PROFESSIONAL PROGRAMME

MODULE 3, PAPER 7

PRACTICE MANUAL

Advanced Tax Laws and Practice

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The **PRACTICE MANUAL** has been prepared by competent persons and the Institute hopes that it will facilitate the students in preparing for the Institute's examinations. It is, however, to be noted that the answers are to be treated as model answers and not as exhaustive and there can be alternative solutions available for a questions provided in this practice manual. The Institute is not in any way responsible for the correctness or otherwise of the answers.

The Practice Manual contains the information based on the Laws/Rules applicable at the time of preparation. Students are expected to be well versed with the amendments in the Laws/Rules made upto six months prior to the date of examination.

This Practice Manual is based on Finance Act, 2016 applicable for Assessment Year 2017-18 (Previous Year 2016-17).

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PREFACE

In the contemporary era, the global business is exemplified under the intense competition from domestic as well as transnational players. Competitive advantages of the inclusive economy can be achieved by placing right strategy in right direction. The successful achievement of the goals requires constant update and brushing up of one's specializations and skills. It is observed time and again that the updating of knowledge is fundamental to development of changing times. In line with the dynamic nature of the economy, the students must be equipped and thorough in their analytical abilities to work in the dynamic environment. This demands the development of basic theoretical concepts as well as practical aspects of this growing and competitive specialization.

In lines with updating the information, the Institute in the past brought Practice Manual on Advance Tax Laws and Practice (Professional Programme). Now, we are presenting the Revised Practice Manual prepared specifically for the subject "Advanced Tax laws and Practice" to the students of Professional Programme. This Practice Manual is prepared to build competency in practical aspects by providing the students with a pool of solved practical problems and would serve as refresher.

This Practice Manual provides a narrative explanation of fundamental provisions of tax laws and their application in the form of question and answer. Questions and case studies based on real tax cases have also been included to enhance analytical abilities of the students and make them conversant with the application of various provisions of tax laws to factual situations.

This Practice Manual is based on Finance Act, 2016 applicable for Assessment Year 2017-18 (Previous Year 2016-17). Students are expected to make a holistic study of both the study material and Practice Manual to gain maximum benefit and acquire in-depth knowledge of the subject.

I acknowledge with thanks all those experts, authors and institutions whose material has been consulted and referred in preparation of this Practice Manual. I place on record my sincere appreciation to Mr. Govind Krishna Agrawal, Assistant Director (Academics) and Ms. Nikita Agrawal (Consultant) in the Academic Team at the Institute headed by Ms. Sonia Baijal, Director for this initiative.

I have great pleasure in introducing this revised practice manual to the students. I am sure, this manual will prove to be useful and beneficial to the students. Therefore, I advise all the students to take maximum benefit out of it by meticulously practicing the questions given therein.

My best wishes to you all!

New Delhi
April, 2017

CS (Dr.) Shyam Agrawal
President, ICSI

CONTENTS

1

Taxation of Individual, Partnership, LLP and Companies

Question 1

There is a two-fold distribution of legislative powers as stipulated in Article 246 read with schedule VII of the Constitution of India. Comment

Answer

The statement that "There is a two-fold distribution of legislative powers as stipulated in Article 246 read with schedule VII of the Constitution of India" is incorrect as there is a threefold distribution of legislative powers as stipulated in Article 246 read with Schedule VII. List I of the Union list which comprises of 99 items or subjects over which the Parliament shall have the exclusive powers of legislation, list II of the State list comprises of 61 items over which the State Legislature shall have the exclusive powers of legislation and list III of the concurrent list comprises of 52 items over which the Parliament and the Legislatures of States shall have concurrent powers to make laws.

Question 2

A non-Indian company is treated as resident, only if the control and management of its affairs is situated wholly in India during the previous year. Comment

Answer

All Indian companies within the meaning of Section 2(26) of the Act are always resident in India regardless of the place of control and management of its affairs.

In the case of a foreign company the place of control and management of its affairs is the basis on which the company's residential status is determinable.

Accordingly a company shall be said to be resident in India in any previous year, if –

(i) it is an Indian company; or

(ii) the control and management of its affairs is wholly situated in India.

The Finance Act, 2015 has amended the test of residence for foreign companies to provide that a company would be treated as resident in India if its place of effective management at any time during the previous year is in India.

The POEM was defined to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are in substance made.

However, POEM based residence test has been deferred by one year vide Amendment in Finance Act, 2016 and the determination of residence based on POEM shall be applicable from 01/04/17.

Question 3

Ms. Ramya avails the benefit of LTC and went by air (economy class) on a holiday in India on 25.1.2016 along with his wife and three children consisting of his son aged 4 years and twin daughters of one year age. The total cost of tickets reimbursed by his employer was Rs. 96,000 (Rs. 60,000 for two adults and 36,000 for three children). State with reasons the amount which can be claimed by Ms. Ramya out of the reimbursement as not subject to tax. Will your answer be different where among his three children the twins were of 4 years of age and the age of the son was of one year.

Answer

Ms. Ramya can avail exemption as section 10(5) on the entire amount of Rs. 96,000/- reimbursed by the employer for the LTC as the same was availed for himself, his wife and the three children in India and the journey was also undertaken by economy class airfare. The restriction imposed for two children is not applicable to the multiple births which take place after the first child. However, if the age of the twin daughters is more than the age of the son, the restriction imposed for two children under the section would be applicable and therefore, Ms. Ramya cannot avail exemption in this case for all the three children. The exemption of LTC can be availed in respect of only two children. Therefore, the fare of Rs. 12,000 (i.e 36000 X 1/3) reimbursed for one child will form part of taxable salary and balance amount of LTC of Rs. 84000/- will be exempt under section 10(5).

Question 4

Briefly discuss the provisions relating to payment of advance tax in case of capital gains and casual income.

Answer

Advance tax is payable by an assessee on its total income, which includes capital gains and casual income like income from lotteries, crossword puzzles etc. Since it is not possible for the assessee to estimate his capital gains, income from lotteries, etc., it has been provided that if any such income arises after the due date for any installment, then, the entire amount of tax payable (after considering tax deducted at source) on such capital gains or casual income should be paid in the remaining installments of advance tax which are due. Where no such installment is due, the entire tax should be paid by 31st March of the relevant financial year. If the entire tax liability is so paid, no interest liability under section 234C of the Income tax Act would arise for deferment in payment of advance tax.

In case of casual income (winnings from lotteries, crossword puzzles, card games, gambling, betting, races including horse races etc.), the entire tax liability is fully deductible at source @30% under section 194B and 194BB. Therefore, advance tax liability would arise only in respect of the surcharge (if applicable), education cess and secondary and higher education cess element of such tax, if the same, along with tax liability in respect of other income, if any, is Rs. 10,000 or more.

Question 5

A Ltd. incurred an expenditure of Rs. 50 lakhs on glow-sign boards displayed at dealer outlets. Examine with the help of a decided case law, whether the above expenditure is revenue or capital in nature.

Answer

The facts of the case are similar with that of the CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR 49 where the Delhi High Court noted the following observations of the Punjab and Haryana High Court, in CIT v. Liberty Group Marketing Division (2009) 315 ITR 125, while holding that such expenditure was revenue in nature.

The expenditure incurred on the glow sign boards are revenue in nature as these were incurred with the object of facilitating the business operation and not with the object of acquiring an asset of enduring nature.

Thus, the expenditure incurred by A Ltd. on glow-sign boards are revenue in nature.

Question 6

Bace drinks Ltd. was carrying more than one business activity, namely manufacturing soft drink and trading in soft drinks. However, the manufacturing activity was not profitable and was hence, discontinued. The employees who were directly connected with this manufacturing activity were laid off and severance cost was paid to those employees. The same was claimed by the assessee as revenue expenditure. The Assessing Officer disallowed the same treating it as capital expenditure, on the argument that it was incurred as a result of closure of business of the assessee. Discuss what would be the nature of expenditure.

Answer

The facts of the case are similar to that of the CIT vs. KJS India P. Ltd. (2012) 340 ITR 380 (Delhi), where the Delhi High Court, held that though one of the business activities was suspended, it cannot be construed that the assessee has closed down its entire business. The assessee still continues to trade in soft drinks. Therefore, the said expenditure will be allowed as revenue expenditure even though it was related to a manufacturing activity which was suspended.

Question 7

Sharad Hospitals purchased second-hand medical equipment for use as spare parts of existing equipment. Examine with the help of a decided case law, that whether the above expenditure is revenue or capital in nature.

Answer

The Karnataka High Court, in *Dr. Aswath N. Rao* v. *ACIT* (2010) 326 ITR 188, held that since the second hand machinery purchased by the assessee was for use as spare parts for the existing old machinery, the same had to be allowed as revenue expenditure.

Question 8

Sukriti Ltd. incurred expenses of Rs. 76,000 for the issue of shares. However, the public issue could not materialize on account of non-clearance by SEBI. Examine with the help of a decided case law, whether the above expenditure is revenue or capital in nature.

Answer

The facts of the case are similar to that of the *Mascon Technical Services Ltd.* v. *CIT* (2013) 358 ITR 545, where the Madras High Court observed that the assessee had taken steps to go in for a public issue and incurred share issue expenses. However, it could not go in for the public issue by reason of the orders issued by the SEBI just before the proposed issue. The High Court observed that though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts.

Thus, the expenditure incurred by Sukriti Ltd. constitutes capital expenditure.

Question 9

S Ltd., a subsidiary of H Ltds. has been incurring losses year after year. The holding company H Ltd. paid an amount of Rs. 1 crore to S Ltd. as a grant to recoup the losses. The assessing officer contends to consider this receipt as a trading receipt and includes it in the assessable income. Examine the case in the light of provisions of Income Tax Act and decided case law, if any.

Answer

The facts of the case are similar to *CIT* v. *Handicrafts and Handlooms Export Corporation of India Ltd.* (2014) 360 ITR 0130 (Delhi), where the assessee was a Government company operating a channelizing agency for sale of handicrafts and handlooms abroad. In the relevant previous year, it received a grant of Rs. 25 lakh from its holding company, the State Trading Corporation of India (STC) to recoup the losses. The Assessing Officer opined that the said amount was a revenue receipt and therefore chargeable to tax.

Tribunal's view: The Appellate Tribunal held that the grant received was not taxable as revenue receipt since the said grant was given to recoup the losses incurred by the assessee and was hence, in the nature of capital contribution.

High Court's Observations: The High Court examined the judgment of the Supreme Court in *Sahney Steel and Press Works Ltd.* v. *CIT* (1997) 228 ITR 253, which laid down the test for determining whether subsidy received by an assessee is taxable as capital or revenue receipt. As per the said test, if any subsidy is given, the character of the subsidy in the hands of the recipient - whether revenue or capital - will have to be determined by having regard to the purpose for which the subsidy is given. The point of time, the source and the form of subsidy are immaterial. The object for which the subsidy is given, would, thus determine the nature of subsidy. If it is given by way of assistance to the assessee in carrying on of his trade or business, it has to be treated as trading receipt.

The High Court observed that grant was not paid by a third party or by a public authority but by the holding company. However, it was not on account of any trade or commercial

transaction between the subsidiary and holding company. Further, the intention and purpose behind the said payment was to secure and protect the capital investment made by STC Ltd. The payment of grant by STC Ltd. and receipt thereof by the assessee was not during the course of trade or performance of trade, and thus, could not partake the character of a trading receipt. The same was in the nature of a capital grant.

The High Court observed the difference between Government Grant and payment made by STC, as pointed out by the *Division Bench in Handicrafts and Handlooms Corporation Ltd.* v. CIT (1983) 140 ITR 532. The grants given were specific amounts paid by STC to the assessee, in order to enable the assessee, which was its subsidiary and was incurring losses year after year, to recoup these losses and to enable it to meet its liabilities. These amounts, therefore, cannot form part of the trading receipts of the assessee since these were not in the nature of grants received from an outsider or the Government on general grounds such as for carrying on of trade.

Thus, the grant given by the holding company in this case is in the nature of capital receipt since its purpose is to secure and protect the capital investment made in the subsidiary company.

Question 10

X Ltd. owns a barren land of 9,000 sq. mtrs., adjacent to the factory premises. It enters into an agreement with Y Ltd. for granting of the above land on lease to Y Ltd. for a period of 12 years.

Under the terms of the agreement, Y Ltd. had to build a factory building, pay an annual rent @ Rs.100 per sq. mtr. of the leased land of 9,000 sq. mtrs. and surrender the building to X Ltd. at the end of the lease without any consideration. Y Ltd. complied with the terms and conditions of the lease agreement.

The depreciated value of the building surrendered and taken possession by X Ltd. in June, 2015 was Rs. 4.22 crore. Accounts department of X Ltd. is of the opinion that an equivalent amount is to be taken in the accounts of the year 2015-16 as income received. Critically examine the matter in the light of decided case law, if any.

Answer

The opinion of the Accounts Department of X Ltd. is incorrect. The depreciated value of the building is of course to be brought into the books of accounts. However, the equivalent amount viz. Rs. 4.22 crores cannot be treated as income from the business or operations. By its very nature it is a capital receipt and is not a revenue income.

The amount cannot be treated as a revenue receipt unless it is conclusively established that this represented deferred rent as the lease rent was unreasonably low. Further, X Ltd. is not in the business of real estate to treat the benefit as incidental revenue receipt earned during the course of such business. Further, the facts of the case of *CIT* v. *Elphinstone Dye Works Pvt. Ltd.* 82 ITR 654 were similar and the Bombay High Court held that the written down value of the building in such a situation can be treated only as a capital receipt.

Question 11

Examine the taxability of the following receipts with reference to Income tax Act, 1961:

a) Bonus shares received by equity shareholder.

b) Bonus shares received by preference share holder.

c) Medical allowance received by an employee, the entire amount of which has been spent by him for medical treatment.

d) Gift of a plot of land given to a chartered accountant by one of his clients. The chartered accountant has been fully compensated for his services and this gift has been given in appreciation of his personal qualities.

e) Receipt of a cash gift of Rs. 60,000 from a friend on the occasion of wedding anniversary.

f) Contribution to provident fund recovered from an employee by an employer but not deposited in his PF Account.

Answer

(a) Issue of bonus shares to equity shareholders does not amount to distribution of dividend, as there is no release of assets. Therefore, bonus shares received by an equity shareholder are not taxable as deemed dividend.

(b) Distribution of bonus shares by a company would be treated as deemed dividend under section 2(22)(b) in the hands of the preference shareholders, to the extent of accumulated profits (whether capitalized or not) of the company. Such dividend would be taxable under the head "Income from other sources".

(c) Fixed medical allowance received by an employee is taxable under the head "Salaries", even if the entire amount has been spent by him for medical treatment.

(d) The value of any benefit or perquisite arising from exercise of profession is taxable as income under the head "Profits and gains of business or profession", irrespective of whether the benefits or perquisites are contractual or gratuitous. Therefore, the value of plot of land would be taxable in the hands of the Chartered Accountant under the head "Profits and gains of business or profession". Even if an argument is advanced that the gift was only in appreciation of his personal qualities, such receipt of immovable property without consideration from a non-relative would, in any case, be taxable under section 56(2)(vii) under the head "Income from other sources".

(e) Cash gift of Rs. 60,000 received from a friend on the occasion of wedding anniversary is taxable under the head "Income from other sources" under section 56(2)(vii), since it represents an amount exceeding Rs. 50,000 received from a non-relative on a occasion other than marriage.

(f) Contribution of provident fund recovered from an employee but not deposited in his Provident Fund account on or before the due date specified under the relevant provident fund Act is treated as income by virtue of section 2(24)(x) and is taxable in the hands of the employer under the head "Profits and gains of business or profession" or "Income from other sources".

However, the employer can claim deduction under section 36(1)(va) or under section 57(ia), as the case may be, if the same is deposited on or before the due date specified under the relevant provident fund Act

Question 12

Write a short note on Allowance for acquisition and installation of new plant and machinery under section 32AC and 32 AC(1A) of Income tax Act.

Answer

Section 32AC was introduced by Finance Act, 2013 to provide that where an assessee, being a company:-

(a) is engaged in the business of manufacture of an article or thing; and

(b) invests a sum of more than Rs. 100 crore in new assets (plant or machinery) during the period beginning from 1st April, 2013 and ending on 31st March, 2015, then, the assessee shall be allowed:-

(i) for assessment year 2014-15, a deduction of 15% of aggregate amount of actual cost of new assets acquired and installed during the financial year 2013-14, if the cost of such assets exceeds Rs. 100 crore;

(ii) for assessment year 2015-16, a deduction of 15% of aggregate amount of actual cost of new assets, acquired and installed during the period beginning on 1st April, 2013 and ending on 31st March, 2015, as reduced by the deduction allowed, if any, for assessment year 2014-15.

However, in Budget 2014, the benefit under section 32 AC has been extended to companies making investment of more than Rs. 25 crores in Plant & Machinery to support and to provide incentive to smaller and medium manufacturing companies. Further, Assessees eligible to claim deduction under the threshold limit of Rs. 100 crore for investments made in Financial Years 2013-14 and 2014-15, continue to be eligible to claim deduction even if its investment in the Financial Year 2014-15 is below the proposed new threshold limit of investment of Rs. 25 crores.

Transfer of the plant or machinery for a period of 5 years has also been restricted. If such asset is transferred within 5 years of its purchase and installation then Investment Allowance allowed as deduction earlier shall be taxable as Profits and Gains from Business of Profession in the year of transfer. This is in addition to capital gain liability. However, this restriction shall not apply in a case of amalgamation or demerger but shall continue to apply to the amalgamated company or resulting company, as the case may be.

Question 13

A corporate assessee, who inadvertently failed to claim deduction under section 80IB during the initial years, cannot claim deduction under the said section for the remaining years during the period of eligibility, inspite of fulfillment of stipulated conditions. Examine the above statement in the light of judicial decision.

Answer

The provisions contained in Section 80IB of the Income tax Act, nowhere stipulates any condition that such a claim has to be made in the first year failing which there would be forfeiture of such claim in the remaining years. As decided in *Praveen Soni* v. *Commissioner of Income Tax* (2011) (Delhi), if the assessee fulfils the conditions mentioned under Section 80IB of Income Tax Act, he will be eligible for claiming the deduction for 10 consecutive years. Merely because of the reason that though the assessee was eligible to claim this benefit from a specific year, but did not claim in that year would not mean that he would be deprived from claiming this benefit for the remaining years during his eligibility.

Further, had the assessee claimed this benefit in the year in which he became eligible, he would have been allowed this benefit for 10 consecutive years but now he could claim the benefit only for the remaining period. For example, if the assessee became eligible in assessment year 2011-12, he would have claimed deduction for 10 years up to assessment year 2020-21, but now, he could claim exemption for only the 5 remaining years that is from assessment year 2016-17 to 2020-21.

Question 14

Duty drawback receipts cannot be treated as profit derived from business of the industrial undertaking to be eligible for deduction under section 80-IB of Income tax Act. Examine in the light of decided case law.

Answer

The above statement is true, in the case of Liberty India v. Commissioner of Income-tax, the Supreme Court held that the tax incentives under Chapter VI A are attracted only to the generation of operational profits and the benefit of deduction under section 80- IB will not be available in respect of the receipts, which do not have any direct nexus with the operation of industrial undertaking of the assessee. Thus, the profits derived by way of incentives like duty drawback did not fall within the expression 'profits derived from industrial undertaking' under section 80-IB.

Question 15

Mobile phones were purchased during the year and were exclusively used for the business purpose. The assessee wants to claim depreciation amounting to Rs. 20 lacs at higher rate of 60% treating them at par with computer. Examine with the help of decided case law.

Answer

Mobile phones are not computers and therefore, are not entitled to higher depreciation @ 60%. It was so held by the Kerala High Court in the case of *Federal Bank Ltd.* v. *ACIT* (2011) 332 ITR 319. Therefore, mobile phones would be entitled to depreciation by applying the rate of 15%, being the general rate applicable to plant and machinery.

Question 16

A Ltd. purchased a new bus for Rs. 12 lacs and donated it to a school where the children of employees were studying. Examine whether A Ltd could claim deduction under section 37(1) of the Income Tax Act, 1961.

Answer

The expenditure incurred for acquiring a new bus and donating it to the school is for the welfare of the children of staff/workmen of the company. Such expenditure is a part of employee's welfare expenses incurred for the purpose of securing healthy services for staff members. Therefore, such expenses were incurred wholly and exclusively for the purpose of the business.

Further, since the bus has been donated to the school, no benefit of enduring nature was derived by the company as the right of ownership was transferred to school. Hence, it is not a capital expenditure Thus, A Ltd. is entitled to claim deduction in full under section 37(1). The same was also held by the Rajasthan High Court in *CIT* v. *Rajasthan Spinning and Weaving Mills Ltd.* (2006) 281 ITR 408.

Question 17

The assessee, purchased a running business from M/s R.G.K. At the time of acquiring the business, the assessee had paid certain amount in respect of trade name, goodwill and for all other business and commercial rights and claimed depreciation on said amount. The Assessing Officer rejected the assessee's claim holding that goodwill could not be treated as intangible asset and, therefore, not depreciable. Decide.

Answer

As per Section 32(1)(ii) of Income tax Act, depreciation is allowable in respect of knowhow, patent, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature being intangible assets. Scanning the anatomy of this section, it can safely be stated that the provision allows depreciation on both tangible and intangible assets and clause (ii) enumerates the intangible assets on which depreciation is allowable. The assets which are included in the definition of 'intangible assets' under Section 32(1)(ii) includes, along with other things, any other business or commercial rights of similar nature.

To effectively understand what would constitute an intangible asset, certain aspects, like the nature of goodwill involved, how the goodwill has been generated, how it has been valued, agreement under which it has been acquired, what intangible asset it represents, namely, trademark, right, patent, etc. and further whether, it would come within the clause, namely, 'any other business or commercial rights which are of similar nature are to be borne in mind.

Yet, allowability of depreciation on goodwill has been a matter of debate before various Courts/Tribunal. In various cases, it has been held that depreciation is not allowable on goodwill because it is not of similar nature to that of intangible assets viz. know-how, patents, trademarks, licences, franchise, etc. as specified under Section 32 of the Income-tax Act, 1961 (the Act).

The Supreme Court in the case of Smifs Securities Ltd. has put the above controversy at rest and held that the goodwill being a difference between the amount paid and cost of shares in case of amalgamation scheme, is an asset eligible for depreciation under Section 32 of the Act. The Supreme Court has applied the principle of *ejusdem generis* and held that the

expression 'any other business or commercial rights of a similar nature includes goodwill for the purpose of allowability of depreciation.

Question 18

Write a short note on carry forward and set off of losses in the event of change in shareholdings of companies in which public are not substantially interested.

Answer

Section 79 prescribes the condition for carry forward and set off of losses in the case of companies, not being companies in which the public are substantially interested. According to the provisions of the said section, no loss incurred in any year prior to the previous year shall be carry forward and set off unless the persons who beneficially held shares of the company carrying not less than 51% of the voting power on the last day of the year or years in which loss was incurred continue to be the shareholders on the last day of the previous year on which the loss is to be set off.

Further, there are two exceptions to this rule:

(a) Where a change in the voting power takes place consequent upon the death of a shareholder or on account of transfer of share by way of gift to any relative of such shareholder.

(b) Where a change in the voting power takes place in an Indian subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company provided 51% of the shareholders of the amalgamating or demerged company continue to be shareholders of the amalgamated or the resulting foreign company.

Question 19

Mr. Buddhadev is carrying on a business as sole proprietor. He died on 31st March, 2016 and on his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2016, a determined business loss of Rs. 4 lakhs is to be carried forward under the Income- tax Act, 1961. Does the firm consisting of all legal heirs of Mr. Buddhadev, get a right to have this loss adjusted against its current income? Examine in the light of provisions of the Act and decided case law.

Answer

Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his/her income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case of *CIT* v. *Madhukant M. Mehta* (2001) 247 ITR 805, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In the given case, the business of Mr. Buddhadev was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of Rs. 4 lakhs of Mr. Buddhadev.

Question 20

An assessee sustained a loss under the head "Income from house property" in the previous year relevant to the assessment year 2015-16, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed under section 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the time allowed under section 139(4). Can the assessee carry forward such loss for set off against income from house property of the assessment year 2016-17?

Answer

Section 139(3) stipulates that an assessee claiming carry forward of loss under the heads "Profits and gains of business or profession" or "Capital gains" should furnish the return of loss within the time stipulated under section 139(1). There is no reference to loss under the head "Income from house property" in section 139(3). The assessee, in the instant case, has filed the return showing loss from property within the time prescribed under section 139(4). The assessee is, therefore, entitled to carry forward such loss for set off against the income from house property of the subsequent assessment year.

Question 21

R purchased equity shares in P Ltd., a constituent of BSE-500 index on Mumbai Stock Exchange on 1st March, 2011. He sold the shares on 14th March, 2016 at a loss of Rs.18,000. He wants to set off the loss against other long-term capital gain during the year. Examine whether such set off is permissible. Both purchase and sale transactions were entered into on a recognized stock exchange.

Answer

Section 10(38) exempts long term capital gain arising from transfer of equity shares in a company or a unit of an equity oriented fund, if such transfer has been subjected to securities transaction tax. Hence, the capital gain / capital loss will have no tax implication.

In this case, the assessee has suffered a loss of Rs. 18,000 by selling eligible equity shares. It is settled principle that the loss arising from an exempt source is not eligible for set off against income arising from a taxable source. In the case of *CIT v. Thiagarajan. S.S (1981) 129 ITR 115 (Mad),* the Madras High Court held that loss incurred by an assessee from an exempted source, cannot go to set off income from a taxable source. In view of the same, the set off in the instant case is not permissible.

Question 22

Mr. Ram was a partner in a firm, representing his HUF, holding 25% of the share in the firm. His wife, Sushma, a houselady, was admitted in her individual capacity in the firm for 25% share. She was paid remuneration which has been proposed by the Assessing Officer

to be clubbed in the hands of Ram- HUF by invoking Section 64 of the Act. Examine the validity of the action of the Assessing Officer in the light of decided case law, if any.

Answer

As per section 64(1)(ii), in computing the total income of any "individual", the remuneration paid to spouse by a firm in which the individual has substantial interest shall be liable for clubbing. For section 64(1) to get attracted, it is necessary that the spouse should be a partner in a partnership firm in his individual capacity. It is not attracted where he is a partner as the Karta of the Hindu undivided family to which his wife belongs. However, in the present case, Mr. Ram is not a partner in his individual capacity, but a partner in representative capacity.

Further, the Supreme Court has, in the case of *CIT* v. *Om Prakash* (1996) 217 ITR 785, held that an individual can be a partner in a partnership firm in his individual capacity or in the capacity of the Karta of a Hindu undivided family or, for that matter, in any other capacity, e.g., as a trustee. Where a person is a partner as the Karta of a Hindu undivided family, the capacity in which he is a partner in the partnership firm is relevant as between him and the other members of the Hindu undivided family. The income the Karta receives as a partner is not his individual income; it is the income of the Hindu undivided family and he receives it on behalf of the Hindu undivided family.

It is for this reason that the income of the wife arising from her membership of the partnership firm is not includible in the income of the Hindu undivided family since the total income of the Hindu undivided family is not the total income of the individual (husband). Thus, the action of the Assessing Officer in this case is, therefore, not correct.

