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FOR CA FINAL EXAM PREPARATION

CA Final 2022 Suggested Answers · Group II (All Papers) (Old Scheme)

EXAM	YEAR	TYPE	SUBJECT
CA Final	2022	Suggested Answers	Group II (All Papers) (Old Scheme)

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SUGGESTED ANSWERS TO QUESTIONS SET AT THE

FINAL EXAMINATION – GROUP II

NOVEMBER, 2022

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PAPER – 5: STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION

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

Candidates are also required to answer any

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

Working notes should form part of the respective answers.

Question 1

Rejuve Hotel is an Indian hotel chain of luxury hotels, based in New Delhi. With over 100 hotels, it is one of the largest hotel chain of the Country. It has a franchise agreement to operate most of its hotels as part of "The Luxury Collection of Fruition International". It is the biggest hotel business operator within the domestic and a well-established player in the international hotel business segment. From the past many decades, the hotel has been catering primarily to the business and premium segment travellers.

To create one-of-a-kind style experiences for the domestic and international travellers, the hotel offered exquisite services along with additional segment of services like in-room styling services by a local luxury boutique, provide exclusive hotel photo opportunities, create super personalized hotel amenities, include kid-friendly surprises, in house forex change services.

The hotel is liberal with the room stay timings such as early check-in and late check-out. They also offered option of auto-upgrade from deluxe/joint room to suite class rooms, if available for free. A free shuttle pick-up and drop services were provided for passengers from the domestic/international airport.

Indian Hotel industry has been growing exponentially in the recent years due to growing economy. Consequently, there have been many new entrants in the domestic segment, offering low-cost rates to customers. These hotels have been offering rooms at huge discounts, thereby attracting a sizable chunk of customers away from the Rejuve Hotel. To counter this and maintain its market share, Rejuve Hotels also followed counter strategy.

For a period of six years, rooms for various domestic travellers were offered at low competitive prices. At the same time, low rates were offered only if it was profitable to do so. Therefore, certain cost management measures were undertaken. The hotel. converted itself from "Create One-of-a-Kind Style Experiences" to limited services hotel. ·

Most of the previously offered exclusive free services by Rejuve Hotels were moved to "paid section". Other measures taken were to immediately terminate the free shuttle pick-up and drop services and to offer last-minute deals for rooms at a heavy discount if the hotel was not fully booked for that date. Vacant rooms are "perishable", therefore instead of letting them go empty, the hotel can be, filled at cheaper rates. This yield management measure based ·on capacity utilization was expected to increase market share and also the hotel's revenue. Rooms could be booked online using the internet or through any associate hotel reception maintained by the hotel group at various locations in selected cities.

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In order to quickly respond to a competitor's move, the pricing and marketing staff of the individual hotel were given sufficient autonomy to make this price war work. Therefore, in many situations, decisions could be taken even without the prior approval of the top management. Meanwhile adding to the stiff competition, prices due to inflation have been soaring in the last few years. Maintenance of Hotels, staff compensation and other overheads have also been increasing. Given this scenario, after six years of operations, the management at Rejuve Hotels found that they were not able to generate sufficient profits on many of the domestic hotel offers. A price discount by a competitor had to be matched with a similar price discount by Rejuve Hotels and vice versa. Offering last minute deals to fill up hotel to full capacity did not generate additional revenue. The volume of last-minute hotel bookers was low. It was found that most travellers booking at the last minute were anyway "price indifferent". Had the deals not been offered, the traveller would have been willing to pay more money anyway to book the hotel. Therefore, neither did these deals generate extra customers nor any extra revenue.

Rejuve Hotels has always been perceived to cater the premium segment traveller, therefore participating in this price war had been contrary to its image of a luxurious hotel. This left a section of the customers confused about the product offering.

Therefore, the management of Rejuve Hotels decided to discontinue its discount pricing strategy and exit the "low cost" hotel business. The rooms are now being offered at its usual "full service" rates. This strategy is proposed to be followed for both current and prospective projects and operations.

In order to improve tourism within the country, the government has been. formulating policies that are aimed at changing the landscape of the hospitality sector. Hotels are being built in smaller cities and towns that did not have any one till date. Concurrently with the expansion of its luxury hotel chain in the major metropolitan cities, the Rejuve Hotel Group also expanded its business hotels. division in the secondary cities· in India. The Rejuve Hotel Group continued to expand its geographic and market coverage in India. It developed specialized operations (such as wildlife lodges) and consolidated its position in established markets through the upgrading of existing properties and development of new properties.

In a new competitive market move, Rejuve Hotels proposed to develop a model where-in travellers booking rooms at smaller towns are redeemable at other hotels within the group in the same price range and category, subject to availability.

Under this policy, the hotels at the major metro cities will serve as a main hub for travellers touring different cities/towns in a sequence. Rejuve Hotels also proposes to develop few budgeted small rooms with limited amenities in its metropolitan hotels to cater budgeted travellers from small cities. The ultra-luxurious amenities in the hotel will remain paid for such budgeted travellers.

The travellers will have the advantage to relish the ultra-luxurious hotel environment in the metropolitan cities at a very budgeted price. More hotel options within the Rejuve Hotel group will now be available for travellers. For example, a tourist from a smaller city, wanting to travel to another smaller city can take a break at the nearest hub with Rejuve hotels under the same

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booking plan. For the tourist, this is a better alternative as compared to staying in the hub at a small hotel with limited facilities. For Rejuve group of hotels, the proposition broadens its customer base. To implement this effect, Rejuve began scouting the market for smaller hotels in small cities that can be operated more economically on the hub-spoke route under its brand.

Along wise, it discussed role for partnership with airlines, car rentals, city tour operators in order to offer attractive holiday packages to customers. Since most of the other hotels do not have the scale of operations to achieve the "hub-spoke" model or the ability to offer holiday packages, Rejuve Hotels identified this as a unique proposition that it can offer to its customers. The hotel proposed tag line for its advertisement as ***"REJUVENATE at REJUVE ANYWHERE, ANYDAY; ANYTIME".***

Room booking continued to be offered over the internet using various online digital payments services. In the past, customers liked this option due to the convenience it offered. Dedicated customer· service lines available 24x7 to resolve issues is proposed. Pay@Hotel services. were also proposed to ease and facilitate bookings by customers. The free shuttle pick-up and drop services were reinstated for passengers from the domestic/international airport and extended to city railway stations and city bus stands.

The management of Rejuve hotel wants to have a seamless implementation of this project. This could be a game changer for the company that will help it to consolidate its position in the hotel industry. Therefore, a meeting has been called to discuss critical reporting that needs to be in place for ensuring a successful launch.

Required

(i) EVALUATE the strategy adopted by Rejuve Hotels in becoming a "low- cost" hotel with limited services. ***(6 Marks)***

(ii) IDENTIFY the strategy adopted by Rejuve Hotels for the proposed project. ***(4 Marks)***

(iii) RECOMMEND the company to adopt a mechanism to avoid errors in its strategy. ***(5 Marks)***

(iv) SUGGEST a control reporting mechanism for timely corrections in the strategy. ***(5 Marks)***

Answer

(i) Rejuve Hotel is a luxury hotel chain catering to the business and premium segment travellers for the past many decades offering facilities at "full service" rates. However, due to intense competition in the domestic market, it converted from "one-of-a-kind style experiences" to "limited services" hotel. It **adopted a "low-cost advantage" strategy**.

Low-cost advantage or cost leadership was achieved through the following measures:

(a) Becoming a **"limited services"** hotel, most of the previously offered exclusive **free services by Rejuve Hotel were moved to "paid section"**. Hence, for certain services that were previously offered free, guests now had to purchase them by paying extra.

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(b) Limited services offered **helped the hotel save costs** on services and staff otherwise offered complimentary under "full service" regime.

(c) **Free services** that were previously offered like free shuttle pick-up and drop services **were discontinued**.

(d) **Online room booking facilitated** so that the extra staff maintained by the hotel; at the reception for reservation only could be reduced.

Cost leadership enabled it to offer "low cost" room rates to the customers that was generated through–

(a) rooms were offered at low competitive rates at huge discounts and

(b) yield management of room booking based on capacity utilization at the hotel.

The "low-cost advantage" strategy did not work due to the following reasons:

(a) **Price war from competitors** reduced the room booking rates to levels that were unviable for Rejuve Hotels.

(b) Variable prices through **last minute deals** to fill up hotel capacity **did not generate additional revenue**. The volume of last minute hotel bookers were low. Most travellers booking at the last minute were **"price indifferent"**. These travellers would have been willing to pay more money anyway to book the hotel. Therefore, neither did these deals generate extra customers nor any extra revenue.

(c) **Cost of operations** including maintenance of hotels, staff compensation and other overheads have been increasing in the recent years.

(d) The transformation to a "limited services" hotel could have **caused confusion** about the product offering in the minds of the premium segment guest travellers, who expect higher service quality. This could have eroded the customer base.

Due to the above reasons, Rejuve Hotel's venture as a "low cost" hotel with limited services became unviable.

(ii) Rejuve Hotels plans to expand its business hotel division in secondary cities in India. This time it has adopted a **"differentiation advantage"** strategy. It is marketing in the following ways as being different from its competitors:

(a) It has **upgraded its existing properties** and **developed new properties**. It also plans to provide **specialized operations (such as wildlife lodges)** which will differentiate it from its limited service hotel competitors.

(b) Ability to offer more connectivity to travellers through its "hub-spoke" model. "REJUVENATE at REJUVE ANYWHERE, ANYDAY, ANYTIME" is the proposed tag line to present its **unique proposition** / concept to potential customers. Other hotels do not have the scale of operations to achieve the **"hub-spoke"** model or the ability to offer holiday packages.

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(c) Ability to offer attractive holiday packages by entering into **partnership with** airlines, car rentals and city tour operators.

(d) **Enhancing customer experience by offering convenient services** such as online hotel booking, online digital payment services, Pay@Hotel services etc. They plan to reinstate the free shuttle pickup and drop services for passengers to and from domestic / international airports. This service is planned to be extended to city railway stations and bus stands.

(e) Dedicated customer service line available 24×7 to resolve issues and providing support to customers.

Superior quality of stay, enhanced customer experience, customer responsiveness and innovation will enable Rejuve Hotels consolidate its position in the industry in the long run.

Note- Where a firm intends to produce a product or deliver a service different from those of its competitors, it is running under a **differentiation strategy**. The fundamental objective of differentiation is ***to make the product or service unique*** so that customers avoid alternatives. The ***customers' needs are met fully*** by the product or service offered by the firm i.e., it has a **'unique selling proposition'**. Other products, services and competitors are unable to enter for this particular market segment.

(iii) Management Control Report – Feed-forward Control Report

Management control is required to set performance measure to determine is the desired objectives of the company are being achieved or not. Control is required at every stage before the activity commences, while the activity is being performed and after the activity has been completed. Accordingly, control reports generated could be Feed-forward reports (prior), concurrent reports (during) and feedback reports (after).

When the management of Rejuve Hotels wants to have a reporting system that enables to take preventive measures, it would need to have a "Feed-forward" control. This control will help measure the error before it actually takes places. Preventive measure can then be taken to change the operational variables to achieve the desired result.

Guidelines to implement a "Feed-forward" control are as follows:

(a) **Thorough planning and analysis are required.** In the case of Rejuve Hotels, the proposal should be planned and analyzed at various levels. *The strategy for selection of appropriate properties to develop, "full service" pricing,* ***strategic partnerships****, financing the proposal etc.* need to be taken at a higher level of management. Decisions relating to hotel operations, procurement of supplies, marketing, human resource planning etc. can be done by the management in charge of operations.

(b) **Feed forward mechanism should be kept dynamic.** Rejuve Hotels should keep a close watch on the ***government policies*** and its implementation in the tourism and hospitality sector. Reporting may be done in pre-determined intervals say a *monthly feedforward reporting* can be decided upon. Changes to plans should be made in a timely fashion to make them relevant.

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(c) **A model control system should be developed**. *Authority* and *responsibility* for various functions need to be determined and clearly defined while developing this model.

(d) **Careful discrimination must be applied in selecting input variables.** Planning and analysis should be done in an integrated fashion. There should be ***synergy in the thinking*** at an operational level and top management strategic level.

(e) **Data on input variables should be collected regularly.** For example*, changes in prices of supplies, property maintenance costs, staff compensation etc. which form a large share of expenses, have to be tracked continuously.* If the prices are expected to fluctuate widely, hedging options or ***long-term price agreements*** with suppliers can be considered.

(f) **Feed-forward control requires action**. At the time of implementation, the control model developed should be followed in order to establish a systematic course of operations.

(iv) Management Control Report – Feedback Control Report

These are control reports that provide feedback about the operations. It tracks the actual results with the budgeted / forecasted results. These reports in themselves do not cause a change in performance. The management has to take timely action to correct the errors and change its operations, if required.

Guideline to implement this reporting system are as follows:

(a) **Feedback report should disclose both accomplishment and responsibility.** As discussed in the feed forward report, Rejuve Hotels would have already put in place an organizational structure defining individual authority and responsibility. ***Performance should be tracked*** accordingly, so that individual performance can be assessed.

(b) **Feedback reports should be extracted promptly.** The management has to decide the interval at which these reports need to be generated. The interval should be such, that changes required can be assessed and action can be taken in a timely manner. In the previous instance, Rejuve Hotels had given autonomy to the marketing and pricing division to take decisions to meet the competitor's actions. ***It took six years to determine that the project was unviable***. *However, a timely reporting mechanism such as a* ***feedback report should have been in place*** to appraise the top management about the decisions taken. This information would have enabled the top management to make an earlier assessment as to the viability of "limited services" hotel.

(c) **Feedback reports should disclose trends and relationships.** Trends could be customer ***travelling preferences***, ***deals offered by competitors*** or other changes

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such as *properties being developed in various locations by competitors,* ***latest business models*** in the industry etc. Relationships could be *supplier relationships, customer relationships, strategic partner relationships* etc. Information generated from all these areas should be collated in order to provide proper feedback to the management.

(d) Feedback reports should disclose variations from standards. These standards could be from *financial budgets* or from non-financial metrics identified as key performance indicators. For example, delay in room check-in time for customers could be a non-financial metric that can be tracked against an expected standard set in the planning stage. The information metric for actual operations should be assessed in the same manner with which the standard was set. For example, an instance of a delay in room check-in procedure considered as one that takes beyond 15 minutes from the time of arrival of the customer at the hotel reception desk. This same standard should be used to assess actual performance. Similar standards shall be set for services like housekeeping, restaurant room service and other services as well.

(e) Feedback reports should be in a standardized format. It should be ***easily understood*** and well presented to the management. Facts should be stated *without ambiguity* and in *a standard manner*.

☞

- *Conceptually correct brief explanations are sufficient for each step.*
- *Alternate points and reasoning are also possible. However, issue must be addressed properly, and answer must respond to the requirement.*

Question 2

(a) Global Bakery is one of the largest bakery service providers for fresh breads. Among all the variants, the focaccia bread is very popular and is favourite of all its customers and envy of its rivals.

The firm has set a price of ₹ 629 for baking the focaccia breads. 'Global Bakery' derived this price as follows: raw materials ₹ 40, labour (4 hrs @ ₹ 60 per hr) ₹ 240, variable overheads ₹ 50, fixed overheads (2 hrs @ ₹ 20 per hr) ₹ 40 plus mark-up 70% on total cost.

Global Bakery is known for its quality work and timely delivery; hence, customers are willing to pay this premium price. Firm's employees receive a fixed salary. The hourly rate ₹ 60 is arrived by dividing the total salary by the total number of hours available. Variable overheads depend on the number of breads baked whereas fixed overheads rate is derived at by dividing the total cost of all related expenses by the number of labour hours available. Fixed overheads generally include office rent and administrative salary.

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A local hotel approached 'Global Bakery' as the focaccia bread bakers of their hotel are on strike, about the possibility of delivering 120 focaccia breads in coming week and they need the work done on a rush basis. 'Global Bakery' has sufficient quantity of required raw material in stock for special order. It perceives that it could complete 70% of the special order during normal working hours. However, to complete the remaining 30%, some employees will have to work overtime. Overtime hours are paid at premium, which could be time and half the normal hourly rate.

Required

(i) ADVISE the company to determine the price to be quoted for the special order.

(5 Marks)

(ii) COMMENT on the suitability of special order decision to deal with excess supply or excess demand. ***(5 Marks)***

(b) A leading Beauty product company manufactures and sells cream. It sells cream in a container of 200 ml. This container is of one time use. Raw material is procured locally. The raw material is blended with additives and fragrance at the manufacturing plant at specified temperatures to produce cream.

The plant has an automated packing facility. The operator is required to pre-set the quantity and number of 'containers' to be filled in a computerised system. No manual intervention is required thereafter. The cream is filled in 'container' at the first stage of packaging with 200 ml. Caps are fixed on the 'Container' and sealed at the second stage of packaging. The container is weighed at third stage of packaging. After weighing the containers are packed in cartons of 500 containers each.

Any 'Container' having lesser quantity of cream is removed before the 'containers' are packed into the cartons. The 'containers' which are short filled cannot be reused. Once the seal is broken, the 'container' is of no use. There is no process by which the cream in short filled 'container' could be reused. Hence the cream is wasted.

The company is considering a proposal to add a machinery in its packaging unit to avoid losses arising out of quantity issues in packaging. The machinery will be installed after the first stage of packaging. The machinery will measure the volume of cream and will forward the 'container' for capping and sealing only if the quantity in 'container' is correct. In case the 'container' does not have required volume of cream, the 'container' will be topped up with balance cream before the capping and sealing process. By this the company will be able to achieve 0% wastage due to short filling after implementation of new system.

Required

IDENTIFY and EXPLAIN the type of existing control system m the company and also the type of control system proposed. ***(10 Marks)***

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Answer

(a) (i) 'Global Bakery' can use the incremental cost numbers for pricing the 'rush order'. The *minimum* price that firm would charge is ₹ 198 per bread (= ₹ 23,760/120). This price is well below normal price of ₹629.

Particulars	Amount (₹)
Raw materials (120 × ₹40)	4,800
Labour (120 × 4 × 30% × ₹ 60 × 1.5)	12,960
Variable overheads (120 breads × ₹ 50)	6,000
Incremental cost	23,760

ADVISE- Firms can face situations where they are confronted with the opportunity of offering for a **one- time special order**. In this situation only the *incremental costs* of undertaking the order should be taken into consideration. ***Quote should be made at prices that exceeds incremental costs***. Any excess of revenues over incremental costs will provide a contribution to committed fixed cost which would not otherwise have been gained.

However, in decision making other conditions are equally important. For instance, if this is **a one-time deal** with ***no prospect of repeat business***, then 'Global Bakery' might well charge a ***premium over the normal price***. Long-term implications also matter. The prospect of *"getting a foot in the door"* to quote for future business would *push the price downward*. Therefore, 'Global Bakery' can price based on both the short-run benefits from accepting the order and the long-run consequences.

(ii) **COMMENT-** Such special order definitely gives 'Global Bakery' opportunity to earn more profits, however, other aspects also need to be analysed. There is excess of ***raw material***, if the current special order does not use up available stock, the firm could store the raw material for later use. It is most likely that 'Global Bakery' ***fixed overhead costs*** will not change due to the special order which mainly consists of rent and administrative salaries. If 70% of the special order could be completed during normal working hours, then the firm clearly has some excess capacity in terms of ***labour hours***. However, for the remaining 30% of the special order, labour will have to work overtime and will be paid 1.5 times.

This clearly indicates that different resources in the 'Global Bakery' have differing capacity levels; a decision may impose constraints on particular resource. It is necessary to consider the opportunity cost of each resource when computing the total cost of a special order.

