.
14. Verify if there are sufficient battery backup systems providing continuous power during momentary black-outs and brown-outs along with generators that protect against prolonged power loss and are in good working.
15. Ensure that a fire alarm is protecting a critical IS facility like data center from the risk of fire, a water system is configured to detect water in high-risk areas of the data center and a humidity alarm is configured to notify data center personnel of either high or low-humidity conditions.
16. Check logs and reports on the alarm monitoring console(s) and alarm systems which are to be monitored continually by data center/IS facility personnel.
17. Verify that fire extinguishers are placed every 50ft within data center isles and are maintained properly with fire suppression systems are protecting the data center from fire.
18. Whether there are emergency plans that address various disaster scenarios for example backup data promptly from off-site storage facilities?
19. Ensure if there exists a comprehensive disaster recovery plan that key employees are aware of their roles in the event of a disaster and are updated and tested regularly.
20. Ensure that detail part inventories and vendor agreements are accurate and current and maintained as critical assets.

PRIME ACADEMY

35TH SESSION PROGRESS TEST – DIRECT TAX LAWS

No. of Pages: 6 Total Marks: 75

Time Allowed: 2Hrs

PART - A

1. Fill in the blanks:

1. Age limit for qualifying as a senior citizen, for availing the higher basic exemption limit under the Income Tax Act is ____Years from AY 2012-13.
2. Revision in Income Tax rates are determined annually through _____________ Act .
3. A company incorporated in Australia, having its control and management partly in India is deemed to be ___________ in India.
4. Income from sale of ICICI Mutual funds units held for a period of 16 months shall be taxable as ___________ Term Capital Gains.
5. ______________________ transaction is defined as a transaction which consists of selling securities to a friend or relative some time before the due date of interest and acquiring back the same securities after the due date is over.

(5 x 1 = 5 Marks)

2. Match the following:

1. Shipping business of Non-Resident	**A.** Short Term Capital Gains
2. Income from Business connection In India	**B.** Assessment Year and Previous Year shall be same
3. Cost Inflation Index	**C.** Income not deemed to accrue or arise in India
4. Sale of land within two years	**D.** Long Term Capital Gains
5. Income from Salary for services rendered outside India	**E.** Deemed to accrue or arise in India

(5 x 1 = 5 Marks)

3. State whether the statement is Correct or Incorrect :

1. Extra Income on account of devaluation of currency is taxable under Income Tax Act, 1961.
2. In case of Bonus Shares the cost of acquisition is same as that of Original Shares.
3. Commission paid by the owner of house property to a broker for Rental Income is deductible from rental income under house property.
4. Sale of drawings and paintings for an assessee not engaged in Art work business is taxable under Capital Gains.
5. Receipt on account of *dharmada, Gaushala & Pathshala* is Income & Liable to tax.

(5 x 1 = 5 Marks)

4. Choose the correct answer from the choices given:

a. A) local authority does not include:
   a) Municipal Committee
   b) Panchayat Board
   c) Bar council
   d) Body of part commissioners

b. Basic Exemption Limit for resident individuals of the age 80 years or more is:
   a) ` 1,80,000
   b) ` 1,90,000
   c) ` 2,50,000
   d) `5,00,000

c. Mr.A borrowed a loan on 2nd June 2011 for renovation of his house at Chennai and the house is self occupied. He pays interest of ` 2,50,000 during the year. What shall be the maximum ceiling limit for claiming interest on borrowed capital?
   a) ` 2,00,000
   b) ` 2,50,000
   c) ` 1,50,000
   d) ` 30,000

d. Which of the following is not taxable under the head Income from other sources :
   a) Dividend on Shares for non-investment company
   b) Interest on Securities
   c) Fees received for Coaching CA students
   d) Winnings from lottery

e. Lease rent on vacant site is taxable under
   a) Income from other sources
   b) Income from house property
   c) Profits & Gains from business or profession
   d) Capital Gains

(5 x 1 = 5 Marks)

5. Explain the following terms in brief with reference to Income Tax Act, 1961:
   1. Basis of Charge.
   2. Full value of consideration as per Sec.48 of Income Tax Act
   3. Unrealized Rent.
   4. Previous Year.
   5. Maximum Marginal Rate.

(5 x 1 = 5 Marks)

PART-B **50 Marks**

Answer any two Questions

1.

A. Compute the gross total income of Mr.Ramesh an Indian citizen, who is in receipt of the following during the previous year if he is;

a. Resident & ordinarily resident

b. Resident and not ordinarily resident

c. Non resident

S.No	Particulars	Amount (`)
1.	Income from agriculture in India	300,000
2.	Income from artwork in USA and spent for medical treatment in France	15,000
3.	Income from activity of purchasing goods in India and exporting to USA	90,000
4.	Income from business of publishing magazine in UK by collecting news and views in India(80% attributable to operations in India)	50,000
5.	Income from shooting of cinematograph films in India(40% attributable to operations in India)	500,000
6.	Income from transfer of residential house in India	60,000
7.	Salaries from ABC Ltd (50% relates to services outside India)	100,000
8.	Arrears of Salary from Govt of India for services rendered outside India(This includes 20,000 worth of allowances)	80,000
9.	Dividends from Indian companies received in UK	20,000

(15 Marks)

B. Mr. Rajesh had acquired painting worth ` 11 Lakhs as on 1.7.2008. On the same date, he inherited a sculpture. His father had acquired the sculpture on 1.7.1995 for `6 Lakhs. He sells all the things for ` 22 Lakhs each on 1.6.2011. Compute the amount of capital gains liable to tax. (Cost Inflation Index: 1995-96: 281; 2008-09 : 582; 2011-12 : 785)

(6 Marks)

C. Briefly explain the rules for determining residential status of Hindu Undivided Family.

(4 Marks)

2.