Part II - Computation of Income Tax Liability

Question 1

Gross total Income of Mr. X, a tax consultant based at Mumbai, is Rs. 18,00,000 (income from profession Rs. 17,00,000 and interest on bank deposit Rs. 1,00,000). He pays Rs. 3,00,000 as house rent. He deposits Rs. 50,000 in public provident fund. Compute his taxable income for the assessment year 2017-18.

Answer

Computation of taxable Income of Mr. X for the A.Y 2017-18

		Amount
		Rs.
Professional Income		17,00,000
Interest on Bank Deposit		1,00,000
Gross Total Income		18,00,000
Less: Deductions under Chapter VI-A		
u/s 80C (PPF)	50,000	
u/s 80 GG (Note-1)	60,000	
		(1,10,000)
Net Income		16,90,000

Note 1 : Deduction u/s 80GG is least of the following:

a) Rs. 60,000

b) Rs. 4,37,500 [25% of total income (Rs. 18,00,000- 50,000)]

c) Rs. 1,25,000 (Excess of rent paid over 10% of total income (Rs. 3,00,000 - 1,75,000))

Question 2

From the following profit and loss account of Vinay for the year ended 31st March, 2017, compute his total income and tax liability for the assessment year: 2017-18:

Particulars	*Amount*	*Particulars*	*Amount*
	Rs.		*Rs.*
Interest on capital	*12,000*	*Gross profit*	*5,10,000*
Insurance	*2,000*	*Brokerage*	*30,000*
Bad debts	*30,000*	*Bad debts recovered (earlier allowed as deduction)*	*15,000*
Depreciation	*34,000*	*Sundry receipts*	*18,000*
Advance tax	*25,000*	*Interest on debentures*	

General expenses	*12,000*	*(gross) [TDS Rs. 4,120]*	*40,000*
Advertisement	*5,000*		
Salary (including salary to Vinay			
Rs.20,000)	*85,000*		
Interest on loan	*8,000*		
Net profit	*4,00,000*		
	6,13,000		*6,13,000*

Additional information:

(i) The amount of depreciation allowable as per income-tax rules is Rs. 42,000.

(ii) General expenses include Rs.5,000 given as Health insurance Premium.

(iii) Vinay pays Rs. 5,200 as premium on his own life insurance policy of Rs. 50, 000 issued in 2015-16.

(iv) Loan was obtained for payment of income-tax.

Answer

Particulars	*Amount (Rs.)*	*Amount (Rs.)*
(I) Income from business		
Net profit for the year		4,00,000
Add: Expenses not allowed under		
Income tax act but debited to P & L A/C		
Interest on capital (Note 2)	12,000	
Depreciation as per books of a/c	34,000	
Advance tax	25,000	
General Expenses	5,000	
Salary to Vinay	20,000	
Interest on loan (Note 2)	8,000	1,04,000
Less : Income not allowed but		
Credited to P& L a/c or deductible expenses		
Interest on debentures	40,000	

Depreciation as per Income tax Act	42,000	(82,000)
Profits and Gains of Business & Profession		4,22,000
(II) Income from other sources Interest on debenture		40,000
Gross total income (I + II)		4,62,000
Less: Deduction U/S 80C – 80U		
(i) Premium on life insurance policy (u/s 80C)(Note 1)		(5,000)
(ii) Health insurance Premium (u/s 80 D)		(5,000)
Total Taxable Income		4,52,000

Note

1. Under section 80C deduction of life insurance premium cannot exceed 10% of the sum assured.
2. Under Section 36(1)(iii) Interest paid on borrowed capital is allowed as a deduction. Interest on own capital is not deductible. Similarly, interest on money borrowed to pay income tax in not allowed as a deduction.

Question 3

Examine the taxability or allowability or otherwise in the following cases while computing income under the head "Profits and gains from business or profession" to be declared in the return of income for the assessment year 2017-18:

(a) The amount of margin money forfeited by a bank on the failure of its constituents of not taking the delivery of the shares purchased by such bank on their behalf.

(b) Amount received towards power subsidy with a stipulation that the same is to be adjusted in the electricity bills.

(c) Profit derived by an assessee engaged in carrying on the business as dealer in shares, on exchange of the shares held as stock in trade of one company with the shares of another company.

(d) Donations received by a person in the course of carrying on vocation, from his followers.

Answer

(a) Since the bank is purchasing shares on behalf of the constituents, the forfeiture of margin money by the bank from the constituents for not paying the balance amount of purchase price and not taking delivery of shares purchased by the bank on their behalf is in the normal course of its banking business and hence, the forfeited amount is assessable as business income of the bank. The forfeited amount being

revenue in nature cannot be adjusted against the purchase price of the shares. The Supreme Court has, in the case of *CIT* v. *Lakshmi Vilas Bank Ltd.* (1996) 220 ITR 305, confirmed this view.

(b) As per section 2(24)(xviii) of Income tax Act, assistance in the form of subsidy or grant or cash incentive by the Central Government or a State Government or any authority or body or agency in cash or kind is chargeable to tax as income. Also, ICDS VII seeks admission of such grant as income. Government grants should not be recognized until there is reasonable assurance that (i) the person shall comply with the conditions attached to them, and (ii) the grants shall be received. However, recognition of such grant shall not be postponed beyond the date of actual receipt. Since power subsidy has been received by the assessee, it is revenue in nature and therefore chargeable to tax in A.Y. 2017-18.

(c) The difference between the price of shares of the first company and the market value of shares of the new company on the date of such exchange has to be treated as "profit" derived by the dealer in shares (on exchange of shares held as stock-in-trade of the first company with the shares of the new company) in the normal course of business, and hence such profit is taxable as business income. It was so held by the Supreme Court in *Orient Trading Co. Ltd*. v. *CIT* (1997) 224 ITR 371.

d) Donations received by a person from his followers in the course of carrying on vocation for the furtherance of the objects of his vocation are receipts arising from carrying on of his vocation and are not casual or non-recurring receipts. The Supreme Court, in *Dr. K. George Thomas* v. *CIT* (1985) 156 ITR 412, has held that such donations are taxable as business income as there is a direct nexus between the vocation carried on by the assessee and the receipt of such donations.

Question 4

Income & Expenditure A/c of Lawyers & Co. for the year ending March 31, 2017

Particulars	*Amount Rs.*	*Particulars*	*Amount Rs.*
To Expenses	*1,50,000*	*By Professional*	
To Depreciation	*20,000*	*Receipts*	*3,80,000*
To Remuneration to partners	*1,50,000*	*By Other fees*	*90,000*
Interest on Capital to partners @ 20 per cent	*20,000*		
To Net Profit	*1,30,000*		
Total	*4,70,000*		*4,70,000*

Other Information:

1. *Expenses include Rs. 18,000 and Rs. 12,000 paid in cash as brokerage to a single party on a single day.*
2. *Depreciation calculated as per section 32 is Rs. 40,000*

Compute the total income of the firm.

Answer

Computation of Total Income of Lawyers & Co. for A. Y. 2017-18

Particulars		*Amount Rs.*
Net profit as per profit and loss account		1,30,000
Add : Expenses not allowable		
Section 40A(3)- Cash payments to a broker exceeding Rs. 20,000 (Note 1)	30,000	
Section 40(b)-Excess interest on capital to partners 20%-12% i.e. (20000*8/20) (Note 2)	8,000	38,000
Add : Remuneration to partners debited to profit and loss account		1,50,000
Less : Depreciation u/s 32		
(Rs. 40,000-Rs. 20,000 debited in profit and loss account)		(20,000)
Book profit (Note 3)		2,98,000
Maximum permissible remuneration(lower of the two :		
(i.e. 90 per cent of Rs. 2,98,000)	2,68,200	
Actual	1,50,000	(1,50,000)
Business Income of the Firm		1,48,000
Tax Liability (30% of 1,48,000)		44,400
Add : Education cess @ 2% & SHEC @ 1%		1,332
Total Tax Liability		45,732

Notes :

1. As per section 40A(3) of the Act, if the aggregate payment made (otherwise than by an account payee cheque/draft) to the same person during a day exceeds Rs. 20,000/- the entire amount of such payment is disallowed.
2. As per section 40 (b) of the Act, if the interest payable to the partners exceeds simple interest of 12% per annum, the excess amount is not deductible.

3. The remuneration paid to the working partners cannot exceed the permissible limits specified under section 40 (b) of the Act.

Question 5

Alpha Ltd., a manufacturing company, which maintains accounts under mercantile system, has disclosed a net profit of Rs.12.50 lakhs for the year ending 31st March, 2017. You are required to compute the taxable income of the company for the Assessment year 2017-18, after considering the following information, duly explaining the reasons for each item of adjustment:

(i) Advertisement expenditure debited to profit and loss account includes the sum of Rs. 60,000 paid in cash to the sister concern of a director, the market value of which is Rs. 52,000.

(ii) Legal charges debited to profit and loss account include a sum of Rs. 45,000 paid to consultant for framing a scheme of amalgamation duly approved by the Central Government.

(iii) Repairs of plant and machinery debited to profit and loss account include Rs. 1.80 lakhs towards replacement of worn out parts of machineries.

(iv) A sum of Rs. 6,000 on account of liability foregone by a creditor has been taken to general reserve. The same was charged to the Revenue Account in the A.Y. 2012-13.

(v) Sale proceeds of import entitlements amounting to Rs.1 lakh has been credited to Profit & Loss Account, which the company claims as capital receipt not chargeable to income-tax.

(vi) Being also engaged in the biotechnology business, the company incurred the following expenditure on in-house research and development as approved by the prescribed authority:

(a) Research equipments purchased Rs. 1,50,000.

(b) Remuneration paid to scientists Rs. 50,000.

The total amount of Rs.2,00,000 is debited to the profit and loss account.

Answer

Computation of total income of Alpha Ltd. for A.Y. 2017-18

Particulars	*Amount (Rs.)*
Net profit as per profit and loss account	12,50,000
Add : Items debited to profit and loss A/c but not deductible	
1. Payment of advertisement expenditure of Rs. 60,000	

(i) Rs. 8,000, being the excess payment to a relative disallowed under section 40A(2)	8,000
(ii) As the payment is made in cash and since the remaining amount of Rs. 52,000 exceeds Rs. 20,000, 100% shall be disallowed under section 40A(3)	52,000
2. Legal charges for framing amalgamation scheme (deductible under section 35DD in five years). 1/5th of Rs.45,000 i.e. Rs. 9,000 to be allowed in the current year. Balance Rs. 36,000 (Rs. 45,000 - Rs.9,000) is to be added back (Note)	36,000
3. Under section 31, expenditure relatable to current repairs regarding plant, Machinery or furniture is allowed as deduction.	
The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery or substantial part of the entire machinery [CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat)].	—
Here expenditure on repairs does not bring in any new asset into existence. Such replacement can only be considered as current repairs.	
Hence, no adjustment is required.	
Add: Items chargeable as business income but not credited to profit and loss A/c	
4. Liability foregone by creditor [taxable under section 41(1)]	6,000
5. Sale proceeds of import entitlements. The sale of the rights gives rise to profits or gains taxable under section 28(iiia). As the amount has already been credited to profit and loss account, no further adjustment is necessary.	—
Less : Amount not debited to profit and loss account but allowable as deduction	
6. Expenditure on in-house research and development is entitled to a weighted deduction of 200% of the expenditure (both capital and revenue) so incurred under section 35(2AB)(1) = Rs. 2 lakhs x 200% = Rs.4 lakhs	(2,00,000)
Expenditure of Rs. 2,00,000 has already been debited to Profit & Loss Account, therefore only additional deduction of Rs. 2 lakhs further to be allowed.	

Taxable Income	11,52,000
Tax Liability (30% of 11,52,000)	3,45,600
Add : Education cess @ 2% & SHEC @ 1%	10,386
Total Tax Liability	3,55,986

Note : As per section 35DD, any expenditure incurred wholly and exclusively for the purpose of amalgamation, would be allowed as a deduction in 5 successive years (1/5th each year) commencing from the year in which the amalgamation takes place.

Question 6

Isac limited is a company engaged in the business of biotechnology. The net profit of the company for the financial year ended 31.03.2017 is Rs 15,25,890 after debiting the following items:

Particulars	*Amount (Rs.)*
(1) Purchase price of raw material used for the purpose of in-house research and development	*1,80,000*
(2) Purchase price of asset used for in-house research and development wrongly debited to profit and loss account:	
(a) Land	*5,00,000*
(b) Building	*3,00,000*
(3) Expenditure incurred on notified agricultural extension project	*1,50,000*
(4) Expenditure on notified skill development project:	
(a) Purchase of land	*2,00,000*
(b) Expenditure on training for skill development	*2,50,000*
(5) Expenditure incurred on advertisement in the souvenir published by a political party	*75,000*

Compute the income under the head "Profits and gains of business or profession" for the A.Y. 2017-18 of Isac Ltd.

Answer

Computation of income under the head "Profits and gains of business or profession" of Isac Limited for the A.Y.2017-18

Particulars	*Amount (Rs.)*	*Amount (Rs.)*
Net profit as per profit and loss account		15,25,890
Add : Items debited to profit and loss account, but to be disallowed		
Land used for in-house research and development (capital expenditure not allowable as deduction under section 35)	5,00,000	
Building used for in-house research and development (capital expenditure, 100% of which is allowable as deduction u/s 35(1)(iv) read with section 35(2))	—	
Expenditure incurred on notified agricultural extension project (to be treated separately)	1,50,000	
Expenditure incurred on notified skill development project -Purchase of land – (capital expenditure not qualified for deduction under section 35CCD)	2,00,000	
Expenditure incurred on notified skill development project -		
Expenditure on training for skill development (to be treated separately)	2,50,000	
Expenditure incurred on advertisement in the souvenir published by a political party not allowed as deduction as per section 37(2B)	75,000	11,75,000
Less:		
Purchase price of raw material used for in-house research and development qualifies for 200% deduction under section 35(2AB). Since, it is already debited to profit and loss account balance 100% is allowed.	1,80,000	
Expenditure incurred on notified agricultural extension project qualifies for 150% deduction under section 35CCC.	2,25,000	

Expenditure incurred on training for skill development in a notified skill development project qualifies for 150% deduction under section 35CCD.	3,75,000	(7,80,000)
Profit and gains from business		19,20,890
Tax Liability (30% of 19,20,890)		5,76,267
Add : Education cess @ 2% & SHEC @ 1%		17,288
Total Tax Liability		5,93,555

Question 7

Indian Gas Limited commenced its operation of the business of laying and operating a cross country natural gas pipeline network for distribution on 1st July, 2016. The company incurred capital expenditure of Rs. 300 lacs (including cost of land Rs.45 lacs and cost of financial instrument Rs. 5 lacs) during the period from 1st April, 2016 to 30th June, 2016. The company did not claim deduction for such expenditure in the earlier assessment years. The entire expenditure was capitalised on 1st July, 2016. Further, during the previous year 2016-17 (from July 2016), the company incurred capital expenditure of Rs. 200 lacs exclusively for the said business.

I. *Compute the amount of deduction allowable under section 35AD assuming that the company has fulfilled all the conditions specified in section 35AD.*

II. *If the company has loss from such business in the assessment year 2017-18, how the same is to be set off and carried forward?*

Answer

Section 35AD provides for investment-linked tax incentive for specified business. One such specified business is business of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network. The benefit will be available in a case where the business relates to laying and operating a cross country natural gas pipeline network for distribution, if such business commences its operations on or after 1st April, 2007.

Under section 35AD, 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above business would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations. Therefore, the deduction admissible under section 35AD for A.Y.2017-18 would be:

Particulars	Rs. (in lacs)
Capital expenditure incurred during the previous year 2016-17	200
Capital expenditure incurred during the period from 1st April 2016 to 30th June, 2016 (i.e. prior to commencement of business) and capitalized in the books of account on 1st July, 2016 (Rs. 300 lacs – Rs. 50 lacs)	250
Total deduction under section 35AD for A.Y.2017-18	**450**

However, the actual deduction under section 35AD for A.Y. 2016-18 would be restricted to the profits derived from specified business for that year. The difference would be treated as loss from specified business to be carried forward as per section 73A.

(ii) Section 73A provides that any loss computed in respect of the specified business shall be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year and so on. There is no time limit specified for carry forward and set-off and therefore, such loss can be carried forward indefinitely for set-off against income from specified business.

Question 8

Ram Manhar & Sons HUF, running Raghuveer Departmental Stores consists of Karta, his wife, two sons and daughter. Both the sons who are having professional/technical qualifications as a Chartered Accountant and as an Automobile Engineer started in partnership, a garage for the repairing of motor cars, with a clear understanding that the technical side of the business be looked after by the Engineer while the general administration and finance part be taken care by the Chartered Accountant. They had taken an interest-free loan of Rs. 5,00,000 from the HUF for starting the venture. The business of garage resulted in a net profit of Rs. 15,00,000 for the year ended 31.03.2017. The Assessing Officer proposes to assess the income from the business of motor garage in the hands of HUF. Examine the validity of the proposition of the Assessing Officer in the light of a decided case law.

Answer

The facts of the case are similar to that of the case of *CIT* v. *Charan Dass Khanna & Sons* (1980) 123 ITR 194, where the Delhi High Court observed that if the investment made by the HUF in the business started by the coparceners plays a minor role and it is primarily the personal efforts, specialized skill and enterprise of the individual coparceners which resulted in setting up of a new business and earning of goods profits, then it may not essentially be said that the income belongs to the HUF.

The Supreme Court has also supported this view in the case of *K.S. Subbiah Pillai* v. *CIT* (1999) 237 ITR 11 and held that where the remuneration and commission earned by the

Karta were on account of the personal qualifications and exertions and not on account of the investment of the family funds, such income cannot be treated as income of the HUF.

Thus, in the given case, profits were earned primarily because of the specialized skills acquired by both the partners in their respective fields and used in the business of motor garage. The initial capital taken from the HUF as interest free loan, of course, has its role but it is nevertheless a minor one. Therefore, the income from the business set up by the brothers is assessable in their individual hands and not as the income of the family.

Further, the proposition of the Assessing Officer to tax the profits of the business of motor garage earned by the two sons in the hands of the HUF is not valid.

Question 9

Who shall sign and verify the return of income of a limited liability partnership?

Answer

Under section 140 of the Income Tax Act, the return of income of a Limited Liability Partnership shall be signed and verified by the designated partner thereof. Where for any unavoidable reason, such designated partner is not able to sign and verify the return, or where there is no designated partner as such, the return can be signed by any partner of the LLP.

Question 10

XYZ LLP is being liquidated. Examine the liability of its partners in respect of its tax dues?

Answer

Section 167C of the Income Tax Act, 1961 provides for the liability of partners of LLP in the event of its liquidation. In case of liquidation of an LLP, where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP. This provision would also apply where tax is due from any other person in respect of any income of any previous year during which such other person was a LLP.

Question 11

XYZ LLP has an income of Rs. 72,00,000 under the head 'profits and gains of business or profession'. One of its business is eligible for deduction @ 100% of profits under section 80-IB for the assessment year 2017-18. The profit from such business included in the business income is Rs. 58,00,000. Compute the tax payable by the LLP, assuming that it has no other income during the previous year 2016-17.

Answer

Computation of Tax payable by XYZ LLP for AY 2017-18

Particulars	*Amount (Rs.)*
Total Income	72,00,000
Less : Deduction under section 80 IB	(58,00,000)
Taxable Income	14,00,000
Tax @ 30%	4,20,000
Education Cess & SHEC @3%	12,600
Total Tax	4,32,600

Computation of Alternate Minimum Tax

Particulars	*Amount (Rs.)*
Total Income	72,00,000
AMT on adjusted Total Income @ 18.5%	13,32,000
Education Cess & SHEC @3%	39,960
Total Tax	13,71,960

Since, the regular income tax payable is less than AMT, the adjusted total income would be deemed to be the income of LLP and it would be liable to tax @ 18.5% plus cess and Tax payable will be higher of AMT or Normal tax i.e. Rs. 13,71,960. Further, the LLP would be eligible for credit in 10 subsequent years to the extent of difference between the AMT and Normal Tax i.e. Rs. 9,39,360, in the year in which the tax payable under regular provisions exceeds the AMT.

Question 12

Mr. X, carrying on the business of operating a warehousing facility for storage of sugar, has a total income of Rs. 80 lakh. In computing the total income, he had claimed deduction under section 35AD to the tune of Rs. 70 lakh on investment in building (on 1.4.2016) for operating the warehousing facility for storage of sugar. Compute his tax liability for A.Y.2017-18. Show the calculations of Alternate minimum Tax also.

Answer

Computation of Tax payable by Mr. X for AY 2017-18

Computation of Normal Tax

Particulars	*Amount (Rs. in lakh)*
Tax liability under the normal provisions of the Income-tax Act, 1961	24.00
Add: Education cess and SHEC @3%	0.72
Total Tax Liability	24.72

Computation of Alternate Minimum Tax

Particulars	*Amount (Rs. in lakh)*
Adjusted Total Income	80.00
Add : Deduction under section 35AD	70.00
Less : Depreciation under section 32	(7.00)
Adjusted Total Income	143.00
AMT @18.5%	26.46
Surcharge @ 12% (since adjusted total income> Rs. 100 lakh)	3.18
Tax	29.64
Add: education cess and SHEC @3%	0.89
Total tax Liability	30.53

Since, the regular income tax payable is less than the AMT payable, the adjusted total income of Rs. 143 lakhs shall be deemed to be the total income of Mr. X and tax is payable @18.5% thereof plus surcharge @ 12% and cess @3%. Therefore, tax liability is 30.53 lakhs.

However, Mr. X would be eligible for credit in 10 subsequent years to the extent of difference between the AMT and Normal Tax i.e. Rs. 5.81 lakhs.

Question 13

Minimum Alternate Tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18.5% of net profit as per the profit and loss account for the relevant previous year. Comment

Answer

The statement is incorrect as, the minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18.5% of book profit. Chapter XII-B is a self contained code for computation of book profit. The net profit as per the profit and loss account for the relevant previous year prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956, as increased/reduced by the specified adjustments provided for in Explanation 1 to section 115JB would be the book profit for levy of MAT under section 115JB.

Question 14

"The provisions of section 115JB are not applicable in case of foreign companies". Examine in the context of the provisions contained in the various Chapters of the Income Tax Act, 1961.

Answer

The statement is incorrect; since, there is no provision in section 115JB restricting its applicability to only domestic companies and therefore, section 115JB is applicable to both domestic and foreign companies. The provisions of section 115JB are applicable in the case of an assessee, being a company, where 18.5% of its book profit exceeds the tax payable on the total income computed under the normal provisions of the Act. Therefore, the provisions of section 115JB would be attracted both in the case of a domestic as well as a foreign company, if the tax payable on its total income is less than 18.5% of its book profit.

However, section 115JB will not be applicable to a foreign company which has no presence or permanent establishment in India - *Timken Company., In re. (2010) 326 ITR 193 / 193 Taxman 20 (AAR- New Delhi).*

Question 15

Parul Pvt. Ltd. made a provision of Rs. 50 lakhs for doubtful debts by debit to profit and loss account. The Assessing Officer, while computing book profit under section 115JB, disallowed the provision for doubtful debts. Is the action of Assessing Officer justified? Comment.

Answer

Explanation 1 under section 115JB(2) has been amended to provide that the net profit should also be increased by, inter alia, the amount set aside as provision for diminution in the value of any asset, if the same has been debited to profit and loss account, for computing the book profit.

Therefore, the Assessing Officer is justified in disallowing (adding back) the provision of Rs.50 lakhs for doubtful debts while computing book profit.

Question 16

ABC Ltd. has invested in bonds of National Highway Authority of India within the prescribed time and claimed exemption on the income from long-term capital gains under section 54EC. Further, it also claimed exclusion of long-term capital gains in the computation of "book profit" under section 115JB because of exemption available on it by virtue of section 54EC.

The Assessing Officer however, reckoned the book profit including long-term capital gains for the purpose of levy of minimum alternate tax payable under section 115JB. Is the action of the Assessing Officer justified? Comment.

Answer

The issue under consideration in this case is whether long-term capital gain exempted by virtue of section 54EC can be included in the book profit computed under section 115JB for levy of minimum alternate tax.

As long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with the provisions of Companies Act, capital gains cannot be excluded unless provided under Explanation 1 to section 115JB.

Since, Explanation 1 to section 115JB does not provide for deduction in respect of capital gain in course of investment in bonds of National Highways Authority of India within the prescribed time, the long term capital gains so exempt would still be taken into account for computing book profit under section 115JB for levy of MAT. The same was so held by the *Kerala High Court in N. J. Jose and Co. (P.) Ltd.* v. *ACIT* (2010) 321 ITR 0132.

Therefore, the action of the Assessing Officer is justified in law.

Question 17

Whether MAT credit admissible under section 115JAA has to be set-off against the assessed tax payable before calculating interest under sections 234A, 234B and 234C? Comment

Answer

The right to carry forward and set-off MAT credit under section 115JAA arises as soon as the tax is paid by the assessee under section 115JB. The tax credit allowable can be set-off by the assessee while computing advance tax/self assessment tax payable for the year. Hon'ble Supreme Court in the case of *CIT* v. *Tulsyan NEC Ltd.* (2011) 330 ITR 226 decided that MAT Credit admissible under section 115JAA has to be set-off against the Assessed tax payable, before calculating interest under section 234A, 234B and 234C.

Question 18

Compute the net income and tax liability of X Ltd. For the assessment year 2017-18 assuming that X Ltd. has a deemed long-term capital gain of Rs.60,000 under proviso (i) to section 54D(2) which is not credited in profit and loss account.

Particulars		*Amount (Rs.)*
Sale proceeds of goods (domestic sale)	*22,23,900*	
Sale proceeds of goods (export sale)	*5,76,100*	
Amount withdrawn from General Reserve (created by debiting the P&L a\c)	*2,00,000*	
Amount withdrawn from revaluation reserve	*1,50,000*	
Total		*31,50,000*
Less:		
Business Expenses	*2,10,000*	
Depreciation (normal)	*6,16,000*	
Depreciation (extra depreciation because of revaluation)	*2,70,000*	
Salary & wages	*2,85,820*	
Income-tax	*3,50,000*	
Outstanding customs duty (not paid as yet)	*17,500*	
Proposed Dividend	*60,000*	
Consultation fees paid to a tax expert	*1,39,000*	
Other expenses	*21,000*	*(19,69,320)*
Net profit		*11,80,680*

The company wants to claim/ set off the following:-

1. *Deduction under section 80-IB (30% of Rs. 11,80,680)*
2. *Depreciation under section 32 (Rs. 5,36,000)*
3. *Bought forward the loss of 2012-13 being Rs. 14,80,000 for tax purposes and Rs. 40,00,000 for accounting purpose*
4. *Unabsorbed depreciation being Rs. 70,000 for accounting purpose.*

Answer

Computation of the net income and tax liability of X Ltd. for the assessment year 2017-18

Tax Liability under normal provisions of Income Tax Act

Particulars	*Amount (Rs.)*	*Amount (Rs.)*
Net profit as per P&L A/c		11,80,680
Add:		
Excess depreciation	3,50,000	
[i.e., Rs. 6,16,000+Rs. 2,70,000 – Rs. 5,36,000]		
Income Tax	3,50,000	7,77,500
Customs Duty which is not paid	17,500	
Proposed dividend	60,000	
Less:		
Amount withdrawn from General reserve	2,00,000	
Amount withdrawn from Revaluation reserve	1,50,000	
Unabsorbed loss	14,80,000	(18,30,000)
Business Income		1,28,180
Long term capital gain		60,000
Deductions under section 80-IB (30% of 1,28,180)		(38,454)
Net Income		1,49,726
Tax Liability		40,085

Computation of Book Profits and Tax Liability as per MAT provisions under section 115 JB of the Act

Particulars	*Amount (Rs.)*	*Amount (Rs.)*
Net Profit		11,80,680
Add:		
Depreciation		
(Rs. 6,16,000+Rs.2,70,000)	8,86,000	
Income Tax	3,50,000	
Proposed dividend	60,000	12,96,000

Less:		
Amount withdrawn from general reserve	2,00,000	
Unabsorbed depreciation	70,000	
Normal depreciation	6,16,000	
Amount withdrawn from revaluation reserve to the extent it does not exceed extra depreciation because of revaluation	1,50,000	(10,36,000)
Book Profit		14,40,680
Tax Liability @ 19.055% (18.5% plus cess and SHEC @ 3%)		2,74,522

X Ltd. will pay Rs. 2,74,522 as tax for the A.Y 2017-18 as per section 115JB. Tax credit however is available in respect of excess tax (Rs. 2,34,437) under section 115JBB).