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- *The calculations of **incremental cost** can be done either on 'per unit' basis or 'total' basis.*

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(b) Control is a management function of establishing benchmarks and comparing actual performance against the benchmarks and taking corrective actions. Control is required at all levels of organisation to ensure that the organisation achieves its intended objective. There are two types of control systems - Feedback Control and Feed-forward Control.

Feedback Control

Feedback Control is a control activity that takes place after a process is complete. 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 control provides information ***only after the process is complete*** and sometimes a significant time is lost to take corrective action. Feedback-based systems have the advantage of being simple and easy to implement.

Beauty Product Company currently has a "feedback control" mechanism in place.

The actual volume of the cream is measured at the end of the packaging process i.e. third stage. The current control process is that any 'container' which is short filled is not packed in the carton. This ensures that a lower quantity of cream is not supplied into the market. The current control system, however, leads to losses as identification of short-filled 'container' at the end of process is not useful to the production process. ***In case, there is a huge variation in the final packaging, the packaging system can be reviewed*** to ensure that such problems do not incur in the future.

Feed-forward Control

Feed-forward Control 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 control are ***costly to implement*** as it requires additional investment and resources. These are ***designed to detect deviation some standard or goal to allow correction to be made before a particular sequence of actions is completed.***

The proposed system in Beauty Product Company is a Feed-forward control.

In this case, ***any short filling is identified in the packaging process itself and corrective action is taken to ensure that the final packed 'container' has proper quantity of cream.*** The new process is beneficial to the company as the wastage arising out of the packaging process can be avoided.

The savings must be compared with the cost required to modify the packaging process before finalising on whether the new system should be implemented or not.

Question 3

A new startup venture ABC Ltd. has successfully entered into their first contract with an offshore pharmaceutical company to supply one of the high demand generic medicines. Expected demand for the medicine will be 98,000 units annually. The plant holds the maximum capacity to 25,200 units per quarter, but it can additionally produce 14,000 units per quarter in overtime.

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Total fixed overheads are expected to be ₹ 16,80,000 for all the quarters. Each unit produced in overtime would incur an additional cost equivalent to 32% of the expected variable cost per unit of that quarter.

Expected sales and variable cost per unit for all quarters are given as under:

Quarter	***Q1***	***Q2***	***Q3***	***Q4***
Sales (units)	*13,300*	*23,800*	*25,900*	*35,000*
Variable cost per unit (₹)	*36*	*36*	*39*	*42*

The production manager has to decide about the production plan.

The choices are:

Plan-I: *Produce at a constant rate of 24,500 units per quarter. Inventory holding costs will be ₹ 7.80 per unit of average inventory per quarter.*

Plan-2: *Use a Just-in-Time (JIT) system.*

Assume that there is no balance of opening inventory.

Required

(a) CALCULATE the incremental production cost and the savings in inventory holding cost by JIT production system. ***(6 Marks)***

(b) ADVISE the company on the choice of the plan. ***(3 Marks)***

(c) STATE, any four pros and cons of the JIT Inventory Management. ***(4 Marks)***

(d) STATE Why Kanban and machine cells are critical elements for the JIT Inventory System. ***(3 Marks)***

(e) STATE the difference between Just-in-Time Inventory Vs Economic Order Quantity (EOQ)? ***(2 Marks)***

(f) STATE any four areas in which JIT purchasing may reduce cost significantly to bring the cost efficiency. ***(2 Marks)***

Answer

(a) Statement Showing 'Inventory Holding Cost' under Plan 1

Particulars		**Q 1**	**Q 2**	**Q 3**	**Q 4**
Opening Inventory	**(A)**	---	11,200	11,900	10,500
Add: Production		24,500	24,500	24,500	24,500
Less: Demand/ Sales		13,300	23,800	25,900	35,000
Closing Inventory	**(B)**	**11,200**	**11,900**	**10,500**	**---**
Average Inventory $\left(\frac{A+B}{2}\right)$		5,600	11,550	11,200	5,250
Inventory Holding Cost @ ₹ 7.80		**43,680**	**90,090**	**87,360**	**40,950**

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Inventory Holding Cost *for the four periods* = ₹ 2,62,080

Statement Showing 'Additional Cost-Overtime' under Plan 2 (JIT System)

Particulars	**Q 1**	**Q 2**	**Q 3**	**Q 4**
Demand/ Sales	13,300	23,800	25,900	35,000
Production in Normal Time	13,300	23,800	25,200	25,200
Production in Over Time (A)	**---**	**---**	**700**	**9,800**
Variable Cost *per unit*	36.00	36.00	39.00	42.00
Additional Cost – Overtime *per unit* (B) (@ 32% of Variable Cost)	11.52	11.52	12.48	13.44
Additional Cost – Overtime (A) × (B)	**---**	**---**	**8,736**	**1,31,712**

Total Additional Payment (Overtime) = ₹ 1,40,448

Statement Showing 'Additional Variable Cost*' under Plan 2 (JIT System)

Particulars	**Q 1**	**Q 2**	**Q 3**	**Q 4**	**Total**
Production (Plan 1)	24,500	24,500	24,500	24,500	98,000
Variable Cost (A)	8,82,000	8,82,000	9,55,500	10,29,000	**37,48,500**
Production (Plan 2, JIT)	13,300	23,800	25,900	35,000	98,000
Variable Cost (B)	4,78,800	8,56,800	10,10,100	14,70,000	**38,15,700**
Total				**(B) – (A)**	**67,200**

* *Excluding overtime cost*

Incremental Production Cost in JIT System = ₹1,40,448 + ₹ 67,200

= **₹ 2,07,648**

Therefore, Saving in JIT System (Net) = ₹ 2,62,080 – ₹2,07,648

= **₹ 54,432**

(b) ADVISE

Though ABC Ltd is saving ₹ 54,432 by implementing its production system to Just-in-time but it has to consider *other factors* as well before taking any final call which are as follows:

(1) ABC Ltd. has to ensure that it receives material from its suppliers on the exact date and exact time when it is needed. Hence, ***credibility and reliability of the vendor/(s)*** must be thoroughly checked.

(2) ABC Ltd. must install a system, which may be as simplistic as a fax machine or as advanced as ***an electronic data interchange system*** or linked computer systems, that tells suppliers exactly how much of which material are to be sent to the company.

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(3) ***Material supplied*** *should be free of any defects* and *must match exactly the production requirements* of ABC Ltd. Visits to supplier's site will help staff to examine the supplier's production process and resolve any quality control issues.

(4) Production of medicines should be aimed at achieving *"Zero Defects"*.

(5) ABC Ltd should also keep in mind the efficiency of its ***work force***. ABC Ltd must ensure that labours capable of performing a variety of operations at effective and efficient manner. The workforce must be completely retrained and *focused on a wide range of activities*.

(6) ***Demand stability*** is an important prerequisite for JIT production planning. Hence ABC Ltd should *constantly monitor whether the actual demand for the quarter is on the lines* expected while it did its production planning. If there are variations it should accordingly match the resources to scale up or scale down required resources.

(7) The key benefit of JIT production system is the ability of the company to respond to customer demand faster. Hence, ABC Ltd. should undertake periodic *preventive maintenance* to ensure that ***least disruption to the production process***. Elimination of defects as quickly as possible is very critical.

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- *Conceptually correct brief explanations are sufficient.*

(c) Pros and Cons of JIT Inventory Management

Pros of JIT inventory management system:

(1) The focus of JIT system is its continuous focus on ***eliminating waste*** from a system like waste of assets, excessive inventory, waste of time, waste of material etc. This helps reduce product costs and improves cost efficiencies.

(2) JIT ***reduces overhead costs***. JIT focused on a very streamlined production process, hence material handling costs, facilities and quality inspection decline under this system. Reduced inventory results in reduction of space required for warehouse facility. Hence, the warehouse overheads relating to cost of staff, equipment, fixed assets, rent etc. are reduced.

(3) JIT creates an urgency to ***eliminate defects as quickly as possible***. Tight link between stages in production line and minimum inventory level at each stage forces the need to eliminate any defects. Defects in one stage can hamper the other stages of production.

(4) Reducing set up time makes production in smaller batches economical and reduces inventory levels. Hence the company can ***respond to customer demand faster***.

(5) Under JIT workers are hired and trained to become multi skilled so that they are capable of performing a variety of operations including repair and maintenance tasks. This ***reduces labour idle time***.

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(6) Carefully selected suppliers capable of ***delivering high quality materials in a timely manner*** directly at the shop floor reduces material receipt time.

(7) A company is not required to purchase huge amounts of stock to meet its production needs. Hence ***working capital investment reduces***.

Cons of JIT inventory system:

(1) Under JIT inventory system the company does not carry any buffer inventory. Hence the ***risk of running out of stock is high***. Incorrect demand forecasting or changes in economic and business environment can lead to variations in customer demand. The company has to have resources to meet these variations very quickly if it implements JIT inventory system, otherwise it will result in stock out situations and loss of business.

(2) ***Dependence on suppliers is high***. Any disruptions in the supply chain can affect the company's ability to meet the customers' demand quickly. Under JIT this can result in heavy loss of business. Hence supplier credibility, reliability should be thoroughly checked. Communication and synchronization of information up and down the supply chain is critical is ensure timely delivery of resources for JIT system.

(3) ***More planning is required*** under the JIT inventory system. An efficient and effective reporting system should be in place to give information about current sales trends, variances, problems in production and procurement etc. Resources must be kept flexible to be able to meet changes and disruption in the business.

(d) Under JIT inventory system workflow between machines should be smooth and streamlined. In many companies there is a large difference in between the operating speeds of different machines. Hence work in progress piles up in front of the slowest machine. Under normal production process*, it has been observed that defective parts produced by an upstream machine may not be discovered until the next downstream operator starts working on it*. The downstream operator may have to work through some work in progress that was piled up before the machine before this error is detected. Hence there is a time lag in the flow of materials between the two machines. In the meantime, the upstream machines may have created more defective parts, all of which must then be reworked or scrapped after the error is discovered.

Excessive work in progress is a waste that needs to be eliminated under JIT inventory system. This problem can be addressed through the use of Kanban cards and machine cells.

(1) **Kanban cards work under a "pull system"**. They are initiated at the end of the production process, pulling work authorizations through the production system. Under this system, a ***downstream machine sends a notification to each machine that feeds it parts***, authorizing the production of just enough components to fulfil the production requirement. This production requirement in turn is being authorized by the next machine downstream. Hence work authorizations are pulled through the

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production process such that it meets the needs exactly at the end of the production process. Since production is based only on Kanban card authorizations, this ***eliminates build-up of work in progress inventory in the production system***. Hence Kanban cards are critical in JIT inventory system.

(2) **Machines cells refer to a cluster of machines handled by a single operator**. It is also called a working cell. The individual machines operator takes each output part from machine to machine within the cell. Hence this eliminates any work in progress piled up between machines. Also, the ***operator can immediately identify defective output*** from any of these machines. This eliminates any waste which is the objective of a JIT inventory system.

Machine cells are also beneficial since their configuration is typically of smaller machines that are simpler to operate as compared to large, automated machinery they replace. The smaller machines enable the production facility to be reconfigured to produce different products. Large expenses for repositioning and aligning the equipment would have otherwise been incurred which are not required under the machine cell set up. This ***builds flexibility in resources*** which is critical for JIT Inventory system.

Both Kanban and machine cells should be used together. They help the company achieve low product defect rates and reduced investments in work in progress.

☞

- *Conceptually correct brief explanations are sufficient.*

(e) **JIT Inventory System** is one whose objective is to produce or procure products or components as they are required by the customer or for use, rather than to stock. This is a pull system that responds to demand. Therefore, no inventory is held under the JIT inventory system. The company benefits from savings in inventory holding costs and any related overheads.

Economic Order Quantity (EOQ) is an ideal order size of components that a company should procure from suppliers to meet customers' demand. The objective is to have an optimal order quantity to minimize costs relating to ordering, receiving, and holding inventory. This optimal order quantity need not match the trends in customer demand. Hence, companies may hold inventory as the order size may result in excess procurement as compared to current demands.

Therefore, under JIT inventory system inventory holding cost is saved but ordering cost is ignored. In EOQ, the ordering cost is optimized while the company incurs inventory holding cost.

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(f) The areas, where JIT purchasing expected to reduce cost significantly are:

Interest cost of working capital– JIT purchasing will reduce the level of raw materials, which cause a reduction in the amount blocked as working capital; hence interest cost (either actual or opportunity) will reduce too.

Storage cost– As we know JIT purchasing reduce the level of raw material stored, hence storage cost is expected to reduce.

Raw material cost– Companies wherein products are based on new innovations and updated features are introduced in a short span of time to keep their market captured ratio intact. This makes their product design highly volatile and creates high probability of raw material wastage once the new/updated feature is introduced in the design. JIT is the right choice to minimize the wastage of raw materials.

Labour and overhead cost– Since JIT purchasing reduced the inventory level of raw material, hence sorting (first S out of 5S) become easy and motions (as per motion study) also reduced, which reduce labour and overhead cost as well.

Question 4

(a) Supreme Automation Limited (SAL) is a leading AI based home automation-based manufacturing firm. SAL started its 5 years back when it was the only manufacturer automation-based systems. SAL manufactures components themselves, irrespective of fact that these business around of such home all assembly components can be acquired from market at a cheaper rate. Major component of total costs in manufacturing of such automation systems is variable in nature. Company was performing well, earning reasonably and enjoyed a large market share up-till two years ago majorly due to the first mover advantage. However, with rough macro-economic conditions, an increase in rival competition and more new entrants coming into the market, the resultant market share and thereby, profitability has started shrinking. If no major steps are immediately taken, then company may run into red in a year to come.

The CEO of SAL attended a workshop where he learnt about the lean management techniques of Cost Management. He asked Mr. X the Chief Management Accountant to report on underlying reasons behind the company's current performance with available set of possible solutions. Mr. X immediately convened, a meeting with top ranked officers to address the issues.

The Marketing department confirmed that it is difficult to maintain the same level of sales in upcoming years because the price of SAL automation systems is much higher than price offered by its competitors in the market with similar Quality and features.

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The Customer Relations department conveyed that the popularity of their product is declining. They quoted that they receive lot of complaints from buyers in e-mails .and tele-calls due to manufacturing defects, which arise in the product within a month period of purchase & frequency of such calls and emails have increased in recent years.

They also mentioned that in some cases, customer reported that assembled part did not belong to model they purchased, and some customers say, assembly is not as per the specifications provided in the product datasheet.

In addition, the maintenance department affirms that the repair issues in case of recently sold products have increased drastically.

The Operations department testifies that firstly large percentage of workers employed with the company are unskilled; secondly, large number of raw materials in each category are dumped by store at the production floor; that's too well prior to requirement. These two reasons cause worker catastrophe in differentiating among parts which appear similar. They also mentioned the entire business process, especially production process is quite old and contains certain activities which are purely unnecessary. To its defence, the purchase department argued about the economics of discount involved behind purchase of large quantities of raw material and also mentioned about possibility of buying too less quantities may lead to stock-out situations.

Required

PREPARE a report to advise the CEO pointing out the factors influencing the current performance and policies of the company and also with available set of possible solutions.

(5 Marks)

(b) *TSK Limited is a mobile manufacturing company. The company using budgets for control which are prepared on traditional basis. The new CEO of the company wants to change the budgeting system from traditional budgeting to Beyond Budgeting in the company on experimental basis.*

Therefore, as the management accountant of the company you have been assigned to explore the possibilities of· introducing Beyond Budgeting system in the company.

You are required to:

EXPLAIN reasons for taking approval of change the budgeting system from Traditional to Beyond Budgeting on following points:

- *The advantages and benefits available in Beyond Budgeting.* ***(3 Marks)***
- *The suitability of Beyond Budgeting to the company.* ***(2 Marks)***

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OR

HRY Limited is a leading company in the kitchenware industry. Due to competition in the market, company is continuously making R&D to develop new products. Product "Aiken" is currently being developed and is about to be launched in the market. The company has made very heavy expenditure to develop this product. This is a highly innovative product which the company believes that it will change the market and consumer behavior. Production and promotional costs in the launching year are likely to be very high. The CEO of the company has decided to use a market skimming approach for pricing this product during its introduction stage.

You are required to:

ANALYZE the reasons for going with market skimming approach of pricing by the CEO of HRY Limited.

(c) *ABC Ltd. is a manufacturer of motorbikes. It has two divisions, Assembly division 'A' and manufacturing division 'P'. Division 'P' manufactures the part which may be used by division 'A' as well as outside customers. Division 'A' gets its entire requirement for the part from division 'P'. The Division 'P' operates at full capacity, with no inventory at the beginning and end of the year. As per company policy, demand from Division 'A' has priority over external customers. The data of Division 'P' during 2021-22 is as under:*

Production Capacity	*1,50,000 Units*
Sales price to external customers	*₹ 6,000 per unit*
Variable cost of production per unit	*₹ 4,125*
Transfer price to Division 'A'	*Any opportunity cost in the form of lost sales.*
Total Sales including transfer to division 'A'	*₹ 81crores*
Sales made to the external customers	*75,000 Units.*

This year, there was an additional demand from external customers for 27,000 components. However, since Division 'P' operated at full capacity, this demand was not catered to.

Required

(i) *ANALYSE the Sales in terms of ₹ and units made by Division 'P' to both external and internal customers.* ***(3 Marks)***

(ii) *RECOMMEND the transfer pricing range that would promote goal congruence between divisions A and P.* ***(2 Marks)***

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(iii) DISCUSS the effect of changes in external demand on the transfer price for the company, assuming the current policy continues. ***(2 Marks)***

(iv) DISCUSS the advantages, disadvantages and behavioral Consequences of Transfer Pricing at Variable Cost method. ***(3 Marks)***

Answer

(a) **Report**

To,

The Office of CEO,

Supreme Automation Limited (SAL)

Dated – 10th Nov 2022

Report on factor influencing the current performance, policies and available set of solution thereto.

Current Performance

a. Financial evaluation suggests that sale at SAL is shrinking and that turn in declining bottom line i.e., profit.

b. Non-financial performance evaluation measures are sustainable action-based indicators such as Triple Bottom Line (TBL; suggested by Elkington in 1994), which consider People and Planet apart from Profit while evaluating performance of entity. Since there is no negative effect on environment and neutral from social aspects, hence business is **bearable**, despite causing low profit. SAL if able to maintain/enhance the profit then it can enter into **sustainable** zone.

Note- Requisite amount of data is not available in given case, to apply other non-financial performance indicators-based model, such as Balance Scorecard (by Robert Kaplan and David Norton), Performance Pyramid (by Lynch and Cross), Building Block Model (by FitzGerald and Moon) and Performance Prism (by Andy Neely and Chris Adams)

Current policies at SAL (underlying reasons behind current poor performance) and solution thereto.

a. **Non-competitive pricing policy–** Marketing Department said price of SAL automation system is much higher than price offered by all the competitors in market, despite the fact it is similar to competitor's product in term of quality and features.

Target Costing (as Cost Management Technique) is solution here. Since market condition are stiff and bargaining power of customer are high due to multiple competitors, and these competitors selling the product at price lesser than price offered by SAL. Hence, price offered by such competitor/rivals should be considered as 'Target

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Price' and after reducing 'Target Profit' from same 'Target Cost' can be identified. Production, operations facilities along with product need to be reengineered to achieve such Target Cost.

b. **100% indigenous - in house manufacturing of all assembly components -** Irrespective of fact that these components can be acquired from market at cheaper rate, **SAL is manufacturing all assembly components themselves.**

Solution here is to take **'Make or Buy'** decision. Only those assembly items need to be made in house whose variable cost of manufacturing cost is less then market price.

c. **Passive value chain - Popularity of product is declining among customer** (decline in sales) and moreover customers are cursing SAL for **manufacturing defects**.