A. Ms. Sandhiya, a citizen of U.S.A is a resident and ordinarily resident in India during the financial year 2011-12. She owns a house property at Texas, U.S.A. which is used as her residence. The annual value of the house is $ 20,000. The value of one US Dollar ($) may be taken as ` 50.

She took ownership and possession of a flat in Chennai on 1.7.2011 which is used for self occupation while she is in India. The flat was used by her 7 months only, during the year ended 31.03.2012.

Whilst the municipal valuation is `32,000 p.m., the fair rent is `4,20,000 p.a. She paid the following to Corporation of Chennai:

Property Tax – ` 16,200

Severage Tax – ` 1,800

She had taken a loan from Standard Chartered Bank for purchasing this flat. Interest on loan was as under:

Period prior to 1.4.2011 : ` 49,200

1.4.2011 to 30.6.2011 : ` 50,800

1.7.2011 to 31.3.2012 : ` 1,31,300

She had a house property in Bangalore which was sold in March 2010. In respect of this house she received arrears of rent of `60,000 in March 2012. This amount has not been charged to tax earlier.

Compute the Income taxable from house property of Ms. Sandhiya for the A.Y. 2012-13 exercising the most beneficial option available.

(15 Marks)

B. Mr.Sunder requires you to compute his taxable Income from the following transactions which took place with his friends during January 2012.

i. Cash gifts received during the year from Mr.Arun and Mr.Sriram : ` 40,000 each

ii. Two flats gifted to him by Mr.Ram and Mr.Shyam: Stamp value `2,00,000 and ` 50,000 respectively.

iii. He purchased a plot of land at ` 5,00,000 from Mr.Dinesh which was not registered but the prevalent stamp value of which was ` 5.3 Lakhs

iv. A Gold Ring worth ` 55,000 received as Gift from Mr.Uday

v. A Gold biscuit purchased by him at `10 Lakhs from Mr.Guru when prevalent market value is ` 10.2 Lakhs. Also shares & securities purchased by him ` 2.5 Lakhs from Mr.Hitesh when prevalent market value was ` 2.9 Lakhs.

(6 Marks)

C. Briefly explain the tax treatment with respect to Conversion of debentures into shares under Sec.49(2A) of the Income Tax Act.

(4 Marks)

3.

A. Explain the Tax treatments in following scenarios with reference to case laws:

a. M/s. Govinda Cements Ltd (Assessee) engaged in the business of Cement manufacturing entered into an agreement with a supplier for purchase of additional cement plant. One of the conditions in the agreement was that if the supplier failed to supply the machinery within the stipulated time, the assessee would be compensated with liquidated damages at 5% of the price of the respective portion of the machinery without proof of actual loss. The assessee received ` 8.50 Lakhs from the supplier by way of liquidated damages on account of his failure to supply the machinery within the stipulated time. The assessee contends that the amount received is a Capital Receipt and is not chargeable to Tax. Is the contention of assessee correct?

(8 Marks)

b. Mr.Raja Seth sold his agricultural land for `200,000 and purchased another agricultural land for` 200,000 on 1st June 2011. The land purchased was registered in the name of his son Jugnu Seth. He claimed exemption from Capital Gains under Sec.54 B of the Income Tax Act. However the same was denied by the assessing officer on the ground that the land was registered in the name of assesse's son. Is the contention of assessing officer correct? Is the exemption allowable?

(7 Marks)

B. Mr.X purchased Tenancy Rights on 1.2.1981 for `2 Lakhs. The same was sold by him on 2.2.2012 for `22 Lakhs. Fair Market value of the Tenancy rights as on 1.4.1981 =` 5 Lakhs. Compute the Capital Gains of Mr.X for the A.Y. 2012-13.
Cost inflation index : 1981-82 : 100, 2011-12: 785

(6 Marks)

C. Briefly explain the concept of Slump Sale and the tax treatment under Sec.50B of the Income Tax Act, 1961.

(4 Marks)

PRIME ACADEMY

35TH SESSION PROGRESS TEST-DIRECT TAX LAWS

SUGGESTED ANSWERS

PART – A

1.

1. 60 Years
2. Finance Act
3. Non resident
4. Long Term Capital Gains
5. Bond Washing Transactions

2.

1. Shipping business of Non-Resident	**B.** Assessment Year and Previous Year shall be same
2. Income from Business connection In India	**E.** Deemed to accrue or arise in India
3. Cost Inflation Index	**D.** Long Term Capital Gains
4. Sale of land within two years	**A.** Short Term Capital Gains
5. Income from Salary for services rendered outside India	**C.** Income not deemed to accrue or arise in India

3.

1. Correct.
2. Incorrect
3. Incorrect
4. Correct
5. Incorrect.

4.

a. Option (c)
b. Option (d)
c. Option (d)
d. Option (c)
e. Option (a)

5.