Part – III - Dividend Distribution Tax

Question 1

Xavier Ltd., a domestic company, has distributed dividend of Rs. 230 lakh to its shareholders on 1/11/2015. On 1/10/2015, it has received dividend of Rs. 60 lakh from its domestic subsidiary company Yale Ltd., on which Yale Ltd. has paid dividend distribution tax under section 115-O. Compute the additional income-tax payable by Xavier Ltd. under section 115-O.

Answer

Computation of Income Tax Payable by Xavier Ltd.

Particulars	*Rs. (in lakhs)*
Dividend distributed by Xavier Ltd.	230
Less : Dividend received from subsidiary Yale Ltd.	(60)
Net Distributed profits	170
Add: increase for the purpose of grossing up of dividend (100 x 170/100-15)	30
Gross Dividend	200
Additional income tax payable by X Ltd. u/s 115-O(15% of Rs. 200 lakhs)	30.00
Add : Surcharge @ 12%	3.60
Tax before cess	33.60
Add : Education cess@ 2% and SHEC @1%	1.00
Tax Payable	34.60

Note :

W.e.f. 1st October, 2014 the dividend paid is required to be to grossed up with the income distributed for computing the tax liability on account of dividend distribution tax. With the grossing up, the effective tax rate on dividend distribution has increased as under:

If surcharge and education cess is excluded then effective rate of dividend distribution tax would be 20.357% {17.647% -(100 X15/85)+ 12% surcharge and 3% education cess thereon}.

If surcharge and education cess is included then the rate would be 20.925%- (100X 17.304/82.696).

Question 2

Write short note on tax on distributed income by a company for buy-back of unlisted shares. Also comment would there be any tax implication in the hands of the shareholders.

Answer

As per section 10 (34A) of Income Tax Act, any income arising on account of buy back of shares (not being listed on a recognised stock exchange) by the company as referred to in section 115QA shall be exempt in the hands shareholders. However, the company shall be liable to pay tax @ 20% plus surcharge @12% and education cess @2% and secondary and higher education cess @1% on such distributed income on account of buy back of shares. For the purpose of the said section, distributed income means the consideration paid by the company on buy-back of shares as reduced by the amount which was received by the company for issue of such shares.

The income arising to the shareholders in respect of such buyback of unlisted shares by the Company would be exempt under section 10(34A) in their hands.

Question 3

Lal Ltd., a domestic company, purchases its own unlisted shares on 17th August, 2015. The consideration for buyback amounted to Rs. 18 lakh, which was paid on the same day. Lal Ltd. had received Rs. 11 lakh on issue of these shares one year back. Compute the additional income-tax payable by Lal Ltd. Further, determine the interest, if any, payable if such tax is paid to the credit of the Central Government on 7th November, 2015. Discuss.

Answer

Computation of Tax Liability of Lal Ltd.

Particulars	*Amount (lakh Rs.)*
Consideration for Buy-Back	18.000
Less : Amount received on Issue of shares	(11.000)
Distributed income	7.000
Tax @ 20%	1.400
Surcharge @ 12% of Rs. 1.4 lakhs	0.168
	1.56800
Education Cess & SHEC @ 3% of Rs. 1.568 lakhs	0.04704
Tax Liability	1.61504

The additional income-tax was payable on or before 31st August, 2015. However, the same was paid only on 7th November, 2015. Thus, interest under section 115QB is attracted @1% for every month or part of the month on the amount of tax not paid or short paid for the period beginning from the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

In this case, the period for which interest @1% per month or part of a month is leviable is calculated as under for 3 months (September-November):

Interest = Rs. (1,61,504 x 1/100 x 3) = Rs. 4,845.12.

Question 4

"The provisions of dividend distribution tax are also applicable to an undertaking or enterprise engaged in developing, operating and maintaining a Special Economic Zone (SEZ)". Comment.

Answer

The statement is correct. Prior to amendment by Finance Act, 2011, as per section 115-O(6), no tax on distributed profits was chargeable in respect of the total income of an undertaking or enterprise engaged in developing or developing and operating or developing, operating and maintaining a Special Economic Zone for any assessment year on any amount declared, distributed or paid by such Developer or enterprise, by way of dividends (whether interim or otherwise) on or after 1.4.2005 out of its current income either in the hands of the Developer or enterprise or the person receiving such dividend.

However, the Finance Act, 2011 has introduced a sunset clause to remove the above exemption in respect of dividend distribution tax for dividends declared, distributed or paid on or after 1st June, 2011. Therefore, the statement given in the question is correct in respect of dividend declared, distributed or paid on or after 1st June, 2011.

Question 5

Dividend received from a foreign subsidiary on which tax is payable under Section 115BBD by domestic holding company shall not be subject to dividend distribution tax under section 115-O. Comment.

Answer

The statement is correct. Dividend received from a foreign subsidiary on which the tax is payable by the domestic company under Section 115BBD is specifically excluded for the purpose section 115-O. Subsidiary means a company, in which the domestic holding company holds more than 50% in the nominal value of equity share capital.

Question 6

X Ltd. an Indian Company received dividend of Rs. 15 lakhs from a foreign company in which it holds 28% in nominal value of the equity share capital of the company. X Ltd. and incurred expenditure of Rs. 0.25 lakhs on earning this income. Examine the taxability of the dividend under the provisions of the Income tax Act, 1961.

Answer

Under section 115BBD, dividend received by an Indian company from a foreign company in which it holds 26% or more in nominal value of the equity share capital of the company, would be subject to a concessional tax rate of 15% plus surcharge and cess, as against the tax rate of 30% applicable to other income of a domestic company. This rate of 15% plus surcharge and cess would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend. Therefore, dividend of Rs. 15 lakhs received by X Ltd. from a foreign company, in which it holds 28% in nominal value of equity share capital of the company, would be subject to tax@15% under section 115BBD. Such dividend would be taxable under the head "Income from other sources". No deduction is allowable in respect of Rs. 0.25 lakhs spent on earning this income.

The Finance (No.2) Act, 2014 extended the benefit of concessional rate of taxation@15% on gross dividend received by Indian companies from specified foreign companies without limiting it to a particular assessment year, in order to encourage Indian companies to repatriate foreign dividends into the country.

Question 7

The business income of Raman Ltd., an Indian company computed as per the provisions of Income Tax Act is Rs. 53,00,000. It has also received following dividend income during the previous year 2016-17:

Particulars	*Amount of Dividend Received (Rs.)*	*Remuneration paid for realizing Dividend (Rs.)*
From Geneva Inc, a Swiss company in which it holds 23% of nominal value of equity share capital	*72,000*	*7,000*
From shares held in Michigan Inc, a US company in which it holds 51% of nominal value of equity share capital	*2,10,000*	*8,000*
From shares held in Ontario Inc, a Canadian company, in which it holds 23% of nominal value of equity share capital	*1,92,000*	-
From shares held in Indian Subsidiaries, on which dividend distribution tax has been paid by such subsidiaries	*Rs. 58,000*	*6,000*

Compute the total income and tax liability of Raman Ltd. ignoring MAT.

Further, assuming that Raman Ltd. has distributed dividend of Rs. 3,80,000 in March, 2017 compute the additional income tax payable by it under section 115-O.

Answer

Computation of total income of Raman Ltd. for A.Y 2017-18

Particulars	*Amount (Rs.)*
Profits and gains of business or profession	53,00,000
Income from other sources (Note: 1)	4,67,000
Total Income	57,67,000

Computation of tax liability of Raman Ltd. for the A.Y 2017-18

Particulars	*Amount (Rs.)*
Tax @15% under section 115BBD on Rs. 2,10,000 (gross dividend) (including surcharge @12%)	35,280
Tax @ 30% on balance income of Rs. 55,57,000	16,67,100
Tax before cess	17,02,380
Add: Education cess and SHEC @ 3%	51,071.40
Tax Liability	17,53,451.40

Computation of additional income tax payable by Raman Ltd. under section 115-O

Particulars	*Amount (Rs.)*	*Amount (Rs.)*
Amount distributed by way of dividend		3,80,000
Less : Dividend received from Indian subsidiaries, on which DDT payable under section 115-O has been paid	58,000	
Less : Dividend received from foreign subsidiary, Michigan Inc, on which tax is payable under section 115 BBD	2,10,000	(2,68,000)
Add : increase for the purpose of grossing up of dividend		19,765
(15* 112000/85)		

Gross Dividend	1,31,765
Additional income tax	19,765
Surcharge @12%	2,372
Education Cess & SHEC @ 3%	664
Total additional tax	**22,801**

Note:

1. "Income from other sources"

Particulars	*Rs.*
From Geneva.Inc. a Swiss company-net dividend (i.e Rs. 72,000-Rs.7000) taxable at normal rates	65,000
From Michigan Inc, a US company- gross dividend is taxable @ 15% under section 115BBD (no deduction is allowable in respect of any expenditure as per section 115 BBD(2))	2,10,000
From Ontario Inc, a Canadian Co. net dividend(i.e Rs. 192,000) is taxable at normal rates	1,92,000
From shares in Indian subsidiaries Rs. 58000 - exempt under section 10(34)	NIL
Since DDT has been paid under section 115-O, as per section 14A no deduction is allowable in respect of expenditure incurred to earn exempt income.	
Total Income from other Sources	4,67,000

2. W.e.f 1st October, 2014 the dividend paid is required to be to grossed up with the income *distributed for computing the tax liability on account of dividend distribution tax. With* the grossing up, the effective tax rate on dividend distribution has increased as under:

   If surcharge and education cess is excluded then effective rate of dividend distribution tax would be 20.357% {17.647% -(100 X15/85)+ 12% surcharge and 3% education cess thereon}.

   If surcharge and education cess is included then the rate would be 20.925%- (100X 17.304/82.696).

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2

International Taxation

Part I : Taxation of Non-Resident Entities

Question 1

Explain which income received by a foreign company, be taxable in India. Also mention the basic tax rate applicable to a foreign company which is based in US.

Answer

A non-resident company be chargeable to tax in India in respect of following incomes:

(i) Income received or deemed to be received in India.

(ii) Income accruing or arising or deemed to accrue or arise in India.

The basic tax rate applicable in respect of the above incomes for the US based company which is a foreign company, is 40% in India. Further, surcharge @ 2% is applicable in case the taxable income exceeds Rs. 1 crore and is up to Rs. 10 crore, and @5% if the income exceeds Rs. 10 crore in the previous year. The Education cess @ 2% and Secondary and Higher education cess @ 1% are also payable.

Question 2

Determine the tax liability of income of Japan based company Fujistu Ltd., in India on entering following transactions during the financial year 2016-17:

a) Rs. 5 lakhs received from an Indian domestic company for providing technical know how in India.

b) Rs. 6 lakhs from an Indian firm for conducting the feasibility study for the new project in Finland.

c) Rs. 4 lakhs from a non-resident for use of patent for a business in India.

d) Rs. 8 lakhs from a non-resident Indian for use of know how for a business in Singapore.

e) Rs. 10 lakhs for supply of manuals and designs for the business to be established in Singapore.

Assume there is no Double Avoidance Tax Agreement and all foreign Income are taxable in India only.

Answer

Computation of Tax Liability of Fujitsu Ltd.

S. No	*Particulars*	*Amount in lakhs (Rs.)*
a)	Amount received from an Indian domestic company for providing technical know how in India	5.00
	(From Business Connection in India, therefore taxable in India)	
b)	Amount received from Indian firm for conducting the feasibility study for the new project in Finland	Nil
	(Not taxable in India as it is for the business outside India)	
c)	Money received from a non resident for use of patent for a business in India	4.00
	(Amount received for business set up in India is taxable in India)	
d)	Money received from a non resident Indian for use of know-how for a business in Singapore	Nil
	(The business is outside India, therefore non taxable in India)	
e)	Payment made for supply of manuals and designs for the business to be established in Singapore	Nil
	(Business is to be established outside India, thus not taxable in India)	
	Total Income in India	9.00
	Tax @ 40%	3.60
	Surcharge	-
	Education Cess & SHEC @ 3%	0.108
	Total tax Liability	3.708

Question 3

Would non-resident match referees and umpires in the games played in India fall within the meaning of sportsmen to attract taxability under the provisions of section 115BBA of Income Tax Act, 1961 ? Discuss briefly with the help of decided case law, if any.

Answer

In the case of *Indcom* v. *CIT*, the High Court has held that the payment made to non-resident match referees & umpires is "income" which has accrued & arisen in India, however, the same are not taxable under section 115BBA of Income Tax Act as the Umpires and Match Referee are neither sportsmen (including an athlete) nor they are non-resident sports

association or institution so they do not attract the provisions contained in said section and the payments made to them do not come within the purview of Section 115BBA.

Question 4

A Ltd, an assessee is engaged in the business of wet-leasing of aircrafts. It had acquired an old aircraft from B Ltd., a Russian non-resident company. The assessee was granted the license by the Director General of Civil Aviation (DGCA) in India to operate the aircraft on international routes only and was also obliged to keep the aircraft in flying condition. The aircraft was stationed at Sharjah base where its crew and engineering personnel were also stationed. According to DGCA directives, various components of the aircraft had to undergo overhaul/repairs which was permissible only in workshops authorized for the purpose. Since, there were no facilities for overhaul/repairs in India, the component needing overhaul/repairs was dismantled by the assessee's engineers and flown to D Ltd.'s (a Russian company) workshop in Russia at the expense of A Ltd.

The overhauled component was then fitted into aircrafts by the assessee's own personnel. The assessing officer held that payments made to D Ltd. were in the nature of "Fees for technical services" as defined in Explanation 2 to Section 9(1) (vii) (b) of the Income Tax Act, and were, therefore, chargeable to tax on which tax should have been deducted at source under Section 195(1) of the Act. Examine the contention of assessing officer and the asseessee in the light of decided case law.

Answer

The facts of the given case are similar to that of the *DIT v. M/s. Lufthansa Cargo India: TS-299-HC-2015*, where the Delhi High Court held that payment made by assessee (an Indian company) to German company for carrying out overhaul repairs to aircrafts was fees for technical services ("FTS") under section 9(1)(vii) of the Income Tax Act, 1961 but was not taxable in India as it did not have its source in India in view of clause (b) thereto.

The High Court observed that since the level of technical expertise and ability required in aircraft maintenance and repairs was specific in nature, so much so that the aircraft supplied by manufacturer had to be serviced and its components maintained, serviced or overhauled by designated centres to ensure safe and airworthy aircrafts, therefore, such exclusive nature of services would be regarded as "technical services" falling within the purview of Section 9(1)(vii) of the IT Act.

In respect of the issue regarding taxability in India of payments made by the assessee towards its activities outside India, the High Court affirmed that since the sources from which the assessee had earned income was outside India, the said payment did not have its source in India and was hence not taxable in India for that reason and no TDS was required therefrom.

Question 5

In the context of provisions contained in the Income Tax Act, 1961 examine the correctness of the following statements:

a) Liaison office maintained in India to explore the opportunity of business in India does not constitute business connection.

b) A non-resident aviation company flying an aircraft in India and paid tax under section 44BBA claims that the employees deputed for flying this aircraft shall not be subject to tax on the remuneration to the extent paid out of such income. Is the claim justified?

c) X while making payments "net of tax" to a non-resident for providing technical services on the World Bank aided project had deducted tax out of such payments as per rates prescribed but says that payee is not entitled for the TDS certificate. Examine.

Answer

a) The statement is correct. If a liaison office is maintained solely for the purpose of carrying out activities which are preparatory or auxiliary in character, and such activities are approved by the Reserve Bank of India, then no business connection is established. In this case the liaison office is maintained for the purpose of exploring the business opportunity which is in the nature of preparatory or auxiliary activity. It is assumed that such activities are approved by the Reserve Bank of India. Since it does not undertake any commercial, trading on industrial activity, directly or indirectly, the liaison office does not constitute a business connection in this case.

b) Section 44BBA provides for deeming 5% of aggregate of amounts received by/ paid or payable to a non-resident assessee engaged in the business of operation of aircraft, for carriage of passengers, livestock, mail or goods, as profits and gains of such business chargeable to tax under the head "profits and gains of business or profession".

The issue under consideration is whether employees deputed for flying the aircraft in India would be exempt from tax on the remuneration received from the non-resident aviation company to the extent paid out of income which is subject to tax in India on the basis of presumptive taxation provisions under section 44BBA.

The issue came up before that Authority for advance rulings in the case of *Lloyd helicopters International Private Limited (2001) 249 ITR 162,* wherein it was observed that as per Article 15 of the DTAA between India and Australia, one of the conditions for exemption of remuneration of employees resident of Australia is that such remuneration should not be deductible in determining the profit chargeable to tax of the non-resident aviation company. In this regard, the AAR observed that the profit is determined under section 44BBA, though arrived at on a statutory basis, cannot be considered to exclude such expenses as non-deductible merely because the statute fixes a percentage in this regard. The fixation of a rate as low as 5% of the gross receipts indicates the statutory attempt at estimating and allowing expenses normally likely to be incurred in such business, which includes remuneration of employees.

Therefore, applying the rationale of the AAR ruling, the remuneration paid to employees is deemed to have been deducted while computing the profit is chargeable to tax of the employer that is, the non-resident aviation company under section 44BBA.

Accordingly the said remuneration paid to non-resident employs shall not be exempt from tax in India. The claim of the non-resident aviation company, therefore is not justified.

Note: the question is silent about the country of residence of the employees of aviation company. Employees may be resident or non-resident in India. In case the remuneration is paid to resident employee is, the same is taxable in their hands.

Also aviation company can be incorporated in the country with which India has no treaty. Therefore, it is possible to answer the question on the basis of provisions of section 9(1) alone. Since the services were rendered in India, salary of employs shall be deemed to accrue or arise in India and therefore the same attracts the liability in India irrespective of the fact that remuneration was paid out of income of the non-resident company chargeable to tax in India as per the provisions of section 44BBA.

c) As per section 198, any sum deducted in accordance with the provisions of chapter XVII – B of the Income Tax Act, 1961 is deemed to be income received while computing the income of the payee. As per section 203, every person deducting tax at source shall furnish to the payee a certificate in the prescribed form within the prescribed time.

Even in a case where X undertakes to pay the tax on the grossed up amount, the non-resident shall be entitled for issue of certificate of tax deducted at source in respect of payment made net of tax in terms of section 195A. This has been clarified wide CBDT circular number 785 dated 24.11.1999. Therefore, X has a legal obligation to issue TDS certificate to the non-resident, even if he has made payment of income "net of tax" to him.

Question 6

Discuss the relief provided to the foreign income of an assessee in following cases:

(a) In case there is bilateral DTAA
(b) In case there is no DTAA.

Answer

Double Taxation Relief is applicable in the case of those assesses whose income is taxed in two or more countries due to residential status or due to source principle. To mitigate the impact of double taxation of income, the provisions for double taxation relief were made.

(a) India has entered into agreement with many countries regarding avoidance of double taxation. In case there is a bilateral Double Taxation Avoidance Agreement ('DTAA' or 'the Treaty') concluded between India and the other country, the assessee can claim relief under section 90 of the Income tax Act, 1961. Foreign tax credit is provided to the assessee who has paid taxes in India as well as in a foreign country. This tax relief is governed by the provisions of respective DTAA. Further, the provision of Income-tax Act, 1961 are applicable to the assessee to the extent they are more beneficial to him.

(b) Where there is no bilateral agreement with a country, under Section 90 of the Income tax Act, section 91 of the Act grants unilateral relief in respect of income which has suffered tax both in India and in a country with which no DTAA exists (i.e. doubly taxed income). This relief is provided in the form of a deduction from the income tax payable in India and is calculated on the doubly taxed income at Indian Tax rate or the tax rate of the foreign country whichever is lower or at Indian rate of tax, if both rates are equal. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

Question 7

The Income-tax Act, 1961 provides for taxation of a certain income earned by Shyam. The Double Taxation Avoidance Agreement, which applies to Shyam, excludes the income earned by him from the purview of tax. Will he be liable to pay tax on the income earned by him? Discuss in the light of provisions of Income Tax Act, 1961 and decided case law, if any.

Answer

Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing the tax liability.

Further, in *CIT* v. *P.V.A.L. Kulandagan Chettiar* (2004) 267 ITR 654, the Supreme Court has held that in case of any conflict between the provisions of the Double Taxation Avoidance

Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 1961.

Shyam will, therefore, not be liable to pay tax on such income earned by him.

Question 8

Yogita Kumari, a resident individual, is a freelance dancer deriving income of Rs. 75,000 from shows performed outside India. Tax of Rs. 10,000 was deducted at source in the country where the shows were performed. India does not have any double tax avoidance agreement with that country. Her income in India amounted to Rs. 3,00,000. Compute tax liability of Yogita for the assessment year 2017-18 assuming she has deposited Rs. 10,000 in Public Provident Fund and paid Rs. 20,000 as medical insurance premium in respect of her father (aged 65 years).

Answer

Computation of Tax Liability of Ms. Yogita Kumari

	Particulars		*Amount in Rs.*
	Indian Income		3,00,000
	Foreign Income		75,000
A	Gross Total Income		3,75,000
B	*Less* : Deductions under Chapter VIA		
	PPF Contribution	Rs. 10,000	
	Medical Insurance Premium for senior citizen	Rs. 20,000	(30,000)
C	Total Income (A-B)		3,45,000
	Tax on first Rs. 2,50,000	Nil	
	Tax on next 95,000		9,500
	Rebate under section 87A		(2,000)
	Education Cess & SHEC @ 3%		225
D	Total Tax		7,725
	Average rate of Tax in India		
	Rs. (7,725/3,45,000 * 100)	2.239%	
	Average rate of tax in foreign country		
	Rs. (10,000 /75,000 * 100)	13.33%	
	Doubly Taxed Income	Rs. 75,000	
E	Relief under section 91 (on Rs. 75,000 @ 2.239%)		(1,679)
F	Tax payable in India (D-E)		6,046

Note:

An assessee shall be allowed Relief under section 91 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, Yogita Kumari is eligible for deduction under section 91 since all the above conditions are fulfilled.

Question 9

The following are the particulars of income earned by Ms. Sunita, a resident Indian aged 25, for the assessment year 2017-18:

Particulars	*Amount in Rs.*
Income from playing basketball match in Netherland	*12,00,000*
Tax paid in Netherland	*1,80,000*
Income from playing basketball match in India	*19,20,000*
Life insurance premium paid	*1,20,000*
Medical Insurance Premium paid through net banking for her father aged 62 years	*25,000*

Compute her total income and tax liability for the assessment year 2017-18. Assume there is no Double Taxation Avoidance Agreement between India and Netherland.

Answer

Computation of total income and tax liability of Ms. Sunita for the A.Y 2017-18

	Particulars	*Amount (Rs.)*	*Amount (Rs.)*
A	Indian Income		
	(Income from playing basketball tournaments in India)	19,20,000	
	Foreign Income		
	(Income from playing basketball matches in Netherland)	12,00,000	

	Gross Total Income			
B	*Less* : Deduction under chapter VIA			31,20,000
	Deduction u/s 80C for Life Insurance Premium		1,20,000	
	Deduction u/s 80D for Medical Insurance Premium paid for her father (being senior citizen)		25,000	(1,45,000)
C	Total Income			
D	Tax on total income			29,75,000
	Tax upto Rs. 10,00,000 -	Rs. 1,25,000		
	Tax on income above Rs. 10,00,000	Rs. 592500	7,17,500	
	Add: Education Cess & SHEC @ 3%		21,525	
E	Average rate of tax in India			7,39,025
	Rs. (7,39,025/ 29,75,000 x 100)	24.84%		
	Average rate of tax in foreign country			
	Rs.(1,80,000/12,00,000 X 100)	15%		
	Rebate u/s 91			
	On Rs. 12 lakh @15% (lower of average Indian tax rate or average foreign tax rate)			
F	Tax payable in India			(1,80,000)
				5,59,025

Note :

Ms. Sunita shall be allowed Relief under section 91 of Income Tax Act, 1961, since conditions mentioned therein are fulfilled.

Question 10

Sudesh (age 62 years) is a resident and ordinarily resident in India. Details of his Income/ Investment are as under:

Rs. 16,80,000 is income from a business in India

Rs.5,45,000 is income from a business in country A

Rs. 32,000 has been paid as tax on income earned in country A

Rs. 28,000 paid as tuition fee for his daughter studying in India

Rs. 90,000 paid as tuition fee for his son studying outside India

Rs. 48,000 received as interest on Government securities.

India has agreement for avoidance of double taxation with country A and according to the agreement, income is taxable in the country in which it is earned and not in other country. However, in the other country, such income is to be included for computation of tax rate. With reference to above information, answer the following:

(i) Find out the tax liability of Sudesh for the Assessment Year 2017-18.

(ii) Does it make any difference, if Sudesh is a non-resident?

Answer

(i) Computation of Tax Liability of Sudesh

For A.Y 2017-18

	Particulars	*Rs.*
	Business Income in India	16,80,000
	Interest on Government Securities	48,000
A	Gross Total Income	17,28,000
B	Deduction u/s 80C For tuition fee (Note 1)	28,000
C	Total Income	17,00,000
	Foreign Income to be included in Indian Income for computation of tax rate	5,45,000
	Total Income for calculating tax rate	22,45,000
D	Tax on 22,45,000	
	Upto Rs. 3,00,000 (in case of senior citizen)	Nil
	From Rs. 3,00,001 to 5,00,000 @ 10% Rs. 20,000	
	From Rs. 5,00,001 to 10,00,000 @ 20% Rs. 1,00,000	
	On balance Rs. 12,45,000 @ 30% Rs. 3,73,500	4,93,500
E	Education Cess (@ 2% of tax) Rs. 9,870	
	SHEC (1% of tax) Rs. 4,935	14,805
F	Tax Payable	5,08,305
G	Average Tax Rate 22.64% (Rs.5,08,305/22,45,000 * 100)	
H	Indian Tax Liability (22.64% of 17,00,000)	3,84,908
	Rounded off Tax liability	3,84,910

Note:

1. Deduction under Section 80C is not available for tuition fee paid outside India.

(ii) If Sudesh is non-resident, his income taxable in India would be Rs. 17,00,000. Rs. 5,45,000 would not be included in his income as the same is earned outside India and would be taxable in country A.