Defects arise in product within month period of purchase. Further some of cases customer reported that assembled part is not belonging to model they purchased, and some customers say assembly is not as per specification provided. Hence, quality of product as well as processes (such product pass through) is critical concern.

One of way to look at **'Quality'** is conformance to need of customer, to ensure same Total Productivity Management/ Total Quality Management supported by Six Sigma need to be applied as part of Lean System Management.

Total Quality Management is management of entire process, including planning process; in order to improve process by total participation, keeping focus on customer. **PRAISE** analysis can be used in order to achieve improve quality.

Using **DMAIC** (Define, Measure, Analyse, Improve and Control) methodology of **Six Sigma**, existing business process can be improved to ensure customer satisfaction, reducing cycle time and reduction in waste also.

d. **Employing unskilled workforce –** Policy of hiring unskilled workforce is also a reason for poor performance and quality issues.

Each worker is needed to provide with *requisite training* and learning curve need to be ensured.

Though **Kaizen** (change for small improvement) workers involvement (participation) into business process (BPR) need to be ensured.

e. **Purchasing in bulk –** SAL is not only purchasing in large volume, but store department also dumped the material at production floor, much prior to their actual need. This may be root cause of one of complaint by customer that assembled part is not belong to model they purchased.

Possible solution is to apply **JIT (purchase and production)**. JIT can be implemented as part of lean system. JIT is **pull system of production**, with **single piece flow** after

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considering **takt time**. In JIT, production facility needs to be integrated with vendor system for signal (Kanban) based automatic supply which depends upon demand-based consumption. Under JIT system of inventory storage cost is at lowest level due to direct issue of material to production department as and when required and resultantly less/no material lying over in store or production floor.

Note - Takt time is the maximum time to meet the demands of the customer, this will help to decide the speed of/at manufacturing facility. Heijunka can be applied in order to reduce variation between takt times over the production.

Cost benefit analysis of 'reduction in storage cost along with opportunity cost saved' and 'increase in ordering cost, purchase cost along with stock-out cost' need to be made.

f. Stick to old **established businesses processes –** Another reason for poor performance at SAL is decision to continue with **old established businesses processes**, especially production processes and contains **certain activities which are purely unnecessary**.

Solution to same is **Process Innovation** and **Business Process Re-engineering (BPR)** that can be applied as part of lean manufacturing. Re-engineering is rethinking and radical design of business process in order to achieve improvement. It will help the SAL to keep them at par with changing technology. It is worth to note here that SAL is operating in domain which is highly dynamic hence technology up-gradation, advancement and breakthrough are inevitable.

Value Analysis needs to be applied in order to ensure maximum value to customer by eliminating activities which are not value generating, this will control cost also, that's too strategically.

Further details can be tabled on requisition basis.

Closure of Report

(For Management Accounting Division)

Supreme Automation Limited

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- *Conceptually correct brief explanations are sufficient.*

(b) (i) Advantages and Benefits of Beyond Budgeting (BB)

BB identifies its two main advantages.

- It is a more *adaptive process* than traditional budgeting.

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- It is a *decentralised process*, unlike traditional budgeting where leaders plan and control organisations centrally.

Benefits of the 'Beyond Budgeting' Model

- Beyond budgeting helps managers to work in coordination to beat the competition. Internal rivalry between managers is reduced as target shifts to competitors.
- Helps in motivating individuals by defining clear responsibilities and challenges.
- It eliminates some behavioural issues by making rewards team-based.
- Proper delegation of authority to operational managers who are close to the concerned action and can react quickly.
- Operational managers do not restrict themselves to budget limits and focus on achieving key ratios.
- It establishes customer-orientated teams.
- It creates information systems which provide fast and open information throughout the organization.

(ii) Suitability of Beyond Budgeting to the Company

TSK Ltd. is a mobile manufacturing company and presently adopting Traditional Costing system. The mobile industry is one of the fastest growing industries. With the rise of technology, more people are using mobile devices to buy, sell, shop, and share their experiences with friends etc. The brands are gearing up for intense competition. So, **the industry goes through *rapid changes*** in its business environment. TSK Ltd. can definitely use Beyond Budgeting **to improve the control system and beat the competition**.

Beyond Budgeting lies an agile, holistic approach based on self-organisation. This will also help the managers to work in close coordination with each other with motivation which in turn will beat the competition.

OR

- **Market Skimming Pricing** involves charging high prices when a product is first launched and spending heavily on advertising and sales promotion to create customer awareness and build a market for the product.
- The aim of market skimming is to gain high profits early in the product's life, allowing the costs of developing the product to be recovered.
- Demand for the product is likely to be inelastic in the earlier stages till the product is established in the market.
- HRY Limited ***incurred very heavy expenditure*** to develop product "Aiken". Therefore, Skimming Price is suitable for "Aiken".

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- Further, it is given to be a *highly innovative product that* ***will change market and customer behaviour***. Due to its innovative feature, the customers would not mind paying a premium for the unique product offering. Demand would be inelastic. A policy of market skimming appears to be most appropriate in this case.

(c) (i) ANALYSIS of sales by Division P to both external and internal customers

The annual capacity and actual production of Division P is 1,50,000 units per year. It is given the Division P operates at full capacity, with no inventory at the beginning and end of the year. Zero inventory implies that annual sales was also 1,50,000 units per year.

Sales to external customers was 75,000 units at ₹ 6,000 per unit. Therefore, external sales amounts to ₹ 45 crores (75,000 units × ₹6,000 per unit). Therefore, internal sales can be derived to be 75,000 units for the year (annual sales 1,50,000 units less external sales 75,000 units). For the year, value of sales made to Division A is ₹ 36 crore (Division P's total sales of ₹ 81 crore *less* external sales of ₹ 45 crores).

Had there been no extra demand, opportunity cost for Division P would have been nil. Therefore, transfer price would only be the variable cost of ₹ 4,125 per unit of component/ part, However, given in the problem, that there was excess demand for 27,000 units of components from external customers, that could not be met since Division P had to give priority to internal demand. Had these sales been made to external customers Division P would have earned ₹ 1,875 per unit contribution (Sale price ₹ 6,000 per unit less variable cost ₹ 4,125 per unit). This lost contribution of ₹ 1,875 per unit is the opportunity cost per unit for Division P. Due to company's policy of giving priority to internal demand, Division P lost a profit (or contribution) of ₹ 5.0625 crores during the year (27,000 units × contribution of ₹ 1,875 per unit).

Therefore, internal sales comprise of two parts:

- **48,000 units of components transferred at variable cost of ₹ 4,125. This amounts to ₹ 19.80 crores.**
- **27,000 units of components transferred factoring any opportunity cost = variable cost per unit + contribution per unit = external sale price per unit = ₹ 6,000 per unit. This amounts to ₹ 16.20 crores. (27,000 units at ₹ 6,000 per unit)**

So, internal sales = ₹ 19.80 crores + ₹ 16.20 crores = ₹ 36 crores.

Summarizing

External sales are 75,000 units amounting to ₹45 crores annual sales value. Internal sales are 75,000 units amounting to ₹36 crores annual sales value. Transfer price for 48,000 units is at variable cost of ₹4,125 per unit while for 27,000 units is at external sales price of ₹6,000 per unit.

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(ii) RECOMMEND- Transfer price range between Division A and P to promote goal congruence

Division A procures its entire demand of 75,000 units from Division P. Out of this, 27,000 units at market price of ₹ 6,000 per unit while 48,000 units are procured at a lower rate of ₹ 4,125 per unit. Had Division A procured 48,000 units from the market, the additional cost of procurement would be ₹ 9 crores {(External price of ₹ 6,000 per unit less internal transfer price at variable cost of ₹ 4,125 per unit) × 48,000 units}. Only Division A currently enjoys this benefit of lower procurement cost. Financials of Division P show no profit from such internal transfers. This may skew the performance assessment of the divisions, if it is based primarily on financial metrics of each division. In order, promote goal congruence, some portion of this benefit can be shared with Division P.

Division P will at the minimum want to recover its variable cost of ₹ 4,125 per unit, while Division A will be ready to pay only up to external market price of ₹ 6,000 per unit. Therefore, transfer price range can be set between ₹ 4,125 - ₹ 6,000 per unit. Division A enjoys lower procurement rate while Division P financial reflect some benefit of transferring components internally to Division A.

(iii) DISCUSSION - Impact of External Demand on Transfer Price

- As per the company's transfer pricing policy, Division P gives priority to demand from Division A. The division has a production capacity of 1,50,000 units annually. **If there is no external market for Division P's components**, then transfer price for the entire internal transfer would be the ***variable cost of ₹ 4,125 per unit plus portion of the fixed cost (if any)***. This is the minimum cost that Division P would like to recover from Division A.
- When there is an external market, transfer price would depend on whether Division P had to incur any opportunity in the form of lost sales. **When total demand (internal and external) is within production capacity** of 1,50,000 units, the entire demand can be met. There would be no lost sales for Division P, no opportunity cost. Therefore, transfer price for the entire internal transfer would be the ***variable cost of ₹ 4,125 per unit***. This is the minimum cost that Division P would like to recover from Division A.
- When there is an external market, such that **total demand (internal and external) is more than production capacity of 1,50,000 units**, due to priority given to internal transfer, some portion of the external demand might not be met. This would be lost sales for Division P, opportunity cost would be the contribution lost from such sales at ₹1,875 per unit. This opportunity cost would be passed onto Division A. As explained in part (ii) above, transfer price range will be from ₹ 4,125 - ₹ 6,000 per unit. *More lost sales for Division P would keep the average transfer price higher towards ₹ 6,000 per unit. Lesser lost sales for Division P would keep the average transfer price towards the lower bound of ₹ 4,125 per unit.* Therefore, the proportion of external demand that could not

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be catered to, would determine the average transfer price***. Higher the demand from external customers would drive up the average transfer price within the company.***

(iv) Advantages, Disadvantages and Behavioral consequences of transfer pricing at Variable Cost method

Transfer price is → recorded at variable (marginal) cost required to produce one additional unit.

Advantage

Useful when the supplying division has excess capacity. The method ensures that the supplying division recoups the cost of internal transfer, while the purchasing division enjoys the benefit of a lower price compared to the market.

Disadvantage

No fixed cost or mark-up is allowed to be charged to the purchasing division. Each unit of internal sale will hence result in a loss at approximately fixed cost per unit.

Behavioural Consequences

In such a setup, profit evaluation is centralized at the entity level. Therefore, the *supplying division may have little incentive* to find measures for making cost efficient. *Non-recovery of fixed costs would demotivate the supplying division*. It may *oppose certain decisions like capacity expansion or further infusion of investment, that lead to higher fixed costs*.



- *Conceptually correct brief explanations are sufficient.*

Question 5

(a) Aeron Electrical Solutions (AES) is a renowned firm for manufacturing a wide range of electrical appliances for professional and domestic use. The Scriver division of Aeron Electrical solutions is engaged in the manufacturing of motorized screw driving machines capable of handling high-end commercial loads. They are particularly very popular in automation plants where the tasks are pre-defined and accuracy is the primary concern. The Scriver division is presently manufacturing only three models namely SD-100, SD-200 and SD-500 based on the increasing order of incorporated features and complexities.

During the manufacturing process, each screw driving machine needs to pass through various level of steps, before it gets ready. One of the manufacturing steps involved manual intervention wherein the programming of the processing chip for automation is done post installation and tested before passing to the next stage. This process is termed as Processor Manual Programming for Automation (PMPA). The production capacity of Scriver division is constrained by PMPA.

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The basic information pertaining to top-line and prime cost is as follows:

(Amount in ₹)

Particulars	***SD-100***	***SD-200***	***SD-500***
Sale price per unit	*168*	*240*	*540*
Material cost per unit	*86.4*	*124.8*	*240*
Labour cost per unit	*36*	*63*	*90*

All the process and division at AES are operating for a single shift of 8 hours in a day. Conversion cost per hour (including labour cost) is ₹6,720. The standard out-put for PMPA during a day is the processing of either 960 units of SD-100 or 672 units of SD-200, or 384 units of SD-500.

AES is capable of sale more than, what they are presently capable to produce in all range of models.

The CEO of AES recently attended a science exhibition, Robo-tech 2022; where he saw a Robot developed by Micro Robotics Limited, capable to assembly including installation and programming of processing chip to any sort of device.

***You are required to** advise the company as management accountant on following aspects:*

(i) On a random day if 576 units, 168 units and 144 units of SD-100, SD-200, and SD-500 respectively are produced and sold. CALCULATE at what efficiency level current constraint (bottleneck) is operational. INTERPRET the same. COMPUTE profit earned during such day. ***(3 Marks)***

(ii) Considering the ranking based upon throughput performance ratio, FIND production of which model is more beneficial for the firm? ***(3 Marks)***

(iii) APPLY Goldratt' s five steps to remove the bottleneck at Scriver Division. ***(4 Marks)***

(b) The TVA Multiplex Pvt Ltd. (TMPL) is a movie theatre chain in India with its headquarter located in Mumbai. Each centre has a cinema with a minimum of 8 screens equipped with IMAX & 4DX technologies, and mainstream auditoriums. It is the biggest chain of Multiplexes showing latest released movies across the country. The business of cinema is extremely competitive in all regions. Each centre operates autonomously and managers are able to offer best services in terms of customer experience and cleanliness.

TMPL's mission statement is "to inspire and enhance customer experience by using latest technologies and experience". To establish long term relationship of trust and commitment with clients, TMPL wants to provide their client highest level of satisfaction with emphasis on

- *Best in class Audio and Video Services*
- *Professionalism, Comfort and Hygiene*

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- *Client's Feedback*

Company has developed a website where it creates blogs, post high quality content related to newly released movies. Website is also connected to social media to reach customers. If a customer searches TMPL's services on search engine, it automatically redirects to the place of nearest TMPL cinema for customers comfort and ease. TMPL's majority of tickets are booked through online channel.

Results for one of the centres, "VT Cinemas", are given below. The column headed "Centre's" shows the average figures for all TMPL cinemas:

Particulars	***VT Cinemas Apr'22***	***Centre's Apr'22***
Revenue (₹)	*45,63,000*	*54,33,450*
Gross profit (₹)	*24,25,200*	*25,68,870*
Number of senior Managers	*45*	*55*
Number of junior staff	*30*	*28*
Number of website hits	*7,505*	*9,630*
Total number of services booked online and completed	*4,958*	*6,135*
Number of services taken from repeat customers	*755*	*802*
Total time spent on completing maintenance tasks (hours)	*12,060*	*12,940*
Number of new combo packages	*3*	*2*
Customer percentage in terms of feedback forms showing score of 9 or 10	*88%*	*79%*

Notes:

(i) Managers are categorized as 'senior' if they have been qualified for more than five years.

(ii) Junior staff includes both trainees and staff who have been qualified for less than five years.

(iii) The VT Cinemas launched three new combo packs during the year:

- *free food coupon of worth ₹ 450 for bookings over and above ₹ 1,000.*
- *a Premium Recliner seat costing only ₹ 260, instead of the usual ₹ 520, for 5 days advanced bookings.*
- *a Popcorn meal charged at t 100, which usually costs ₹ 300, for all customers booking for minimum of 6 tickets.*

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These three new combo packs produced revenues of ₹ 3,96,000; ₹ 3,48,000 and ₹ 3,24,000 respectively. Two comparable new combo packs developed by other centre's produced revenues of ₹ 2,64,000 and ₹ 2,52,000.

(iv) Customers to rate the particular centre from 1 to 10 in an online feedback form with 10 being the best.

Required

The Chief Executive Officer (CEO) of TMPL has recently attended a webinar and heard about Building Block Model of Performance Management. The CEO is interested to know how the dimensions block could be applied at TVA Multiplex Pvt Ltd.

(i) ANALYSE VT Cinema's performance relative to the other Centres. ***(8 Marks)***

(ii) EXPLAIN how the Standards and Rewards block support the Dimensions block in case of Building Block Model. ***(2 Marks)***

Answer

(a) (i) Efficiency level can be measured with help of Efficiency Ratio, which is one among the control ratios.

Efficiency ratio indicates the degree of efficiency attained in production. It is expressed in term of standard hours for actual production as a percentage of the actual hours spent in producing that work.

$$\frac{\text{Standard hours for actual production}*100}{\text{Actual hours worked}}$$

= (9.8/8) × 100 = **122.5%**

Working Note – Standard hour required for actual production.

Product	Actual output (Units) (a)	Standard Daily Output (Units) (b)	Standard Hourly Output (Units) (c) (b)/8	Standard Hour Required (a)/(c)
SD-100	576	960	120	4.8
SD-200	168	672	84	2
SD-500	144	384	48	3
Standard Time Required (in hours)				**9.8**

Interpretation – **122.5%** signifies that efficiency (usage) of exploiting bottle-neck activity is 22.5% better than the standard use. PMPA (Processor Manual Programming for Automation) is producing out-put which require 9.8 hours, in 8 hours.

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Profit earned during the day

Particulars	Amount in ₹
Revenue [(576×168) + (168×240) + (144×540)]	2,14,848.00
Less: Material Cost [(576×86.4) + (168×124.8) + (144×240)]	1,05,292.80
Less: Conversion Cost (including labour cost) [(6720×8hrs)]	53,760.00
Profit	**55,795.20**

(ii) Statement of ranking, based upon throughput performance ratio (using throughput contribution)

Particulars		SD-100	SD-200	SD-500
Sale price per units	(a)	168	240	540
Material cost per unit	(b)	86.4	124.8	240
Throughput contribution per unit	(c) = (a) – (b)	81.6	115.2	300
Maximum possible production	(d)	960	672	384
Maximum possible throughput contribution	(e) = (c)×(d)	78,336	77,414.4	1,15,200
Conversion cost (including labour cost) (6,720×8hrs)	(f)	53,760	53,760	53,760
Throughput performance ratio	(e)/ (f)	1.46	1.44	2.14
Ranking		II	III	I

Considering the throughput performance ratio (or TA ratio) and ranking above most beneficial model to produce is SD-500 followed by SD-100 and SD-200.

$$\textbf{TA Ratio} = \frac{\text{Throughput contribution}}{\text{Conversion cost}}$$

Throughput accounting developed by **Galloway and Waldron** which use the term factory cost and completely relay upon the **Goldratt's theory of constraints** which use the term operating expenses, but the meaning of factory cost and operating expenses used at both places are identical.

Theory of constraints consider short-run time horizons and assume other current operating cost to be fixed costs.

Higher the throughput performance ratio (or TA ratio) is better and beneficial.

All the products/models which have throughput performance ratio (or TA ratio) more than one may be produced/continued to produce, depending upon constraint function.

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(iii) Application of Goldratt's five steps to remove the bottleneck at Scriver division

Goldratt's theory of constraints describes the following mentioned five steps process of identifying and taking steps to remove the bottlenecks that restrict output.

1. **Identifying the System Bottlenecks –** At Scriver division of Aeron Electrical Solutions, *Processor Manual Programming for Automation (PMPA)* is bottleneck.
2. **Exploit the Bottlenecks –** Bottleneck activities' capacity must be fully utilised. Although the efficiency of bottleneck activity is already 122.5% but further attention on the possibility to enhance the flow of products from bottleneck activity is needful.
3. **Non-bottleneck activities are subordinate –** Bottleneck activity should setup the pace for non-bottleneck activities. Scriver division shall plan its production keeping PMPA at the centre point, because even if the efficiency of other activities which are non-bottleneck enhanced beyond current level; the output can be maximum possible by PMPA.
4. **Elevate the bottleneck –** Eliminate the bottleneck by enhancing the capacity and efficiency. *Major change (business reengineering) or continuous minor change (kaizen)* may do. In the case of Scriver division, the introduction of the robot may be a way to elevate the bottleneck. It is specified in fact of case that CEO recently attended the Robo-tech 2022, where at he saw robot developed by Micro Robotics Limited, capable to assembly including installation of processing chip to any sort of device.