1. Basis of Charge: Basis of Charge of an Income specifies on what grounds Income earned by a person is chargeable to tax. It specifically defines whether Income so received is tax chargeable on receipt basis or accrual basis, or in case of variations in accounting method how tax should be charged. All five heads of Income have different Basis of Charge.

2. Full value of consideration is the consideration received or receivable by the transferor in exchange of assets transferred. Such consideration may be received in cash or in kind. Even if the full value of consideration is received in installments in different years the entire value of consideration has to be taken into account for computing Capital Gains.

3. Unrealized Rent: It denotes the amount of Rent receivable from House Property which could not be realized due to various reasons such as tenants absconding or insolvent etc. It is taxable in the year of receipt.

4. Previous Year: “previous year” means the financial year immediately preceding the assessment year Provided that, in the case of a business or profession newly set up, or a source of income newly coming into existence, in the said financial year, the previous year shall be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending with the said financial year.

5. Maximum Marginal Rate: It is defined u/s 2(29c) as the rate of tax(including surcharge) applicable in relation to the highest slab of income in case of individual as specified by the relevant Finance Act.

PART-B

1.

A. Computation of Gross Total Income of Mr.Ramesh for A.Y.2012-13

S.No	Particulars	a.Resident (`)	b.RNOR (`)	c.Non resident (`)
1.	Income from agriculture in India(Exempt under sec. 10(1))	0	0	0
2.	Income from artwork in USA and spent for medical treatment in France	15,000	0	0
3.	Income from activity of purchasing goods in India and exporting to USA (Not a business connection in case of non resident only)	90,000	90,000	0
4.	Income from business of publishing magazine in UK by collecting news and views in India(80% attributable to operations in India) (Not a business connection in case of non resident only)	50,000	40,000	0
5.	Income from shooting of cinematograph films in India(40% attributable to operations in India) (It is a business connection as Mr.Ramesh is an Indian citizen)	500,000	200,000	200,000
6.	Income from transfer of residential house in India	60,000	60,000	60,000
7.	Salaries from ABC Ltd (50% relates to services outside India)	100,000	50,000	50,000
8.	Arrears of Salary from Govt of India for services rendered outside India(This includes 20,000 worth of allowances – Allowances are exempt under Sec 10(7)	60,000	60,000	60,000
9.	Dividends from Indian companies received in UK (Exempt u/s 10(34))	0	0	0
	Gross Total Income	**875,000**	**500,000**	**370,000**

B. Computation of Capital Gains of Mr.Rajesh for the A.Y. 2012-13

Particulars	Painting (`)	Sculpture (`)
Full value of Consideration	22,00,000	22,00,000
Less: Cost of Acquisition For painting – no indexation – Refer note II. For Sculpture – Indexation available (6,00,000 x 785/582) – refer note III.	11,00,000	8,09,278
Short Term Capital Gains	11,00,000	-

Long Term Capital Gains	-	13,90,722

Notes:

I. Paintings and Sculpture are Capital Assets.

II. In case of sale of paintings the holding period is less than 36 months (1.7.2008 to 1.6.2011). Hence the gains are short term capital gains.

III. In case of sale of sculpture, Holding period is taken from the period when previous owner purchased the asset. So the holding period is 1.7.1995 to 1.6.2011, which is more than 36 months and hence gains are long term capital gains. However the benefit of indexation is available from the year in which the asset was first held by the current owner.

C. Residential Status of a Hindu Undivided Family :

Residential status of a Hindu Undivided Family is determined as per the provisions of Sec. 6(2) of the Income Tax Act. The rules for residential status are based on the location of controlling place of business i.e. where the decisions concerning the affairs of the H.U.F. are taken.

Rules :

a. When the controlling place of business is wholly outside India, the H.U.F is treated as Non-resident.

b. When the controlling place of business in wholly or partly in India, the residential status is based on the status of Karta.HUF is treated as Resident and ordinarily resident if Karta satisfies the two conditions viz.

- Karta has been resident in India in at least 2 out of 10 previous years immediately preceding the relevant previous year
- Karta has been present in India for a period of 730 days or more during the 7 years immediately preceding the relevant previous year.

In case the above conditions are not satisfied, HUF is treated as Resident and not ordinarily resident in India.

2.

A. Income from House Property of Ms.Sandhiya for the A.Y. 2012-13

	Particulars	`	`
1.	**Self occupied house at Texas, U.S.A (Note 1 to 4)**		
	Annual Value	Nil	
	Less: Deduction u/s 24	Nil	
	Income from house property		**Nil**
2.	**Deemed let out house property at Chennai (Note 4)**		
	Annual Value (Refer note 3)	3,15,000	
	Less: Municipal Taxes	18,000	
	Net Annual Value	**2,97,000**	
	Less: deductions u/s 24		
	30% of N.A.V	89,100	
	Interest on borrowed capital (Refer note 6)	1,91,940	
	Income from this House property		**15,960**

3.	**Arrears of Rent for Bangalore Property**		
	Arrears of rent received	60,000	
	Less: 30% deduction	18,000	
	Income from house property		**42,000**
*****	**INCOME TAXABLE UNDER THE HEAD "INCOME FROM HOUSE PROPERTY"**		**57,960**