Further, the tax liability of Sudesh in India would be calculated in following manner:

Particular	*Rs.*	*Rs.*
Total Income		17,00,000
Tax on 17,00,000		
Upto Rs. 2,50,000 (for non resident)	Nil	
From 2,50,000 to 5,00,000 @ 10%	25,000	
From 5,00,000 to 10,00,000 @ 20%	1,00,000	
On balance 7,00,000 @ 30%	2,10,000	3,35,000
Education Cess & SHEC @ 3%		10,050
Tax liability in India		3,45,050

Part II - Advance Ruling

Question 1

Explain the term 'Advance Ruling' under the Income-tax Act 1961.

Answer

The term 'Advance Ruling' has been defined in section 245N(a) of Income Tax Act, 1961 to mean:

(a) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant; or

(b) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident, and such determination shall include the determination of any question of law or of fact specified in the application;

(c) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision on any question of law or of fact relating to such computation of total income specified in the application;

(d) a determination or decision by the Authority as to whether an agreement, which is proposed to be undertaken by any person being a resident or non-resident, is an impermissible avoidance agreement as referred to in Chapter X-A or not.

Question 2

Explain in brief the procedure for making an application for advance ruling to Authority for Advance Rulings under Income Tax Act, 1961.

Answer

(a) An applicant shall make an application in such form and in such manner as may be prescribed, stating the question on which the advance ruling is sought. The application can be withdrawn within thirty days from the date of the application.

(b) Application should be made in the forms given below:

(i) **Form No. 34C :** Applicable for a non-resident applicant.

(ii) **Form No. 34D :** Applicable for a resident having transactions with a non-resident.

(iii) **Form No. 34DA** : A resident seeking advance ruling in relation to his tax liability arising out of one or more transactions valuing Rs.100 crore or more in total which has been undertaken or proposed to be undertaken by him

(iv) **Form 34E**: Applicable for class of persons notified by Central Government

(v) **Form No. 34EA** : Any person (resident or non-resident) making an application for determination of whether an arrangement, is an impermissible avoidance agreement as referred to in Chapter X-A. (applicable from 1-4-2015)

(c) The application shall be made in quadruplicate and be accompanied by a fee of Rs.10,000 or such higher fees as may be prescribed in this behalf, whichever is higher.

Question 3

State the powers of the Authority for Advance Ruling under the Income-tax Act, 1961.

Answer

Under section 245U of Income Tax Act, the Authority of Advance Ruling shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely -

(1) discovery and inspection;

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

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

(4) issuing commissions.

Question 4

Can a person resident in India seek advance ruling from the Authority for Advance Ruling under the Income-tax Act, 1961?

Answer

A resident can made an application to the Authority of Advance Ruling to seek an advance ruling in the following cases:

(i) Section 245N of Income Tax Act enables a resident falling within any such class or category of persons as may be notified by the Central Government to make an application for Advance Ruling. Such notified resident applicant can seek ruling in respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Such a resident applicant can make an application to seek decision on a question of law or a question of fact. "Public sector companies" as defined in section 2(36A) of the Income-tax Act, 1961 have been notified as applicant for this purpose.

(ii) In a case where the resident makes an application seeking advance ruling in relation to the tax liability of a non-resident arising out of a transaction undertaken or proposed to be undertaken by him with such non-resident.

(iii) In a case where the resident makes an application to the Authority of Advance Ruling for determination of decision as to whether the arrangement proposed to be

undertaken is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

(iv) In a case where a resident who has undertaken or propose to undertake one or more transactions of value of Rs.100 crore or more in total for determination by the AAR in relation to the tax liability of a resident applicant arising out of such transactions and such determination shall include the determination of any question of law or of fact specified in the application.

Question 5

Discuss in brief whether the concerned authority shall allow the application for advance ruling in the following cases:

(i) Application filed by a resident, where an appeal made by the non-resident company is pending before the appellate authority which is related to the application made by the resident taken up by the authority for advance ruling.

(ii) Application involving determination of fair market value of a house property.

(iii) Application involving an issue, already decided by the appellate tribunal in another case in favour of the revenue.

Answer

(i) Section 245N enables a resident falling within any such class or category of persons as may be notified by Central Government to make an application for Advance Ruling. Such notified resident can seek ruling in respect of issues relating to computation of total income which is pending before any income tax authority or appeallate tribunal. Such a resident applicant can make an application to seek decision on a question of law or a question of fact.

(ii) The facility of Advance Ruling has been introduced to assist non-residents in determining their tax liability in India well in advance. However, the Authority for Advance Rulings is prohibited in pronouncing any ruling on a question which involves determination of Fair Market Value of any property.

(iii) In the case of *Burmah Castrol Plc.* (A.A.R. NO. 772 OF 2008) it was held that the Commissioner of Income Tax cannot disarray the Authority for Advance Ruling. The final view has to be taken in the course of regular assessment. If before such assessment proceeding is initiated, this Authority gives a ruling in exercise of jurisdiction conferred by the Act, that ruling is binding on the assessing authority and it has to be followed. Thus, the order passed under section 197 as a tentative measure does not in any way fetter the jurisdiction of this Authority to proceed with the application.

Question 6

Mr. Raman is a non-resident. His appeal pertaining to the assessment year 2015-16 is pending before the Income-tax Appellate Tribunal, on the issue of computation of export profit and tax thereon. The same issue persists for the assessment year 2016-17 as well. Mr. Raman's brother Mr. Baman has obtained an advance ruling under Chapter XIX – B of

Income-tax Act, 1961 from the Authority for Advance Ruling on an identical issue. Mr. Raman proposes to use the said ruling for his assessment pertaining to the assessment year 2016-17. Can he do so?

Answer

As per section 245S(1) of Income tax Act, the advance ruling pronounced under section 245R by the Authority for Advance Ruling shall be binding only on the applicant who had sought it and in respect of the specific transaction in relation to which advance ruling was sought. It shall also be binding on the Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction. In view of the above provision, Mr. Raman cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment pertaining to the assessment year 2016-17.

Question 7

Amir, a non-resident, made an application to the Authority for Advance Rulings on 2.7.2015 in relation to a transaction proposed to be undertaken by him on 31.8.2015. Can the said application be withdrawn on 31.8.2015? Comment in the light of the provisions of the Income tax Act, 1961.

Answer

Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed from the date on which application was made by Amir to the Authority for Advance Rulings, he cannot withdraw the same.

Question 8

A foreign company entered into contracts with several Indian companies for installation of computer system and made an application for the advance ruling on the rate of withholding tax on receipts from Indian companies.

One of the Indian companies had also made an application to the Assessing Officer for determination of the rate at which tax is deductible on payment to the said foreign company. The Authority for Advance Rulings rejected the application of the foreign company on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of the foreign company justified?

Answer

The matter relates to the admission or rejection of the application filed before the Advance Ruling Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961. Clause (i) of the first proviso of section 245R(2) provides that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.

In the above case, no application had been filed or contention urged by the applicant (foreign company) before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with Authority for Advance Ruling. One of the Indian companies, however, had raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to a non-resident.

Thus, although the question raised pertains to one of the payments made or to be made to the non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case.

Further, in the case of *Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203, where the Authority for Advance Ruling has held that* the application filed by the Indian company before the Assessing Officer cannot be treated to have been filed by the non-resident. Hence, it would not be proper to reject the application of the foreign company relying on clause (i) of the proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

Thus, the application is maintainable.

Question 9

"An advance ruling can become void." Discuss.

Answer

As per section 245T of Income tax Act, an advance ruling can be declared to be *void ab initio* by the Authority for Advance Ruling if, on a representation made to it by the Commissioner or otherwise, it finds that the ruling has been obtained by fraud or misrepresentation of facts. Thereafter, all the provisions of the Act will apply as if no such advance ruling has been made. A copy of such order shall be sent to the applicant and the Commissioner.

Question 10

Whether an advance ruling pronounced by the authority can be challenged by the applicant or any income-tax authority under Articles 226/227 of the Constitution before the High Court or under Article 136 of the Constitution before the Supreme Court ?

Answer

Section 245S of the Income tax Act provides that a ruling by the Authority of Advance Ruling (AAR) is binding on the applicant as well as the income tax authorities for a particular transaction in respect of which the ruling is sought. On a strict interpretation of this section, no appeal should lie to any higher appellate authority and the ruling should be treated final. However, in the case of *Columbia Sportswear Company* v. *Director of Income Tax,* Supreme Court, held that–

(a) An AAR is a tribunal within the meaning of the expression in Articles 136 and 227 of the Indian Constitution;

(b) Section 245S of the Act does not bar the jurisdiction of the Supreme Court under Article 136 or the jurisdiction of the High Court under Articles 226 and 227 of the Indian Constitution to entertain a challenge to the advance ruling of the Authority;

(c) To hold that an advance ruling of an AAR should not be permitted to be challenged before the High Court under Articles 226 and 227 of the Indian Constitution would be to negate the basic structure of the Constitution;

(d) The power of the Supreme Court to entertain a Special Leave Petition under Article 136 of the Indian Constitution is discretionary in nature and hence, even if good grounds are made to challenge the advance ruling, the apex court may still refuse to grant special leave on the ground that the challenge to the advance ruling can also be made to the High Court under Article 226 and/or Article 227 of the Indian Constitution.

As can be seen from the above, the apex court through its decision in the Case has clarified that the advance ruling can be challenged before a High Court by filing a writ petition under Articles 226/227 or Special leave Petition under Article 136 of the Constitution.

Part III - Transfer Pricing

Question 1

Discuss the meaning of the term 'associated enterprise' as defined under section 92A (1).

Answer

Transfer pricing provision applies only to transaction between associated enterprises.

As per Section 92A(1) an associated enterprise in relation to another enterprise means:

a) An enterprise which participates directly or indirectly or through one or more intermediaries in the management or control or capital of the other enterprise or
b) An enterprise in respect of which one or more persons who participate directly or indirectly or through one or more intermediaries in its management or control or capital are the same persons who participates directly or indirectly or through one or more intermediaries in the management and control or capital of other enterprise.

Further, sub-clause (2) of Section 92A(1) states the purposes of Section 92(A)(1), two enterprises shall be deemed to be associated enterprises if at any time during the previous year any of the conditions prescribed under this sub clause are satisfied.

Section 92A(2) enlists 13 situations in which two enterprises shall be deemed to be associated enterprises if the prescribed conditions are satisfied.

Question 2

Explain in the following cases whether the entities shall be deemed to be 'associated enterprises' under section 92A(2) :

(i) Run India Ltd has 12 directors on its Board, out of which 6 directors are appointed by Race Ltd.

(ii) Cane UK Ltd. possesses 25% of the voting power in Bane (India) Pvt. Ltd.

(iii) Joy India's total borrowings amounted to Rs. 1000 crore, out of which guarantee has been given by Chapple India Ltd., for a borrowing of Rs. 400 crore.

Answer

(i) Two enterprises shall be deemed to be Associated Enterprises, if more than half of the directors or members of the board of one enterprise are appointed by other enterprise.

In the given case:-

Race Ltd. has appointed only half (6 out of 12) of the directors on the Board of Run India Ltd. Thus, both are not Associated Enterprises.

(ii) Two enterprises shall be deemed to be Associated Enterprises, if one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise.

In the given case, the volume of voting power possessed by Cane UK Ltd. in Bane (India) Pvt. Ltd. is less than 26%, thus they are not Associated Enterprises.

(iii) Two enterprises shall be deemed to be Associated Enterprises, if one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise;

Here, as the percentage of borrowings guaranteed by Chapple India Ltd. is 40% (Rs. 400 crore out of Rs 1000 crore) is more than the prescribed limit thus, Joy India Ltd. and Chapple India Ltd., are deemed to be Associated Enterprises.

Question 3

Brat Inc. of U.K. holds 9% shares in Pit Ltd. of India. The total book value of Pit Ltd., is Rs. 57,25,000. Brat Inc. of U.K. has given a loan to Pit Ltd. of Rs. 30,00,000. Examine whether Brat Inc and Pit Ltd. are associated enterprises.

Answer

Two enterprises shall be deemed to be Associated Enterprises, if a loan advanced by one enterprise to other constitutes not less than 51% of the book value of total assets of other enterprise.

In the given case:-

Total book value of Pit Ltd. is Rs. 57,25,000/-

51% of Rs. 57,25,000/- = Rs. 29,19,750/-

Loan given by the UK company = Rs. 30,00,000/-

Since, the loan amount is more than 51% of the book value of the total assets of the Indian company, Brat Inc. and Pit Ltd. are deemed to be Associated Enterprises.

Question 4

Coco Ltd. supplied consumables and raw material of Rs.300 crore to Parrot Ltd. Total consumables and raw materials consumed by Parrot Ltd. was Rs. 400 crore.

Answer

Two enterprises shall be deemed to be Associated Enterprises, if, 90% or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise.

Here, Coco Ltd. supplied 75% of the raw material (i.e. raw material worth Rs. 300 crore out of Rs. 400 crore) to Parrot Ltd. Therefore, Coco Ltd. and Parrot Ltd. would not be associated enterprises.

Question 5

Indira Ltd, an Indian Company supplied billets to Charles Ltd. an UK based company which holds 40% of the shares of Indira Ltd., during the previous year 2015-16. Indira Ltd. also supplied the same product to another UK based company, Vales Ltd., an unrelated entity.

The transactions with Charles Limited are priced at Euro 400 per MT (FOB), whereas the transactions with Vales Ltd. are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with Charles. Limited.

Answer

Here, since the foreign company, Charles Ltd., holds more than 26% shares in Indira Ltd., both be deemed to be associated enterprises within the meaning of section 92A.

As Indira Ltd. supplies similar product to an unrelated entity, Vales Ltd. UK, the transactions between Indira Ltd. and Vales Ltd. can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between Indira Ltd. and Charles Ltd.

Thus, Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with Chalres Ltd. are on FOB basis, whereas transactions with Vales Ltd. are on CIF basis. This difference has to be adjusted before comparing the prices.

Particulars	*Amount (in Euro)*
Price per MT of billets to V Ltd.	700
Less : Cost of insurance and freight per M.T.	(200)
Adjusted price per M.T.	500

Since, the adjusted price for Vales Limited, UK is greater than the price fixed for Charles Ltd., the arm's length price be Euro 500 per MT.

Question 6

Transfer pricing rules shall have no implication where the income is computed on the basis of book profits. Comment.

Answer

The statement is correct. For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the profit and loss account prepared in accordance with the companies that can be increased/decreased only by the addition / deductions specified in explanation to section 115JB. No other adjustments can be made to arrive at the book profit for the levy of MAT, except where:

a) it is discovered that the profit and loss account is not drawn up in accordance with the relevant schedule of the Companies Act
b) incorrect accounting policies and or accounting standards have been adopted for preparing such accounts and
c) the method and rate of the depreciation adopted is not correct.

Therefore transfer pricing adjustment cannot be made while computering book profit for levy of MAT.

Question 7

Explain how the arm's length price in relation to an international transaction is computed under 'resale price method' as per rule 10B(1)(b) of the Income-tax Rules, 1962.

Answer

Rule 10B (1) (b) of Income tax Rules, 1962 prescribes Resale Price method under which arm's length price is determined in the following manner:

(a) The price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise is identified;

(b) Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;

(c) The price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

(d) The price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;

(e) The adjusted price arrived as under (d) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

Example : A sold a machine to B (Associated Enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for Rs.4,00,000 but B has incurred expenses of Rs. 4000 in sending the machine to C. Here Arm's length price would be calculated as :

Sales price to B = Rs. 4,00,000

Less : Gross Margin = Rs. 4,00,000 × 30%= Rs.1,20,000

Less : Expenses incurred by B = Rs.4,000

Arm's length price = Rs. 2,76,000

Question 8

Write a short note on Advance Pricing Agreement (APA).

Answer

"An APA is an agreement between a tax payer and tax authority determining the transfer pricing methodology for pricing the tax payer's international transactions for future years."

Types of APA's

- Unilateral APA: an APA that involves only the tax payer and the tax authority of the country where the tax payer is located.
- Bilateral APA (BAPA): an APA that involves the tax payer, associated enterprise (AE) of the tax payer in the foreign country, tax authority of the country where the tax payer is located, and the foreign tax authority.
- Multilateral APA (MAPA): an APA that involves the tax payer, two or more AEs of the tax payer in different foreign countries, tax authority of the country where the tax payer is located, and the tax authorities of AEs.

Benefits of APA's

- Certainty with respect to tax outcome of the tax payer's international transactions, by agreeing in advance the arm's length pricing or pricing methodology (ies) to be applied to the tax payer's international transactions covered by the APA.
- Removal of an audit threat (minimize rigours of audit), and deliverance of a particular tax outcome based on the terms of the agreement.
- Substantial reduction of compliance costs over the term of the APA.
- For tax authorities, an APA reduces cost of administration and also frees scarce resources.

Procedure for an APA

- An application for a unilateral agreement should be made to the Director General of Income Tax (International Taxation) (DG-IT).
- For BAPA/MAPA, application should be made to the Competent Authority (CA) in India. The CA will send the application to DG-IT who in turn will send it to respective APA teams.
- In the case of BAPA/MAPA, negotiations between the CAs of India and other country (ies) shall be carried out in accordance with the provisions of the tax treaties.
- Further, the process in India will be initiated, only after filing the application with the CAs in the AEs' jurisdiction and evidence to that effect is provided to the Indian CA.

Question 9

Briefly explain the concept of rollback provisions under the Advance Pricing Agreement (APA) introduced by the Finance (No.2) Act, 2014.

Answer

The Finance (No.2) Act, 2014 introduced the rollback provisions under the Advance Pricing Agreement (APA) program. The roll back provisions were made applicable to the APAs signed or applied post 1st October 2014.

An Advance Pricing Agreement (APA) is an ahead of time agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for some set of transactions at issue over a fixed period of time. The Roll Back provisions allow an APA entered into from April 1, 2013 to be applied to four previous years for the international transactions covered in the APA. Rules/regulations, including the manner in which the Rollback will apply to bilateral APAs have been notified on vide Notification No. S.O. 758 of 2015 (E) dated 14th March 2015.

Question 10

Hind Ltd. and Videsh Ltd. are associated enterprises as Hind. Ltd. is a subsidiary of Videsh Ltd. The computation of Arm's Length Price (ALP) By Comparable Uncontrolled Price Method and additions required to be made in total income of Hind Ltd. shall be computed as under:

Particulars		*Amount (Rs.)*
Actual Price Paid by Hind Ltd. to Videsh Ltd.		*12,000*
Arm's Length Price (ALP)		
Sale Price charged by Videsh Ltd. to Bharat Ltd.	*Rs. 11,000*	
Less: Cost of warranty for 6 months included in the process charged to Bharat Ltd. (500 x 6/12)	*Rs. (250)*	*(10,750)*
Difference per unit		*1250*
Addition required to be made in the computation of total income of Hind Ltd. (Rs. 1,250 X 48,000 units)		*6,00,00,000*

State the consequences that would follow, if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?

Answer

In case the Assessing Officer makes adjustment to arm's length price in an international transaction it will results in increase in taxable income of the assesse. Further, the following consequences shall follow:-

(a) No deduction under section 10AA or Chapter VI-A of Income tax Act shall be allowed from the income so increased.
(b) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

1) In case the assessee is an eligible assessee under section 144C of Income tax Act he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.

2) In any other case, he can file an appeal under section 246A of the Act to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.

3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 11

Discuss whether adjustment is required in the context of transfer pricing provisions where the transfer price adopted for an international transaction on sale of goods by an Indian company during the financial year 2015-16, is Rs. 25 lakhs whilst the Arm's Length Price determined using appropriate method are Rs. 25 lakhs and Rs. 27 lakhs. Assume that the rate of permissible variation prescribed by the Central Government is 3% of the transfer price for this class of international transaction.

Answer

The proviso to section 92C (2) of Income tax Act, provides that where more than one price is determined by the most appropriate method, the arm's length price (ALP) shall be taken to be the arithmetical mean of such prices. However, if the arithmetical mean, so determined, is within such percentage of the transfer price notified by the central government, then the transfer price shall be deemed to be the arm's length price and no adjustment is required to be made.

Here, the arithmetical mean of the prices =

(Rs. 25 + Rs. 27) / 2 = Rs. 26 lakhs

Permissible variation =

3% of 25 lakhs = 0.75 lakhs

Thus, since the variation between the arm's length price of Rs. 26 lakhs and the transfer price of Rs. 25 lakhs is outside 3% of Transfer Price (i.e., Rs. 0.75 lakhs), adjustment in price is required.

***

3

Tax Planning and Tax Management

Question 1

Distinguish between 'tax evasion' and 'tax avoidance'.

Answer

Tax evasion means a method of evading tax liability by dishonest means like suppression, conscious violation of rules, inflation of expenses etc. while tax avoidance means planning for minimization of tax burden according to the provisions of the tax laws and within legal framework, though it defeats the basic intention of legislature.

Tax evasion involves no payment of tax after the liability of tax has arisen while tax avoidance is planning before hand to avoid tax legally.

Tax evasion involves use of unfair means while tax avoidance takes into account various lacunas of law.

Question 2

Distinguish between tax planning and tax evasion.

Answer

Tax planning is carried out within the framework of law by availing the deductions and exemptions permitted by law and thereby minimising the tax liability. Tax planning is an arrangement by which full advantage is taken of the concessions and benefits conferred by the statute, without violation of legal provisions. Tax evasion on the other hand is an attempt to reduce tax liability by dubious or artificial methods or downright fraud. It is illegal and denies the state its legitimate share of tax.

Question 3

Specify with the reason, whether the following acts can be considered as tax planning or tax management or tax evasion.

(i) Mr. P deposit Rs.1 lakh in PPF account so as to reduce his total income from Rs.3 lakh to Rs.2 lakh.

Answer

The investment of Rs.1 lakh in PPF account so as to reduce his total income from Rs.3 lakh to Rs.2 lakh is considered as Tax Planning because the same is carried out within the framework of law by availing the deductions permitted by law and thereby minimising the tax liability.

Question 4

Indicate whether the following acts can be considered as tax evasion/tax avoidance or otherwise:

(i) Samarth deposits Rs. 65,000 in the term deposit of 5 years with the Post Office to avail tax deduction under section 80C.

(ii) Sushant is using a motor car for his personal purposes, but charges as business expenditure.

(iii) PQR industries Ltd installed and air-conditioner costing Rs.75,000 at the residence of a director as per terms of his appointment but treats it as fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.

(iv) SQL limited maintains a register of tax deduction at source affected by it to enable timely compliance.

(v) R. Ltd issues a credit note for Rs.90,000 for brokerage payable to Suresh who is son of R, managing director of the company. The purpose is to increase his total income from Rs.1,60,000 to Rs.2,50,000 and reduce it's income correspondingly.

Answer

(i) It is neither a tax avoidance nor tax evasion. The claiming of deduction from gross total income under Section 80C by depositing Rs. 65,000 in the term deposit of 5 years with the Post Office falls under the purview of tax planning.

(ii) It is an unlawful act to treat a personal expenditure as business expenditure, which is disallowed under the law. Sushant is resorting to unfair means to claim deduction by falsification of records. Therefore it is tax evasion and illegal.

(iii) It is a case of tax evasion and as the air-conditioner fitted at residential place is furniture, depreciable at 10% whereas the rate of depreciation applicable for plant and machinery is higher. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit.

(iv) It is tax management because maintaining register of payment subject to TDS helps in complying with the obligations under the Income Tax Act, 1961.

(v) Net effect of transaction is reduction of tax liability of the company by improper means. The company is liable to tax at the flat rate of 30% whereas Suresh would not be liable to pay tax since income does not exceed the basic exemption limit of Rs.2, 50,000. The issue of credit note to reduce the liability of company amounts to tax evasion.

Question 5

Suresh is employed in Delhi and is drawing Rs. 30,000 per month as salary. Besides, he got one month salary as bonus. He is given an option by the employer, either to accept HRA or a rent-free accommodation which is owned by the employer. HRA is payable @ Rs. 10,000 per month, while the rent for accommodation in Delhi is Rs. 12,000 per month. Advise Suresh, whether it would be beneficial for him to avail HRA or rent-free accommodation provided by the employer.

Answer

Calculation of Tax Liability of Suresh, in case he accepts rent free accommodation

Particulars		*Amount (Rs.)*
Salary (Rs. 30,000 x 12)		3,60,000
Bonus (One month salary)		30,000
Value of rent free accommodation 15% x Rs.(3,60,000 + 30,000)		58,500
Taxable salary		4,48,500
Tax Liability		
On first Rs. 2,50,000	Nil	
On remaining Rs. 1,98,500@10%	19,850	19,850
Rebate under section 87A		(2,000)
Net Tax		17,850
Add: Education Cess & SHEC @ 3%		535.5
Net Tax Liability		18385.5
Rounded off Tax Liability		18,390

Calculation of Tax Liability of Suresh, in case, if he accepts H.R.A

Particulars		*Amount (Rs.)*
Salary (Rs. 30,000 x 12)		3,60,000
Bonus (One month salary)		30,000
Taxable HRA (Note 1)		12,000
Taxable salary		4,02,000
Tax Liability		
On first Rs. 2,50,000	Nil	
On remaining Rs. 1,52,00@10%	15,200	15,200

Rebate under section 87A	(2,000)
Net Tax	13,200
Add: Cess & SHEC @ 3%	396
Net Tax Liability	13,596
Rounded off Tax Liability	13,600

Extra tax paid by Suresh, if Rent free accommodation is opted is Rs. (18,390- 13,600) i.e. Rs.4,790. **Thus, option II of accepting HRA is better.**

Notes:

1. According to section 10(13A) and rule 2A of Income Tax Act, HRA is exempted as least of the following limits:
   (i) HRA actually received i.e. Rs.1,20,000
   (ii) 50% of the salary i.e. 50% x Rs.3,60,000 = Rs.1,80,000
   (iii) Rent paid in excess of 10% of the salary i.e. (Rs. 1,44,000 - Rs. 36,000) = Rs. 1,08,000

   Least of the above is Rs.1,08,000, is allowed as exemption. Thus, taxable HRA would be : (Rs. 1,20,000- 1,08,000)= Rs.12,000
2. It is assumed that both the houses under HRA and Rent free accommodation are identical.
3. Bonus is not a part of salary for the purpose of computation of HRA.

Question 6

Differentiate between the diversion of income and application of income in context of Income Tax Act.

Answer

Sr. No.	*Diversion of income*	*Application of Income*
1	It is an obligation to apply the income in a particular way before it is received by the assessee or before it has arisen or accrued to the assessee	It is an obligation to apply income, which has accrued or has arisen or has been received
2	Obligation is on the source of income	Obligation is on the receipt of income
3	The source is charged with an overriding title, which diverts the income	There is no overriding title in this case
4	The income is not included in the income of the assessee	The income is included in the income of the assessee
5	Since, the income is diverted from the source before coming to the hands of the assessee, hence he is not liable for tax	Income is said to have accrued/arisen and therefore, is taxable in the hands of assessee

Question 7

Peer Ltd. took over the running business of a Ramu, a sole-proprietor by a sale deed. As per the sale deed, Peer Ltd. undertook to pay overriding charges of Rs. 15,000 p.a. to Ramu's wife in addition to the sale consideration. The sale deed also specifically mentioned that the amount was charged on the net profits of Peer Ltd., who had accepted that obligation as a condition of purchase of the going concern. Examine, in the light of a decided case law that whether the payment of overriding charges by Peer Ltd. is in the nature of diversion of income or application of income.