   Note – There will always be one bottleneck in the system, if such bottleneck is eliminated then a new constraint emerges as a bottleneck. Hence this process continues. Ultimately improvement is a never-ending continues process.
5. **Repeat the process –** Apply step 1 to new bottleneck activity which emerges at Scriver division and repeat the process.

(b) (i) **ANALYSIS:** Under Building Block Model (By Fitzgerald and Moon) there are six dimensions apart from standards and rewards. Dimensions are better to be known as CSFs and hence suitable measures must be linked to each dimension to analyse the performance. So, dimensions are the goals to measure performance and subcategories into Results and Determinants Framework. The results are lagging indicators, whereas determinants are conceptualised as leading indicators. The six dimensions are analysed below–

Competitiveness: Competitiveness can be measured through conversion rate i.e., rate of seats confirmed and number of hits at website

	VT Cinema	TMPL Average
Website hits converted sale of tickets (in percentage)	**66.06%** (4,958/ 7,505) × 100	**63.71%** (6,135/ 9,630) × 100

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This ratio shows VT Cinema is more attractive compared to its peer, which is good from performance perspective because it is specified that business of cinema is highly competitive in all the regions. **VT Cinema able to convert 66.06% of website hits into confirmed tickets against 63.71% as average of others.**

Financial Performance: Financial Performance can be measured through Gross Profit Ratio. It indicates the percentage of revenue which exceeds the cost of goods sold.

	VT Cinema	TMPL Average
Gross profit ratio (in percentage)	**53.15%** (24,25,200/ 45,63,000) ×100	**47.28%** (25,68,870/ 54,33,450) ×100

VT Cinema performed better as it has gross profit of 53.15% comparing with 47.28% of others. The higher gross profit in case of VT Cinema may be **either due to new combo packs or less number of senior managers** (as compared to junior staff, 1.5 times in case of VT cinema vis-à-vis 2 times in case of others; because it is for sure that senior manager salary is higher than junior staff.

Quality of Service: 'Inspire and Enhance the Customer Experience' is mission of TMPL hence quality is a key aspect. Customer will return back only if quality of service is acceptable.

	VT Cinema	TMPL Average
Repeat customers (in percentage)	**15.23%** (755/ 4,958) × 100	**13.07%** (802/ 6,135) × 100
Customer percentage giving 9 or 10 score.	88%	79%

Since in case of VT cinema the number of repeat customers as percentage to total number of bookings (seats sold) is higher by 2.16%, as VT cinema has repeat customer 15.23% of its total customer against 13.07% of others, hence quality of services is believed to be higher in case of VT Cinema as compared to others.

Despite less number of senior manager as ratio to junior staff in case of VT cinema, the quality is expectedly better, this **may be due too enthusiastic workforce** that develop the relation with customer; hence customer came back to VT cinema. Customers of VT cinema are satisfied is evident from better customer percentage ratio who give feedback score of 9/10.

Flexibility: Flexibility is capability to adapt the change. To judge flexibility a question can be shall be answered - How quickly business able to deliver, what is asked for by customer? Time spent in maintenance task apart from percentage of customer who give score of 9 or 10 can be analysed as measure of flexibility.

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	VT Cinema	TMPL Average
Time spent on maintenance task (in hours)	**12,060**	**12,940**
Customer percentage giving 9 or 10 score.	88%	79%

VT cinema took lesser time in maintenance (presuming same space and features in every other cinema also) and have a greater number of percentage of customer who award feedback Score of either 9 or 10 than average of other cinemas hence flexibility is believed to be higher in case of VT cinema.

Alternatively

	VT Cinema	TMPL Average
Time spent on maintenance per booking (hrs.) [i.e., based on total number of tickets booked online and utilised]	**2.43** (12,060/ 4,958)	**2.11** (12,940/ 6,135)

The comparison shows that VT Cinema takes longer time to complete maintenance task than the TMPL average, which is not really good, and is probably because of they have slightly less experienced staff on the whole.

Resource Utilization

In service entity the most precious resource is human; hence it is the human that make any service organisation a great success. So, these indicators measure how the employees is being utilized to create revenue.

	VT Cinema	TMPL Average
Revenue per employee (both manager and staff)	**60,840** (45,63,000/75)	**65,463** (54,33,450/83)

The revenue per employee is lower in case of VT Cinema (60,840) as compared to average (65,463) of other cinemas by 4,623, hence performance is poor, but there is valid reason for poor performance i.e., **inexperienced/less experience staff**. The ratio of junior staff to senior manager is higher in case of VT Cinema as compared to others.

Innovation

Innovation can be measured in term of new combo pack launched and revenue earn through same.

	VT Cinema	TMPL Average
Number of New Combo offers	3	2

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Revenue generated from new packs (in percentage to total revenue)	**23.41%** (10,68,000^/ 45,63,000) × 100	**9.50%** (5,16,000^^/ 54,33,450) × 100

^ *(3,96,000 + 3,48,000 + 3,24,000);* ^^*(2,64,000 and 2,52,000)*

VT Cinema launched 3 new combo pack for it customer as compared to 2 by others, resultantly it able to earn 23.41% of revenue from new service packs as compared to 9.50% in case of others. The performance in terms of innovation is a really good performance.

Hence, over all VT Cinema has outperformed the rest of cinemas.

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- *Conceptually correct brief explanations are sufficient for each step.*
- *It has been stated that "total number of services booked online and completed". The same has been considered as number of "**seats** booked online and availed/ utilized". Similarly, "number of services taken from repeat customers" has been considered as "number of **seats** booked by repeat customers".*

(ii) The **standards** block fixes the target for the performance indicators chosen for each of the dimensions. The targets must meet three criteria – they must be achievable, fair and encourage employees to take ownership. The performance of the organization could suffer if the targets set do not meet these criteria.

The **rewards** block makes sure that employees are motivated to attain the standards. It also examines the properties of good reward schemes which are that they should be clear, motivating and based on controllable factors.

If standards and rewards are set appropriately, the staff will be engaged and motivated and it is then more likely that the goals, i.e., **dimensions**, of the organisation will be achieved.

Question 6

(a) During the second peak wave of Covid-19 m April 2021 in the country, many patients were deprived of oxygen due to its non-sufficient availability at the hospitals. A private company ABC Limited offers the government to manage the delivery and ensuring the availability of liquid oxygen at all hospitals of locale within the expected time limit.

ABC Limited plans to manage 1,68,750 metric tons of liquid oxygen at the rate of ₹ 6.00 per metric ton. The company estimates that variable cost (all resources) will be equal to ₹ 1.50 per metric ton and that fixed costs (Cryogenic Oxygen tanker rent, driver wages, fuel and maintenance charges) will be equal to ₹ 1,04,400 per month.

In April 2021, ABC Limited managed 2,02,500 metric ton liquid oxygen and received ₹ 10, 12,500 as total revenue. However, ABC Limited paid ₹ 3,24,000 on resources (including urgent purchase of PPE kits and other safety equipment). In addition, ABC Limited paid

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₹ 1,10,000 for Cryogenic Oxygen tanker rent, fuel and maintenance charges under fixed costs. This past April was unusually high with infections and more than expected hospitals needed oxygen urgently. Due to the time constraint and urgency, ABC Limited resorted to use extra Cryogenic Oxygen tankers than expected which were partially filled with liquid oxygen. As a result, ABC limited has to incur extra expenses for Cryogenic Oxygen tanker rent, fuel and additional driver's wages.

Required

Prepare a budget reconciliation report along with suitable ANALYSIS. ***(10 Marks)***

(b) *Yummy Foods Limited (YFL) is known to be the leading restaurant in India offering best in quality foods to its customers at very reasonable prices. YFL has made its credit pioneering effort and service for over one decade in development of domestic and international cuisines with its decade old unique recipes & hygiene. One of its Signature dishes is produced by mixing and cooking with three main ingredients: A1, A2 and A3. It uses a standard costing system to monitor its costs. The standard material cost for 120 kg of the Signature dish is as follows:*

Ingredients	Standard Qty. (Kg)	Cost per kg. (₹)	Cost per 120 kg of "Signature Dish" (₹)
A1	48	4	192
A2	72	5	360
A3	23	3.5	80.5
	143		632.5

Notes:

A1, A2 and A3 are organic & region-specific products. Their quality and price change significantly every year. Standard prices are determined at the average market price over the last three years YFL has a purchasing manager responsible for purchasing and pricing. The standard mix is decided by the Managing Partner having 15 years rich experience in food recipes. The last time this was done at time of launching the signature dish was six years back. The standard mix has not been changed since.

Mixing and cooking process are subject to some evaporation losses.

In current month 5,520 kg of "Signature dish" was produced, using the following ingredients. ·

Ingredients	Actual Qty. (₹)	Cost per Kg.	Total Cost of "Signature Dish" (₹)
A1	2,528	3.8	9,606.40
A2	2,891	6	17,346.00
A3	947	4.1	3,882.70
	6,366		30,835.10

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At every month end, the production manager receives a statement from the Managing Partner. This statement contains material price and usage variances for the month and no other feedback on the efficiency of the processes is provided,

Required

EVALUATE the performance measurement system in YFL. ***(10 Marks)***

Answer

(a) The following table shows ABC's budget profit and actual profit for the month of April 2021:

Particulars	Budgeted Profit	Actual Profit
Liquid Oxygen	1,68,750 mt.	2,02,500 mt.
Revenue (₹)	10,12,500	10,12,500
Less: Variable Costs	2,53,125	3,24,000
Contribution Margin (₹)	7,59,375	6,88,500
Less: Fixed Costs	1,04,400	1,10,000
Profit (₹)	**6,54,975**	**5,78,500**

ANALYSIS

ABC's standard selling delivery rate is ₹ 6.00 per metric ton (mt.) and its standard variable cost (all resources) is ₹ 1.50 per mt. Therefore, ABC's budgeted revenue = 1,68,750 mt. × ₹ 6.00 = ₹10,12,500 and its budgeted variable costs = 1,68,750 mt. × ₹ 1.50 = ₹ 2,53,125. From the table, we can identify that ABC's actual profit for April 2021 was ₹ 5,78,500 lower than its budgeted profit of ₹ 6,54,975. Therefore, ABC's **total profit variance** is ₹ 76,475 (A).

ABC's **sales contribution volume variance** equals to the difference between its standard contribution and budgeted contribution (or standard contribution for actual quantity over budgeted quantity). Each unit (metric ton) is budgeted to contribute ₹ 4.50 toward profit; since ABC delivered 33,750 mt. more than budgeted, the increase in volume should have contributed ₹1,51,875 = 33,750 mt. × ₹4.50 to actual profit. Therefore, ABC's sales contribution volume variance is ₹**1,51,875 (F)**.

Similarly, ABC's **sales price variance** equals to the effect of change in price on actual quantity. The selling rate decreased by ₹ 1, from a standard rate of ₹ 6 per mt. to an actual rate of ₹5 per mt. on actually delivery of 2,02,500 mt. Therefore, ABC's sales price variance is ₹ **2,02,500 (A)**.

ABC's overall **variable cost variance** equals to the difference between its standard variable costs and its actual variable costs, or ₹3,03,750 – ₹3,24,000 = ₹ **20,250 (A).** But there is not adequate data to segregate ABC's variable cost variance into price/ rate and quantity elements. To compute these variances, we would require the amount of resources

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ABC budgets to use per **unit (qty delivered)** and the actual & budgeted rate of each resource (i.e., an adverse variable cost variance can arise as ABC used more resources per mt. delivered and/or it paid more than budgeted for the resources used). ***While the issue appears to suggest that ABC's adverse variable cost variance arose due to spending more on resources (PPE kits and other safety equipment) than planned, it is not sure that the entire ₹ 20,250 variance is attributable to this. In fact, it is likely that the quantity variance was greater than ₹ 20,250 (A) and that ABC had a favorable rate variance to offset this.***

ABC's **fixed cost expenditure variance** equals the difference between budgeted and actual fixed costs, or ₹ 1,04,400 – ₹ 1,10,000 = **₹ 5,600 (A).**

We can now prepare the following budget reconciliation report:

Item	Amount (₹)
Budgeted Profit	6,54,975
Sales Contribution Volume Variance	1,51,875 (F)
Sales Price Variance	2,02,500 (A)
Variable Cost Variance	20,250 (A)
Fixed Cost Expenditure Variance	5,600 (A)
Actual Profit	5,78,500

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- ***Budget Reconciliation Report*** *can also be prepared in an alternative manner i.e., based on 'standard absorption costing' system.*

(b) Price Variance

Input	Actual Qty. (Kg)	Std. Cost (₹)	Actual Cost (₹)	Difference (₹)	Variance (₹)
A_1	2,528	4.0	3.8	0.20 (F)	505.60 (F)
A_2	2,891	5.0	6.0	1.00 (A)	2,891.00 (A)
A_3	947	3.5	4.1	0.60 (A)	568.20 (A)
	6,366				2,953.60 (A)

Usage Variance

Input	Standard Qty. (Kg)	Actual Qty. (Kg)	Difference (Kg)	Std. Cost (₹)	Variance (₹)
A_1	2,208	2,528	320 (A)	4.0	1,280.00 (A)
A_2	3,312	2,891	421 (F)	5.0	2,105.00 (F)

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A_3	1,058	947	111 (F)	3.5	388.50 (F)
	6,578	6,366	212 (F)		1,213.50 (F)

Mix Variance

Input	Rev. Actual Qty. (Kg)	Actual Qty. (Kg)	Difference (Kg)	Std. Cost (₹)	Variance (₹)
A_1	2,136.84	2,528	391.16 (A)	4	1,564.64 (A)
A_2	3,205.26	2,891	314.26 (F)	5	1,571.30 (F)
A_3	1,023.90	947	76.90 (F)	3.5	269.15 (F)
	6,366.00	6,366	NIL		275.81 (F)

Yield Variance / Sub-usage Variance

Input	Standard Qty. (Kg)	Rev. Actual Qty. (Kg)	Difference (Kg)	Std. Cost (₹)	Variance (₹)
A_1	2,208	2,136.84	71.16 (F)	4	284.64 (F)
A_2	3,312	3,205.26	106.74 (F)	5	533.70 (F)
A_3	1,058	1,023.90	34.1 (F)	3.5	119.35 (F)
	6,578	6,366.00	212 (F)		937.69 (F)

OR

Yield Variance = Std. Material cost per Kg of output (Actual Yield - Standard Yield)

= ₹ 632.5/120 kg (5,520 - 5,342.098) = **₹ 937.69 (F)**

Standard Yield = [120 kg x 6,366 kg] / 143 kg = 5,342.098 kg

EVALUATION of Performance Measurement System

The statement reported, ₹2,953.60 adverse material price variance. The responsibility for controlling the materials price variance is usually the purchasing manager's. Undoubtedly, in current scenario, the price of materials is largely beyond his or her control; however, ***the price variance can be influenced by such factors as quality, quantity discounts, distance of supplier's location, and so on. These factors are often under the control of the purchase manager***. The production manager is responsible for material usage and cannot be held responsible for the material price variance.

Since total usage variance reported, ₹ 1,213.50 favourable, production manager could assume good performance. However, if usage variance is considered in more detail, through the mix and yield calculations, it can be observed that ***variance was driven by a change in the mix and by using a mix of ingredients which was different from standard,*** it has resulted in a saving of ₹ 275.81; Similarly, it has led to a favourable yield.

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It is worthwhile to note that changing the mix could impact the product quality and sales as well, however, no information has been given about this.

Prices and quality of three ingredients are changing significantly every year. ***Using ex ante prices and usage standards can implicit an outdated view of variances***. Failing to separate variances caused by uncontrollable factors and planning errors from variances caused by controllable factors can be demoralizing for the managers.

In addition, ***managers are not involved in setting the standard mix*** and the same has not been changed for six years despite continuous changes in the quality and prices of the ingredients. This can also mislead the managers i.e., to carryout control activities which are based on the outdated standards.

Furthermore, a true image is missing in relation to managers' ***performance as statement does not include any feedback or comments on the variances***. Even no follow up is being taken on the same.

Overall, it appears that YFL is **not having comprehensive performance measurement system**, and this could adversely impact the firm in long run.

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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 answer

All questions relate to Assessment Year 2022-23, unless stated otherwise in the question.

Question 1

M/s MPK Pharma Ltd, a company resident in India, in which the public are not substantially interested, is engaged in the manufacture of pharmaceutical products. The Statement of Profit & Loss for the year ended 31st March, 2022 shows a net profit of ₹ 50,75,000 after debiting or crediting the following items:

(i) One-time license fee of ₹ 12 lakhs paid to a foreign company for obtaining a franchise on 28th July, 2021.

(ii) Convertible debentures were issued by the company on which expenditure of issue and collection of ₹ 3,15,000 was incurred.

(iii) The company has paid ₹ 2,25,000 to share brokers for transactions in relation to equity shares listed in stock exchange and ₹ 1,20,000 to commodity broker for transactions in relation to commodities at MCX. Tax was not deducted at source on such transactions.

(iv) Contributed 15% of basic salary in National Pension Scheme referred in section 80CCD towards salary paid to an employee Mr. Gaurav whose basic salary was ₹ 6,00,000 p.a. and Dearness allowance of 30% of basic salary was considered. 50% of Dearness allowance formed part of the salary.

(v) Expense of ₹ 7,00,000 has been incurred for providing freebies to medical practitioners.

(vi) Expenditure of ₹ 5,20,000 incurred on feasibility study conducted for examining proposals for technological advancement for existing business. The project was abandoned without creating a new asset.

(vii) Depreciation of ₹ 13,00,000 on the basis of useful life of assets has been charged.

(viii) Employees Provident Fund (EPF) for the month of March, 2022 amounting to ₹ 5,20,000 was remitted on 17th May, 2022 which includes ₹ 2,60,000 of employer's contribution and ₹ 2,60,000 of employee's contribution.

(ix) Donation to Swachh Bharat Kosh ₹ 2,00,000.

(x) Industrial power tariff concession of ₹ 4,50,000 is received from Central Government.

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, 2021, which are relevant for November, 2022 examination. The relevant assessment year is A.Y.2022-23.

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(xi) Interest and borrowing costs amounting to ₹ 6,85,000 and ₹ 5,65,000 though not meeting the criteria for recognition as a component of cost, is included in the cost of opening and closing inventory, respectively.

(xii) The profit from setting of warehouse in rural area for storage of sugar (before claiming deduction under section 35AD) is ₹ 10,00,000. The warehouse commenced operations on 24th October, 2021.

The Company has furnished the following additional information:

(i) The company has collected ₹ 14,00,000 as GST from its customers and remitted to the Government before due the dates. Consequent to an appeal filed, the Honourable High Court ordered the GST department to refund ₹ 5,00,000 to the Company. The Company in tum refunded ₹ 3,00,000 to its customers from whom GST was collected. Balance amount is shown under "current liabilities".

(ii) On 14.01.2022, the company has issued 2,00,000 equity shares of ₹ 10 each at ₹ 22 per share. The fair market value of the shares determined as per Income-tax Rules, 1962 was ₹ 19 per share.

(iii) The company has brought forward losses of ₹ 13,00,000 relating to assessment year 2019-20. Mr. X who continuously held 55% shares carrying voting power since incorporation of the company, had sold his entire shareholding to Mr. Y on 25.11.2021.

(iv) Depreciation allowable as per Income-tax Rules ₹ 14,50,000.