NOTES:

1. In the given case, Ms. Sandhiya is a resident & ordinarily resident in India. Accordingly her global income shall be taxable in India. This includes income earned in India as well as outside India.
2. She possesses a self occupied house at Texas (USA) as well as in Chennai. At her option one house shall be treated as Self Occupied and the other will be deemed to be let out.
3. The annual value of Texas house is USD 20000 @ `50 i.e. `10 Lakhs. In case of the Chennai house the Fair Rent `35,000 p.m. (`420,000/12 months) is higher than Municipal Valuation of `32,000 p.m. Hence the annual value for 9 months (1.7.2011 to 31.3.2012) is `3,15,000/- (35,000 X 9 mths).
4. As the annual value of Texas house is higher, it is beneficial if that property is treated as self-occupied. The Chennai house will therefore be treated as "deemed to be let out".
5. In case of Bangalore House, arrears of rent will be chargeable to tax as Income from house property in the year of receipt under Section 25B. The ownership criteria is not essential and 30% of the arrears of rent shall be allowed as deduction.
6. <u>Interest on borrowed capital for Chennai property</u>

Interest for Current Year (1.4.2011 to 31.3.2012) =` 50,800+`1,31,300	= 1,82,100
Add: $1/5^{th}$ of pre-construction Interest i.e. 49,200/5	= 9,840
Interest allowable under Sec.24	1,91,940

B. Computation of Taxable Income for Mr.Sunder – Income from Other Sources

Note : Mr. Sunder has received Cash and various items of property after 1.10.2009. Hence the taxability of these amounts as per Sec.56(2) shall be as follows:

	Particulars	**Amount (`)**
1.	Aggregate Cash gifts exceeding `50,000 from Mr.Arun and Mr.Sriram – fully taxable – 40,000 X 2	80,000
2.	Gift of Flat from Mr.Ram is fully taxable as Stamp Value exceeds `50,000	2,00,000
3.	Gift of Flat from Mr.Shyam is not taxable as Stamp Value does not exceed 50,000	Nil
4.	Plot of land acquired for inadequate consideration is not taxable	Nil
5.	Value of Gift – Gold Ring exceeds ` 50,000; hence fully taxable	55,000
6.	Total price paid for movable properties i.e. Gold Biscuit and Shares is `12,50,000 (10 Lakhs plus 2.5 Lakhs). Total fair market value of the properties is `13,10,000 (10.2 Lakhs plus 2.9 Lakhs). Since the FMV is higher by more than 50,000, whole difference is taxable	60,000
	INCOME FROM OTHER SOURCES	**3,95,000**

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C. Conversion of debentures into Shares (Sec. 49(2A))

Any transfer by way of conversion of Debentures, debenture stock or deposit certificates in any form, of a Company into shares or debentures of that company is not regarded as a transfer giving rise to any Capital Gains. On sale of shares or debentures received on such conversions, the capital gain shall be computed by taking the cost of acquisition as that part of Cost of debentures, debenture stock or deposit certificates which has been appropriated towards the shares or debentures.

- Cost of debentures shall be taken as cost of acquisition of Shares
- To determine whether or not the shares are long term or short term capital assets, the period of holding shall be considered from the date of allotment of shares.
- The indexation will start from the date of conversion of debentures into shares.
- The aforesaid rule is not applicable if preference shares are converted into equity shares.

3.

A. Tax treatments with reference to Case laws:

a. Yes. The contention of the Assessee is correct and the amount of liquidated damages is treated as Capital Receipt.
The present scenario on treatment of liquidated damages was enlightened by Supreme Court in its judgment in the case of CIT vs Saurashtra Cement Ltd (2010) 325 ITR 422(SC).
The facts of the case were same and department had assessed the amount of Liquidated damages as revenue receipt and charged to tax. Later appellate tribunal and also the High court held that it was a capital receipt and is not taxable.
Apex court affirmed the decision of the high court holding that the damages were directly and intimately linked with the procurement of capital asset i.e. the Cement plant, which led to delay in coming into existence of the profit making apparatus. It was not a receipt in the course of profit earning process. Therefore the amount received by the assessee towards compensation of sterilization of the profit earning source, not in the ordinary course of business, is a Capital Receipt in the hands of Assessee.

b. No. The contention of Assessing officer is incorrect. The exemption is allowed u/s 54B in view of the judgment in the case of CIT vs Gurnam Singh (2010) 327 ITR 278 (P&H)
The tribunal observed that the agricultural land sold belonged to assessee and sale proceeds were also used for purchasing agricultural land. The possession of the said land was also taken by the assessee. It is not the case that the sale proceeds were used for other purposes or beyond the stipulated period. The only objection raised by the revenue was that the land was registered in the name of son. Therefore, it cannot be said that the capital gains were in any way misused by the other purpose contrary to the provision of law.

In this case, the high court concurred with the tribunal's view that merely because the assessee's son was shown in the sale deed as co-owner, it did not make any difference. It was not the case of the revenue that the land in the question was exclusively used by the son. Therefore, the assessee was entitled to deduction under section 54B.

B. Note: If the asset is acquired before 1.4.1981, then option of Fair Market Value on 1.4.81 is not allowed and the original cost shall be used for indexation.