Answer

The facts of the case are similar to that of the case *Jit & Pal X-Rays (P.) Ltd. v. CIT (2004) 134 Taxman 62 (All)***,** *where* the Allahabad High Court observed that the overriding charge which had been created in favour of the wife of the sole-proprietor was an integral part of the sale deed by which the going concern was transferred to the assessee. The obligation, therefore, was attached to the very source of income i.e. the going concern transferred to the assessee by the sale deed. The sale deed also specifically mentioned that the amount in question was charged on the net profits of the assessee-company and the assessee-company had accepted that obligation as a condition of purchase of the going concern. Hence, it is clearly a case of diversion of income by an overriding charge and not a mere application of income.

Thus, the payment of overriding charges by Peer Ltd to Ramu's wife is a case of diversion of income

Question 8

Teerath Ltd. is a widely held company. It is currently considering a major expansion of its production facilities and the following alternatives are available:

Particulars	*Alt-1*	*Alt-2*	*Alt-3*
	(Rs.)	*(Rs.)*	*(Rs.)*
Share capital	*10,00,000*	*20,00,000*	*50,00,000*
14% Debentures	*15,00,000*	*20,00,000*	
18% Loan from Bank	*25,00,000*	*10,00,000*	

Expected rate of return before tax is 30%. Rate of dividend of the company since 2000 has not been less than 22% and date of dividend declaration is 30th June every year. Which alternative should the company opt with reference to tax planning?

Answer

Analysis of Financing Options for expansion of Teerath Ltd.

Particulars	*Amount in Rs.*		
	Option 1	*Option 2*	*Option 3*
Share Capital	10,00,000	20,00,000	50,00,000
14% Debentures	15,00,000	20,00,000	-
Bank Loan @ 18%	25,00,000	10,00,000	-
Total Capital	50,00,000	50,00,000	50,00,000
PBIT (Expected Rate of Return @ 30% of total Capital)	15,00,000	15,00,000	15,00,000
Less: Interest on debenture@14%	(2,10,000)	(2,80,000)	-
Less: Interest on bank loan @18%	(4,50,000)	(1,80,000)	-
Profit Before Tax	8,40,000	10,40,000	15,00,000
Tax @ 30.9% on PBT	(2,59,560)	(3,21,360)	(4,63,500)
Net Profit After Tax	5,80,440	7,18,640	10,36,500
Rate of Return in % (Net profit / Share Capital)	58.04%	35.93	20.73

Since, Alternative 1 offers the maximum rate of return. Thus, with reference to tax planning, company should opt for the same.

Question 9

Beaker Ltd. wants to acquire a machine on 1st April, 2015. If he purchases the same, it will cost Rs. 60 lakhs, have the expected useful life of 5 years and scrap value will be Rs.10,000. The company could either purchase the machinery with its own fund or borrowed funds. If the machine is purchased through borrowed funds, rate of interest will be 11.5% per annum and the loan will be repayable at the end of 5 years. If machine is acquired through lease, lease rent would be 16 lakh per annum.

Profit before depreciation and tax is expected to be 4.50 crore every year. Depreciation is charged @ 15% on written down value. Besides, additional depreciation is available in the first year. Investment allowance is, however, not available. Average rate of tax may be taken at 32.445%.

Advice Beaker Ltd. whether it should — (i) Acquire the machine through own funds or borrowed funds; or (ii) Take it on lease.

Present value factor shall be taken @10%. At this rate present values of rupee one are — year 1 : 0.9091; year 2 : 0.8264; year 3 : 0.7513; year 4 : 0.6830; and year 5 : 0.6209.

Answer

Purchasing Machine out of own fund

Particulars	*Amount in Rs.*					
	Year 0	*Year 1*	*Year 2*	*Year 3*	*Year 4*	*Year 5*
Profit before Interest, depreciation and tax (PBDT)		4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000
Less: Depreciation (including additional depreciation)		(21,00,000)	(5,85,000)	(4,97,250)	(4,22,663)	(23,85,088)
PBT		4,29,00,000	4,44,15,000	4,45,02,750	4,45,77,337	4,26,14,912
Less: Tax @ 32.445% of PBT		(1,39,18,905)	(1,44,10,447)	(1,44,38,917)	(1,44,63,117)	(1,38,26,408)
Profit After Tax		2,89,81,095	3,00,04,553	3,00,63,833	3,01,14,220	2,87,88,504
Add: Depreciation (including additional depreciation)		21,00,000	5,85,000	4,97,250	4,22,663	23,85,088
Cash Inflows after tax		3,10,81,095	3,05,89,553	3,05,61,083	3,05,36,883	3,11,73,592
Add: Scrap Value						10,000
Less: Cash Outflow	(60,00,000)					
Net cash flow	(60,00,000)	3,10,81,095	3,05,89,553	3,05,61,0833	3,05,36,883	3,11,83,592
Present Value Factor @ 10%	1	0.9091	0.8264	0.7513	0.683	0.6209
Present Value	(60,00,000)	2,82,55,823	2,52,79,207	2,29,60,542	2,08,56,690	1,93,61,892
Net Present Value	11,07,14,154					

Purchasing Machine out of borrowed fund

Particulars		*Amount in Rs.*				
	Year 0	*Year 1*	*Year 2*	*Year 3*	*Year 4*	*Year 5*
Profit before Interest, depreciation and tax (PBDT)		4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000
Less: Depreciation including additional depreciation		(21,00,000)	(5,85,000)	(4,97,250)	(4,22,663)	(2385088)
Less: Interest (60,00,000 x 115)		(6,90,000)	(6,90,000)	(6,90,000)	(6,90,000)	(6,90,000)
PBT		4,22,10,000	4,37,25,000	4,38,12,750	4,38,87,337	4,19,24,912
Less: Tax @ 32.445% of PBT		(1,36,95,035)	(1,41,86,576)	(1,42,15,047)	(1,42,39,247)	(1,36,02,538)
PAT		2,85,14,965	2,95,38,424	2,95,97,703	2,96,48,090	2,83,22,374
Add: Depreciation including additional depreciation		21,00,000	5,85,000	4,97,250	4,22,663	23,85,088
Cash Inflows after tax		3,06,14,965	3,01,23,424	3,00,94,953	3,00,70,753	3,07,07,462
Add: Scrap Value						10,000
Less: Cash Outflow						(60,00,000)
Net cash flows		3,06,14,965	3,01,23,424	3,00,94,953	3,00,70,753	2,47,17,462
Present Value (PV) Factor @ 10%	1	0.9091	0.8264	0.7513	0.683	0.6209
Present Value (Net Cash Flow x PV Factor)	0	2,78,32,065	2,48,81,948	2,26,10,338	2,05,38,324	1,53,47,072
Net Present Value	11,12,09,747					

Take Machine on lease (Assumption: Lease rental is payable at each year end)

Particulars	*Amount in Rs.*				
Cash Outflow	*Year 1*	*Year 2*	*Year 3*	*Year 4*	*Year 5*
PBDT	4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000	4,50,00,000
Lease rent	(16,00,000)	(16,00,000)	(16,00,000)	(16,00,000)	(16,00,000)
PBT	4,34,00,000	4,34,00,000	4,34,00,000	4,34,00,000	4,34,00,000
Tax @ 32.445% of PBT	(1,40,81,130)	(1,40,81,130)	(1,40,81,130)	(1,40,81,130)	(1,40,81,130)
Net Inflow	2,93,18,870	2,93,18,870	2,93,18,870	2,93,18,870	2,93,18,870
Present Value Factor@10%	0.9091	0.8264	0.7513	0.683	0.6209
Present Value	2,66,53,785	2,42,29,114	2,20,27,267	2,00,24,788	1,82,04,086
Net Present Value	11,11,39,040				

Advice:

From purely financial perspective, Beaker Ltd. should purchase the machine out of borrowed funds as the Net Present Value in that case is highest.

Working Note: Calculation of Depreciation and Additional Depreciation

Particulars	*Amount in Rs.*		
*Depreciation**	*Cost/ WDV*	*Depreciation@15 %*	*Additional Depreciation @ 20%*
For Year 1	60,00,000	9,00,000	12,00,000
For Year 2	39,00,000	5,85,000	-
For Year 3	33,15,000	4,97,250	-
For Year 4	28,17,750	4,22,663	-
For Year 5	23,95,087	23,95,087	-
Scrap Value	10,000		

*Additional Depreciation is available as per provisions of Income Tax.

*Assuming this is the only asset in the block.

Question 10

Distinguish between Slump sale and demerger.

Answer

Slump Sale : As per Section 2(42C) of Income tax Act slump sale means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. Any profits or gains arising from the slump sale, affected in the previous year, shall be chargeable to income tax as capital gains and shall be deemed to be the income of the previous year in which the transfer took place. Slump sale can be between any person and consideration is always in cash.

Demerger: As per section 2(19AA) of Income tax Act demerger, in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956. The transfer is ongoing concern basis and all the property and liabilities of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property and liabilities of the resulting company by virtue of the demerger. Demerger is between companies only and consideration is in form of shares only.

Question 11

ABC Finance Corp., a finance company had received certain amount from its subsidiary, under a scheme of arrangement sanctioned by the High Court under sections 391 to 394 of the Companies Act, 1956. Can this scheme of arrangement be treated as slump sale to attract capital gains provisions? Discuss in the light of decided case law.

Answer

The facts of the case are similar to that of *SREI Infrastructure Finance Ltd. v. Income-tax Settlement Commission (2012) 207 Taxman 74 of Income tax Act (Delhi), where* the Delhi High Court held that it would be wrong to infer that section 50B is applicable only in case of actual "sale" of assets. Moreover, section 50B of Income tax Act of Income tax Act shall be applicable in all types of "transfer" mentioned in section 2(47). When a scheme under sections 391 to 394 of the Companies Act, 1956 is sanctioned by the Court, it is treated as a binding statutory scheme because the scheme has to be implemented and enforced. However, this cannot be a ground for the assessee to escape tax on 'transfer' of a capital asset under the provisions of the Income-tax Act, 1961. The taxability of the said transaction is to be decided as per the provisions of the Income-tax Act, 1961.

Therefore, although the scheme is approved by the court under sections 391 to 394 of the Companies Act, 1956 it shall be treated as slump sale and capital gains provisions would be attracted.

Question 12

XYZ Pvt. Ltd. has converted itself into a Limited Liability Partnership (LLP) on 1.4.2015 and at the time of conversion, all the conditions specified in section 47(xiiib) have been fulfilled. The unabsorbed business loss and depreciation of the company as on the date of conversion were Rs. 40 lakhs and Rs. 27 lakhs respectively. The business profits of the LLP

for the previous year 2015-16 were Rs. 75 lakhs. However on 5.9.2016, two partners (who were erstwhile shareholders of XYZ Pvt. Ltd) having in aggregate 51% of the profit sharing in LLP, resigned. Discuss the tax consequences of the conversion of company into LLP and subsequent resignation of partners.

Answer

As per section 72A(6A), the LLP would be able to carry forward and set-off the unabsorbed depreciation and business loss of Rs. 40 lakhs and Rs. 27 lakhs, respectively, of XYZ Pvt. Ltd. since at the time of conversion, all the conditions specified in section 47(xiiib) have been fulfilled. Further, the LLP can set off the unabsorbed depreciation and business loss aggregating to Rs. 67 lakhs against its business profits of Rs. 75 lakhs for A.Y.2016-17.

However, if in any subsequent year, the LLP fails to fulfill any of the conditions mentioned in section 47(xiiib), the business loss or unabsorbed depreciation of the company already set off by the LLP would be deemed to be the income chargeable to tax of the LLP for the year in which it fails to fulfill such conditions.

One of the conditions mentioned in section 47(xiiib) is that the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion. Since two partners (who were erstwhile shareholders of ABC Pvt. Ltd.) holding in aggregate 51% of the profit-sharing in the LLP have resigned on 5.9.2016, thus the LLP has failed to fulfill this condition.

Therefore, the amount of Rs. 67 lakhs representing unabsorbed depreciation and business losses set-off against profits of the LLP for the A.Y. 2016-17, would deemed to be income of the LLP for the A.Y.2017-18, being the year in which it failed to fulfill the conditions.

Question 13

ABC Ltd. was amalgamated with XYZ Ltd. on 31.03.2016. All the conditions of section 2(1B) were satisfied. ABC Ltd. has the following carried forward losses as assessed till the Assessment Year 2017-18:

Particulars		*Rs. (in lakhs)*
(i)	*Speculative Loss*	*4*
(ii)	*Unabsorbed Depreciation*	*18*
(iii)	*Unabsorbed expenditure of capital nature on scientific research*	*2*
(iv)	*Business Loss*	*120*

XYZ Limited has computed a profit of Rs. 140 lakhs for the financial year 2016-17 before setting off the eligible losses of ABC Ltd. but after providing depreciation at 15% per annum on 150 lakhs, being the consideration at which plant and machinery were transferred to XYZ Ltd. The written down value as per income-tax record of ABC Ltd. as on 31st March, 2016 was Rs. 100 lakhs. The above profit of XYZ Ltd. includes speculative profit of Rs. 10 lakhs. Compute the total income of XYZ Ltd. for Assessment Year 2017-18.

Answer

Computation of total income of XYZ Ltd. for the A.Y. 2017-18

Particulars		*Rs. (in lakhs)*
Business income		
Business income before setting-off brought forward losses of ABC Ltd.		140
Add: Excess depreciation claimed in the scheme of amalgamation of ABC Limited with XYZ Ltd.		
Value at which assets are transferred by ABC Ltd.	150	
WDV in the books of ABC Ltd.	100	
Excess accounted	50	
Excess depreciation claimed in computing taxable income of XYZ Ltd. [Rs. 50 lakhs × 15 %] [*Explanation 2* to section 43(6)]		7.50
		147.50
Set-off of brought forward business loss of ABC Ltd. (Notes 2 & 4)		(120.00)
Set-off of unabsorbed depreciation under section 32(2) read with section 72A (Notes 2 & 4)		(18.00)
Set-off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) (Note 5)		(2.00)
Income		7.50

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income tax Act, 1961.
2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.
3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of Rs. 4 lakhs of ABC Ltd. cannot be carried forward by XYZ Ltd.
4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed

scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 72.

5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.

6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set-off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set-off against profits of a speculative business. Consequently, there is no loss or allowance to be carried forward by XYZ Ltd. to the F.Y. 2017-18.

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4

Indirect Tax Laws and Practice – An Introduction

Question 1

Explain the Constitutional validity of Service Tax.

Answer

Article 265 of the Constitution lays down that no tax shall be levied or collected except by the authority of law. Schedule VII divides this subject into three categories –

(a) Union list (only Central Government has power of legislation)

(b) State list (only State Government has power of legislation)

(c) Concurrent list (both Central and State Government can pass legislation).

Entry 97 of the Union list is the residuary entry and empowers the Central Government to levy tax on any matter not enumerated in state list or in the concurrent list. In 1994, the service tax was levied by the central government under the power granted by the entry 97 of the union list.

Question 2

Explain the meaning of the term "Service" under Service tax laws.

Answer

The Finance Act, 2012 has defined a term "Service" for the first time. Clause (44) of Section 65B of the Finance Act, 1994 has defined a term Service as under:

"Service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include—

(a) an activity which constitutes merely,––

  (i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or

  (ii) a transaction in money or actionable claim;

(b) a provision of service by an employee to the employer in the course of or in relation to his employment;

(c) fees taken in any Court or tribunal established under any law for the time being in force.

Question 3

Briefly explain "Value Added Tax" (VAT).

Answer

The Value Added Tax (VAT) in India is a state level multi-point tax on value addition which is collected at different stages of sale with a provision for set-off for tax paid at the previous stage i.e., tax paid on inputs. It is levied as a proportion of the value added (i.e. sales minus purchase) which is equivalent to wages plus interest, other costs and profits. It is a tax on the value added and can be aptly defined as one of the ideal forms of consumption taxation since the value added by a firm represents the difference between its receipts and cost of purchased inputs. VAT intends to tax only the value added at each stage and not the entire invoice value of the product. By ensuring that only the incremental value is taxed, VAT aims at eliminating the cascading effect of taxes on commodities, and thereby reduces the eventual cost to the consumer.

Question 4

What is Provisional Collection of Taxes Act, 1931?

Answer

Provisional Collection of Taxes Act, 1931 is applicable to excise and customs only. Under this, any duty imposed or increased in the budget will have immediate effect if the Finance Minister makes any declaration to that effect on the budget day in the parliament. But any decrease or reduction of duty will have effect only after the Finance Bill is passed, i.e. Finance Bill becomes Finance Act. Further, the declaration made under this Act expires on 75th day from the date of introduction of bill, if the bill is not passed by parliament. If the increased duties are reduced / rejected by Parliament while passing the Finance Bill, then the excess amount collected will be refunded.

Question 5

List out the different rates of VAT as enumerated in White Paper on State level Value Added Tax issued by Empower Committee of State Finance Minister.

Answer

The different rates of VAT as enumerated in White Paper on State level Value Added Tax issued by Empower Committee of State Finance Minister are as follow:

- Exempted for unprocessed agricultural goods, and goods of social importance;
- 1% for precious and semiprecious metals;
- 4% for inputs used for manufacturing and on declared goods, capital goods and other essential items;
- 20% for demerit / luxury goods; and
- Rest of the commodities will be taxed at a Revenue Neutral Rate of 12.5%.

Question 6

Write a short note on Constitution (122nd) Amendment Bill, 2014.

Answer

The Constitution (122nd) Amendment Bill has been introduced for levy of Goods and Services Tax (GST) in India. Currently, fiscal powers between the Centre and the States are clearly demarcated in the Constitution with almost no overlap between the respective domains. For the levy of GST, assignment of concurrent jurisdiction to the Centre and the States was required. It also required a unique institutional mechanism that would ensure that the decisions about the structure, design and operation of GST will be taken jointly by the two.

Such a mechanism needs to have Constitutional force. The Constitution (122nd Amendment) Bill received the assent of Lok Sabha 6th May, 2015 and has been passed by Rajya Sabha on 3rd August, 2016. The Bill was also ratified by majority of States in their respective assemblies and the final nod of the President for its enactment was received on September 8,2016 after which it became The Constitution (101st Amendment) Act,2016.

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5

Central Excise Law

Part I– Basis of Chargeability of Excisable Goods

Question 1

Discuss briefly, whether excise duty is attracted on the excisable goods manufactured in the following cases:

(a) by or on behalf of the Government

(b) in Jammu & Kashmir

(c) in Special Economic Zone

(d) beyond Indian territorial waters(within 150 nautical miles from the shore line).

Answer

(a) Section 3(1A) of the Central Excise Act, 1944 provides that the excise duty shall be levied and collected on all excisable goods other than salt which are produced or manufactured in India by, or on behalf of, Government, as they apply in respect of goods which are not produced or manufactured by Government. Thus, excise duty is attracted on goods manufactured by, or on behalf of, the Government (both Central & State) also.

(b) As per section 1(2) of Central Excise Act, 1944, Central Excise Act, 1944 extends to the whole of India. Thus, excise duty is attracted on the excisable goods manufactured in Jammu & Kashmir. Though originally the Central Excise Act, 1944 did not apply to Jammu and Kashmir, its application was extended to the same with the enactment of Taxation Laws (Extension to Jammu and Kashmir) Act, 1954.

(c) Goods manufactured in Special Economic Zone are not excisable as they are excluded from the scope of charging provisions of section 3 of Central Excise Act, 1944.

(d) Excise duty is attracted on the excisable goods manufactured beyond Indian territorial waters, but within 150 nautical miles from the shore line, as Central Excise Act, 1944 has been extended to the designated areas in the Continental Shelf and Exclusive Economic Zone of India *vide* Notification No. 166/87-CE dated 11.6.1987. It may be noted that exclusive economic zone extends upto 200 nautical miles inside the sea from the base line.

Question 2

Distinguish between 'exempted goods' and 'nil' rated goods under excise law.

Answer

Exempted goods mean and include such goods, on which exemption is granted by a notification under Section 5A of the Central Excise Act. These are excisable goods, which are mentioned in the Tariff Schedule and are exempted from payment of duty by a notification.

Exempted goods continue to remain excisable, however no duty is charged on removal of such goods. Further, such excisable goods do not become non-excisable merely upon their being exempted from duty.

Excisable goods may be nil rated goods, if the rate of excise duty applicable on such goods is shown as nil in the Tariff Schedule. Such a situation may arise, when by virtue of any notification, the rate of excise duty on any goods is reduced to nil. However, in such a situation also, the goods shall continue to be treated as excisable and it would be treated as 'duty paid' goods on its removal, even if nil duty is paid on such goods. This would be so, because nil duty is also a rate of duty.

Both exempted goods and nil rated goods are excisable goods but not liable to duty. Basic difference lies in the fact that nil rated goods are basically chargeable at nil rates fixed by enactment whereas exempted goods are chargeable at a tariff rate determined under the law but the liability is offset by an exemption notification by Central Government.

Question 3

"The taxable event for levy of excise duty is removal of goods". Define place of removal and examine the statement in the light of decided case law, if any.

Answer

'Place of removal' has been defined under section 4(3)(c) of the Central Excise Act, 1944 as

- a factory or any other place or premises of production or manufacture of the excisable goods;
- a warehouse or any other place or premises wherein the excisable goods have been permitted to be deposited without payment of duty;
- a depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearance from the factory from where such goods are removed.

Sales depot, place of consignment agent, branch office etc. are brought within the purview of the place of removal under the new definition but the sale from them is governed by Rule 7 of Valuation Rules.

In *Wallace Flour Mills v. C.C.* EX. (1989) 44 ELT 598, the Supreme Court held that the taxable event for the levy of excise duty is manufacture of goods but the duty could be levied and collected at any later stage for administrative convenience. The apex court

observed that merely because the payment of duty under Rules is postponed to the stage of removal, it could not be contended that the removal of goods has become the taxable event for the levy of excise duty.

Question 4

A Ltd. manufactures certain items which are outside the purview of the Central Excise Tariff Act at the time of manufacture but same were made chargeable to duty after manufacture but prior to their removal from the factory. Determine whether the goods be chargeable to excise duty.

Answer

The taxable event for the levy of excise duty is manufacture of goods, thus where the goods were outside the purview of the Tariff Act at the time of manufacture such goods would not be chargeable to duty even though subsequent to manufacture but prior to removal, such goods were brought within the purview of the Tariff or were charged to a duty of excise by means of an amendment to the Central Excise Tariff Act.

Therefore, considering that taxable event for the levy of excise duty is manufacture of goods, the goods will not be chargeable to excise duty in the given case.

Question 5

Differentiate between process, production and manufacture under Central Excise Act, 1944.

Answer

The term process has not been defined in the Act. However, dictionary meaning of process is a continuous and regular action or succession of actions taking place or carried on in a definite manner and leading to accomplishment of some results. In both production and manufacture, certain processes are involved. For example, cotton is produced by some natural process and cloth is manufactured by artificial processes such as ginning, pressing, threading etc. But in the context of excise, a process is an operation or activity which may or may not result in production/manufacture.

Production is a natural process by which a product is brought into existence. For example: production of tobacco, iron ore, jute, flowers etc. Every production need not amount to manufacture.

Manufacture, on the other hand involves some artificial process which adds some more utility to the product, e.g. Tobacco is produced and cigarettes are manufactured, similarly, sugar cane is produced and sugar is manufactured. Every manufacture is production but not vice-versa. Under excise, manufacture is more relevant than production since many items of production are either not excisable or exempted from duty.

Under excise, the taxable event is manufacture or production, mere process is not enough to call it manufacture/production. Such process/processes should bring into existence an excisable entity preferably with a distinct name, character or use. For instance, a log of wood is cut into pieces. Cutting is a process, but not manufacture. Furniture is made out of wood. The process is manufacture as it is a distinct excisable item. Hence, the three terms

are distinct from each other, further, every manufacture/production is a process and not necessarily vice versa.

Question 6

A process not resulting into any new commodity can amount to manufacture. Discuss in the light of provisions of Central Excise Act.

Answer

Manufacture as defined by various Courts is a process which results into a new and different article having a distinctive name, character and use. However, the central excise law also has a concept of deemed manufacture by virtue of which the processes which are not manufacture per se are deemed to be manufacture. As per section 2(f) of the Central Excise Act, 1944 manufacture includes any process:

(i) incidental or ancillary to the completion of a manufactured product;

(ii) which is specified in relation to any goods in the Section or Chapter Notes of the First Schedule to the Central Excise Tariff Act, 1985 as amounting to manufacture; or

(iii) which, in relation to the goods specified in the Third Schedule, involves packing or repacking of such goods in a unit container or labelling or re- Iabelling of containers including the declaration or alteration of retail sale price on it or adoption of any other treatment on the goods to render the product marketable to the consumer;

and the word manufacturer shall be construed accordingly and shall include not only a person who employs hired labour in the production or manufacture of excisable goods, but also any person who engages in their production or manufacture on his own account.

The processes that qualify to be manufacture as per clause (ii) and (iii) of section 2(f) are termed as deemed manufacture. Thus, if any process which is specified in the Section or Chapter Notes of the First Schedule to the Central Excise Tariff Act, 1985 as amounting to manufacture is carried out, goods will be deemed as manufactured. For instance, Note 2 of Chapter 9 provides that in case of tea, or tea waste, blending, sorting, packing or re-packing into smaller containers shall amount to manufacture. Similarly, if any of specified processes (like re-packing, relabelling, alteration of retail sale price etc.) is being carried out on goods covered in Third Schedule to the Central Excise Act, 1944, the process will be deemed to be as that of manufacture.

Question 7

"Assembly" would amount to manufacture under Central Excise Act, 1944. Discuss in the light of decided case law.

Answer

Assembly is a process of putting together a number of items or parts of an item to make a product or item. Assembly of various parts and components may tantamount to manufacture if new product emerges, which is movable and marketable. In the case of

Narne Tulaman Manufacturers Pvt. Ltd. v. *CCE* 1988 (38) E.L.T. 566 (S.C.) it was inferred that if the assembly results in new commercial commodity with a distinct name, character and use, then it would amount to manufacture.

Similarly, in *BPL India Ltd.* v. *CCE* 2002 (143) ELT 3, the Supreme Court held that assembly of imported kits of VTR with colour monitors imported in disassembled condition amounted to manufacture since the end product had a distinct character and use and the process of assembly was done by technical experts or skilled persons.

However, assembly of plant at site will not be liable to duty, if "immovable property" emerges after such assembly because excise duty can be levied only on 'goods'.

Question 8

"Mere improvement in quality does not amount to manufacture". Examine the statement in the light of decided cases, if any.

Answer

"Manufacture" could be said to have taken place only when there was transformation of raw materials into a new and different article having a different identity, characteristic and use. **It is a well settled principle that mere improvement in quality did not amount to manufacture. It is only when the change or a series of changes take the commodity to a point where commercially it could no longer be regarded as the original commodity but was instead recognized as a new and distinct article that manufacture could be said to have taken place.**

In case of ***CCE v. Osnar Chemical Pvt. Ltd. 2012 (276) ELT 162 (SC), the Supreme Court has held that t***he process of mixing polymers and additives with bitumen merely resulted in the improvement of quality of bitumen. However, bitumen remained bitumen. There was no change in the characteristics or identity of bitumen and only its grade or quality was improved. The said process did not result in transformation of bitumen into a new product having a different identity, characteristic and use. The end use also remained the same, namely mixing of aggregates for constructing the roads.