(v) The company has invested ₹ 35 lakhs in the construction of warehouse in a rural area for storage of sugar as an additional line of business. The investment includes land value of ₹ 20 lakhs.

You are required to compute the Total Income of M/s MPK Pharma Ltd. for the Assessment Year 2022-23. The company has not opted for tax u/s 115BAA of the Income-tax Act, 1961.

(14 Marks)

Answer

Computation of Total Income of M/s MPK Pharma Ltd. for the A.Y. 2022-23

	Particulars	Amount (in ₹)	
I	**Profits and gains of business and profession**		
	Net profit as per Statement of profit and loss		50,75,000
	Add: **Items debited but to be considered separately or to be disallowed**		
	(i) One time license fee [Franchise is in the nature of an intangible asset eligible for depreciation @ 25%. Since one-time license fees of ₹ 12 lakh paid to a foreign	12,00,000	

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	company for obtaining franchise has been debited to statement of profit and loss, the same has to be added back.]			
	(ii) Expenditure of issue of convertible debenture [The expenditure incurred on the issue and collection of debentures would be treated as revenue expenditure even in case of convertible debentures, i.e., the debentures which had to be converted into shares at a later date.[1] Since the said expenditure has been debited to statement of profit and loss, no further adjustment is required.]	Nil		
	(iiia) Payment to share brokers for transaction in relation to equity shares [Since the company is engaged in the manufacture of pharmaceutical products, investment in equity shares is not related to the business and the payment to share broker is not wholly and exclusively for the purpose of assessee's business. Since the said payment has been debited to statement of profit and loss, the same has to be added back] ***Note** – If it is assumed that the company also carries on share trading business and the profits of such business are included in the figure of ₹ 50,75,000, then, the payment to share brokers would be allowable as deduction. There would be no disallowance under section 40(a)(ia) since section 194H is not attracted in respect of payment for transaction in relation to equity shares. The figures of business income, gross total income and total income would, accordingly, change]*	2,25,000		
	(iiib) Payment to commodity broker without deducting tax at source [Assuming that the commodity transactions at MCX are in relation to the business of the company, the payment of ₹ 1,20,000 to commodity broker on which tax is deductible	36,000		

[1] *CIT v. ITC Hotels Ltd. (2011) 334 ITR 109 (Kar.)*

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	under section 194H would attract disallowance@30% u/s 40(a)(ia), due to non-deduction of tax at source u/s 194H.] ***Note*** *– If the transactions are not related to the business, the entire amount of ₹ 1,20,000 would be disallowed. The figures of business income, gross total income and total income would accordingly change.*		
	(iv) Contribution towards NPS in excess of 10% of salary disallowed [Contribution to the extent of 10% of salary (basic salary + dearness allowance, if it forms part of pay for retirement benefits) is allowable as deduction under section 36(1)(iva). In this case, ₹ 90,000 (15% of ₹ 6,00,000) – ₹ 69,000 [10% of (₹ 6,00,000 + 50% of 30% x ₹ 6,00,000)], would be disallowed]	21,000	
	(v) Expense on freebies to medical practitioners [Any expense incurred in providing freebies to medical practitioners is an expense prohibited by the law. Any expenditure incurred by an assessee for any purpose which is prohibited by law is not deemed to have been incurred for the purpose of business or profession and hence, has to be disallowed from business income.[2]	7,00,000	
	(vi) Expenditure on feasibility study [If there is no creation of a new asset, then the expenditure incurred on feasibility study would be of revenue nature. In this case, since the feasibility study was conducted for the existing business and the project was abandoned without creating a new asset, the expenses were of revenue nature[3]. Since the expenditure of ₹ 5,20,000 has already been debited to statement of profit and loss, no further adjustment is required.	Nil	

[2] *Circular No. 5/2012 dated 01.08.2012 and Confederation of Indian Pharmaceutical Industry (SSI) v. CBDT (2013) 353 ITR 388 (H.P.)*
[3] *CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594 (Delhi)*

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	(vii) Depreciation on the basis of useful life of asset	13,00,000	
	(viiia) Employees' contribution to EPF	2,60,000	
	[Since employees' contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per *Explanation 2* below to section 36(1)(va). Since the same has been debited to Statement of profit and loss, it has to be added back for computing business income].		
	(viiib) Employer's contribution to EPF	Nil	
	[As per section 43B, employers' contribution to EPF is allowable as deduction since the same has been deposited on or before the due date of filing of return of income u/s 139(1). Since the same has been debited to statement of profit and loss, no further adjustment is necessary]		
	(ix) Donation to Swachh Bharat Kosh	2,00,000	
	[Donation to Swachh Bharat Kosh is not an allowable expenditure under section 37 since it is not laid out wholly or exclusively for the purposes of business or profession. Hence, the same has to be added back while computing business income.]		
	(xi) Difference on account of interest and borrowing costs	1,20,000	
	[As per ICDS II, Interest and borrowing costs not meeting the criteria for recognition as component of cost shall not be included in the cost of opening and closing stock. ₹ 1,20,000 [₹ 6,85,000 – ₹ 5,65,000] being the difference between closing and opening stock, has to be adjusted to remove the effect of interest and borrowing costs included in the value of stock.		40,62,000
			91,37,000

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	***Add:* Income taxable but not credited to statement of profit and loss**		
	AI(i) GST not refunded to customers out of GST refund received from Government [The amount of GST refunded to the company by the Government is a revenue receipt chargeable to tax. Out of the refunded amount of ₹ 5 lakhs, the amount of ₹ 3 lakh stands refunded to customers and hence, would not be chargeable to tax. The balance amount of ₹ 2,00,000 lying with the company would be chargeable to tax]		2,00,000
			93,37,000
	***Less:* Items credited but chargeable to tax under another head/expenses allowed but not debited**		
	(x) Industrial power tariff concession received from Central Government [Any assistance in the form of, *inter alia*, concession received from the Central or State Government would be treated as income as per section 2(24)(xviii). Since the same has been credited to Statement of Profit and Loss, no adjustment is required]	Nil	
	(xii) Profits from setting of warehouse in rural area for storage of sugar [Since it is a specified business, its profits would be computed separately]	10,00,000	
	AI(iv)Depreciation as per Income-tax Rules [As depreciation is as per Income-tax Rules is stated as ₹14,50,000, it has been considered that it includes depreciation on Franchise. ***Note -*** *If it is assumed that the figure does not include depreciation on franchise, then, depreciation of ₹ 17,50,000 (₹ 14,50,000 + ₹ 3,00,000, being depreciation@25% on franchise) has to be reduced*]	14,50,000	24,50,000
			68,87,000

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	Less: Brought forward business loss relating to A.Y. 2019-20 [Brought forward loss relating to A.Y. 2019-20 not allowed to be set off from the profits of A.Y. 2022-23 as 51% or more of the shares of MPK Pharma Ltd., which is a company in which public are not substantially interested, on 31.3.2022 are not held by the same persons who held not less than 51% shares of the company on 31.3.2019]		Nil
	Profits and gains from manufacture of pharmaceutical products		68,87,000
	Profits and gains from setting of warehouse in rural area for storage of sugar		
	Net profit before deduction under section 35AD	10,00,000	
	Less: Deduction under section 35AD 100% deduction u/s 35AD in respect of cost of warehouse [₹ 35 lakhs – ₹ 20 lakhs, being cost of land, not allowable]	15,00,000	
	Loss from the specified business of setting up a warehousing facility to be carried forward as per section 73A for set-off against profits of any specified business in the subsequent year	(5,00,000)	
II	**Income from Other Sources**		
	Consideration received in excess of FMV of shares issued [The shares of the company are issued at a premium (i.e., issue price exceeds the face value of shares); The excess of the issue price of the shares over the FMV would be taxable u/s 56(2)(viib). ₹ 6,00,000 [2,00,000 × ₹ 3 (₹ 22 – ₹ 19)] shall be treated as income in the hands of MPK Pharma Ltd., which is not a company in which public are substantially interested]		6,00,000
	Gross Total Income		**74,87,000**

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	***Less:* Deduction under Chapter VI-A**		
	Deduction u/s 80G in respect of donation to Swachh Bharat Kosh, assuming that the donation is otherwise than by way of cash		2,00,000
	Total Income		**72,87,000**

Question 2

(a) M/s PRK LLP, a limited liability partnership, set up a unit in Special Economic Zone (SEZ) on 1st April, 2019 to develop and export computer software. The unit complied with all the conditions of section 10AA. The net profit of the unit as per Statement of Profit & Loss for the year ended 31st March, 2022 was ₹ 65 lakhs after debiting/crediting the following items:

(i) Profit on sale of import entitlement ₹ 9 lakhs.

(ii) Remuneration to its working partners ₹ 58 lakhs.

(iii) Interest at the rate of 16% per annum on partners' capital ₹ 20 lakhs.

(iv) Donation to a political party ₹ 3 lakhs.

(v) Depreciation ₹ 17 lakhs.

Additional Information:

(i) Payment of remuneration to working partners and interest on capital are authorized by the partnership deed.

(ii) Brought forward business loss from assessment year 2017-18 was ₹ 4 lakhs.

(iii) Unabsorbed depreciation brought forward from assessment year 2016-17 was ₹ 35 lakhs.

(iv) Total export turnover was ₹ 45 crores and the sale proceeds in convertible foreign exchange received in India by 30th September, 2022 was 38 crores. Total export turnover of ₹ 45 crores include telecommunication charges of ₹ 5 crores attributable to delivery of software. Sale proceeds realization of ₹ 38 crores also include such telecommunication charges of ₹ 2 crores.

(v) Depreciation allowable as per Income-tax Rules is ₹ 26 lakhs.

You are required to compute:

(i) Income-tax (including AMT under section 115JC) payable by Mis PRK LLP for the Assessment Year 2022-23.

(ii) Amount of tax credit allowed to be carried forward.

Necessary working notes should form part of your answer. ***(8 Marks)***

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(b) Mr. Robert, a non-resident and German citizen, is employed in a German company. The German company has a PE in India and accordingly the income of the PE is chargeable to tax in India. Robert visited India during the FY 2021-22 on official work and stayed for 85 days. His salary for that period was ₹ 28,00,000 which is borne by the Indian PE.

Robert held 1200 shares of Nalapir Pvt. Ltd. (NP), an Indian company since 28.11.2015 which he acquired for ₹ 15 per share. For acquiring the shares, he remitted USD 50,000 to India on 1.11.2015. He sold these shares on 23.6.2021 for ₹ 43 per share.

Robert also held 2000 equity shares of Aribitz GmbH (AG), a German company, which he had acquired for ₹ 145 per share in 2018. AG follows April to March as its financial year. He sold all these shares for ₹ 615 per share to David, another non-resident, on 26.08.2021. The relevant information of AG as on 31.3.2021 is given below:

(i) Total value of assets ₹ 15 crores.

(ii) Total value of immovable properties worldwide= ₹ 12 crores.

(iii) Immovable properties held in India (included in (ii) above) - ₹ 8 crores.

Dividend from Aribitz GmbH received in India on 28.06.2021 was - ₹ 1,11,000.

You are required to compute the total income taxable in India of Mr. Robert ignoring the provisions of DTAA between India and Germany, if any.

Exchange rates for 1 USD on the relevant dates is given as hereunder:

Date	*Buying Rate (1 US $)*	*Selling Rate (1 US$)*
28.11.2015	*₹ 59*	*₹ 61*
1.11.2015	*₹ 61*	*₹ 64*
23.6.2021	*₹ 74*	*₹ 76*

(6 Marks)

Answer

(a) Computation of total income and tax liability of M/s PRK LLP for A.Y.2022-23

(under the regular provisions of the Income-tax Act, 1961)

Particulars	Amount (in ₹)	Amount (in ₹)
Net profit as per Statement of Profit & Loss		65,00,000
***Add:* Items debited but to be considered separately or to be disallowed**		
- Remuneration to its working partners	58,00,000	
- Interest@16% p.a. on partners' capital (Interest on capital account would be fully	5,00,000	

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allowed to the extent of 12%, since the same is authorized by the partnership deed. Thus, interest in excess of 12% i.e., ₹ 20 lakhs/16% x 4% would be disallowed)		
- Donation to a political party [not allowed as deduction as per section 37(1) while computing business income, since it is not incurred wholly and exclusively for the business]	3,00,000	
- Depreciation	17,00,000	
		83,00,000
		1,48,00,000
***Less:* Permissible expenditure and allowances**		
- Depreciation allowable as per Income-tax Rules, 1962	26,00,000	
- Unabsorbed depreciation under section 32(2) [allowable as deduction while computing book profit as per *Explanation 3* to section 40(b)]	35,00,000	61,00,000
Profit on sale of import entitlement [taxable as profits and gains from business as per section 28, since the same has already credited in Statement of profit and loss, no further adjustment is required]		Nil
Book Profit		**87,00,000**
On first ₹ 3 lakh of book profit [₹ 3,00,000 × 90%]	2,70,000	
On balance ₹ 84 lakh of book profit [₹ 84,00,000 × 60%]	50,40,000	
	53,10,000	
Remuneration actually paid of ₹ 58,00,000 is allowable to the extent of		53,10,000
Business Income		**33,90,000**
***Less*:** Brought forward business loss for A.Y. 2017-18		4,00,000
Gross Total Income		**29,90,000**
***Less:* Deduction under section 10AA**		
Profit from SEZ unit x Export Turnover/ Total Turnover x 100% [₹ 24,90,000 x 36 crores /40 crores x 100% (since it is the third year of operation)]		22,41,000
Profit derived from SEZ unit	33,90,000	

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Less: Profits from sale of import entitlement [business income which are in the nature of ancillary profits, do not constitute profit 'derived from' business for the purpose of exemption under section 10AA]	9,00,000	
	24,90,000	
Export Turnover [₹ 38 crores – ₹ 2 crores, being telecommunication charges included therein. Telecommunication charges[4] not includible in export turnover]	36 crores	
Total Turnover [₹ 45 crores – ₹ 5 crores, being telecommunication charges included therein. Since telecommunication charges has been excluded from export turnover, the same has to be excluded from total turnover also]	40 crores	
***Less:* Deduction under section 80GGC** [Donation to political party [allowable as deduction under section 80GGC, assuming the donation made otherwise than by way of cash]		3,00,000
Total Income		**4,49,000**
Tax liability		
Tax@30%		1,34,700
Add: Health and education cess@ 4%		5,388
Tax Liability		**1,40,088**
Tax Liability (rounded off)		1,40,090

Computation of adjusted total income of M/s PRK LLP and Alternate Minimum Tax

Particulars	Amount (in ₹)
Total Income (as computed above)	4,49,000
Add: Deduction under section 10AA	22,41,000
Adjusted Total Income	**26,90,000**
Alternate Minimum Tax@18.5%	4,97,650
Add: Health and Education cess@4%	19,906
Tax liability under section 115JC	**5,17,556**
Since the regular income-tax payable is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income and tax is leviable @18.5% thereof *plus* cess@4%. Therefore, the tax liability is ₹ 5,17,560 (rounded off).	

[4] *It is assumed that telecommunication charges are incurred in foreign currency outside India.*

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AMT Credit to be carried forward under section 115JEE	
Tax liability under section 115JC (rounded off)	5,17,560
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	1,40,090
Amount of Credit	**3,77,470**

Note *– In the above solution, while computing deduction under section 10AA, the brought froward business loss of ₹ 4,00,000 from A.Y. 2017-18 is not deducted from profits derived from SEZ, considering the view that such profits have to be computed as per Chapter IV-D and hence, effect of carry forward and set-off of losses is not given.*

However, alternate view is also possible based on Circular No. 7/DV/2013 [FILE NO.279/MISC./M-116/2012-ITJ], dated 16-7-2013 that provisions contained in Chapter VI relating to set-off and carry forward and set-off of losses shall also apply while determining the income for the purpose of computing deduction under section 10AA. If this view is considered, the deduction under section 10AA has to be computed after deducting brought forward business losses of ₹ 4,00,000 from the profits of SEZ. In such case, the deduction under section 10AA would be ₹ 18,81,000 [(₹ 20,90,000 x ₹ 36 crores/₹ 40 crores) x 100%], total income would be ₹ 8,09,000, tax liability as per normal provisions would be ₹ 2,52,410. Alternate minimum tax liability would remain same. However, AMT credit to be carried forward would be ₹ 2,65,150]

(b) Computation of Total income of Mr. Robert for the A.Y. 2022-23

Particulars	₹	₹
Salary	28,00,000	
[Salary deemed to accrue or arise in India, since it is paid for services rendered in India as per section 9(1)(ii). Hence, it is taxable in the hands of Mr. Robert.		
Exemption u/s 10(6)(vi) would not be available to him, though he stayed in India for a period of not exceeding 90 days during the previous year since he is receiving salary from a German company which is engaged in business and trade in India through a PE in India and such salary is borne by Indian PE]		
Less: Standard deduction u/s 16(ia)	50,000	
		27,50,000
Capital Gains		
Transfer of 1200 equity shares of Nalapir Pvt. Ltd. [Taxable in India, since shares are situated in India]		
Sale Consideration (1200 x ₹ 43 per share/75, being average of ₹ 74 (TTBR) + ₹ 76 (TTSR)/2 on 23.6.2021)	$ 688	

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Less: Cost of acquisition (1200 x ₹ 15 per share/60, being average of ₹ 59 (TTBR) + ₹ 61 (TTSR)/2 on 28.11.2015)	$ 300	
	$ 388	
Long-term capital gain [$ 388 x ₹ 74, being TTBR on 23.06.2021]		28,712
Transfer of 2000 Equity shares of Aribitz GmbH (AG)		Nil
[Not taxable in India, since shares of foreign company do not derive its value substantially from assets located in India as value of Indian assets do not exceed ₹ 10 crores]		
Income from Other Sources		
Dividend received in India from Aribitz Gmbh [taxable in India, since dividend is received in India]		1,11,000
Gross Total Income/total income		**28,89,712**
Total income (rounded off)		**28,89,710**

Question 3

(a) *The Head of Accounts of Fit Me Foundation, a trust, established for the purpose of promotion of Yoga has approached you to guide him about the tax implications of the following:*

(i) *During the financial year 2021-22, it received a voluntary contribution of ₹ 125 lakhs with a specific direction that it should form part of the corpus of the trust. The trust invested such amount in the shares of M/s. Bend and Blend Private Ltd., a private sector company.*

(ii) *Apart from the above-mentioned ₹ 125 lakhs, during the financial year 2021-22, it received ₹ 95 lakhs from other voluntary contributions and ₹ 60 lakhs of fees towards providing Yoga classes.* ***(4 Marks)***

(b) *Mr. Nagaraj is the founder of SSVB Trust, a public charitable trust registered u/s 12A of the Income-tax Act, 1961. The trust runs a hospital for the treatment of various diseases. Mr. Ram, son of Mr. Nagaraj, was admitted in May 2021 in the hospital due to COVID for treatment. He was charged a total fee of ₹ 3 lakhs as against the amount of ₹ 5 lakhs charged by the hospital for similar treatment to the general public.*

The Board of trustees were served with a notice by the income tax authorities for cancellation of registration u/s 12A.

Discuss whether registration can be denied to the trust. What are the further tax implications? ***(4 Marks)***

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(c) Mr. Ritesh, a resident individual, aged 42 years, received the following sums during the previous year 2021-22:

Income from a business in India ₹ 4,85,000

Royalty from Country N ₹ 7,80,000 (Rate of Tax in Country N 10%, Tax deducted ₹ 78,000)

Interest from Country Y US $ 9,500 (interest became due on 01.04.2021) Tax deducted (on 21.02.2022) : US $ 950 (Rate of Tax 10%)

Agriculture income in Country M: ₹ 1,09,000

Additional Information:

(i) As per the DTAA between India and Country N, the royalty will only be taxable in the Source State.