Capital Gains of Mr.X for the A.Y. 2012-13

Capital Gain on sale of Tenancy right >> Period of holding : 1.2.1981 to 1.2.2012

Particulars	Amount (`)
Full value of consideration	22,00,000
Less: Indexed cost of acquisition `3,00,000 x 785/100	15,70,000
Long Term Capital Gains	***6,30,000***

C. Slump sale is transfer of one or more business undertakings for a lump sum consideration, without assigning individual values to the each assets and liabilities to be transferred. It is not sale of assets which on its own cannot produce sustainable revenue.

Under Indian Income tax Act, 1961, "slump sale" means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. Therefore transferor is not required to assign value to each "assets and liabilities" of "business undertaking" to be transferred.

Tax Treatment under Sec.50B

(1) Any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place.
(2) In relation to capital assets being an undertaking or division transferred by way of such sale, the "net worth" of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 and no regard shall be given to the provisions contained in the second proviso to section 48.
(3) Every assessee, in the case of slump sale, shall furnish in the prescribed form along with the return of income, a report of an accountant as defined in the Explanation below sub-section (2) of section 288 indicating the computation of the net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division, as the case may be, has been correctly arrived at in accordance with the provisions of this section.

PRIME ACADEMY

35TH SESSION PROGRESS TEST – INDIRECT TAX LAWS

No. of Pages: 3 Total Marks: 75

Time Allowed: 2Hrs

PART – A

Question 1- 7 each question carries 3 Marks .

Question no 8 carries 4 Marks.

1) If the sale price is `275, inclusive of VAT @ 13.5% and ED @ 16%. Calculate the transaction value and excise duty.
2) Write a short note on Interest payable on delayed payment of duty.
3) How would you arrive at the assessable value for the purpose of levy of excise duty from the following particulars : • Cum-duty selling price exclusive of sales tax ` 20,000 • Rate of excise duty applicable to the product 10.30% • Trade discount allowed ` 2,400 • Freight ` 1,500
4) Discuss about the Power to grant exemption from duty of Excise. U/S Section 5 A of the Central Excise Act.
5) Briefly write about Certain offences to be non-cognizable(Section 9A)
6) Write Short note on Recovery of sums due to Government
7) Raj & Co. furnish the following expenditure incurred by them and want you to find the assessable value for the purpose of paying excise duty on captive consumption. Determine the cost of production in terms of rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 and as per CAS-4 (cost accounting standard) (i) Direct material cost per unit inclusive of excise duty at 20% - ` 1,320 (ii) Direct wages – `250 (iii) Other direct expenses – `100 (iv) Indirect materials – ` 75 (v) Factory Overheads – ` 200 (vi) Administrative overhead (25% relating to production capacity) ` 100 (vii) Selling and distribution expenses – ` 150 (viii) Quality Control – ` 25 (ix) Sale of scrap realized – ` 20 (x) Actual profit margin - 15%
8) .
Write a brief note on section 11 AC of central excise Act 1944.

(25 Marks)

Part –B 50 Marks

Each question carries 10 Marks

1) B Limited manufactures two products namely- Eye ointment and Skin ointment. Skin ointment is specified product U/S 4 A of the Central Excise Act,1944.The sale prices of both the products are @ `43 per unit and `33 per unit respectively.. the sale price of both the product included 12% excise duty as BED plus applicable cess. It also includes CST @2%. Additional information :

Unites cleared

Eye Ointment : 100000 units

Skin Ointment : 150000 units

Deduction permissible under section 4 A: 40%

Calculate the total excise duty liability on both the products.

(10 Marks)

2) Determine the transaction value and the Excise duty payable from the following information :

(i) Total Invoice Price ` 18,000; (ii) The Invoice Price includes the following :

(a) Sales-tax` 1000

(b) Surcharge on ST `100

(c) Octroi `100

(d) Insurance from Factory to depot ` 100

(e) Freight from factory to depot `700

(f) Rate of Basic Excise duty 10% ad valorem

(g) Rate of Special excise duty 24% ad valorem

(10 Marks)

3) Determine the value on which Excise duty is payable in the following instances. Quote the relevant section/rules of Central Excise Law.

(a.) A. Ltd. sold goods to B Ltd., at a value of ` 100 per unit, In turn, B Ltd. sold the same to C Ltd. at a value of ` 110 per unit. A Ltd. and B Ltd. are related, whereas B Ltd. and C Ltd. are unrelated.

(b). A Ltd. and B. Ltd. are inter-connected undertakings, under section 2(g) of MRTP Act. A Ltd. sells goods to B Ltd. at a value of ` 100 per unit and to C Ltd. at ` 110 per unit, who is an independent buyer.

(c). A Ltd. sells goods to B Ltd. at a value of ` 100 per unit. The said goods are captively consumed by B Ltd. in its factory. A Ltd. and B Ltd. are unrelated. The cost of production of the goods to A Ltd. is ` 120 per unit.

(d). A Ltd. sells motor spirit to B Ltd. at a value of ` 31 per litre. But motor spirit has administered price of ` 30 per litre, fixed by the Central Government.

(e). A Ltd. sells to B Ltd. at a value of ` 100 per unit. B Ltd. sells the goods in retail market at a value of ` 120 per unit. The sale price of ` 100 per unit is wholesale price of A Ltd. Also, A Ltd. and b Ltd. are related.