Therefore mere improvement in quality does not amount to manufacture.

Question 9

M/s. Kool Ltd. has two units, one in Kanpur and another in Jodhpur. Kanpur unit manufactures condensing units which are cleared to Jodhpur unit on payment of appropriate excise duty. Jodhpur unit procures cooling units manufactured locally, affixes the brand name and clears the complete units along with pipe kits, electrical cord, remote control, etc. The Department contends that the process being carried out by Jodhpur unit amounts to manufacture as it is not a mere process of assembly whereas, the assessee argues that putting together various duty paid articles in a carton with a brand name to be marketed as 'air conditioner' is not manufacture. No process is involved except that all the items are put together in one box. Determine, in the light of a decided case law whether the contention of the Department is correct in law.

Answer

The facts of the given case are similar to the case of *Fedders Lloyd Corporation Ltd.* v. *CCEx.* (2008) 221 ELT 3 (SC), wherein it was held that neither condensing unit nor cooling unit by itself was complete air conditioner. It was only when these two were put together that the complete unit of air conditioner fit for use came into existence. Thus, the air conditioner, so cleared by Jodhpur unit was a commercially new article and hence the process amounted to manufacture.

Therefore, processing and assembly of various parts and components may amount to manufacture if a new and identifiable product known in the market emerges, which is movable and marketable. Thus, the contention of the Department is valid in the eyes of law.

Question 10

A Ltd, the assessee was the manufacturer of the white cement. It repaired his worn out machineries/parts of the cement manufacturing plant at its workshop such as damaged roller, shafts and coupling with the help of welding electrodes, mild steel, cutting tools, Angles, Channels, Beams, etc. In this process of repair, scrap and Iron scrap were generated. The assessee cleared this metal scrap and waste without paying any excise duty. The Department issued a show cause notice demanding duty on the said waste contending that the process of generation of scrap and waste amounted to the manufacture in terms of section 2(f) of the Central Excise Act. Discuss.

Answer

The facts of the given case are similar to that of *M/S Grasim Industries Ltd.* v. *Union of India* (2011), where the apex court observed that "the process of repair and maintenance of the machinery of the cement manufacturing plant, in which scrap and Iron scrap arise, has no contribution or effect on the process of manufacturing of the cement, which is the excisable end product. Since welding electrodes, mild steel, cutting tools, Angles, Channels, Beams etc. which are used in the process of repair and maintenance are not raw material used in the process of manufacturing of the cement, which is the end product. The issue of getting a new identity as Scrap and Iron Scrap as an end product due to manufacturing process does not arise for our consideration." The Supreme Court held that scraps are not excisable on the ground that metal scrap and waste cleared by the assessee does not arise out of any manufacturing activity.

Further, the definition of manufacture under section 2(f) of the Central Excise Act, manufacture includes any process incidental or ancillary to the completion of a manufactured product. But the scrap arising in the instant case is not incidental or ancillary to the completion of the manufactured product (cement in the instant case). Rather, it is incidental to the process of repair, not manufacture. Thus, the contention of the Department in the given case is not correct.

Question 11

"Mere selling of a commodity means it is marketable". Examine the statement, in the light of the decided case law.

Answer

Marketability is the capability of a product of being put into the market for sale. *Supreme Court in Union of India* v. *Delhi Cloth and General Mills Case* – 1977 (1) ELT (J199) has held that in order to become goods, it is necessary that an article must be something which can ordinarily come to the market to be bought and sold.

However, the Apex Court in *UOI* v. *Indian Aluminium Co. Ltd. 1995 (77) ELT 268* has held that dross and skimmings are not marketable commodity even if they can be sold to recover some metal as everything which is sold is not necessarily a marketable commodity as known to the commerce and which, it may be worthwhile to trade in. The dross and skimmings arising during the manufacture of aluminium are nothing but waste or rubbish which is thrown up in the course of manufacture. They are not metal in the same class as waste or scrap. It may be possible to recover some metal from them and therefore they can be sold.

This view has been reiterated by the Supreme Court in *CCEx* v. *Tata Iron and Steel Co. Ltd.* 2004 (165) E.L.T. 386 (S.C.) wherein the Apex Court has held that the dross and skimming are merely the refuse, scum or rubbish produced during the process of manufacture. The Supreme Court has held that merely because the dross and skimming are sold to customers, it cannot be inferred that they are marketable commodity as even rubbish can be sold.

However, that does not make rubbish a marketable commodity. Thus, mere selling of a commodity does not mean that it is marketable since a commodity can also be sold as rubbish. Marketability means selling of a commodity which is known to the commerce and which may be worthwhile to trade in.

In view of these decisions, it can be inferred that in order to be marketable an item should be capable of being bought and sold. However, the item should be something which is worthwhile to trade in and not just refuse, scum or rubbish.

Question 12

Zen Engineering Ltd. manufactures various types of flexible packaging machines known as form, fill and seal machines. Machines are made to order as all the dimensions of packaging/sealing of pouches are provided by the customer. The machines are required to be tested by the engineers of the customers before dispatch of the machines. The company makes entry in daily stock account (RG-1) only after the completion of inspection and when the customer is satisfied. The contention of the Department is that the manufacture of machine is complete before testing of machine and its acceptance by the customer. Examine with the help of decided case law, whether the contention of the department is justified.

Answer

The contention of the department that the manufacture of machine is complete before its testing and acceptance by customer is not correct. This is in the light of the decision of the Supreme Court in the case of *Flex Engineering Ltd.* v. *CCE,* where the Apex Court observed that marketability is an essential criterion for charging duty.

The Supreme Court was of the opinion that the process of testing the customized packing machines was inextricably connected with the manufacturing process to the extent that until this process was carried out in terms of the purchase order, the manufacturing process was not complete and the machines were not fit for sale. Hence, the contention of the Department stands unjustified.

Question 13

B&B Ltd. is manufacturer of medicines. It manufactured physician samples for free distribution to medical practitioners with the words – "Physician's sample – not for sale" printed on the samples. Sale of physician samples is expressly prohibited under the Drugs and Cosmetics Act, 1940 and the rules made thereunder. The assessee contended that free samples are not liable to excise duty as these are not marketable in view of the statutory prohibition and moreover these are the samples. Examine the veracity of the assessee's contention with reference to decided case law.

Answer

The contention of B&B Ltd is not correct as per law. As, physician samples are excisable and dutiable even if sale is prohibited. The same has been held by Supreme Court in the case of *Medley Pharmaceuticals Ltd. (S.C.) 2011*. Earlier also in *CCE* v. *M/s. Bal Pharma. (S.C.)* 2010, the Supreme Court made following observations:

(a) The purpose and object of Drugs Act, 1940 and Rules made there under, is to regulate the manufacture of drugs in order to maintain the standard or quality of drugs for sale and distribution as a drug. While the primary object of the Central Excise Act is to raise revenue by imposing duty on goods that are manufactured. These two Statutes and the Rules made thereunder, operate in entirely two different fields having different objects, purposes and schemes. The conditions or restrictions contemplated by one statute should not be lightly and mechanically imported and applied to fiscal statue for non levy of excise duty, thereby causing a loss of revenue.

(b) The prohibition on the sale of Physician Samples intended for distribution to medical practitioners as free samples by Rule 65 (18) of the Drugs Rules shall have no bearing or effect upon the levy of excise duty under the Act, since excise is a duty on manufacture, duty is payable whether or not goods are sold.

(c) When the product is manufactured by a Pharmaceutical Company, it is for the purpose of sale, but the pharmaceutical company makes the choice to distribute the same as a free sample. This choice made by the pharmaceutical companies in terms of Rule 96 (1) (ix) of the Drugs Rules by overprinting words 'Physician's sample- Not to be sold' on the label of the drugs will not come in the way of the Revenue from levying excise duty on the drugs so manufactured.

Part II – Classification of Goods

Question 1

Write a short note on Interpretative Rules for classification under the Central Excise Tariff Act, 1985.

Answer

The Central Excise Tariff Act, 1985 incorporates five Rules of interpretation, which together provide necessary guidelines for classification of various products under the schedule. As regards the Interpretative Rules, the classification is to be first tested in the light of Rule 1. Only when it is not possible to resolve the issue by applying this Rule, recourse is taken to Rules 2, 3 & 4 in seriatim.

Rule 1 provides that section and Chapter titles are only for the ease of reference and, therefore, do not have any legal bearing on the classification of goods, which is determined according to the terms of headings and relevant section or Chapter notes and according to the other interpretative rules if such headings or notes do not otherwise require.

Rule 2(a) provides classification of an article referred to in a heading, even if that article is incomplete or unfinished, or is presented in an unassembled or disassembled form.

Rule 2(b) relates to mixture or combination of materials or substances, and goods consisting of two or more materials or substances.

Rule 3 lays down three steps for classifying the goods which are, prima facie, classifiable under several headings. The sequential order of the steps contemplated are:

(a) most specific description;

(b) essential character; and

(c) heading which occurs last in numerical order.

Rule 4 provides that when goods cannot be classified in accordance with rules 1, 2, & 3, then they are to be classified in a heading of a product, which is most akin to the goods in question.

Rule 5 postulates that the classification of any product under a sub-heading is to be contemplated after the product concerned has been properly classified under its proper four digit Chapter heading.

Question 2

What is the legal status or otherwise of the Explanatory Notes to Harmonised System of Nomenclature (HSN) for the purpose of classification of goods under the Central Excise Tariff Act, 1985?

Answer

The Explanatory Notes to the Harmonised System of Nomenclature (HSN) are the official notes issued by the Customs Cooperation Council, Brussels. They explain and clarify the scope and extent of each and every heading of the HSN, on the basis of which the present Central Excise Tariff has been patterned. However, Central Excise Tariff Act, 1985 nowhere states that notes to HSN will be applicable for interpretation.

Thus, the Explanatory Notes to HSN do not have legal backing, unlike the Chapter Notes and Section Notes contained in the Tariff. Consequently, these Explanatory Notes are only of persuasive value and can be used as an aid to classification of goods when there is ambiguity as to the scope of the entry.

Further, in the case of *CCE* v. *Wood Craft Products Ltd.* 1995 (77) ELT 23 (SC), it has been held that as per Statement of Objects and Reasons of Central Excise Tariff Bill, 1985, new tariff has been introduced, based on HSN to reduce classification disputes. Thus, in case of doubt, HSN is a safe guide for ascertaining true meaning of any expression used in the Act, unless there is an express different intention indicated in the Tariff Act itself. As per Chapter 4 Paras 4 and 10 of CBEC's Customs Manual, 2001, in case of difficulty in understanding the scope of the headings/sub-headings reference should be made to supplementary texts like the Explanatory Notes to HSN.

Question 3

How are incomplete or unfinished goods having the essential characteristics of finished goods classified under the Central Excise Tariff Act, 1985? Give a suitable example or quote a relevant case law.

Answer

According to Rule 2(a) of Central Excise Tariff Act, 1985, if any particular heading refers to a finished or complete article, the incomplete or unfinished form of that article shall also be classified under the same heading provided the incomplete or unfinished goods have the essential characteristics of the finished goods. For example, railway coaches removed without seats would still be railway coaches. Likewise a car without seat would still be classified as car.

In the case of *Sony India Ltd.* v. *CCE* 2002 (143) ELT 411, it was held that Rule 2(a) applies only when components are not subject to further working operation for completion into the finished state.

Question 4

Company X manufactures copper bolts and nuts specially for a die casting machine and claims classification of such bolts and nuts as parts of 'die casting machine' under Chapter 84 of the Central Excise Tariff Act, 1985 covering 'machinery'. However, it is the contentions of the excise department that such bolts and nuts are classifiable under Chapter 74 as 'copper bolts and nuts' as 'parts of general use'. Determine the correct classification?

Answer

As per Rule 3(a) of Rules for the interpretation of Tariff Schedule "the heading which provides the most specific description shall be preferred to headings providing a more general description." Hence, the correct classification of such bolt and nuts is under Chapter 74 as "copper bolt and nuts" as "Part of general use".

Question 5

Mention briefly Rule 5 of general rules for the interpretation of Schedule to the Central Excise Tariff Act, 1985.

Answer

Rule 5 of general rules for the interpretation of Schedules to Central Excise Tariff Act provides that in addition to the goods mentioned in Rule 1 to 4, the rules shall apply to following goods:

a) Cases of camera, musical instrument, gun, drawing instrument, necklace and similar containers shall be classified with a specific article or a set of articles when normally sold therewith subject to the condition that these cases are:

   (i) Specially shaped or fitted to contain a specific article or a set of articles; and

   (ii) Suitable for long term use and presented with the articles for which they are intended.

   Example: Leather cases, which are normally supplied along with the goods, however costly they may be, need not be treated separately for the purpose of classification.

b) Packing materials and packing containers presented with the goods therein shall be classified with the goods, if they are of a kind normally used for packing such goods. However, this provision does not apply when such packing material or packing containers are clearly suitable of repetitive use. Example: Gas cylinders are meant for repetitive use and therefore cannot be classifiable along with gas.

Question 6

A Ltd., manufactures a cream "Oiltox" available across the counters as well as on prescription of dermatologists for treating oily skin conditions. The pharmaceutical content of the cream included urea (10%), lactic acid (10%) and propylene glycol (10%). The same was also available in chemist or pharmaceutical shops without prescription of a medical practitioner. The assessee classified the cream as medicament under Heading 30.03 of the Central Excise Tariff Act while the Department contended that "Oiltox" is mainly used for care of the skin and thus, the same ought to be classified as cosmetic or toilet preparations under Heading 33.04. Examine the case in the light of the decided case law.

Answer

The facts of the case are similar to that of the *CCEx.* v. *Ciens Laboratories* 2013 (295) ELT 3 (SC), where, the Apex Court observed the following:

(a) The cream was not primarily intended to protect the skin but was meant for treating or curing dry skin conditions of the human skin.

(b) The presence of pharmaceutical ingredients in the cream, show that it is used for prophylactic and therapeutic purposes.

(c) Though a product is sold without a prescription of a medical practitioner it does not lead to the immediate conclusion that all products that are sold over / across the counter are cosmetics.

The Apex Court held that owing to the pharmaceutical constituents present in the cream and its use for the cure of certain skin diseases, the same would be classifiable as a medicament under Heading 30.03.

Thus, it is to be seen that how do the people who actually use the product, understand it to be. If a product's primary function is "care" and not "cure", it is not a medicament. Medicinal products are used to treat or cure some medical condition whereas cosmetic products are used in enhancing or improving a person's appearance or beauty. Therefore, in the given case 'Oiltox', which is used for treating oily skin conditions is to be treated as medicament under Heading 30.03.

Question 7

Shiney Ltd. is manufacturer of coconut oil sold in the retail packaging of 2 ltrs and 5 ltrs. Disputes arose in respect of its classification under 'edible oil' or 'coconut oil'. The Department contended that the coconut oil falling under these two categories are meant for sale as hair oil and should be classified under Chapter 33 of the Central Excise Tariff Act. The manufacturers contended that the specific use of such oil is not printed and this should be classified as vegetable oil under Chapter 15 of the Central Excise Tariff irrespective of its use by the consumer.

Examine the veracity of the contentions made by the assessee and the Department, in the light of the provisions of the Central excise law.

Answer

Chapter Note 2 of Chapter 33 of Central Excise Tariff prescribes a condition that Heading No. 3305 (which covers hair oil) applies to products put up in packing of a kind sold by retail for such use. Section Note 2 to Section VI supports the interpretation that although a product is capable of being classified under more than one heading, owing to the nature of its retail packing which is indicative of its use as hair oil, the classification under heading 3305 would get priority.

What follows is that if the same coconut oil is packed in larger packs of 1 litre or 2 litre generally used by consumers for edible purposes (even though some customers may use it as hair oil), it would be classified under Chapter 15. Thus, in the given case contention of Shiney Ltd. is valid in law.

Question 8

BCD Auto parts Ltd. is manufacturing rail assembly front seat, adjuster assembly slider seat, rear lock assembly etc. used in motor vehicles for fitment along with seats. Assessee classified the items under Chapter Heading No. 8708 – parts and accessories of motor vehicles of the First Schedule to Central Excise Tariff Act, 1985. Department's contention is that goods manufactured are integral parts of seats and hence have to be classified under Chapter Heading No. 9401.00 – seats. Examine whether contention of the department is correct by referring to case law, if any, and principles for classification of goods.

Answer

The facts of the given case are similar to the case of *CCEx. Delhi* v. *Insulation Electrical (P) Ltd.* 2008 (224) ELT 512 SC, wherein the Apex Court held that, the products manufactured by the assessee cannot be considered as parts of a seat. The rail assembly front seat, adjuster assembly slider seat etc., manufactured by the assessee were used to facilitate fitment of seat, in the motor vehicle and helped the driver and passenger of vehicle in

adjusting the seat. The seat was complete and fully functional without rail assembly or adjuster assembly. None of the items manufactured could be considered as part of the seat. Thus, in view of the above-mentioned decision of the Supreme Court, Department's contention is not correct.

Question 9

Baba Ltd. is a small scale unit manufacturing plastic name plates for motor vehicles as per specifications provided to them by their customers, who are vehicle manufacturers. For the purpose of classification under First Schedule to the Central Excise Tariff Act, 1985, the assessee has claimed that plastic name plates are 'parts and accessories of motor vehicles'. The Central Excise Department has proposed classification as 'other plastic products' in respect of these plastic name plates. The Department's view is that motor vehicle is complete without affixation of name plates and name plate cannot be treated as part of the motor vehicle. Whether the stand taken by the Department is legally correct ? Briefly discuss with reference to relevant case law.

Answer

The facts of the case of Baba Ltd. are similar to that of *Pragati Silicons Ltd.* v. *CCEx Delhi* (2007), where the issue was whether the Name Plates, Labels, Emblems made from plastic for use on Motor Vehicles are classifiable under Chapter 87 of the Schedule to the Central Excise Tariff Act as parts of Motor Vehicle or Motor Cycles or as other articles of plastics.

In the case of Pragati Silicons Ltd., the Apex Court has applied the test laid down in Mehra Bros. case and observed that name plates add to the convenient use of the motor vehicle and give an identity to the vehicle. Each vehicle comes with different brand name and in different models having distinct features. The manufacturers of different type of models of vehicles market them under a name and the vehicles are recognized and referred to by the name plate affixed on them. Therefore, they add effectiveness and value to the vehicle and are at the very least accessories of the vehicle.

Further, even if there was any difficulty in the inclusion of the plastic name plates as 'parts' of the motor vehicles, they would most certainly have been covered by the broader term 'accessory'. In this view the Supreme Court held that, 'plastic name plates' are 'parts and accessories' of motor vehicles.

Thus, in this case, the contention of Department that name plate cannot be treated as part of motor vehicle is not valid.

Part III – Valuation of Excisable Goods

Question 1

Briefly explain the situations where transaction value does not apply for computation of assessable value under Central Excise Act, 1944.

Answer

According to section 4(1)(a) of the Central Excise Act, 1944, following four conditions are required to be satisfied individually and cumulatively for valuing excisable goods on the basis of transaction value:

(a) There should be sale of goods.

(b) The goods sold should be for delivery at the time and place of removal.

(c) The assessee and the buyer of the goods should not be related persons.

(d) The price should be sole consideration for the sale.

In those cases where any of the above requirements are not fulfilled, transaction value method could not be applied and the assessable value is required to be determined on the basis of the Central Excise (Determination of Price of Excisable Goods) Rules, 2000.

Transaction value is also not applicable in case where excise duty is charged on the basis of MRP based valuation under Section 4A, compounded levy, duty based on production capacity under section 3A and tariff values under section 3(2).

Question 2

Determine the basis of valuation under section 4 (transaction value based) or section 4A (Maximum Retail Price based) of the Central Excise Act, 1944 in the following cases:

(a) Packaged products with MRP printed/marked thereon, exported to Nepal.

(b) A packaged commodity covered under MRP notification and also the Standard of Weights and Measures Act, 1976 unpacked and shown to the customer, tested and then sold to the customer.

(c) Telephone instruments supplied in bulk to a service provider with MRP duly marked and the purchaser (i.e., the service provider) lent the instruments to its customers/subscribers retaining ownership.

Answer

(a) MRP provisions do not apply to export of goods to Nepal. Thus, in the given case valuation is to be done as per transaction value and hence section 4 of the Central Excise Act for valuation is applicable.

(b) A pre-packaged commodity is one which is purchased in a packed form. Products like refrigerators, ACs, and other electronic goods though packed are shown to the customer, tested and then sold. However, as decided in the case of *Whirlpool of India*

Ltd. v. *UOI* [(2001)(137) ELT 42, these products are to be valued at MRP. Hence Section 4A of Central Excise Act is applicable.

(c) The facts of the given case are similar to that of the case of *ITEL Industries Pvt. Ltd.* v. *CCE* 2004 (163) ELT 219 (CESTAT 2 VI decision), where it was held by the CESTAT that Valuation is to be done under Section 4A of the Central Excise Act i.e. on basis of MRP

Question 3

Alok Ltd. supplies raw material to a job worker Karan Ltd. After completing the job-work, the finished products of 5,000 packets are returned to Alok Ltd., putting the retail sale price as Rs. 20 on each packet. The product in the packet is covered under MRP provisions and 40% abatement is available on it. Determine the assessable value under Central Excise law from the following details:

Particulars	*Rs.*
Cost of raw material supplied	*30,000*
Job worker's charges including profit	*10,000*
Transportation charges for sending the raw material to the job worker	*3,000*
Transportation charges for returning the finished packets to Alok Ltd.	*3,000*

Answer

Section 4A overrides section 4 of the Central Excise Act. Thus, as the product is under MRP scheme, the duty shall be payable only as per the provisions of section 4A of the Central Excise Act i.e., on the basis of MRP less abatement and not on the basis of material cost plus job charges etc. Assessable value shall be determined as under:

Particulars	*Rs.*
Retails sale price of 5000 packets (5000X20)	1,00,000
Less : Abatement @ 40% of Retail selling Price	(40,000)
Assessable Value	60,000

Question 4

Suresh Engineers Ltd. removed goods from their factory at Lucknow on 20th April, 2015 for sale from their depot at Baroda. On that date, the normal transaction value of goods at Lucknow factory was Rs. 35,000 while normal transaction value at Baroda depot was Rs. 33,000. The rate of excise duty was 12.5% ad valorem. The said goods were sold from

Baroda depot on 15th May, 2015. On that date the normal transaction value at Baroda depot was Rs. 39,000 and rate of duty was 16%. Suresh Engineers Ltd. paid the duty on Rs. 35,000 @ 12.5%. The Central Excise Department claimed that central excise duty should be levied @ 16% on the value Rs. 39,000. Examine the Department's claim and comment.

Answer

Rule 7 of the Central Excise (Determination of price of Excisable Goods) Rule, 2000 *interalia,* provides that where excisable goods are not sold at the factory gate but are transferred to a depot, the assessable value for the goods cleared from factory is the normal transaction value of such goods at the depot at or about the same time at which the goods as being valued are removed from the factory or warehouse.

In the given case, Rs. 35,000 represents value on 20.04.2015 (time of removal) at Lucknow factory, but it is not the value prevalent at the depot. Similarly Rs.39, 000 represents depot price, but it is not the price prevalent on 20.04.2015 (time of removal).

The correct value to be adopted in this case is the depot price of such goods (normal transaction value) on 20.04.2015. i.e., Rs.33, 000.

Further, the applicable rate of duty shall be the rate of duty in force on the date when such goods are removed from the factory. Hence, the correct rate of duty will be 12.5%. Thus, the Department's claim is not correct in the instant case.

Question 5

Compute the assessable value and amount of excise duty payable under the Central Excise Act, 1944 and rules made there under from the following information:

	Particulars	*No. of units*	*Price at factory per unit*	*Price at depot per unit*	*Rate of duty ad valorem*
(i)	*Goods transferred from factory to depot on 8th February, 2016*	*1,000*	*Rs. 200*	*Rs. 220*	*12.5%*
(ii)	*Goods actually sold at depot on 18th February, 2016*	*750*	*Rs. 225*	*Rs. 250*	*10%*

Answer

According to Rule 7 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, in cases where the goods are not sold at factory gate, but they are transferred by the assessee to his depot, the assessable value of the goods cleared from the factory and sold from depot shall be normal transaction value of such goods at the depot at or about the same time at which the goods being valued are removed from the factory.

Assessable Value= 1,000 units x Rs. 220= Rs. 2,20,000

Calculation of Central Excise Duty:-

Basic Excise duty @ 12.5%= Rs. 27,500

Question 6

On 15.05.2015 goods were removed from the factory at Ludhiana for sale from the depot at New Delhi. On that date (at Ludhiana factory) assessable value = Rs. 20,000 and tariff rate = 8%. These goods were sold ex New Delhi depot on 13.06.20015. On that date assessable value at New Delhi depot = 21,000 and tariff rate = 14%. The manufacturer has paid duty @ 8% on Rs. 20,000, but the department claims duty @ 14% on Rs. 21,000. Discuss the correct approach to be adopted in the case.

Answer

Rule 7 of Central Excise Valuation Rules, 2000 provides that in case of sale through depot, the assessable value is equal to the ex-depot normal transaction value of the goods at the depot at or about the same time on which such goods are removed from the factory.

In the given case, though Rs. 20,000 represents the assessable value on 15.05.2015 (date of removal from the factory) but it is not the value prevalent on the depot. Similarly, though Rs.21,000 represents depot price, but then it is not the price prevalent on 15.05.2015 (date of removal from the factory).

The correct value to be adopted in this case is the depot price of such goods (normal transaction value) on 15.05.2015. This information has to be ascertained and adopted as assessable value. The rate of duty shall, however, be the rate prevailing on the date at which the goods were cleared from the factory.

Question 7

Following information is provided in respect of manufacture of a product 'X' for the purpose of captive consumption in the same factory:

	Rs.
Cost of direct material (excluding excise duty)	*15,000*
Central Excise duty on raw material	*1,854*
Cost of direct employees	*12,300*
Consumable stores and repairs	*8,400*
Quality control cost	*4,300*
Research and development cost	*2,700*
Production related administrative cost	*3,000*
Other administrative cost	*1,500*
Selling and distribution cost	*3,600*
Scrap value realised	*1,500*

Note : CENVAT credit of the excise duty so paid is available.

Determine the assessable value for the purpose of levy of Central Excise duty giving notes wherever required.

Answer

Rule 8 of the Central Excise Valuation (Determination of Price of excisable Goods) Rules, 2000 prescribes that the value of excisable goods used for captive consumption is 110% of the cost of production of such goods. Calculation as per Cost Accounting Standard for determination Cost of Production for Captive Consumption – (CAS-4), issued by ICWAI as under:

Particulars	*Amount (Rs.)*
Cost of Direct Material (excluding taxes)	15,000
Cost of Direct Employees	12,300
Consumable stores & Repairs	8,400
Quality Cost Control	4,300
Research & Development Cost	2,700
Administrative Overheads (Production related)	3,000
Total	45,700
Less : Scrap value realized	(1,500)
Cost of Production (CoP)	44,200
Assessable Value (110% of CoP)	48,620

Notes:

1. Since, CENVAT credit is available, the excise duty paid on direct material has not been included in the cost of direct material.
2. Administrative overheads related to production are included in cost of production while other administrative overheads are not included in the cost of production.
3. As per CAS-4, selling and distribution expenses do not form the part of cost of production.
4. Realizations from sale of scrap are to be deducted from the cost of production.