(ii) As per the DTAA between India and Country Y, interest can be taxed in both the states and tax credit will be available in respect of tax payable in resident state.

(iii) Agriculture income is exempt in country M. India does not have a DTAA with Country M.

Telegraphic transfer buying rate on different dates of US $:

Date	Rate (₹)
31.03.2021	75
31.01.2022	78
21.02.2022	79
31.03.2022	80
01.01.2022	80

You are required to calculate the total income and tax payable by Mr. Ritesh assuming that he did not opt to be governed by provisions of Section 115BAC. ***(6 Marks)***

Answer

(a) (i) Voluntary contribution of ₹ 125 lakhs received with a specific direction that it will form part of corpus of the trust would be exempt from tax only if it is invested in any of the modes specified under section 11(5) specifically maintained for such corpus. If the same is not so invested, then, it would not be exempt under section 11(1)(d) for P.Y.2021-22.

Investment in shares of private company is not a specified mode under section 11(5). Hence, ₹ 125 lakhs received by Fit Me Foundation would not be exempt under section 11.

(ii) Yoga is included in the definition of "charitable purpose" under section 2(15).

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Accordingly, voluntary contributions of ₹ 95 lakhs and fees towards providing Yoga classes of ₹ 60 lakhs would be income from property held for charitable purposes and eligible for unconditional exemption of 15% under section 11.

Exemption will be available under section 11 subject to the fulfilment of the necessary conditions.

(b) As per section 13(6), SSVB Trust shall not be denied the benefit of exemption under section 11 in respect of its entire income merely due to the reason that the benefit of medical facilities have been provided to Mr. Ram, son of Mr. Nagaraj, being the specified person. Accordingly, the registration of SSVB Trust cannot be cancelled by the Income-tax authorities on this basis.

As per section 12(2), the value of medical facilities provided to Mr. Ram, being the specified person, at a concessional rate would be deemed to be the income of the trust and such income would not be eligible for exemption under section 11. Hence, ₹ 2,00,000, being the concessional value of medical services would be deemed to be the income of SSVB Trust.

The remaining income would be eligible for benefit of section 11.

(c) Computation of total income and tax payable by Mr. Ritesh for A.Y.2022-23

Particulars	₹	₹
Profits and Gains of Business or Profession		
Income from business in India		4,85,000
Income from Other Sources		
Royalty from Country N [As per India-Country N DTAA, royalty is taxable in Country N only]	Nil	
Interest from Country Y [US $ 9,500 x 80 (being conversion rate as on 31.3.2022 i.e., last day of the previous year – Rule 115]	7,60,000	
Agricultural Income in Country M [Not exempt in India]	1,09,000	
		8,69,000
Gross Total Income/ Total Income		**13,54,000**
Tax liability on ₹ 13,54,000		
Tax on total income [30% of ₹ 3,54,000 + ₹ 1,12,500]		2,18,700
Add: Health and Education cess@4%		8,748
		2,27,448
Less: **Deduction under section 91**		Nil
[Since agricultural income is exempt in Country M, there is no doubly taxed income. Hence, no deduction under section 91 is allowable]		

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Less: Deduction u/s 90 **(See Working Note below)**		74,100
Tax payable		**1,53,348**
Tax payable (Rounded off)		**1,53,350**

Working Note: Calculation of deduction under section 90

Particulars	₹
Average rate of tax in India [i.e., ₹ 2,27,448 / ₹ 13,54,000 x 100]	16.798%
Tax payable in India on interest from Country Y [₹ 7,60,000 x 16.798%]	1,27,665
Tax paid in Country Y [US $ 950 x 78, being conversion rate as on 31.1.2022 i.e., the last day of the month immediately preceding the month in which tax has been deducted – Rule 128]	74,100
Deduction u/s 90 [being the lower of tax paid on interest income in Country Y and tax payable in India]	**74,100**

Note – *Interest from Country Y represents interest other than interest on securities, in the absence of specific information that the same represents interest on securities. Accordingly, the same has been converted applying the TTBR as on 31.3.2022, being the last day of the P.Y.2021-22. If it is specifically assumed that the same represents interest on securities, then, the TTBR as on 31.3.2021, being the last date of the month immediately preceding the month in which interest became due (April, 2021) has to be considered.*

Question 4

(a) In respect of the following independent case scenarios, you are required to discuss the provisions related to tax deducted at source for the year ended 31st March, 2022:

(i) Tam Electronics Ltd., an Indian company, imports certain computer software from Jam Electronics Inc., a non-resident company based in USA for reselling it to the end users in India. During the F.Y. 2021-22, Tam Electronics Ltd. paid a sum of ₹ 85 crores to Jam Electronics Inc.

(ii) DEHP Ltd., a public sector bank in India, paid ₹ 20 crores to M/s NFGS Ltd., an organisation that provides ATM networks to the banks as commission for facilitating ATM credit/debit cards. NGFS Ltd. also facilitates online convenience banking. It links together the country's ATM in a single network.

(iii) Mr. A received an order from PQR Ltd. to stich T-shirts. To complete such order, he purchased cloth of ₹ 35 lakhs from Fashion Ltd. on 24th May 2021. He stitched T-shirts as per given specifications and supplied to PQR Ltd. He raised a consolidated invoice in the following manner:

Sale of 8000 T-shirts @ ₹ 500 each = ₹ 40,00,000

Fashion Ltd. is closely related to PQR Ltd. as specified under section 40A(2)(b).

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(iv) Mr. David, a Canadian citizen and a non-resident sportsman, received the following sums during the F.Y. 2021-22 from India:

(i) Income from participation in matches ₹ 4,58,000

(ii) Honorarium from writing an article related to sports for a sports magazine ₹ 1,25,000. ***(4 x 2 = 8 Marks)***

(b) MNO Ltd., Mumbai, is engaged in providing IT and communication services. It is a subsidiary company of MNO Inc., USA. During the previous year 2021-22, MNO Ltd. has provided such services to MNO Inc. and similar type of services were also provided to HTY Ltd., Hong Kong. Billing details and other information are given below:

(i) Billing per month to MNO Inc.: USD 85,000

(ii) Billing per month to HTY Ltd.: USD 92,000

(iii) MNO Inc. has given a loan of USD 1,20,000 to MNO Ltd. to purchase hardware for execution of its project. Rate of interest is 4%p.a.

(iv) Direct and indirect cost incurred are USD 120 and USD 210 per hour respectively.

(v) MNO Ltd. works 9 hours per day for 18 days to execute the projects for MNO Inc. and 8 hours per day for 18 days to execute projects for HTY Ltd. MNO Ltd. has provided such services throughout the year to both the customers.

(vi) Warranty was provided to HTY Ltd. for a period of 2 years. Cost of warranty is calculated at the rate of 1.5% of direct cost incurred. The cost of warranty is neither included in the direct nor indirect cost.

Assume all the cost and billing are even throughout the year.

Compute Arm's Length Price as per the cost-plus method and the amount to be added, if any, to the income of MNO Ltd. Assume conversion rate 1 USD = ₹ 75. ***(6 Marks)***

Answer

(a) (i) For the payment in question, since the payment has been made to a non-resident, applicability of TDS will have to be considered as per the provisions of section 195. The obligation to deduct tax at source u/s 195 arises only in respect of any sum chargeable to tax in India.

As per *Explanation 4* to section 9(1)(vi) of the Income-tax Act, 1961, "royalty" includes transfer of all or any right for use or right to use a computer software. Hence, royalty payable by a resident in India to a non-resident company based in USA for the purposes of importing computer software for reselling to end users in India would be deemed to accrue or arise in India in the hands of the non-resident company, and hence, would be chargeable to tax in India in its hands. There being income chargeable to tax in India, TEL is required to deduct tax at source under section 195 at the rates in force as per the provisions of the Income-tax Act, 1961.

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However, as per India-USA DTAA, since Tam Electronics Ltd. (TEL) resells the computer software purchased from Jam Electronics Inc. to resident Indian end-users without modification, the amount paid by Tam Electronics Ltd. to Jam Electronics Inc. for purchase of computer software is not royalty, due to absence of provision akin to *Explanation 4* to section 9(1)(vi) in the DTAA including such payment within the definition of royalty. It was so held by the Supreme Court in *Engineering Analysis Centre of Excellence P. Ltd v. CIT and Another (2021) ITR 471*.

As per section 90(2), where India has entered into a DTAA with a country outside India, the provisions of the Income-tax Act, 1961 will apply only to the extent they are more beneficial to the assessee. In this case, since the DTAA provisions are more beneficial to TEL, the same will prevail over the provisions of the Income-tax Act, 1961. Accordingly, there being no income chargeable to tax in India, TEL is not required to deduct tax at source.

(ii) The relationship between the DEHP Ltd., a public sector bank, and M/s NFGS Ltd., is not of an agency but that of two independent parties on principal-to-principal basis. Therefore, TDS provisions under section 194H would not be attracted on commission payment made by DEHP Ltd., a public sector bank to M/s NFGS Ltd. for ATM network services provided by it. It was so held in *CIT and another vs. Corporation Bank (2021) 431 ITR 554 (Kar).*

Also, section 194J will not apply is case of provision of ATM network services. since the same takes place without manual or human intervention.

(iii) Tax is required to be deducted under section 194C by PQR Ltd. on payment for stitching of T-shirts to Mr. A,

- since the supply of t-shirts is as per the specification of PQR Ltd. and the cloth is purchased from Fashion Ltd., which is an associate of PQR Ltd, specified under section 40A(2), and
- Since a consolidated invoice has been raised, tax would be deducted on the entire amount, including the cost of purchases.

Tax rate would be deducted@1% under section 194C since the contractor is an individual. Therefore, tax to be deducted = ₹ 40,00,000 x 1% = ₹ 40,000.

(iv) Tax is to be deducted under section 194E at 20% on amount payable to a non-resident sportsman who is not a citizen of India for participation in matches and honorarium for writing an article related to sport for a sports magazine.

Further, since Mr. David, a Canadian citizen, is a non-resident, health and education cess@4% on TDS should also be added. Thus the effective TDS rate will be 20.8%

Tax to be deducted = (₹ 4,58,000 + ₹ 1,25,000) x 20.80% = ₹ 95,264 + ₹ 26,000 = ₹ 1,21,264.

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(b) Computation of Arm's Length Price as per Cost Plus Method

Determination of Gross Margin of Comparable Uncontrolled transaction i.e., of HTY Ltd.

Particulars	HTY Ltd. (USD)
Direct Cost (USD 120 x 8 hours x 18 days)	17,280
Indirect Cost (USD 210 x 8 hours x 18 days)	30,240
Total Direct and Indirect cost	**47,520**
Billing per month	92,000
Gross Margin being gross profit	**44,480**
Gross Margin to cost (%) [44,480 x 100/47,520]	**93.60%**
Adjustment for functional difference on account of cost of warranty	
Total Direct and Indirect Cost	47,520.00
Add: Cost of warranty [1.5% of direct cost of USD 17,280]	259.20
Total Cost	**47,779.20**
Billing per month	92,000.00
Margin after cost of warranty being profit margin [92,000 – 47,779.20]	**44,220.80**
Profit margin to cost (%) [after considering functional difference on account of cost of warranty [44,220.80 x 100/47,779.20]	**92.55%**

Computation of Arm's Length Price by applying Cost Plus Method

	MNO Inc (USD)
Direct Cost (USD 120 x 9 hours x 18 days)	19,440.00
Indirect Cost (USD 210 x 9 hours x 18 days)	34,020.00
Total Direct and Indirect cost	53,460.00
Add: **Interest on loan of USD** 1,20,000 borrowed for purchase of hardware [USD 4,800 (i.e., USD 1,20,000@4%) / 12]	400.00
Total Cost	53,860.00
Profit margin by applying the margin of 92.55% of total cost of USD 53,860	49,847.43
Arm's length price of billing per month	**1,03,707.43**
Arm's length price (in ₹) [USD 1,03,707.43 x 75]	77,78,057
Actual Billing per month [USD 85,000 x ₹ 75]	63,75,000
Income to be added to the total income of MNO Ltd. [77,78,057 – 63,75,000] = 14,03,057 x 12 =	1,68,36,684

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Question 5

(a) Answer any two out of the following three sub-parts, viz. (i), (ii) and (iii).

Your answer should cover

(a) Issue involved

(b) Provision applicable

(c) Analysis

(d) Conclusion

(i) During the scrutiny assessment of Refresh Me Ltd., a company engaged in manufacture and distribution of packaged juices, the Assessing Officer (AO) increased the income and thus, passed an order of demand. Aggrieved by the order, the assessee filed an appeal to CIT(A), who confirmed the order of A.O. Assessee further appealed to ITAT and requested ITAT for the stay of collection of tax, which the Honourable ITAT provided initially for 180 days which was further extended till 365 days as provided in section 254(2A) of the Act. The ITAT did not dispose off the appeal before the time extended for collection of tax. The revenue served an order of demand citing the reason that the order of stay automatically gets vacated post the expiry of 365 days. The assessee seeks your opinion as to whether the contention of the revenue is justified.

(ii) On 31.12.2021, a search under section 132 of the Income-tax Act was conducted in the business and residential premises of Mr. Rajshekaran and some gold bars were seized from the locker. Mr. Rajshekaran voluntarily disclosed ₹ 12.50 crores of income during the course of search. Later on, he filed an application for sale of the gold bars worth 5 kgs for adjustment "towards the automatic tax liability", even before the completion of the assessment by the AO. However, AO rejected the application and observed that such action can be taken only after. the assessment is completed and a demand has been quantified.

Is the AO justified in rejecting the application?

(iii) On 31.3.2021, Pastro Ltd. (the assessee) had an outstanding interest liability of ₹ 2 crores towards loan payable to financial institutions. It issued debentures to the financial institutions in lieu of the outstanding interest on 1.5.2021 and deducted the same from the taxable income as payment thereof. The Assessing Officer, however, rejected the deduction claimed by the assessee, by invoking Explanation 3C of section 43B of the Income-tax Act. You are required to discuss the validity of the Assessing Officer's claim. ***(4 x 2 = 8 Marks)***

(b) (i) Explain the correctness or otherwise of the following statements giving proper reasons thereof:

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(A) Mr. Rikky, a resident individual, is aggrieved by an order passed by the Board for Advance Ruling on 1.10.2021. Since the decision of the Board is binding on the applicant, he has no other option but to accept the ruling of the Board.

(B) M/s Aritri Ltd., an Indian public sector company, wants to seek advance ruling from the Board for Advance Ruling (BOAR) in respect of a matter relating to computation of its total income involving a question of law relating to such computation. However, the matter is already pending before the Income-tax Appellate Tribunal (ITAT) as on the date of application for advance ruling i.e., 12.12.2021. It cannot seek the BOAR ruling till the matter is pending before the ITAT. ***(3 Marks)***

(ii) M/s Boggle LLC., an entity resident in the USA, owns and operates an online shopping app, Flipzone. On this platform, it facilitates the sale of various kinds of goods owned by different entities. M/s Boggle LLC does not have a permanent establishment in India. During the F.Y. 2021-22, it gives you the following details:

Particulars	***Amount In ₹***
Receipts from sale of good to persons resident in India using internet from India	*1,96,00,000*
Sale proceeds received from persons resident in India, while visiting some other neighboring countries.	*7,00,000*

You are required to discuss the tax implications of these transactions in respect of M/s Boggle LLC. ***(3 Marks)***

Answer

(a) (i) **Issue Involved:** The issue under consideration is whether the stay order can be automatically vacated upon expiry of extended period of stay of 365 days, where the delay in disposing of the appeal is not attributable to the assessee.

Provision Applicable: The third proviso to section 254(2A) provides that where the appeal filed before the Appellate Tribunal is not disposed of within the period of stay or extended period of stay granted by the Tribunal, the order of stay shall stand vacated after the expiry of 365 days, even if the delay in disposing of the appeal is not attributable to the assessee.

Analysis: This provision would result in the automatic vacation of a stay upon the expiry of 365 days, even if the Appellate Tribunal could not take up the appeal in time for no fault of the assessee. Thus, the vacation of stay in favour of the Department would ensue even if the Department is itself responsible for the delay in hearing the appeal. This will cause undue hardship to the assessee, even where he is not at fault. In this sense, the provision is arbitrary and disproportionate so far as the assessee is concerned.

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Conclusion: The contention of the revenue is **not** justified. Any order of stay shall stand vacated after the expiry of the period or periods mentioned in the section, only if the delay in disposing of the appeal is attributable to the assessee.

Note – *The facts given in the question are similar to the facts in DCIT v. Pepsi Foods Ltd (2021) 433 ITR 295, wherein the above issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court ruling in that case.*

(ii) **Issue Involved:** The issue involved in this case is whether Mr. Rajshekaran's application, for adjustment of tax liability on income surrendered during search by sale of seized gold bars, can be entertained where assessment has not been completed.

Provision applicable: The provision contained in section 132B(1) lays down the manner in which the assets seized under section 132 may be dealt with. An assessee is entitled to make an application to the Assessing Officer for adjustment of seized assets towards existing tax liability.

Analysis: Here, the application by the assessee is not for adjustment of any existing liability, but "towards the automatic tax liability". In the said provision, the expression used is "the amount of the liability determined". "A liability is determined" only on completion of the assessment. Until the assessment is complete, it cannot be postulated that a liability has been crystallized.

Conclusion: Accordingly, the action of the Assessing Officer rejecting the application on the ground that such action can be taken only after the assessment is completed and a demand has been quantified, is justified.

Note - *The facts given in the question are similar to the facts in Hemant Kumar Sindhi & Another v. CIT (2014) 364 ITR 555 wherein the issue came up before the Allahabad High Court. The above answer is based on the rationale of the Allahabad High Court in the said case.*

(iii) **Issue Involved:** The issue under consideration is whether issue of debentures in lieu of outstanding interest payable to Financial Institution can be treated as "actual payment" as contemplated under section 43B for allowability as deduction while computing business income.

Provision Applicable: *Explanation 3C* to section 43B clarifies that interest that remained unpaid and converted into a loan or borrowing shall not be deemed to have been actually paid. Hence, such interest would not be deductible while computing profits and gains of business or profession.

Analysis: Interest to bank can be claimed as deduction only when the same if actually paid within the stipulated time. Where it is paid in any subsequent period, it can be claimed in the year of actual payment.

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Explanation 3C to section 43B was enacted to plug the loophole and to overcome the argument of the taxpayer that conversion of outstanding interest into loan would tantamount to actual payment and thus claim deduction under section 43B.

The issue of debentures by the assessee was to extinguish the liability of bank interest altogether. The interest was "actually paid" by the assessee by issuance of debentures, which extinguished its liability to pay interest.

Conclusion: *Explanation 3C* to section 43B, which was meant to plug a loophole, could not be invoked in this case, where debentures were issued in lieu of interest. The interest is, therefore, deductible. The Assessing Officer's claim rejecting the deduction claimed by the assessee is **not** valid.

Note - *The facts given in the question are similar to the facts in M.M. Aqua Technologies Ltd. v. CIT (2021) 436 ITR 582, wherein the issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court in the said case.*

It may be noted that this position has undergone a change subsequently consequent to amendment of Explanation 3C to section 43B by the Finance Act, 2022 to provide that conversion of interest into debentures or any other instrument, by which liability to pay is deferred to a future date, would not be deemed as actual payment.

(b) (i) (A) The statement is **not** correct.

The binding provision will not apply to an advance ruling pronounced on or after 1.9.2021 by the Board of Advance Ruling. Therefore, the order passed by the Board for Advance Ruling on 1.10.2021 is not binding on Mr. Rikky.