(f). Depot price of a company are – **Place of removal Price at depot Price at depot Actual sale price at on 1-1-2012 on 31-1-2012 depot on 1-2-2012** Amritsar Depot ` 100 per unit ` 105 per unit ` 115 per unit Bhopal Depot ` 120 per unit ` 115 per unit ` 125 per unit Cuttack Depot ` 130 per unit ` 125 per unit ` 135 per unit

Additional information:

(i) Quantity cleared to Amritsar Depot – 100 units

(ii) Quantity cleared to Bhopal Depot – 200 unit

(iii) Quantity cleared to Cuttack Depot – 200 units

(iv) The goods were cleared to respective depots on 1-1-2009 and actually sold at the depots on 1-2-2009.

(10 Marks)

4) Virgo had been manufacturing and supplying signages (illuminated signs) under a contract with M/s. Indian Oil Corporation Ltd. (IOC) and had erected them at the retail outlets of IOC located at various places.

Virgo fabricated only the sign poles of iron and steel required for the signages. Other items such as fibre glass reinforced plastic sheets, the vinyl sheets cut into signs, the electrical panels concealed within the signboard etc. had been got manufactured by third parties and that the signages proper had been erected at the various IOC bunks.

At the premises of Virgo only the sign poles were fabricated and the signages were erected using the components received at the various sites from their manufacturers.

Issue-

1) whether signages erected at various petrol bunks of IOC are liable to duty.

(10 Marks)

5) Parsavnath Furnishers Limited (PFL) is engaged in procuring the duty paid Office Furniture System/Work Stations (OFS/WS) from the suppliers an erecting and installing them at site of customers, from whom it has procured the orders.

After receiving the orders from its clients, a team of engineers prepares a lay out on computer aided design system where ready-made furniture systems and work stations manufactured by independent manufactures/suppliers are superimposed.

Thereafter, based on the clients' specifications, orders are placed upon the manufacturer of the furniture for each works station. After procuring the various elements of furniture system from the manufacturer, they join the same together according to the site drawing and the project code.

The assessee contends that that they are only marketing OFS/WS. However, the Revenue alleges that PFL is liable to pay duty as the said activity amounts to manufacture.

1) **Examine, with reference to a decided case law, if any, whether the Revenue's allegation is tenable in law?**

(10 Marks)

PRIME ACADEMY

35TH SESSION PROGRESS TEST – INDIRECT TAXES

SUGGESTED ANSWERS

PART-A

1) Transaction Value= `(275*100*100)/(100+VAT@13.5%)(100+ED @16%)=`208.87
   Excise Duty= `208.87*16% = `33.41
   VAT =(`208.87+`33.41) * 13.5% = `32.71

2) **SECTION 11AA Interest on delayed payment of duty —**

   (1) Subject to the provisions contained in section 11AB, where a person chargeable with duty determined under sub-section (2) of section 11A, fails to pay such duty within three months from the date of such determination, he shall pay, in addition to the duty, interest at such rate not below ten per cent. and not exceeding thirty-six per cent per annum, as is for the time being fixed by the Central Government, by notification in the Official Gazette, on such duty from the date immediately after the expiry of the said period of three months till the date of payment of such duty :

   Provided that where a person chargeable with duty determined under sub-section (2) of section 11A before the date on which the Finance Bill, 1995 receives the assent of the President, fails to pay such duty within three months from such date, then, such person shall be liable to pay interest under this section from the date immediately after three months from such date, till the date of payment of such duty.

   Explanation1 - Where the duty determined to be payable is reduced by the Commissioner (Appeals), Appellate Tribunal or, as the case may be, the court, the date of such determination shall be the date on which an amount of duty is first determined to be payable.

   Explanation 2 - Where the duty determined to be payable is increased or further increased by the Commissioner (Appeals), Appellate Tribunal or, as the case may be, the court, the date of such determination shall be, -

   (a) for the amount of duty first determined to be payable, the date on which the duty is so determined;
   (b) for the amount of increased duty, the date of order by which the increased amount of duty is first determined to be payable;
   (c) for the amount of further increase of duty, the date of order on which the duty is so further increased.
   not apply to cases where the duty becomes payable on and after the date on which the Finance Bill, 2001 receives the assent of the President.

   SECTION 11AB Interest on delayed payment of duty

   (1) Where any duty of excise has not been levied or paid or has been short-levied or short-paid or erroneously refunded, the person who is liable to pay the duty as determined under sub- section (2), or has paid the duty under sub- section (2B), of section 11A, shall, in addition to the duty, be liable to pay interest at such rate not below ten per cent. and not exceeding thirty-six per cent. per annum, as is for the time being fixed by the Central Government, by notification in the Official Gazette, from the first date of the month succeeding the month in which the duty ought to have been paid under this Act , or from the date of such erroneous refund, as the case may be, but for the provisions contained in sub-section (2), or sub-section (2B), of section 11A till the date of payment of such duty :

   Provided that in such cases where the duty becomes payable consequent to issue of an order, instruction or direction by the Board under section 37B, and such amount of duty payable is voluntarily paid in full, without reserving any right to appeal against such payment at any subsequent stage, within forty-five days from the date of issue of such order, instruction or direction, as the case may be, no

interest shall be payable and in other cases the interest shall be payable on the whole of the amount, including the amount already paid.
(2) The provisions of sub-section (1) shall not apply to cases where the duty had become payable or ought to have been paid before the date on which the Finance Bill, 2001 receives the assent of the President.