5. Assessable value for captive consumption is 110% of Cost of production = (110% x Rs. 44,200).

Question 8

Determine the assessable value as per transaction value method and calculate the total amount of excise duty @12.5%) payable on a machine using the details given below:

	Particulars	*Amount (Rs.)*
(i)	*Sale Price of the machine excluding taxes and duties*	*2,00,000*
(ii)	*Sale tax*	*20,000*
(iii)	*Cost of durable and returnable packing included in the sale price given at (i) above*	*5,000*
(iv)	*Design and development charges paid by buyer on behalf of seller to a third party*	*20,000*
(v)	*Warranty charges charged separately by the seller*	*5,000*

Support the calculation with notes, wherever required.

Answer

Computation of total amount of excise duty payable

Particulars	*Amount (Rs.)*
Sale price of the machine excluding taxes and duties	2,00,000
Add: Design and development charges (Note-2)	20,000
Add: Warranty charges (Note-3)	5,000
Less: Cost of durable and returnable packing (Note-4)	(5,000)
Assessable value	2,20,000
Excise duty @12.5% of Assessable Value	27,500

Notes:

1. Taxes are not included in the sale price since the definition of transaction value as per section 4 specifically excludes sales tax paid or payable on the goods.
2. Design and development charges are essential for the purpose of manufacture and to make the product marketable. Hence, they have to be included in the assessable value, since payment is 'in connection with sale.'

3. If the warranty charges are charged separately and are not considered as 'price' of the goods by the assessee, then warranty charges will be includible in the transaction value forming basis of the valuation.(Circular No. 354/81/2000-TRU dated 30.06.2000)

4. Cost of Durable and Returnable packing does not form a part of transaction value.

Question 9

Cost of production of a product manufactured by ABC Ltd. worked out to Rs. 350 per piece. Out of the total produced pieces, company sold 120 pieces @ Rs. 700 per piece to industrial consumers, 70 pieces to a Central Government department @ Rs. 690 per piece, 210 pieces to wholesaler @ Rs. 720 per piece and 70 pieces in retail @ Rs. 800 per piece. 20 pieces were distributed as free samples.

Out of the 70 pieces sold to Government department, 20 pieces were rejected by them, which were subsequently sold to other customers @ Rs. 300 per piece, without bringing them back into the factory. Balance pieces were in stock, out of which 25 pieces got damaged and have become unsaleable.

All the above prices are exclusive of excise duty and VAT. The rate of excise duty is 12.5%. Calculate the amount of excise duty payable.

Answer

Calculation of Excise Duty Payable

Particulars	*No. of pieces*	*Rate per pc. Rs.*	*Total Rs.*
Industrial Consumers	120	700	84,000
Central Government Department (Note-1)	70	690	48,300
Wholesaler	210	720	1,51,200
Retailers	70	800	56,000
Others (Free sample) (Note-2)	20	720	14,400
Assessable Value			3,53,900
Excise Duty @ 12.5% (3,53,900 x 12.5%)			44,237.5

Notes :

1. The pieces returned by Government department and subsequently sold to others at lesser price will also be charged at the value at which the same were first removed because the same have not entered back in to the factory after its first removal.

2. As per Rule 4 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000, value of the excisable goods shall be based on the value of such goods sold by the assessee for delivery at any other time nearest to the time of removal of goods under assessment.

   Rule 4 cannot be applied here as the dates/ times of removal are not available in the question. Hence best judgment method under Rule 11 has been applied. Normal transaction value (price of the greatest aggregate quantity) ie., Wholesale price of highest quantity of 210 has been taken.

Question 10

Differentiate between compounded levy scheme and duty based on annual production capacity under central excise.

Answer

(a) *Relevant Provisions*: Rule 15 of the Central Excise Rules, 2002 provides for the compounded levy scheme. While Section 3A of the Central Excise Act, 1944 provides for the duty based on production capacity.

(b) *Criteria for levy*: Under compounded levy scheme, prescribed duty is paid for a specified period on the basis of certain factors relevant to production, like size of equipment employed, production capacity or some other criteria. While in case of duty based on production capacity, prescribed duty is paid on the basis of annual production capacity of the factory.

(c) *Products covered*: Compounded levy is presently applicable to stainless steel pattas/patties and aluminum circles. On the other hand, duty based on production capacity is presently applicable to pan masala, unmanufactured tobacco, jarda scented tobacco and chewing tobacco.

(d) *Optional or compulsory* : Compounded levy is an optional scheme i.e., in respect of the goods covered under this scheme, the manufacturer can also opt to pay duty as per normal rules while, duty based on production capacity is compulsory i.e, in respect of the goods covered under this scheme, the manufacturer cannot pay duty in any other manner.

Part IV - CENVAT Credit Rules

Question 1

State whether the following goods are 'input' as per Rule 2(k) of the CENVAT Credit Rules, 2004:

(a) All goods used for generation of electricity for captive use

(b) Light diesel oil

(c) Goods used for making of structures for support of capital goods

(d) Goods used for providing free warranty for final products.

(e) Machinery worth Rs 9,000 per piece.

Answer

(a) Yes, included in the definition of input under Rule 2(k)

(b) No, excluded from the definition of input under Rule 2(k)

(c) No, excluded from the definition of input under Rule 2(k)

(d) Yes, included in the definition of input under Rule 2(k)

(e) Yes, capital goods upto the value of Rs. 10,000 per piece are inputs and full credit can be taken on them

Question 2

I Ltd. was a manufacturer of excisable goods. A ground plan of the factory was provided by the assessee to the jurisdictional Central Excise Officer and the same was approved. The ground plan showed the area in which the manufacturing is carried out as also the areas occupied for purpose of storage godowns, cycle sheds, canteen as well as the housing complex for staff and workers. The assessee had a captive power plant in the approved area. The electricity generated was supplied to the housing complex as well as for use in the manufacturing activity. I Ltd. claimed Cenvat credit on the duty paid on furnace oil used for generation of electricity as it was used within the factory and was covered by the expression "for any other purpose" in rule 2(k) of the Cenvat Credit Rules, 2004. The Central Excise Department denied the Cenvat credit on the duty paid on furnace oil for generation of electricity which in turn is supplied to the housing complex on the ground that it was not used in relation to manufacture of the final product. Examine, with the help of a decided case law, if the stand of the Department is correct in law.

Answer

The facts of this case are similar to the case of *M/s Indorama Synthetics (I) Ltd*. v. CCEx. (2008) 226 ELT A181(SC), wherein, the Supreme Court maintained the judgment of the Bombay High Court and held that the CENVAT credit of the duty paid on furnace oil used in the generation of electricity in turn used in the residential complex was not allowable. The assessee submitted that "factory' under section 2(f) of the Central Excise Act, 1944 is wide enough to cover precincts thereof, even if the manufacturing is carried out only in a part of such premises. Therefore, the electricity supplied to the residential complex situated

within the factory premises must be covered within the meaning of the word 'for any other purpose' set out in the erstwhile rule 57(B) (w) of the Central Excise Rules, 1944 [similar to present Rule 2(k) of the CENVAT Credit Rules, 2004]. The assessee's submission was rejected by the High Court on the grounds that credit of duty would be available on inputs used in the generation of electricity, provided the electricity is used for manufacture of final products or for any other purpose connected with or related to manufacture of final products. In other words, the use of electricity must have nexus with the goods manufactured in the factory. The mere fact that the residential complex is situated within the licensed premises would not entitle the assessee to avail the credit of duty paid on the furnace oil used in the manufacture of electricity supplied to the residential complex. Thus, the stand taken by the Department of disallowing the CENVAT credit is legally correct.

In addition, the case of *CCE* v. *Solaris Chemtech* (2007) 214 ELT 481(S.C.) may also be quoted wherein also it was held that CENVAT Credit will not be available to the extent the electricity is consumed in residential colony of workers.

Question 3

Indicate the eligibility of CENVAT credit under the CENVAT Credit Rules, 2004, in each of the following transactions took place in the factory of Rishabh Ltd, given that it is not eligible for exemption available under Notification No.8/2003 CE dated 01.03.2003.

(i) A consignment of 1,000 kgs of inputs was received. The excise duty paid as per the invoice was Rs. 10,000. While the input was being unloaded, 50 kgs were damaged and were found to be not usable.

(ii) A vehicle containing machinery was received. The machinery was purchased through a dealer and not from the manufacturer. The dealer's invoice marked "original for buyer" certified that the excise duty paid by the manufacturer of machinery was Rs. 24,000. The dealer is registered with the Central Excise Authorities.

(iii) Some inputs for final product were received. The original or duplicate copy of invoice pertaining to the same was not traceable. However, they were accompanied by a Photo copy of the invoice indicating that excise duty of Rs. 6,400 had been paid on inputs. Rishabh Ltd. got the said photo copy attested by the jurisdictional Range Superintendent of the supplier.

(iv) Inputs were received on which excise duty of Rs. 10000 was paid vide Invoice No 1203 dated 5-04-2015. The goods were received in the factory on 10-11-2015.

Answer

(i) Rule 2(k) of CENVAT Credit Rules, 2004 interalia provides that input means all goods used in or in relation to the manufacture of final products, whether directly or indirectly. Thus, the inputs lost/ damaged before issued for production cannot be termed as "used in or in relation to manufacture of final product". Hence, CENVAT credit in respect of 50 kgs of inputs will not be available but CENVAT credit of Rs. 9,500 on balance 950 kgs of inputs can be availed.

(ii) Clause (iv) of rule 9(1)(a) of the CENVAT Credit Rules, 2004 provides that CENVAT credit shall be taken by manufacturer on the basis of an invoice issued by a first/second stage dealer. Further, as per rule 9 of Central Excise Rules, 2002, a first/second stage dealer requires registration. Thus, in the given case, CENVAT credit can be claimed against dealer's invoice since the dealer is registered with Central Excise Authorities.

However, CENVAT credit in respect of capital goods shall be taken only for an amount not exceeding 50% of duty paid on such capital goods in the same financial year and balance 50% shall be available in the subsequent financial year [Rule 4(2) of CENVAT Credit Rules, 2004]. Hence, CENVAT credit of Rs. 12,000 will be available in the current financial year. Balance credit of Rs. 12,000 can be availed in any subsequent year.

(iii) The High Court in the case of *CCEx & Cus. Vadodara II* v. *Steelco Gujarat Ltd.* 2010 (255) ELT 518 (Guj.) has held that mere xerox copy of invoice by itself should not be made the basis of allowing the credit but where the assessee has made efforts to get the said xerox copy attested by the Range Superintendent of the supplier's end and has established beyond doubt that the duty stands paid on the goods and the goods stand received by him, denial of credit on this procedural irregularity would not be justified. Since in the given case also the invoice has been certified by the jurisdictional Range Superintendent, CENVAT credit of Rs. 6,400 can be availed on the basis of photocopy of invoice. However, such orders can be passed only by High Court under its writ powers, based on facts of the case. Otherwise, CENVAT credit is not permissible on basis of Xerox copy.

(iv) With effect from 01.03.2015, a duty paying document is valid only for one year from date of invoice. Since the inputs were received within one year from the date of invoice, credit of excise duty of Rs. 10,000 can be availed.

Question 4

Supra Pipe Ltd. engaged in the manufacture of water pipes is not eligible for SSI exemption available under Notification No.8/2003 CE dated 01.03.2003. From the following details for the month of May, 2015, compute the amount of CENVAT credit available to it under the CENVAT Credit Rules (CCR), 2004 for the year 2015-16. CENVAT paid on purchases is detailed below:

Particulars	*Rs.*
Raw steel	*42,000*
Water pipe making machine	*16,000*
Grease and oil	*3,000*
Office equipment	*42,560*
Diesel	*12,980*

Provide explanation for treatment of various items.

Answer

CENVAT credit admissible to Supra Pipe Ltd. for the month of May, 2015

Particulars	*Rs.*
Raw Steel	42,000
Water pipe making machine (Rs. 16,000 × 50%) (Note 1)	8,000
Grease and Oil	3,000
CENVAT credit admissible	53,000

Notes :

1. Water pipe making machine and spare parts, being capital goods, only 50% of CENVAT credit is available since Supra Pipe Ltd. is not eligible for SSI exemption [Rule 2(a) along with rule 4(2)(a) of the CCR, 2004]
2. A manufacturer cannot avail credit on office equipment since the definition of capital goods under rule 2(a) of the CCR, 2004 specifically excludes equipment/ appliance used in an office.
3. No credit is available on light diesel oil since the definition of input under rule 2(k) of the CCR, 2004 specifically excludes the same.

Question 5

Sincere Exporters (Pvt.) Ltd. furnishes following information and requests you to compute the maximum refund allowable under Rule 5 of the CENVAT Credit Rules, 2004 for the relevant period :

		Rs.
(i)	*Total CENVAT credit taken on inputs*	*2,00,000*
(ii)	*Total CENVAT credit taken on capital goods*	*2,50,000*
(iii)	*CENVAT credit reversed under Rule 3(5C)*	*20,000*
(iv)	*Export without payment of duty under bond*	*5,00,000*
(v)	*Export on payment of duty under rebate*	*3,50,000*
(vi)	*Value of exempted goods cleared*	*2,25,000*
(vii)	*Value of dutiable goods cleared*	*3,75,000*
(viii)	*Value of inputs removed as such under Rule 3(5)*	*50,000*

Answer

Computation of maximum refund admissible under Rule 5 of the CENVAT Credit Rules, 2004

Particulars		*Rs.*
Net CENVAT Credit taken (2,00,000 – 20,000) [Note 1]		1,80,000
Export turnover without payment of duty		5,00,000
Total turnover		
All exports [Note 2]	8,50,000	
Exempted Goods Cleared	2,25,000	
Dutiable goods cleared	3,75,000	
Inputs removed under Rule 3(5)	50,000	15,00,000
Maximum Refund Admissible under Rule 5 [Note 3]		60,000

Notes:

1. Net Cenvat Credit = CENVAT Credit on inputs only minus credit reversed under Rule 3(5C).
2. Total Export = export without payment of duty plus export on payment of duty.
3. Computation of Refund under Rule 5, as amended w.e.f 01-04-2012 assuming all other conditions are fulfilled as prescribed under Notification No. 27/2013 (N.T) dated 18.6.2012. (Export turnover of goods without payment of duty x Net CENVAT credit/ Total turnover) = Rs. 5,00,000 x 1,80,000 / Rs. 15,00,000.

Question 6

The assessee purchased some capital goods and paid the excise duty on it. Since, the said goods were used in the manufacture of excisable goods, he claimed CENVAT credit of the excise duty paid on it. However, after three years, the said capital goods (which were insured) were destroyed by fire. The insurance company reimbursed the amount to the assesse which included the excise duty which the assessee had paid on excisable goods. Excise department demanded the reversal of CENVAT credit by the assessee. Discuss in the light of decided cases whether the demand of excise department is correct or not.

Answer

The facts of the case are similar to *CCE* v. *Tata Advanced Materials Ltd*. (2011) 271 ELT 62 (Kar.) wherein, the High Court noted that as per CENVAT Credit Rules, 2004, CENVAT credit taken irregularly stands cancelled and CENVAT credit utilised irregularly has to be paid for. In the instant case, the insurance company in terms of the policy had

compensated the assessee. The High Court observed that merely because the insurance company had paid the assessee the value of goods including the excise duty paid, it would not render the availment of credit wrong or irregular. It was not a case of double benefit as contended by the Department.

The High Court, therefore, answered the substantial question of law in favour of the assessee and against the Revenue. Thus, in the given case, demand of the excise department is not correct.

Question 7

KSP Ltd. purchased a pollution control equipment for Rs. 15,14,240 which is inclusive of excise duty @16% plus education cess @ 2% and secondary and higher education cess @1%. The equipment was purchased on 1.9.2013 and was disposed off as second hand equipment on 10.10.2015 for a price of Rs. 12,00,000. The excise duty rate on the date of disposal was 12.5%.

(i) Calculate the amount of CENVAT credit allowable for the financial year 2013-14 and 2014-15.

(ii) What is the amount payable towards CENVAT credit already availed at the time of disposal of the equipment in the financial year 2015-16?

KSP Ltd. is not eligible for SSI exemption and the pollution control equipment has been received in the factory on 01.09.2013. The disposal price of the equipment is the transaction value which is exclusive of excise duty.

Answer

Computation of amount of CENVAT credit allowable for financial year 2013-14 and 2014-15

		Amount (Rs.)
Cum duty price of Pollution Control Equipment		15,14,260
Rate of excise duty including education cess and secondary and higher education cess	16.48%	
Excise duty paid on equipment		
= Rs. 15,14,240 X 16.48/116.48		
CENVAT credit allowable on pollution control equipment for the		2,14,240
Financial Year 2013-14 @ 50% (Note 1)		1,07,120
Financial Year 2014-15 @ 50% (Note-1)		1,07,120

Computation of amount of CENVAT credit allowable for financial year 2013-14 and 2014-15

Particulars		*Rs.*	*Rs.*
Total CENVAT credit availed on the equipment			2,14,240
Less:			
(i)	First 50% credit = (Rs. 1,07,120 x 2.5) x 10 quarters (Credit availed on 1.09.2013)	26,780	
(ii)	Next 50% credit= (Rs. 1,07,120 x 2.5%) x 7 quarters (credit availed on 1.4.2014)	18,746	45,526
Amount payable on disposal of machinery			1,68,714
Duty leviable on transaction value (Rs. 12,00,000 x 12.5%)			1,50,000
Amount payable towards CENVAT credit on disposal of equipment (Note 2)			1,68,714

Notes:

1. Pollution control equipment is an eligible capital goods under rule 2(a) of the CCR, 2004 and credit upto 50% can only be taken in the financial year in which the capital goods is received. Balance credit can be taken in any subsequent financial year. [Clause (a) and (b) of rule 4(2) of the CCR, 2004].
2. As per rule 3(5A) of the CENVAT Credit Rules, 2004, if the capital goods, on which CENVAT credit has been taken, are removed after being used, higher of the following two amounts has to be paid
   (i) an amount equal to the CENVAT credit taken on the said capital goods reduced by 2.5% by straight line method for each quarter of a year or part thereof from the date of taking the CENVAT credit;

   OR

   (ii) duty leviable on transaction value.

Part V - Exemptions and Benefits

Question 1

Write a short note on exemption to Small scale Industry units (SSI) under Central Excise Act, 1944.

Answer

Under the provisions of the Central Excise Act, a Small Scale Industry (SSI) is one whose aggregate value of turnover does not exceed Rs. 400 Lakhs during the previous year. The SSI units are eligible for exemption from duty upto a turnover of Rs. 150 lakhs vide Notification No. 8/2003- CE dated 1.3.2003.

The exemption to be given to SSIs is not applicable for all the goods. The benefit of the said notification is restricted to the products listed in the notification. Products like, tobacco products, pan masala, aluminium pattis/patta, steel pattis/pattas and some textile products are specifically excluded from SSI exemption.

Question 2

How is the aggregate value of clearances for home consumption of Rs. 400 Lakh determined for the purpose of SSI exemption?

Answer

For the purpose of determining the clearances upto an aggregate value not exceeding Rs. 400 Lakh during the previous year, the following clearances shall not be taken into account:

(a) Clearances exempt from the excise duty

(b) Clearances bearing the brand name or trade name of another person (other than those manufactured in rural areas)

(c) Clearances of intermediate goods/goods captively consumed in case the final products is eligible for SSI exemption

(d) Export clearances (other than those exported to & Bhutan)

(e) Clearances to FTZ/SEZ/100% EOU/EHTP/STP/UNO/International organization.

(f) Clearances exempt under specific job work notifications.

Question 3

Glam Garments, a small scale unit, supplies uniforms to the Girls' High School, bearing the name and logo of the school. It has approached you as their consultant to know whether their unit will be eligible for SSI exemption under the Central Excise Act, 1944. Write a brief note explaining the relevant provisions under the Act.

Answer

Normally, the goods bearing brand name or trade name of any other person (whether registered or not) are not eligible for exemption under Notification No.8/2003—CE, dated 1.3.2003. However, as per Circular no.947/8/2001-CX, dated 21.6.2011, in case of

readymade garments and textile made-ups-logo/name on uniforms, etc., of a school would not merit treatment as 'branded' products. In these cases, there is no nexus between such a name or logo & the product at the time of its sale which is essential ingredient in the definition of the term "brand name". Unless such garments/made-ups also bear a brand name in addition to the name or logo of the school, they would not attract the excise duty. Hence, M/s Glam Garments will be eligible for SSI exemption on clearance of uniforms to 'Girls' High School' bearing the name and logo of the School.

Question 4

Jyoti Ltd. is a manufacturer, having two factories at Mumbai and Pune with turnover of Rs. 250 lakh and Rs. 140 lakh respectively in the previous year 2014-15. Turnover during the year 2015-16 from two factories were Rs. 270 lakh and Rs. 150 lakh respectively. Compute the total amount of excise duty paid by Jyoti Ltd. during 2014-15 in each of the following independent cases :

(i) If it has availed CENVAT credit on inputs.

(ii) If it has not availed CENVAT credit on inputs.

Turnover represents value of clearances for home consumption computed in accordance with Notification No. 8/2003, excluding excise duty. Normal rate of duty payable is 12.5%.

Answer

In exercise of powers given by section 5A of Central excise Act, the Central Government has exempted the clearance for home consumption of excisable goods specified in the notification number 8/2003 – Central Excise. This is also known as SSI exemptions notification. As per this notification, exemption of duty on Rs.150 lakh is available to small-scale industries. To be eligible for benefits of exemption given by the notification, Jyoti Ltd should be engaged in manufacture of excisable goods and the previous year's turnover should not exceed Rs. 400 lakh.

Here, since nothing is given, it is assumed that Jyoti Ltd is engaged in manufacture of specified goods other than those in the negative list. Further, the total turnover in the previous year is Rs. 390 lakh (after clubbing the turnover of both the units) which is less than Rs. 400 lakh and hence exemption on duty will be available to Jyoti Limited.

(i) Availed CENVAT credit

As per notification, the exemption is not available if CENVAT credit has been availed on inputs. Thus, Jyoti Ltd. will not be eligible for any exemptions on excise duty.

Excise duty payable would be :

Total turnover (Rs. 270 lakhs + Rs. 150 lakhs)	Rs. 420 lakh
Excise duty at the rate of 12.5%	Rs. 52.5 lakh

(ii) Not availed CENVAT credit

In case Jyoti Limited has not availed CENVAT credit, it will be eligible for exemption up to Rs. 150 lakh and pay normal duty at the rate of 12.5% on remaining clearances.

Excise Duty Payable in this case would be :

Total turnover	Rs. 420 lakh
Less : Exemption	(Rs. 150 lakh)
Excisable Turnover	Rs. 270 lakh
Excise duty at the rate of 12.5%	Rs. 33.75 lakh

Question 5

XYZ Ltd. has a manufacturing unit situated in Lucknow. In the financial year 2015-16, the total value of clearances from the unit was Rs. 450 lakh. The break-up of value of clearances are as under:

(i) Clearances worth Rs. 50 lakh of certain non excisable goods manufactured by it.

(ii) Clearances worth Rs. 50 lakh exempted under specified jobwork notification.

(iii) Exports worth Rs. 100 lakh (Rs. 75 lakh to USA and Rs. 25 lakh to Nepal).

(iv) Clearances worth Rs. 50 lakh which were used captively to manufacture finished products that are exempt under notifications other than Notification No. 8/2003-CE dated 1.3.2003 as amended.

(v) Normal Clearances worth Rs. 200 lakh of excisable goods.

Explain briefly, the treatment for various items and state, whether the unit will be eligible for the benefits of exemption under Notification No. 8/2003-CE dated 1.3.2003 as amended for the year 2016-17

Answer

In order to claim the benefit of exemption under Notification No. 8/2003-CE in a financial year, the total turnover of a unit should not exceed Rs. 400 lakh in the preceding year. For the purpose of computing the turnover of Rs. 400 lakh, given clearances will be treated in the following manner:

(i) Turnover of non excisable goods has to be excluded. Therefore, clearances of non excisable goods of worth Rs. 50 lakh shall be excluded.

(ii) Clearances exempted under jobwork notifications should not be considered. Therefore, exempted clearances of Rs. 50 lakh under job work notification should be excluded.

(iii) Export turnover has to be excluded. Export to Nepal will also be considered as export and not for home consumption and hence to be excluded while calculating the total value. Therefore, clearances worth Rs. 75 lakh exported to USA will be excluded along with clearances worth Rs. 25 lakh exported to Nepal

(iv) Value of intermediate products manufactured has to be included if the final product is exempt under any notification other than Notification No. 8/2003-CE dated 1-3-2003. Therefore, clearances worth Rs. 50 lakh which were used captively to manufacture finished products exempt under notifications other than Notification No. 8/2003 will be included.

(v) Clearances of excisable goods of Rs. 200 lakh in the normal course will be included.

Therefore, the turnover of XYZ Ltd. for claiming the SSI exemption will be:

Rs. 450 lakh- (Rs. 50 lakh+ Rs.50 lakh+ Rs. 75 lakh+25 lakhs)= Rs. 300 lakh

Since, the turnover of XYZ ltd. during the preceding year is less than Rs. 400 lakh, XYZ Ltd. will be eligible for exemption under Notification No. 8/2003-CE in the financial year. 2016-17.

Question 6

Whether the manufacture and sale of specified goods, not physically bearing a brand name, from branded sale outlets would disentitle an assessee to avail the benefit of small scale exemption? Examine, in the light of decided case law, if any.

Answer

The facts of the case are similar to *CCEx* v. *Australian Foods India* (P) Ltd 2013 (287) ELT 385 (SC) where the assessee was engaged in the manufacture and sale of cookies from branded retail outlets of "Cookie Man" and had acquired this brand name from M/s Cookie Man Pvt. Ltd, Australia (which in turn acquired it from M/s Autobake Pvt. Ltd., Australia). The assessee was selling some of these cookies in plastic pouches/containers on which the brand name described above was printed. No brand name was affixed or inscribed on the cookies. Excise duty was duly paid, on the cookies sold in the said pouches/containers. However, on the cookies sold loosely from the counter of the same retail outlet, with plain plates and tissue paper, duty was not paid.

The assessee contended that SSI exemption would be available on cookies sold loosely as they did not bear the brand name.

In this case the Supreme Court made the following significant observations:

(a) Physical manifestation of the brand name on goods is not a compulsory requirement as such an interpretation would lead to absurd results in case of goods, which are incapable of physically bearing brand names viz., liquids, soft drinks, milk, dairy products, powders etc. Such goods would continue to be branded good, as long as its environment conveys so viz., packaging/wrapping, accessories, uniform of vendors, invoices, menu cards, hoardings and display boards of outlet, furniture/props used, the specific outlet itself in its entirety and other such factors, all of which together or individually or in parts, may convey that goods is a branded one.

(b) The test of whether the goods are branded or unbranded, must not be the physical presence of the brand name on the good, but whether it is used in relation to such specified goods for the purpose of indicating a connection in the course of trade between such specified goods and some person using such name with or without any indication of the identity of the person. The Court opined that a brand/ trade name must not be reduced to a label or sticker that is affixed on a good.