He may appeal to the High Court against such order within sixty days from the date of the communication of that order.

(B) The statement is **not** correct.

A resident falling within any class or category of persons as notified by the Central Government i.e., a public sector undertaking can seek advance ruling even if question raised is pending before the Appellate Tribunal.

(ii) M/s. Boggle LLC is an e-commerce operator since it is a non-resident owning and operating an online shopping app for facilitating sale of goods. Equalisation levy is attracted since it does not have a permanent establishment in India. Equalisation levy@2% is leviable on the amount of consideration received or receivable by M/s. Boggle LLC from online sale of goods facilitated by it to persons resident in India, since the aggregate consideration from such sale exceeds ₹ 2 crore in the F.Y.2021-22.

	Particulars	Amount in ₹
(a)	Receipts from sale of goods to persons resident in India using internet from India	196 lakhs

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(b)	Receipts from persons resident in India, even if it is while visiting neighbouring countries	7 lakhs
Amount of consideration		**203 lakhs**

Equalisation levy = 2% of ₹ 203 lakhs = ₹ 4.06 lakhs.

Question 6

(a) In the following independent circumstances, discuss whether the provisions of GAAR would be applicable:

(i) Milo Ltd., an Indian company, is making losses for the past several years. Tilo Ltd., another Indian company, having huge profits acquired Ms. Milo Ltd.

(ii) DAMP Inc., a company incorporated in Country A, holds 1000 equity shares in MAP Ltd., an Indian listed entity since 1.4.2016. On 1.5.2021, MAP Ltd. issued 1000 bonus shares to DAMP Inc. As per the treaty between India and Country A, the capital gain is taxable in the country where the transferor of shares is a resident. The tax laws of Country A, exempt capital gains. DAMP Inc. sells all the shareholding in MAP Ltd. on 1.1.2022 and earned a capital gain of ₹ 5 crores.

(iii) A Ltd., an Indian company, incorporates a wholly owned subsidiary Company B, in Country B which is a Low Tax Jurisdiction with equity share capital of ₹ 1 crore. Out of the equity capital, company B gives loan to C Ltd., an Indian company at the rate of 5%. There is no other activity in Company B.

(iv) Bee Ltd., an Indian company sets up a unit in SEZ in FY 2018-19 for manufacturing of chemicals. It claims 100% deduction of profits of ₹ 100 crores earned from that unit in FY 2021-22, u/s 10AA of the Act. ***(4 Marks)***

(b) The jurisdictional Assessing Officer of Mr. Albert, a non-resident, wants to treat the following persons as his agent in India for AY 2022-23 as per the provisions of section 163 of the Income-tax Act, 1961. You are required to discuss the validity of the Assessing Officer's claims.

(i) Mr. Albert owned a residential house in Goa, India. During the financial year 2021-22, he sold the house to Mr. D'Souza, another non-resident. AO wants to treat Mr. D'Souza as an agent of Mr. Albert.

(ii) Mr. Albert employed Mr. Rakesh, a resident of India, to work for him on 1.4.2020. Mr. Rakesh left India to be employed by Mr. Albert on 1.4.2021. ***(4 Marks)***

(c) Explain the action plan for taxation of income arising from intellectual property rights in India on the basis of OECD recommendations for BEPS action plan-5. ***(2 Marks)***

(d) Significant economic presence of a non-resident in India shall also constitute business connection in India. Explain. ***(2 Marks)***

(e) What is Static approach and Ambulatory approach in interpreting tax treaties? ***(2 Marks)***

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Answer

(a) Applicability of GAAR

(i) In the present case, Tilo Ltd. having huge profits acquired Milo Ltd. a loss-making company. Due to provisions relating to merger and acquisition in the Act and considering that the scheme would have been sanctioned by the High Court/National Company Law Tribunal considering tax implications, GAAR need not be invoked.

(ii) In case of investment made prior to 1.4.2017, income arising from transfer thereof would not be subject to GAAR. Accordingly, income from transfer of shares acquired on 1.4.2016 by DAMP Inc. would not attract GAAR.

If the original shares are acquired before 1.4.2017, but bonus shares are issued after that date, GAAR provisions would not be attracted on transfer of such bonus shares also.

(iii) An impermissible avoidance arrangement means an arrangement, the main purpose or one of the main purposes of which is to obtain a tax benefit and also, *inter alia*, lacks commercial substance or is deemed to lack commercial substance. An arrangement is deemed to lack commercial substance if it involves*, inter alia,* round tripping of funds.

In this case, the arrangement of routing money through wholly owned subsidiary Company B in Country B, a low tax jurisdiction, to an Indian company (C Ltd.) involves round tripping of funds even though funds emanating from A Ltd. are not traced back to A Ltd. The alternate course available in this case is direct advance to C Ltd. an Indian company, in which case the interest income would have been chargeable to tax in the hands of A Ltd.

Therefore, the agreement is deemed to lack commercial substance as it involves round tripping of funds. Also, its main purpose is to obtain tax benefit and there is no other activity in Company B.

However, if the tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does not exceed ₹ 3 crore, then, GAAR provisions would not be invoked.

(iv) Bee Ltd. set up a SEZ unit and claiming 100% deduction under section 10AA resulting in tax benefit. However, setting up of SEZ is for the purpose of taking benefit of a fiscal incentive offered for promoting SEZs. In such a case, GAAR provisions would **not** be applicable.

(b) As per section 163, an agent, in relation to a non-resident person, *inter alia* includes

- any person in India who is employed by or on behalf of the non-resident or
- any person (whether resident or non-resident) who has acquired a capital asset in

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India by means of a transfer from the non-resident.

(i) Since Mr. D'Souza acquired residential house in Goa from Mr. Albert, the jurisdictional Assessing Officer can treat Mr. D'Souza as an agent of Mr. Albert even though Mr. D'Souza is a non-resident.

(ii) Mr. Rakesh was employed by Mr. Albert on 1.4.2020. He left India on 1.4.2021 to be employed by Mr. Albert. Since he is not in India during the P.Y. 2021-22, the jurisdictional Assessing Officer cannot treat him as an agent of Mr. Albert for the P.Y. 2021-22.

(c) Approach recommended by the OECD under BEPS Action Plan 5

The nexus approach has been recommended by the OECD under BEPS Action Plan 5 Counter Harmful Tax Practices. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership.

Accordingly, section 115BBF has been inserted in the Income-tax Act, 1961 line with BEPS Action Plan 5 to provide that where the total income of the eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess).

For this purpose**,** "developed" means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act.

(d) Significant economic presence of a non-resident in India shall also constitute business connection in India. Significant economic presence means

– Transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, if aggregate of payments arising from such transaction or transactions during the previous year exceed ₹ 2 crores; or

– systematic and continuous soliciting of business activities or engaging in interaction with atleast 3 lakhs users in India.

(e) Static Approach – under static approach, a term not defined in the treaty to be assigned the meaning which prevailed on the date of signing the tax treaty.

Ambulatory Approach – under Ambulatory approach, a term not defined in the treaty to be assigned the meaning which is prevailing on the date of application of the tax treaty.

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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 and by the amendments made by the Finance Act, 2021 which have become effective, till 30.04.2022 and (ii) Customs law as amended by the Finance Act, 2021 and significant notifications/circulars and other legislative amendments made upto 30.04.2022.

Question 1

The details of transactions of J Ltd., Vadodara (Gujarat), a registered taxable person, during the month of February, 2022, are as under:

S. No.	Particulars
1.	Purchased goods from a manufacturer in Maharashtra as a merchant exporter (on payment of 0.1% IGST) and exported the same directly to an importer of Spain under LUT. FOB value is ₹7,00,000. Invoice for the supply to J Ltd. was received on 5/2/22 and payment was made on 8/2/22.
2.	Imported goods from China with CIF value of ₹5,00,000. The goods were sold for ₹5,10,000 as high sea sales to an Indian party on 21/2/22.
3.	Purchased goods from a party in Taiwan. Sold the goods to a party in Turkey without bringing the goods to India. Purchase value was ₹5,00,000 and the sale price was ₹7,00,000. J Ltd paid sales commission of ₹50,000 to Mrs. T, their agent in connection with this transaction. The transaction was completed in the third week of February. (The figures in rupees have been given after conversion though transaction was in convertible foreign currency).
4.	J Ltd. has agreed to provide technical services to Mr. K of Ahmedabad who is an unregistered person in connection with the manufacturing operations to be undertaken by him for a consideration of ₹5,00,000 and has received an advance of ₹1,00,000 for the same on 2/2/22.
5.	It has imported raw materials from China. CIF value of the goods for the purpose of Customs included ₹1,00,000 as ocean freight paid by J Ltd. The value for the purpose of levy of IGST worked out by Customs was ₹6,00,000. Clearance of the goods took place on 4/2/22.
6.	Locally purchased taxable raw material stored in the factory got spoiled due to rainwater in the factory and became unusable. J Ltd. claimed and received on insurance amount of ₹60,000 for the same. Value of the raw material at the time of

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	receipt was ₹ 70,000. Raw material was purchased from a party in Gujarat on 3/2/22 and payment was made on 7/2/22.
7.	*Company purchased a three-wheeler having capacity of 2 persons including driver (engine capacity 20CC) at a cost of ₹ 2,50,000 which is being used for transportation of staff of company from residence to factory and back. The vehicle was received on 5/2/22 and payment was made on the same date.*
8.	*It has paid inward transportation expense of ₹ 30,000 to Mr. Z, a tempo owner who has not issued any consignment notes. He has issued a consolidated bill only on 3/2/22 and payment was made on 4/2/22.*
9.	*It has supplied goods of value of ₹ 50,00,000 to V Ltd. Padra, Gujarat (includes ₹ 10,00,000 supplied to SEZ unit of V Ltd).*
10.	*It has purchased goods from X Impex Ltd. Kadi, Gujarat for use as raw materials in its factory. The value of the goods ₹ 30,00,000. Invoice is dated 2/2/2022.*
11.	*It has availed supply of manpower security services from Y Ltd. Vadodara, Gujarat, a registered taxable person. The amount paid is ₹ 1,00,000. The invoice was received on 1/2/2022 and payment was made on the same day.*

Assume the CGST and SGST rates to be 9% each and IGST rate to be 18% except the supply received as a merchant exporter. Ignore compensation cess. J Ltd. had an opening balance of ITC of CGST of ₹ 20,000 and SGST of ₹ 20,000 as on 1/2/2022. In respect of all the inward supplies, suppliers have uploaded their invoices in respective Form GSTR-1 and the supplies are reflected in GSTR-2A/2B. All the figures given above are exclusive of GST, wherever applicable.

Work out the admissible ITC and GST liability [CGST, SGST or IGST, as the case may be] payable in cash, by J Ltd, Vadodara (Gujarat), for February, 2022.

Ensure that all the items in the table are covered in your answer. Provide supporting explanatory notes for your conclusion wherever required. ***(14 Marks)***

Answer

I. Computation of admissible ITC for February, 2022				
Particulars	**Value (₹)**	**CGST (₹)**	**SGST (₹)**	**IGST (₹)**
Opening balance		20,000	20,000	
Goods purchased as merchant exporter [Merchant exporter is eligible to take ITC of IGST paid @ 0.1%.[1]]	7,00,000	--	--	700

[1] In the absence of the value of supply of goods purchased as a merchant exporter, FOB value of export of such goods has been taken as their purchase price for computing the ITC amount.

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Goods imported from China [No ITC since tax is not payable. In case of high sea sales, IGST is paid by the last high sea sales buyer who files the bill of entry for home consumption.]	Nil	--	--	--
Goods purchased from Taiwan [No ITC since tax is not payable as goods do not become part of the landmass of the country.]	Nil	--	--	--
Sales commission paid to agent - Mrs. T[2] [Since service provider - Mrs. T is an intermediary in the given transaction, place of supply is location of Mrs. T, i.e. outside India. Thus, tax is not payable under reverse charge on said services.]	50,000	--	--	--
Imported raw material from China [Input tax, *inter alia,* includes IGST charged on import of goods.[3]]	6,00,000			1,08,000 [6,00,000 × 18%]
Raw material spoiled[4] [ITC is blocked under section 17(5) on destroyed goods.]	--	--	--	--
Three-wheeler purchased[5] [ITC on a three-wheeler with engine capacity of 20cc is allowed as it is not a motor vehicle and is used in course or furtherance of business[6].]	2,50,000	22,500 [2,50,000 × 9%]	22,500 [2,50,000 × 9%]	--

[2] Since the transaction was undertaken in convertible foreign exchange, it is logical to infer that Mrs. T is located outside India.

[3] It has been assumed that the contract for import of goods from China is on CIF basis.

[4] Insurance amount received is an actionable claim. Thus, it is treated neither as supply of goods nor as supply of services.

[5] It has been assumed that purchase of three-wheeler is an intra-State supply. Alternatively, it is also possible to assume that purchase of three-wheeler is an inter-State supply. In that case, IGST of ₹ 45,000 will be available as ITC.

[6] It has been assumed that the depreciation has not been claimed on GST paid on said capital goods, under the Income-tax Act, 1961.

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Inward transportation from Mr. Z [Services of transportation of goods without issue of consignment note is not covered under services of GTA and hence exempt. Thus, no ITC is available.]	--	--	--	--
Raw material purchased from X Impex Ltd., Gujarat [ITC on goods used in course or furtherance of business is allowed.]	30,00,000	2,70,000 [30,00,000 × 9%]	2,70,000 [30,00,000 × 9%]	
Manpower security services from Y Ltd. [Since security services are provided by a body corporate, tax on the same is not payable under reverse charge.]	1,00,000	9,000 [1,00,000 × 9%]	9,000 [1,00,000 × 9%]	
Total ITC available		3,21,500	3,21,500	1,08,700
II. Computation of GST liability payable in cash, by J Ltd.				
GST payable on outward supplies				
Export of goods to Spain under LUT [No IGST is payable.]	7,00,000			Nil
High sea sales of goods imported from China [Neither treated as supply for goods nor as supply of services.]	Nil	--	--	--
Goods purchased from Taiwan sold in Turkey without bringing into India [Neither treated as supply for goods nor as supply of services.]	Nil	--	--	--
Advance received for the technical services to be provided to Mr. K [Tax on the services to be provided is payable at the time of receipt of advance.]	1,00,000	9,000 [1,00,000 × 9%]	9,000 [1,00,000 × 9%]	

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Goods supplied to SEZ unit of V Ltd. [Supply to SEZ unit is a zero-rated supply[7].]	10,00,000			Nil
Supply of goods to V Ltd., Gujarat	40,00,000	3,60,000 [40,00,000 × 9%]	3,60,000 [40,00,000 × 9%]	
Total output tax		**3,69,000**	**3,69,000**	**Nil**
Less: ITC* [Credit of IGST can be utilized towards payment of CGST and SGST liability in any order and in any proportion. Credit of CGST and SGST can be utilized only after IGST credit has been fully utilized. Thereafter, credit of CGST and SGST is utilised for payment of CGST and SGST liability respectively. CGST credit cannot be utilized for payment of SGST and *vice versa*.]		54,350 (IGST)	54,350 (IGST)	
		3,14,650 (CGST)		
			3,14,650 (SGST)	
Net GST payable		Nil	Nil	Nil
***Add:* GST payable on inward supplies**				
Imported raw material from China	6,00,000			1,08,000 [6,00,000 × 18%]
Total net GST payable in cash		**Nil**	**Nil**	**1,08,000**

***Note:** ITC of IGST can be utilised towards payment of CGST and SGST in any proportion and in any order. Therefore, there can be multiple ways of setting off of IGST credit against CGST and SGST. However, total amount of net GST payable in cash will be same in each case.*

Question 2

(a) RAM Company Ltd., a registered supplier of Prayagraj (Uttar Pradesh), is a manufacturer of goods. The company provides the following information pertaining to GST paid on inward supplies during the month of April (current financial year):

[7] It has been assumed that goods have been supplied to SEZ without payment of tax.

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Serial No.	*Items*	*GST paid in (₹)*
(i)	*Life insurance premium paid by the company for the life insurance cover of factory employees as per the policy of the company. There is no legal obligation to provide insurance cover for employees.*	*1,50,000*
(ii)	*In the month of September of previous financial year, RAM Company Ltd. availed ITC of ₹ 2,40,000 on purchase of raw material which was directly sent to job worker's premises under a challan on 25th September (previous financial year). The said raw material has not been received back from the job worker upto 30th April (current financial year).*	
(iii)	*Raw materials purchased which are used for exempted goods supplied as zero-rated supply.*	*50,000*
(iv)	*Works contractor's service used for repair of factory building which is debited in the profit and loss account of company.*	*30,000*
(v)	*Company purchased the capital goods for ₹ 4,00,000 and claimed depreciation of ₹ 44,800 (@ 10%).*	*48,000*
(vi)	*Raw materials purchased from Neha Traders (Invoice of Neha Traders is received in the month of April but goods were received in month of June)*	*20,000*
(vii)	*Car purchased for making further supply of such car. Such car is destroyed in accident while being used for test drive by potential customers.*	*30,000*
(viii)	*Goods used for setting up tele-communication towers*	*50,000*

Other information:

All the above inward supplies except at S.No.(iii) above have been used in the manufacture of taxable goods.

Compute the amount of net ITC available to RAM Company Ltd. for the month of April with necessary explanations for the treatment of all the items in the table as per the provisions of the CGST Act. Subject to the information given above, assume that all the other conditions necessary for availing ITC have been fulfilled. ***(9 Marks)***

(b) Mr. X, a chemical manufacturer, imports a machine from Germany on 12th January, 2019 for ₹ 20 lakh. Mr. X is eligible for concessional rate of customs duty on capital goods imported by him subject to the condition that he follows the Customs (Import of Goods at Concessional Rate of Duty) Rules, 2017. Machinery was put to use on 1st February, 2019. On 5th April, 2022, Mr. X wants to clear the machine for home consumption after having used the machine for the specified purpose for which it was imported. Mr. X requires your

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help in calculating the customs duty he will be liable to pay for such clearance as per rule 7 of the Customs (Import of Goods at Concessional Rate of Duty) Rules, 2017. Concessional rate of basic customs duty is 5%. Normal rate of basic customs duty is 20%. Calculate the basic customs duty payable by Mr. X on clearance of such capital goods for home consumption on 5th April, 2022. Ignore interest calculation. ***(5 Marks)***

Answer

(a) Computation of ITC available to RAM Company Ltd. for the month of April

S. No.	Particulars	ITC (₹)
(i)	Life insurance premium paid by the company for factory employees [ITC is blocked under section 17(5) since it is not obligatory for the employer to provide life insurance service to its employees under any law.]	Nil
(ii)	Raw material sent to job worker [ITC taken in the month of September last year is valid since. Further, since 1 year period from of the date of receipt of inputs by the job worker has yet not lapsed in April, there will be no tax liability on such inputs.]	Nil
(iii)	Raw materials used for zero rated supply [ITC can be availed for making zero-rated supplies, notwithstanding that such supply may be an exempt supply]	50,000
(iv)	Work contractor's service [ITC on works contract services supplied for construction of an immovable property is blocked. Repairs of building debited to P & L Account does not amount to 'construction' and it is not blocked under section 17(5), hence ITC is available]	30,000
(v)	Capital goods purchased in respect of which depreciation is claimed[8] on the tax component [ITC is not available when depreciation has been claimed on the tax component of the cost of capital goods under the Income-tax Act.]	Nil
(vi)	Goods purchased from Neha Traders [ITC is available assuming that that invoice is received in the month of April in the current financial year, but goods were received in the	20,000

[8] under the Income-tax Act, 1961

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	month of June in the preceding financial year.[9]]	
(vii)	Cars purchased for making further supply [Though ITC on motor vehicles used for further supply of such vehicles is not blocked, ITC on goods destroyed is blocked under section 17(5)]	Nil
(viii)	Goods used for setting telecommunication towers [ITC on goods used by a taxable person for construction of immovable property (other than plant and machinery) on his own account is blocked. Since plant & machinery excludes telecommunication tower, ITC is blocked under section 17(5). Further, such goods are not used in course or furtherance of business.]	Nil
	Total ITC available	**1,00,000**

(b) Computation of basic customs duty payable by Mr. X

An importer who has imported the capital goods availing benefit of an exemption notification, may clear such goods after using them for specified purpose, on payment of duty equal to difference between the duty leviable on such goods without exemption and duty already paid at the time of importation, along with interest, on the depreciated value allowed in straight line method, as below:

(i) for every quarter in the first year @ 4%;

(ii) for every quarter in the second year @3%;

(iii) for every quarter in the third year @ 3%;

(iv) for every quarter in the fourth and fifth year @ 2.5%;

(v) and thereafter for every quarter @ 2%.