Explanation 1 - Where the duty determined to be payable is reduced by the Commissioner (Appeals), the Appellate Tribunal or, as the case may be, the court, the interest shall be payable on such reduced amount of duty.
Explanation 2 - Where the duty determined to be payable is increased or further increased by the Commissioner (Appeals), the Appellate Tribunal or, as the case may be, the court, the interest shall be payable on such increased or further increased amount of duty.

3) Trade discount of ` 2,400 and freight of ` 1,500 are allowed as deductions. Hence, net price will be ` 16,100 [` 20,000 – 2,400 – 1,500]. Since the price is inclusive of excise duty of 10.30%, Excise Duty will be ` (16,100 × 10.30)/110.30 *i.e.* ` 1,503.45 and Assessable Value will be ` 14,596.55 [16,100 – 1,503.45]

4)

SECTION 5A.Power to grant exemption from duty of excise. — (1) If the Central Government is satisfied that it is necessary in the public interest so to do, it may, by notification in the Official Gazette exempt generally either absolutely or subject to such conditions (to be fulfilled before or after removal) as may be specified in the notification, excisable goods of any specified description from the whole or any part of the duty of excise leviable thereon :
Provided that, unless specifically provided in such notification, no exemption therein shall apply to excisable goods which are produced or manufactured —
(i) in a free trade zone [or a special economic zone and brought to any other place in India; or
(ii)by a hundred per cent export-oriented undertaking and brought to any place in India.
Explanation. — In this proviso, "free trade zone", "special economic zone" and "hundred per cent export-oriented undertaking" shall have the same meanings as in *Explanation* 2 to sub-section (1) of section 3.
(1A) For the removal of doubts, it is hereby declared that where an exemption under sub-section (1) in respect of any excisable goods from the whole of the duty of excise leviable thereon has been granted absolutely, the manufacturer of such excisable goods shall not pay the duty of excise on such goods.

5) **SECTION 9A. (1) Certain offences to be non-cognizable. —** Notwithstanding anything contained in the Code of Criminal Procedure, 1898 (5 of 1898), offences under section 9 shall be deemed to be non-cognizable within the meaning of that Code**.**
(2) Any offence under this Chapter may, either before or after the institution of prosecution, be compounded by the Chief Commissioner of Central Excise on payment, by the person accused of the offence to the Central Government, of such compounding amount as may be prescribed.

6) **SECTION 11: Recovery of sums due to Government —**
In respect of duty and any other sums of any kind payable to the Central Government under any of the provisions of this Act or of the rules made there under [including the amount required to be paid to the credit of the Central Government under Section 11D, the officer empowered by the Central Board of Excise and Customs constituted under the Central Boards of Revenue Act , 1963 (54 of 1963)] to levy such duty or require the payment of such sums may deduct the amount so payable from any money owing to the person from whom such sums may be recoverable or due which may be in his hands or under his disposal or control, or may recover the amount by attachment and sale of excisable goods belonging to such person; and if the amount payable is not so recovered, he may prepare a certificate signed by him specifying the amount due from the person liable to pay the same and send it to the Collector of the district in which such person resides or conducts his business and the said Collector, on receipt of such certificate, shall proceed to recover from the said person the amount specified therein as if it were an arrear of land revenue.
Provided that where the person (hereinafter referred to as predecessor) from whom the duty or any other sums of any kind, as specified in this section, is recoverable or due, transfers or otherwise disposes of his business or trade in whole or in part, or effects any change in the ownership thereof, in consequence of which he is succeeded in such business or trade by any other person, all excisable

goods, materials, preparations, plants, machineries, vessels, utensils, implements and articles in the custody or possession of the person so succeeding may also be attached and sold by such officer empowered by the Central Board of Excise and Customs, after obtaining written approval from the Commissioner of Central Excise, for the purposes of recovering such duty or other sums recoverable or due from such predecessor at the time of such transfer or otherwise disposal or change.

7)

Particulars	**Amount (`)**
(1) Direct Material (exclusive of Excise Duty) [1,320 x 100/120	1,100.00
(2) Direct Labour	250.00
(3) Direct Expenses	100.00
(4) Works Overhead [indirect material (`75) (+) Factory OHs (`200)]	275.00
(5) Quality Control Cost	25.00
(6) Research & Development Cost	Nil
(7) Administration Overheads (to the extent relates to production activity)	25.00
Less: Realizable Value of scrap	(20.00)
Cost of Production	1,755.00
Add 10% as per Rule 8	175.50
Assessable Value	**1,930.50**

8)

SECTION: 11 AC: Mandatory penalty

The amount of penalty for non-levy or short-levy or non-payment or short payment or erroneous refund shall be as follows :(a) where any duty of excise has not been levied or paid or short-levied or short-paid or erroneously refunded, by reason of fraud etc. the person who is liable to pay duty as determined under sub-section (10) of section 11A shall also be liable to pay a **penalty equal to the duty so determined;**
(b) where **details of any transaction available in the specified records**, the person who is liable to pay duty as determined under sub-section (10) of section 11A shall also be liable to pay a penalty equal to 50% of the duty so determined;
(c) where any duty as determined under sub-section (10) of section 11A and the interest payable thereon under section 11AA in respect of captured transactions is paid within 30 days of the date of communication of order, the amount of penalty liable to be paid by such person **shall be 25% of the duty so determined**;
(d) where the appellate authority or tribunal or court modifies the amount of duty of excise determined by the Central Excise Officer under sub-section (10) of section 11A, then, the amount of penalties and interest payable shall stand modified accordingly.

Where the amount as modified by the appellate authority or tribunal or court is more than the amount determined under sub-section (10) of section 11A by the Central Excise Officer, the time within which the interest or penalty is payable under this Act shall be counted from the date of the order of the appellate authority or tribunal or court in respect of such increased amount.”.

PART -B

1) Duty Liability in case of both the ointments (amount in `)

Eye ointment (Section 4, Transaction value)	(Amt `)
Price (43 *100000 units)	43,00,000
Less: Sales tax 43 lacs* 2/102	84,314
Price inclusive of excise duty	42,15,686
Excise duty	
4215686*12.36/112.36	4,63,740
Skin ointment(Section 4A, MRP based)	
MRP (33*150000 units)	49,50,000
Less: 40% abatement	19,80,000
Assessable value	29,70,000
Excise Duty	
2970000*12.36	3,67,092

2) Let us assume that the Invoice Price of `18,000 is depot price. Thus, deduction of insurance and transport charges from factory to depot will not be available. The deductions available will be : •
Sales Tax `1,000;
Surcharge on Sales Tax `100; and
Octroi `100
Thus, net price excluding taxes on final product (but inclusive of excise duty) will be `16,800. The rate of excise duty is 35.02% [10% basic plus 24% special plus 3% Education Cess]. Hence, duty payable is as follows – Assessable Value =` 16,800 – ` 4,357 =` 12,443
Check: Excise duty payable (basic plus special) is 35.02% of ` 12,443 i.e. ` 4,357.

3) (a) Transaction value ` 110 per unit (Rule 9 of Transaction value Rules). [Sale to unrelated party].
(b) Transaction value `100 per unit for sale to B and ` 110 for sale to C – Rule 10 read with Rule 4 [Note that inter connected undertaking will be treated as 'related persons' for purpose of excise valuation only if they are 'holding and subsidiary' or are 'related person' as per any other part of the definition of 'related person'. Note that A is selling directly to C as per the question, and not through B Ltd
(c) Transaction value will be `100. – Section 4(1)—Incase of sale to unrelated person, question of cost of production does not arise.
(d) Transaction value `31. – section 4. – Since the goods are actually sold at this price, administered price is not considered.
(e) Transaction value ` 120 per unit – Rule 9 read with section 4 of Central Excise Act. Sale to an unrelated buyer. *Under new rules, there is no concept of 'wholesale price and retail price'
(f) Under Rule 7, the price prevailing at the Depot on the date of clearance from the factory will be the relevant value to pay Excise duty. Therefore:
(i) Clearance to Amritsar depot will attract duty based on the price as on 1-1-2012.
Transaction value rs. 110 × 100 units =
` 11,000
(ii) Clearance to Bhopal depot. Depot price on 1-1-2012. Transaction value ` 120 × 200 units
= 24,000

(iii) Clearance to Cuttack Depot. Depot price on 1-1-2012. Transaction value rs.130 × 200 units = `26,000.

Note The relevant date is 1-1-2012, since the goods were cleared to the depots on that date. No additional duty is payable even if goods are later sold from depot at higher price.

4) Decision –

We find that-

In the instant case the complete signage is movable and is installed by fixing it on a concrete foundation. These can be detached and shifted to another location without damaging them – Undisputedly signages are capable of being assembled at the premises of the appellants and then transferred to the site of its erection after dismantling the same.

The signages do not emerge as an immovable property on assembly or erection. They have base plates of steel with provision to fit them on bolts of the concrete foundation. The signage is fixed to earth. Signage is complete before fixing on the concrete platform. held that the signages are dutiable goods. - As regards the claim of limitation we find that the appellants have undertaken manufacture, supply and erection of signages involving huge value under a contract with IOC without intimating the activity to the Department.

No acceptable reason has been advanced by the appellants to support the claim that they had not will fully suppressed the fact of the impugned activity from the Department. We, therefore, hold that the demand of duty on the signages has been validly made invoking larger period.

5) **DECISION**

The facts of the given case are similar to the case of **CCE v. Blow Plast Ltd. 2009** (236) (Del.).

The Tribunal arrived at the conclusion that since the supplier had cleared the complete set of elements required for the work station in a knocked down condition, it could not be said that the supplier had manufactured the parts and not the complete system.

The High Court while affirming the Tribunal‘s order held that the same product as known to the trade could not be manufactured twice over.

Consequently, nothing new had come into existence so as to bring the activities of the assessee within the parameters specified in section 2(f) of the Central Excise Act, 1944.

What the assessee received was complete OFS/WS and what it left on its clients‘ sites was also complete OFS/WS. Nothing new had come into existence. Hence, no duty was payable by the assessee.

Therefore, **it can be inferred that the Revenue‘s allegation is not tenable in law**