Thus, depreciation % will be computed as follows:

2019 : 4 quarter x 4= 16%

2020 : 4 quarter x 3= 12%

2021 : 4 quarter x 3= 12%

2022 : 2 quarter x 2.5= 5%

Total depreciation % will be 45%

[9] It is also possible to assume that that invoice is received in the month of April in the current financial year, but goods are received in the month of June of the same financial year. In that case, the ITC with respect to said goods will be available in the month of June when goods will be received, and no ITC is available in April.

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Depreciation amount will be : 45% of ₹ 20 Lakh = ₹ 9 lakh

Depreciated value of the machine is

₹ 20 Lakh – ₹ 9 lakh = ₹ 11 lakh

Accordingly, basic customs duty payable by Mr. X will be computed as follows:

= [₹ 11 lakh × 20%] - [₹ 20 lakh × 5%]

= ₹ [2.20-1.00] lakh

= ₹ 1.20 lakh

Question 3

(a) Determine the place of supply for the following independent cases:

I. Festival Event, an event management company at Mumbai, organises two business promotion events for Prabhu Enterprises (registered in Ahmedabad, Gujarat) at New Delhi and in Malaysia.

II. Global Planners (Jodhpur, Rajasthan) is hired by Mr. John (unregistered person based in Kochi, Kerala) to plan and organize his son's wedding at Mumbai, Maharashtra. Will your answer be different if the wedding is to take place in Singapore? ***(5 Marks)***

(b) XYZ Consultancy, registered in Bangalore, supplies technical consultancy services to its clients. It has been providing technical services to BA Ltd., Mumbai since past two years. Consideration is settled by BA Ltd. assignment wise. BA Ltd. paid ₹ 37 lakh to XYZ Consultancy on 10th January, 2022 for XYZ Consultancy agreeing not to provide similar technical services to any other business entity in India or abroad for a period of 8 years. XYZ Consultancy is of the view that ₹ 37 lakh is not chargeable to GST.

You are required to examine whether the view taken by XYZ Consultancy is valid in law. Calculate GST liability of XYZ Consultancy, in case you feel that GST is chargeable. Round off the tax amount if due in accordance with law. The technical services provided by XYZ Consultancy is otherwise chargeable to IGST at the rate of 18% and XYZ have been discharging the GST liability on consultancy charges. It may be noted that BA Ltd. is not ready to pay any further amount to XYZ Consultancy in addition to the amount already agreed. ***(4 Marks)***

(c) KIP Chemical, Ahmedabad, Gujarat supplies goods to ACCP, Bharuch, situated in Dahez SEZ (Gujarat). Examine with reference to decided case law, whether such supply is chargeable to export duty under the provisions of Customs Act, 1962. ***(5 Marks)***

Answer

(a) (I) When service of organization of event is provided to a registered person, the place of supply is location of recipient, whether event is held in India or outside India.

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Thus, in the given case, place of supply of:

- event held at New Delhi is Ahmedabad, Gujarat, and
- event held at Malaysia is Ahmedabad, Gujarat.

(II) When service of organization of event is provided to an unregistered person, the place of supply is location where the event is held when event is held in India and place of supply is location of recipient where event is held outside India.

Thus, in the given case, place of supply:

- if wedding takes place at Maharashtra is Mumbai, Maharashtra, and
- if wedding takes place at Singapore is Kochi, Kerala.

(b) In the given case, XYZ Consultancy is providing the service of agreeing to the obligation to refrain from an act to BA Ltd. against a consideration of ₹ 37 lakh. Therefore, the same is liable to tax. Thus, view taken by XYZ Consultancy is incorrect.

Since the place of supply of said services is the location of the recipient, viz. Mumbai and supplier is located in Bangalore, said services are inter-State supplies liable to tax @ 18%[10].

GST liability (IGST) of XYZ Consultancy is:

= ₹ 37,00,000[11] × 18/118

= ₹ 5,64,407 (rounded off)

(c) Supply made by KIP Chemical, Gujarat, to ACCP situated in Dahez SEZ, Gujarat is not chargeable to export duty.

In a judicial pronouncement[12], it is held that the clearances of goods from DTA to SEZ are not chargeable to export duty on the basis of the following observations:-

- The charging section under Customs Act needs to be construed strictly.
- If a person is not expressly brought within the scope of the charging section, he cannot be taxed at all.

Customs duty can be levied only on goods imported into or exported beyond the territorial waters of India. Since both the SEZ unit and the DTA unit are located within the territorial

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[10] Rate of tax applicable on service of agreeing to the obligation to refrain from an act.

[11] Since GST has not been separately collected for the supply, consideration has been assumed to be inclusive of tax.

[12] *vide Tirupati Udyog Ltd. v. UOI 2011 (272) E.L.T. 209 (A.P.).* View taken in said case has also been confirmed in *Essar Steel v. UOI 2010 (249) ELT 3 (Guj.)* [maintained by SC] wherein the Departmental appeal has been dismissed by Supreme Court on *12.07.2010 - 2010 (255) ELT A115.*

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waters of India, supplies from DTA to SEZ would not attract charging section for customs duty. Since there is no charging provision in the SEZ Act providing for levy and collection of export duty on goods supplied by a DTA unit to a Unit in a SEZ, export duty cannot be levied on the DTA supplier.

Question 4

(a) *BSA Corporation is a Public Sector Undertaking registered in Karnataka. For entertainment events in Bengaluru and at Mumbai, BSA has given contract to Mr. A, a renowned artist, registered person in Maharashtra, to perform on contemporary Bollywood songs. BSA Corporation agreed to pay ₹12,39,000 and ₹18,29,000, inclusive of GST, for Mumbai and Bengaluru events respectively. BSA Corporation seeks your advice regarding amount of TDS to be deducted assuming GST rate @ 18% (CGST @ 9%, SGST @ 9%, IGST @l8%).*

(5 Marks)

(b) *Khurania Filling Station, having its head office in Faridabad, Haryana has given details of transactions as under in a financial year:*

Supply of petrol at Faridabad, Haryana	*14,00,000*
Value of inward supplies on which tax is payable on reverse charge basis	*11,00,000*
Supply of transformer oil at Faridabad, Haryana	*2,50,000*
Value of branch transfer from Faridabad, Haryana to Ludhiana, Punjab without payment of consideration	*3,00,000*
Value of taxable supplies at Mizoram branch	*12,40,000*

It argues that it does not have taxable turnover crossing threshold limit of ₹ 40,00,000 either at Faridabad, Haryana or Ludhiana, Punjab and including turnover at Mizoram branch. Therefore, there is no need to take registration.

Compute the aggregate turnover of Khurania Filling Station and indicate whether the firm is required to take registration. Give reasons for your conclusion. ***(4 Marks)***

(c) *Mission Life, an NGO, from Indore, M.P. has imported 800 MT of food products from Australia for free distribution to needy people in backward area of Sagar, M.P. under a Central Government scheme.*

Exporter from Australia has charged only US$ 20 per MT to cover costs towards freight, insurance etc. and none towards cost of food products. Customs Department found that at or about the same time of importation, following imports of said food products of Australian origin have been made:

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S. No	*Quantity imported in MT*	*Unit CIF price in US$*
1.	*40*	*270*
2.	*100*	*220*
3.	*500*	*200*
4.	*900*	*180*
5.	*400*	*190*
6.	*760*	*160*

Discuss the various principles to determine the transaction value of aforesaid transaction under the Customs Act, 1962 and determine the CIF price that can be considered for assessment in this case. ***(5 Marks)***

Answer

(a) A Public Sector Undertaking is required to deduct tax @ 2% (on inter-State supplies) from payment made to the supplier of taxable services where the total value of such supply, excluding tax indicated in the invoice, under a contract, exceeds ₹ 2,50,000.

Value of supplies excluding tax are

₹ 10,50,000 (₹ 12,39,000 × 100/118) and

₹ 15,50,000 (₹ 18,39,000 × 100/118)

Further, in the given case, since the location of supplier is Maharashtra and place of supply of services provided by Mr. A to BSA Corporation is the location of recipient, viz. Karnataka, said services provided at both Mumbai and Bengaluru events are inter-State supplies.

Accordingly, in the given case, BSA Corporation is required to deduct tax as follows:

(i) ₹ 10,50,000 × 2% = **₹ 21,000** (IGST)

(ii) ₹ 15,50,000 × 2% = **₹ 31,000** (IGST)

(b)

Particulars	**Amount (₹)**
Supply of petrol at Faridabad, Haryana [Supply of petrol being a non-taxable supply is an exempt supply. Value of exempt supply is includible in aggregate turnover.]	14,00,000
Value of inward supplies on which tax is payable under reverse charge [Inward supplies taxable under reverse charge are excludible.]	Nil
Supply of transformer oil at Faridabad, Haryana	2,50,000
Inter-State branch transfer without consideration	3,00,000

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[Supplies made between distinct persons is deemed supply and thus, includible.]	
Taxable supplies from Mizoram branch [Supplies made under same PAN are includible.]	12,40,000
Aggregate turnover	**31,90,000**

Enhanced threshold limit of aggregate turnover to obtain registration of ₹ 40 lakh gets reduced to ₹ 10 lakh if the supplier is also engaged in making supplies from special category State of Mizoram. In the given case, the aggregate turnover of Khurania Filling Station exceeds applicable threshold limit of ₹ 10 lakh. Further, since Khurania Filling Station is required to pay tax under reverse charge, it is liable to obtain registration compulsorily irrespective of its quantum of turnover. Moreover, since Khurania Filling Station is making inter-State branch transfer[13], it is liable to obtain registration compulsorily irrespective of its quantum of turnover.

Thus, Khurania Filling Station is liable to obtain registration in all the States from where it makes a taxable supply.

(c) While determining the transaction value of the goods, following factors need consideration:-

1. In the given case, US $20 per metric tonne has been paid only towards freight and insurance charges and no amount has been paid or payable towards the cost of goods. Thus, there is no transaction value for the subject goods. Consequently, transaction value of identical goods has to be determined.
2. Value of imported goods shall be the transaction value of identical goods sold for export to India and imported at or about the same time as the goods being valued. In the six imports given during the relevant time, the goods are identical in description and of the same country of origin.
3. Further, the comparable import should be at the same commercial level and in substantially same quantity as the goods being valued. Since nothing is known about the level of the transactions of the comparable consignments, it is assumed to be at the same commercial level.
4. As far as the quantities are concerned, the consignments of 40 and 100 metric tonnes cannot be considered to be of substantially the same quantity. Hence, remaining 4 consignments are left for consideration.
5. However, the unit prices in these 4 consignments are different. If more than one transaction value of identical goods is found, the lowest of such value shall be used to determine the value of imported goods. Accordingly, the unit price of the consignment under valuation would be US $ 160 per metric tonne.

[13] In case where it is assumed that inter-State branch transfer from Faridabad to Ludhiana is of taxable goods.

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CIF value of 800 metric tonnes is as follows:

= 800 x 160 = **US $ 1,28,000**

Question 5

(a) *Arjun has committed offence under CGST Act which can be compounded as per provisions of section 138(1) of the CGST Act, 2017. He has paid the tax amount of ₹ 10 lakh involved in the offence. He wishes to apply to Commissioner for compounding the said offence. You are required to compute minimum and maximum compounding amount as per provisions of section 138(2) of the CGST Act, 2017 payable by Arjun. What are the consequences, if Arjun pays such compounding amount as may be determined by Commissioner?* ***(5 Marks)***

(b) *Comet Chem of Ahmedabad handed over goods to transporter Ram Roadways to carry the same from Ahmedabad to Bharuch in Gujarat.*

The value of the goods is ₹ 80,000 which is chargeable to tax @ 18% GST (9% SGST + 9% CGST) and in transit, proper officer intercepted the vehicle under section 68 of CGST Act and seized the goods.

Calculate the penalty payable under section 129 of CGST Act, 2017 for release of the goods:

- *If Comet Chem, owner of goods, comes forward for payment of penalty.*
- *If Comet Chem, owner of goods, does not come forward for payment of penalty.*

(4 Marks)

(c) *Kiara of Indian origin, came to India on tour with her baby of 1 year. She brought following goods:*

1.	*Personal effects*	*50,000*
2.	*Used personal effects of infant*	*10,000*
3.	*New camera*	*45,000*
4.	*Mobile phone*	*12,500*
5.	*Cigarette sticks 70*	*1,000*
6.	*Wine - 2 litres*	*18,000*
7.	*Travel souvenirs*	*5,000*
8.	*Laptop*	*90,000*

Indicate the taxability or taxable value in respect of each item in the table and calculate customs duty payable rounded off to the nearest rupee in accordance with law. There is no need for any notes to support the conclusions regarding taxability or taxable amount.

(5 Marks)

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Answer

(a) (i) Minimum limit for compounding amount is higher of:-

- 50% of tax involved, viz., ₹ 5,00,000 (₹ 10 lakh × 50%) or
- ₹ 10,000,

i.e. ₹ 5,00,000.

(ii) Maximum limit for compounding amount is higher of: -

- 150% of tax involved, viz., ₹ 15,00,000 (₹ 10 lakh × 150%) or
- ₹ 30,000

i.e. ₹ 15,00,000.

If Arjun pays such compounding amount as may be determined by Commissioner, no further proceedings shall be initiated under this Act against him in respect of the same offence and any criminal proceedings, if already initiated in respect of the said offence, shall stand abated.

(b) When Comet Chem. - owner of goods - comes forward for the payment of penalty, penalty payable under section 129 of CGST Act is 200% of the tax payable on such goods, i.e., ₹ 14,400 [200% of (₹ 80,000 × 9%)].

i.e. ₹ 14,400

When Comet Chem. - owner of goods - does not come forward for the payment of penalty, penalty payable under section 129 of CGST Act is higher of:

(i) 50% of value of goods, i.e., ₹ 40,000 (50% of ₹ 80,000) or

(ii) 200% of the tax payable on such goods, i.e., ₹ 14,400 [200% of (₹ 80,000 × 9%)].

i.e. ₹ 40,000

(c)

Particulars	₹
Personal effects	Nil
Used personal effects of infant	Nil
New camera	45,000
Mobile phone	12,500
Cigarette sticks 70	1,000
Wine -2 litres	18,000
Travel souvenirs	Nil
Laptop	Nil

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Total	76,500
Less: General Free Allowance	50,000
Baggage on which duty is payable	26,500
Duty payable on baggage @ 38.50% (including 10% Social welfare surcharge) [rounded off]	**10,203**

Note: In the above solution, it has been assumed that Kiara is returning from a country other than Nepal, Bhutan and Myanmar. However, in case it is assumed that Kiara is returning from Nepal, Bhutan or Myanmar, General Free Allowance is ₹ 15,000 instead of ₹ 50,000. In that case, duty payable on baggage @ 38.50% will be ₹ 23,678.

Question 6

(a) Can Mr. Venkat obtain advance ruling for the issue related to place of supply? Also list all issues for which advance ruling can be sought. ***(4 Marks)***

OR

Mr. Mahendra, a registered person, came to know about QRMP (Quarterly Return-Monthly Payment) scheme but was unable to make a decision whether to opt for the same or not. Describe the eligibility criteria and benefits of QRMP Scheme to help Mr. Mahendra make a decision regarding the same. ***(4 Marks)***

(b) Explain in what cases, assessment order passed by proper officer may be withdrawn under CGST Act, 2017 in cases of summary assessment and best judgements assessment?

(5 Marks)

(c) What are the exceptions provided under sub-section (2) of section 27 of the Customs Act, 1962 in which refund of duty and interest may be paid to the applicant? ***(5 Marks)***

Answer

(a) No, Venkat cannot obtain advance ruling for issue related to place of supply[14].

Advance Ruling can be sought for the following questions:

(a) Classification of any goods or services or both;

(b) Applicability of a notification issued under provisions of the GST law;

[14] The above answer is based on the view taken by the CBIC in its e-flyer issued on 'advance ruling'. However, it is also possible to take a view that the question relating to determination of the liability to pay tax on goods and/or services as provided under section 96(2)(e) of the CGST Act, 2017 encompasses within its ambit the question relating to place of supply. This is so because place of supply is one of the factors to determine as to whether the supply is leviable to CGST & SGST or IGST. In that case, conclusion will be that Venkat can obtain advance ruling for issue related to place of supply.

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(c) Determination of time and value of supply of goods or services or both;

(d) Admissibility of input tax credit of tax paid or deemed to have been paid;

(e) Determination of the liability to pay tax on any goods or services under the GST law;

(f) Whether applicant is required to be registered;

(g) Whether any particular thing done by the applicant with respect to any goods or services or both amounts to or results in a supply of goods or services or both, within the meaning of that term.

Alternative Answer

(a) Eligibility criteria for QRMP scheme

Registered persons,

- other than supplier of online information and database access or retrieval services (OIDAR) located in non-taxable territory and providing such services to a non-taxable online recipient and whose aggregate annual turnover (PAN based) is up to ₹ 5 crore in the preceding financial year.
- who have opted to furnish quarterly returns under QRMP scheme
- who have furnished the last return due on the date of exercising such option

are eligible to opt for QRMP scheme.

Benefits of QRMP scheme

- It is a trade facilitation measure and eases the process of doing business.
- It will significantly reduce the compliance burden on such taxpayers as now the taxpayers need to file GSTR-3B returns and Form GSTR-1 - on quarterly basis only 4 times a year.

(b) Where the registered person furnishes a valid return for the default period within 30 days of the service of the best judgment assessment order, the said order shall be deemed to have been withdrawn but the liability for payment of interest on delayed payment of tax or for payment of late fee shall continue.

The summary assessment order may be withdrawn by Additional Commissioner/Joint Commissioner, –

(a) on an application filed by taxable person for its withdrawal within 30 days from the date of receipt of order; or

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(b) on his own motion, where he finds such order to be erroneous and may instead follow the procedures laid down in section 73/74 to determine the tax liability of such taxable person.

(c) The amount of duty and interest found refundable is to be paid to the applicant only in following situations:

(a) if the importer or the exporter, as the case may be, has not passed on the incidence of such duty and interest to any other person.

(b) if imports were made by an individual for his personal use.

(c) if amount found refundable relates to export duty paid on goods which has returned to exporter as specified in section 26.

(d) if amount relates to drawback of duty payable.

(e) if the duty or interest was borne by a notified class of applicants.

(f) if excess duty paid by the importer before order permitting clearance of goods for home consumption is made where such excess payment of duty is evident from the bill of entry in the case of self-assessed bill of entry.

(g) if excess duty paid by the importer before an order permitting clearance of goods for home consumption is made where the duty actually payable is reflected in the reassessed bill of entry in the case of reassessment.

(h) if the buyer has not passed on the incidence of such duty and interest to any other person.

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