(c) Once it is established that a specified good is a branded good, whether it is sold without any trade name on it, or by another manufacturer, it does not cease to be a branded good of the first manufacturer.

The Supreme Court held that it is not necessary for goods to be stamped with a trade or brand name to be considered as branded goods for the purpose of SSI exemption. A scrutiny of the surrounding circumstances is not only permissible, but necessary to decipher the same; the most important of these factors being the specific outlet from which the good is sold. However, such factors would carry different hues in different scenarios. There can be no single formula to determine if a good is branded or not; such determination would vary from case to case.

Question 7

Total value of clearances of Baba & Company, a small scale industry, during the financial year 2015-16 is Rs. 820 lakhs (excluding VAT). The total clearances include the following:

Particulars	*Rs. (in lakhs)*
Total exports (including for Bhutan)	*500*
Exports to & Bhutan	*200*
Clearances of excisable goods without payment of duty to a unit in Software Technology Park	*20*
Job work under Notification No. 84/94-CE dated 11.4.94	*50*
Job work under Notification No, 214/86-CE dated 25.3.86	*50*
Clearances of excisable goods bearing brand name of Khadi and Village Industries Commission	*200*

Determine the eligibility for exemption based on value of clearances for the financial year 2016-17in terms of Notification No. 8/2003-CE dated 1.3.2003 as amended. Make suitable assumptions and provide brief reasons for your answers where necessary.

Answer

Calculation of value of clearances during financial year 2014-15

Particulars	*Rs.(in lakhs)*
Total value of clearances during the financial year 2014-15	820
Less : Exports excluding exports to Bhutan (Rs 500-200 lakh) [Note 1]	(300)
Clearances of excisable goods without payment of duty to a unit in Software Technology Park [Note 2]	20
Job work under Notification No. 84/94-CE dated 11.4.94 and Notification No, 214/86-CE dated 25.3.86 Rs. (50+50) lakh [Note 3]	100
Value of clearances during the financial year 2014-15	400

Notes:

1. Export turnover has been excluded. However, export to Bhutan cannot be excluded as these are treated as "clearances for home consumption".
2. Clearances of excisable goods without payment of duty to a unit in Software Technology Park are deducted.
3. Job work under Notification No. 214/86 - CE and Notification No. 84/94-CE is not taken into consideration.
4. Clearances of excisable goods bearing brand name of Khadi and Village Industries Commission are included.

In order to claim the benefit of exemption under Notification No. 8/2003 – C.E. in a financial year, the total turnover of a unit should not exceed Rs.400 lakh in the preceding year. Since, the value of clearances in the previous financial year 2014-15 does not exceed Rs. 400 lakh, Baba & Company is eligible to claim the benefit of Notification No. 8/2003 dated 1st March, 2003 in the financial year 2015-16.

Question 8

A SSI unit has effected clearances of goods of the value of Rs. 475 lakhs during the financial year 2014-15. The said clearances include the following:

Particulars	*Rs. (inlakhs)*
Clearance of excisable goods to 100 % EOU without payment of excise duty	*120*
Job work in terms of Notification No. 214/86 CE, exempted from duty	*75*
Export to Bhutan	*50*
Goods manufactured in rural areas with other's brand name	*90*

Examine with reference to the notification governing SSI under the Central Excise Act whether the benefit of exemption would be available to the unit for the financial year 2015-16.

Answer

A SSI unit shall be eligible for benefit of exemption notification only if value of clearances during preceding financial year does not exceed Rs. 400 lakhs. The item wise treatment shall be as under -

(i) Clearance to 100% EOU shall be excluded for calculating the limit of Rs. 400 lakhs.

(ii) Clearance under Notification No. 214/86 shall be excluded for calculating the limit of Rs. 400 lakhs.

(iii) Export to Bhutan is considered as home consumption and thus, it shall be included for computing limit of Rs. 400 lakhs.

(iv) The turnover of goods manufactured in rural area with the brand name of the others shall be included for computing limit of Rs. 400 lakhs.

Calculation of clearances during financial year 2014-15

Particulars	*Rs. (in lakhs)*
Total value of clearances	475
Less : Clearance to 100% EOU	(120)
Less : Clearance under notification No. 214/86	(75)
Clearance for home consumption	280

As the value of clearances for home consumption in financial year 2014-15 does not exceed Rs. 400 lakhs, the benefit of exemption shall be available to the SSI unit during financial year 2015-16.

Question 9

Raman, an assessee availing the SSI exemption scheme, paid central excise duty of Rs. 1,00,000 for the goods cleared in the month of March 2016, on April 15, 2016. Discuss whether any interest will be charged from Raman for late payment of duty. If yes, what will be the interest liability ?

Answer

The second proviso to Rule 8(1) of the Central Excise Rules, 2002 lays down where an assessee is availing an exemption under a Notification based on value of clearances in a financial year, the duty on goods cleared during a quarter of financial year shall be paid by the 5th day of the month following that quarter. However, in case of goods removed during the month of March the duty shall be paid by the 31st day of March.

Sub rule (3) of Rule 8 provides that if the assessee fails to pay the amount of duty by the due date, he shall be liable to pay outstanding amount along with interest at the rate specified by the Central Notification under section 11AA of the Central Excise Act on the outstanding amount. Such interest shall be paid from the period starting from the first day after the due date till the date of actual payment of the outstanding amount. The rate of interest has been specified as 18% vide Notification no. 6/2011 CE (NT) dated 01.03.2011.

Therefore, since Raman has paid the duty for the month of March on 15th April, he will have to pay the duty with interest for the delay of 15 days.

The amount of interest shall be computed as follows:

= Rs. 1,00,000 x 18/100 x 15/366 = Rs. 737.7

= Rs. 738 (Rounded off)

Question 10

Binu Ltd. started manufacturing excisable goods in June, 2015. It availed small scale exemption in terms of Notification No. 8/2003 C.E. dated 1-3-2003 as amended for the financial year 2015-16. The following details are provided by Binu Ltd. :

Particulars	*Rs.*
18,000 kg of inputs purchased @ Rs. 985.60 per kg (inclusive of central excise duty @12.5%)	*1,77,62,905*
Capital goods purchased on 24.7.2015 (inclusive of excise duty @ 12.5%)	*45,20,625*
Finished goods sold (at uniform transaction value exclusive of excise duty) throughout the year	*3,00,00,000*

Calculate the amount of excise duty payable by Binu Ltd. in cash, if any, during the year 2015-16. Rate of duty on finished goods sold being 12.5%. There is neither any processing loss nor any inventory of input and output. Show workings and notes with suitable assumptions as required.

Answer

Computation of excise duty payable in cash by Binu Ltd.

Particulars	*Rs.*	*Rs.*
Finished goods sold during the year		3,00,00,000
Less: Exemption of Rs. 150 lakhs under Notification No.		

8/2003 CE dated 01.03.2003		(1,50,00,000)
Dutiable Clearances		1,50,00,000
Excise duty payable @ 12.5% (Rs.1,50,00,000 x 12.5%)		18,75,000
Less:		
1. CENVAT credit available on inputs (Note 2)		
Proportion of inputs consumed in dutiable clearances		
=Rs. 1,50,00,000/3,00,00,000 = 0.5		
Excise Duty paid on such inputs		
(1,77,62,905 x 12.5/112.5) x 0.5	9,86,828	
2. CENVAT Credit on capital goods (Note 3)		
(45,20,625 x 12.5/112.5)	5,02,292	(14,89,120)
Excise duty payable in cash		3,85,880

Notes:

1. Since there is neither any processing loss nor inventory of input and output, it implies that all goods manufactured have been sold and entire quantity of inputs has been used in manufacturing these goods.
2. In respect of units availing SSI exemption, no CENVAT credit is available on inputs consumed in exempt clearances of Rs. 150 lakh [Notification No. 8/2003 CE dated 01.03.2003].
3. In respect of units availing SSI exemption, CENVAT credit on capital goods can be availed but utilized only after clearances of Rs.150 lakh [Notification No. 8/2003 CE dated 01.03.2003]. Further, entire credit on capital goods can be taken in the same financial year by such units [Third proviso to rule 4(2)(a) of the CENVAT Credit Rules, 2004].

Question 11

Distinguish between Export under bond by 'merchant exporter' and 'manufacturer exporter' under Rule 19 of the Central Excise Rules, 2002.

Answer

Procedures for export under bond under Rule 19 of the Central Excise Rules, 2002 are prescribed in Notification No.42/2001-CE(NT) dated 26.6.2001.

Merchant exporter is required to execute a bond in Form B-1. Merchant Exporter registered with recognized Export Promotion Council and Star Export Houses do not have to furnish any security/surety while executing bond, unless they have come to adverse notice of department. After execution of bond, merchant exporter has to obtain CT-1 certificates from excise office.

He has to then send CT-1 certificate to the manufacturer from whom goods are to be procured for export without payment of duty. The merchant exporter will maintain a 'Running Bond Account' for export.

The manufacturer exporter needs not to execute a bond. He can furnish a Letter of Undertaking (LUT) in Form UT-1. The LUT once given is valid for 12 calendar months. The LUT will not be discharged unless proof of export is submitted or duty is paid upon deficiency with interest.

Question 12

Answer in brief the following questions relating to export without payment of duty to any country other than to Bhutan under Rule 19 of the Central Excise Rules, 2002:

(i) What is the type of bond to be executed? Who is exempted from furnishing such bond?

(ii) What is the export document for export clearance? How many copies are required to be prepared for it?

(iii) Is it necessary to prepare an invoice also? If yes, how should it be prepared?

(iv) What will be the duty payable, if goods are not exported within six months after clearance?

Answer

Procedures and conditions for export without payment of duty to all countries except Bhutan are specified in Notification No.42/2001 C.E. (N.T.) dated 26.6.2001. Part-wise answers to the questions are given below:

(i) A bond in Form B-1 is required to be executed by a merchant exporter in case of export without payment of duty. The bond should be at least equal to the duty chargeable on the goods, with such surety or security as the excise officer may approve. Manufacturer exporter is exempted from furnishing such bond. He can furnish an annual Letter of Undertaking (LUT) in Form UT-1.

(ii) ARE-1 is the export document for export clearance which shall be prepared in five copies (quintuplicate). The fifth copy is the optional copy which the assessee can use for claiming other export incentives.

(iii) Yes, the goods have to be cleared from the factory under an invoice which shall be prepared in terms of rule 11 of the Central Excise Rules, 2002. The invoice should be prominently marked as "FOR EXPORT WITHOUT PAYMENT OF DUTY".

(iv) Goods must be exported within 6 months from the date of clearance for export, unless extension is granted by Assistant Commissioner/Deputy Commissioner. If goods are not exported within 6 months from the date of clearance for export, the exporter should deposit the applicable excise duty on such goods along with the interest. As per rule 5 of the Central Excise Rules, 2002, the applicable duty shall be computed as per the rate and tariff value applicable on the date of removal of such goods from the factory.

Question 13

Can export rebate claim be denied merely for non-production of original and duplicate copies of ARE-1 when evidence for export of goods is available? Comment in the light of decided case law.

Answer

Where any goods are exported, rule 18 of the Central Excise Rules, 2002 empowers the Central Government to grant by way of a notification a rebate of duty paid on such excisable goods or on materials used in the manufacture or processing of such goods. The rebate is subject to such conditions or limitations, if any, and the fulfilment of such procedure as may be specified in the notification. Notification No. 19/2004 CE (NT) dated 06.09.2004 as amended has been issued by the Central Government to grant rebate under rule 18.

In the case of *UM Cables Limited* v. *Union of India* 2013 (293) ELT 641 (Bom.), the High Court observed that the objective of the procedure laid down in Notification No. 19/2004 CE (NT) dated 06.09.2004 and CBEC's Manual of Supplementary Instructions 2005 is to facilitate the processing of a rebate claim and to enable the authority to be duly satisfied that the two fold requirement of goods (i) having been exported and (ii) being duty paid is fulfilled.

The High Court referred to the decision of Supreme Court in the case of *Mangalore Chemicals & Fertilizers Ltd.* v. *Deputy Commissioner* 1991 (55) E.L.T. 437 (SC), wherein the Apex Court held that non-compliance of a condition which is substantive and fundamental to the policy underlying the grant of an exemption would result in an invalidation of the claim. However, it would be erroneous to attach equal importance to the non-observance of all conditions irrespective of the purposes which they intend to serve, as some requirements may merely relate to procedures.

The High Court, therefore, held that the procedure cannot be raised to the level of a mandatory requirement. Rule 18 itself makes a distinction between conditions and limitations subject to which a rebate can be granted and the procedure governing the grant of a rebate. It was held by the High Court that while the conditions and limitations for the grant of rebate are mandatory, matters of procedure are directory. The High Court ruled that non-production of ARE-1 forms ipso facto cannot invalidate rebate claim. In such a case, exporter can demonstrate by cogent evidence that goods were exported and duty paid and satisfy the requirements of rule 18 of Central Excise Rules, 2002 read with Notification No. 19/2004 CE (NT).

Part V - Procedural Aspects of Central Excise

Question 1

Answer the following questions regarding submission of records, etc. under Rule 22 of the Central Excise Rules, 2002 :

(i) Who is required to submit the records?

(ii) To whom should these records be submitted?

(iii) What are the records, etc. to be submitted?

Answer

(i) Under Rule 22(3) of the Central Excise Rules, 2002, every assessee, first stage dealer and second stage dealer shall, on demand, make available the records etc.

(ii) The records etc. need to be produced to the following persons:

(a) Officer empowered by Commissioner under Rule 22(1); or

(b) Audit party deputed by the Commissioner or Comptroller and Auditor General of India (C&AG); or

(c) Cost Accountant or Chartered Accountant nominated under Section 14A/ 14AA of Central Excise Act, 1944.

(iii) Following records etc., are to be submitted :

(a) the records, financial statements etc. maintained or prepared under Rule 22(2); and

(b) the cost audit reports, if any, under Section 233B of the Companies Act, 1956; and

(c) the income-tax audit report, if any under Section 44AB of the Income-tax Act, 1961.

Question 2

Can Daily Stock Account be maintained in electronic form? If yes, how?

Answer

With effect from 1st March, 2015, Rule 10 of Central Excise Rules has been amended. Now facility of maintenance of Daily Stock Account (DSA) is provided in electronic form as well, with a condition that each page of DSA will be authenticated by Digital Signatures.

Question 3

Name the quarterly returns to be filed under Rule 12 of the Central Excise Rules, 2002.

Answer

Quarterly returns to be filed include :

(1) ER-3 by SSI units availing exemption

(2) Form - A by units availing area based exemption

(3) ER-8 by assessees availing exemption under Notification No. 1/2011 and 12/2012.

Question 4

Mention the last date of filing the following returns under the Central Excise Rules, 2002:

(i) ER-4 for the financial year 2015-16

(ii) ER-7 for the financial year 2015-16.

Answer

(i) ER-4 for the preceding financial year to which it relates is filed annually by 30th November of the succeeding year [Rule 12(2) of the Central Excise Rules, 2002].

(ii) ER-7 for the financial year to which it relates is filed by the 30th April of the succeeding financial year [Rule 12(2A) of the Central Excise Rules, 2002].

Question 5

Whereas e-payment is mandatory for all assesses under central excise, e-filing of returns is not. Examine the statement in the light of the provisions of Central Excise law.

Answer

E-payment of excise duty and e-filing of returns, both are mandatory for all assessees under central excise albeit with certain exceptions. As per third proviso to rule 8(1) of the Central Excise Rules, 2002, it is mandatory to pay duty electronically under Central Excise. Similarly, rule 12(5) of the Central Excise Rules, 2002 requires every assessee to mandatorily file various returns electronically under central excise.

However, the said rule also exempts the following assessees availing exemption with respect to specified goods cleared from a unit from the requirement of e-filing of returns:

- located in the State of Uttarakhand or Himachal Pradesh vide Notification No. 49/2003 CE dated 10.06.2003].
- located in the Industrial Growth Centre or Industrial Infrastructure Development Centre or Export Promotion Industrial Park or Industrial Estate or Industrial Area or Commercial Estate or Scheme Area in the above two States vide Notification No.50/2003 CE dated 10.06.2003.

Question 6

"High Court is empowered to condone delay in filing appeal and cross objection filed under sections 35G and 35H of the Central Excise Act, 1944, beyond the prescribed period". State with reasons whether the statement is true or false.

Answer

The statement is true. Section 35G (2A) and section 35H (3A) of Central Excise Act, 1944 , empowers the High Court to condone the delay in filling appeal and cross objections filed under sections 35G and 35H of the Central Excise Act, 1944 after the expiry of the prescribed period.

Question 7

Briefly discuss whether the following powers vest with the Commissioner (Appeals) under the Central Excise Act, 1944/Customs Act, 1962 :

(i) Remanding the case back to the adjudicating authority; and

(ii) Condoning the delay in filing appeal before him.

Answer

(i) No, Commissioner (Appeals) does not have power to remand the case back to the adjudicating authority for fresh adjudication — *MIL India Ltd.* v. *CC* Ex/(2007) 210 ELT 188 (SC) and CBEC F. No.275/34/2006-CX.8A, dated 18.2.2010.

(ii) Yes, Commissioner (Appeals) can condone the delay in filing the appeal before him for a further period of 30 days — Section 35 of the Central Excise Act and Section 128 of the Customs Act.

Question 8

Write a short note on the principle of "unjust enrichment" under Central Excise Law.

Answer

The term "unjust enrichment" is used to describe a situation when a person undeservedly gets enriched. In the context of refund in Central Excise, the principle of unjust enrichment is the first and foremost principle which is kept in mind by the sanctioning authorities. If the manufacturer has charged excise duty to his buyer, it is clear that he has passed on the burden to the buyer and has already recovered duty from his customer. In such cases, refund of excess duty paid to the manufacturer will amount to excess and undeserved profit to him. It will not be equitable to refund the duty to him as he will get double benefit-first from the customer and then from the Government. This is called "unjust enrichment". Refund of duty should, therefore, be paid to the customer who has borne the burden of duty. Since it is practically not feasible to identify such customers on individual basis, the amount of refund is credited to Consumer Welfare Fund in accordance with Section 12C of the Central Excise Act 1944.

The principle of unjust enrichment has been held as valid and constitutional by the Apex Court in the famous case of *Mafatlal Industries Ltd.* v. *U.O.I.* 1997 (89) E.L.T. 247. In addition, it has also been held in the case of *CCE* v. *Allied Photographics* 2004(166) ELT 3 that doctrine of unjust enrichment applies even when duty is paid under protest.

Question 9

Briefly explain with reference to section 11AC of the Central Excise Act, 1944 the circumstances under which penalty has to be imposed mandatorily. State whether it can be reduced statutorily.

Answer

As per section 11AC (1) (a) of Central Excise Act, a mandatory penalty equal to the duty short paid or not paid or erroneously refunded is payable if such non-payment or short-payment or erroneous refund was due to fraud, collusion, willful mis-statement or

suppression of facts, or contravention of any of the provisions of the Act or rules with intent to evade payment of duty.

There is no discretion to adjudicating authority to impose penalty less than or more than the amount of duty evaded. However, in case the duty, interest and the penalty all are deposited within 30 days from the date of communication of the order, then, the assessee will be liable to pay penalty equal to 25% of the duty payable.

Question 10

What are the powers of Central Excise Officer under Central Excise Act, 1944 to recover the sum due to the Government?

Answer

Section 11 of the Central Excise Act, 1944 empowers the Central Excise Officers to recover the sum due to Central Government; the officer may exercise this power by:

1. Deducting from any money owed to the defaulter;
2. Attachment and sale of excisable goods belonging to the defaulter;
3. Attachment and sale of goods in possession/custody of transferee/successor;
4. Certificate Action to the District Collector;
5. Recover from any person who is required to pay any amount to the defaulter assessee.

Question 11

Distinguish between the provisions of Special Audit under section 14A and 14AA of the Central Excise Act, 1944.

Answer

Section 14A of Central Excise Act was introduced *vide* Finance Act, 1995 enabling the Chief Commissioner of Central Excise to order for special audit of the accounts of any factory, depots or distributors by a nominated chartered accountant or a Cost Accountant at Government cost for the purpose of enquiry, investigation or any other proceeding. The intention evidently is to use the services of accounts experts in complicated cases of suspected undervaluation etc. where stakes involved are heavy.

Section 14AA of Central Excise Act was introduced *vide* Finance Act, 1997. According to it similar special audit at Government cost may be ordered in cases where CENVAT Credit of duty availed or utilized is not considered within normal limits. Further, Valuation Audit has to be finished within 180 days. No time limit was fixed for CENVAT credit utilization audit. Undervaluation and complicated cases involving high stake will be the cause of valuation audit whereas availing of credit in abnormal levels/ fraud could be the causes for ordering CENVAT credit audit. Moreover, Chief Commissioner nominates the auditor for valuation audit and commissioner is the appointing authority for CENVAT credit utilization audit.

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6

Customs Law

Part I - Introduction and Basic Concepts

Question 1

Explain the concept of "Import" and "importer", with reference to the provisions of the Customs Act, 1962.

Answer

As per section 2(23) of the Customs Act, 1962, the term import refers to bringing into India from a place outside India. Import of goods into India commences when the goods enter the territorial waters of India, but gets completed only when the goods become part of the mass of goods within the country.

As per section 2(26) of the Customs Act, 1962, importer, in relation to any goods at any time between their importation and the time when they are cleared for home consumption, includes any owner or any person holding himself out to be the importer.

Question 2

Write a short note on the taxable event for levy of import duty under Customs Act, 1962 giving reference of decided case law, if any.

Answer

In *Garden Silk Mills Ltd*. v. UOI 1999 SC ELT 358, the Supreme Court held that the import of goods in India commences when the goods enter into territorial waters and is completed when goods become part of the mass of goods within the country. The taxable event is at the time when the goods reach customs barrier and the bill of entry for home consumption is filed. In case of warehoused goods, the goods continue to be in customs hand. Hence, import takes place only when goods are cleared from the warehouse.

Question 3

Write a short note on the Basic Custom Duty and Additional Custom duty under Customs Act, 1962.

Answer

Basic Custom Duty is levied under section 2 of Customs Tariff Act at the rates specified in Schedule I & II of the Customs Act at Standard Rate and Preferential rate

Additional Duty of Customs is levied under Section 3 of Customs Tariff Act. It is usually referred to as "countervailing duty" (CVD) and is levied in addition to BCD. It is levied at the rate equal to excise duty leviable on a like article if produced or manufactured in India.

Question 4

Goods exempt from basic customs duty would automatically be exempt from additional duty of customs. Examine the validity of the said statement.

Answer

The statement is not valid. Exemption from basic customs duty would not mean exemption from additional duty. When goods are exempted from basic customs duty in terms of section 12 of the Customs Act, 1962, it would not mean that they are exempted from additional duty of customs also, as basic customs duty is leviable by virtue of section 12 of the Customs Act, 1962 while additional customs duty is leviable under section 3 of the Customs Tariff Act, 1975 [*Kaur Sarin Traders* v. *Union of India* 2006 (199) ELT 224 (Pat.)].

Question 5

Write a short note on "Clearance for home consumption" and "Clearance for warehousing" with reference to the provisions of the Customs Act, 1962.

Answer

Clearance for home consumption implies that the customs duty on the imported goods has been discharged and goods are cleared for utilization whereas clearance for warehousing implies that the goods may, instead of being cleared for home consumption, be deposited in a warehouse and cleared later. When the goods are deposited in a warehouse the collection of duty is deferred till the time such goods are cleared for home consumption. However, the importer has to execute a bond up to a sum equal to twice the amount of duty assessed on the goods at the time of import.

Question 6

With reference to the Customs Act, 1962, write a brief note on "Remission of duty on imported goods lost".

Answer

Section 23(1) of the Customs Act, 1962 provides for remission of duty on imported goods lost (otherwise than as a result of pilferage) or destroyed, if such loss or destruction is at any time before clearance for home consumption. Such loss or destruction covers loss by leakage. Duty is payable under this section but it is remitted by Assistant/Deputy Commissioner of Customs if the importer is able to prove the loss or destruction. Thus, unless remitted, duty has to be paid and burden of proof is on the importer. Remission is at the discretion of Customs authorities. The provisions of this section are applicable for warehoused goods also.

Question 7

"No duty is payable on the pilfered goods". Comment in the light of the provisions of the Customs Act, 1962.

Answer

Section 13 of the Customs Act, 1962 provides that if imported goods are pilfered after unloading thereof but before the proper officer has made an order for clearance for home consumption or deposit in a warehouse, no duty is payable on the goods, unless the pilfered goods are restored to importer. In such a case, duty on pilfered goods is payable by the port authorities. Also, the importer does not have to prove pilferage. However, the loss must be only due to pilferage. Section 13 is not applicable for warehoused goods.

Part II - Valuation

Question 1

Mention the expenses which are to be included in the assessable value of imported goods as per Rule 10(2) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 2007.

Answer

The value of the imported goods shall be the value of such goods, for delivery at the time and place of importation and shall include –

(i) The cost of transport of the imported goods to the place of importation, where the cost of transport is not ascertainable, shall be 20% of the free on board (FOB) value of the goods. In the case of goods imported by air, even where the cost of transportation is ascertainable, such cost shall not exceed 20% of free on board value of the goods. The cost of transport of the imported goods includes the ship demurrage charges on chartered vessels, lighterage or barging charges.

(ii) Loading, unloading and handling charges associated with the delivery of the imported goods at the place of importation. These shall be 1% of the free on board (FOB) value of the goods + the cost of transport + cost of insurance i.e. CIF (Cost, Insurance and Freight) Value.

(iii) The cost of insurance actually incurred, where the cost of insurance is not ascertainable, shall be 1.125% of free on board (FOB) value of the goods.

Question 2

Examine the validity of the following statements with reference to the Customs Act, 1962 giving brief reasons.

(a) Service charges paid to canalizing agent are not includible in the assessable value of imports.

(b) Design and engineering charges are includible in the assessable value of the imported goods only if the goods imported are specifically manufactured on the basis of the design and engineering specifications provided by the importer.

(c) Inspection charges are not includible in the assessable value of the imported goods if contract does not specify for certification by an independent agency.

Answer

(a) The statement is not correct. Since the canalizing agent is not the agent of the importer nor does he represent the importer abroad, purchases by canalizing agency from foreign seller and subsequent sale by it to Indian importer are independent of each other. Hence, the commission or service charges paid to the canalizing agent are includible in the assessable value as these cannot be termed as buying commission [*Hyderabad Industries Ltd.* v. *UOI* 2000 (115) ELT 593 (SC)].

(b) The Supreme Court in the case of *TISCO Ltd.* v. *CCEx. & Cus.* 2000 (116) ELT 422 (SC) has held that design and engineering charges paid for use during construction, erection, assembly etc. of imported goods, being relatable to post import activity, are not includible in the value. Thus, the design and engineering charges which relate to pre importation activity are only includible in the value. Since, in this case the design and engineering charges are paid for manufacturing the imported product, i.e. they relate to pre-importation activity, the same are includible in the value. Thus, the statement is correct.

Further, the explanation to rule 10(1) of the Customs Valuation (Determination Imported Goods) Rules 2007 clarifies that the royalty, licence fee or any other payment for using a process shall be added to the price actually paid or payable, notwithstanding the fact that such goods may be subjected to the said process after their importation if such payments are related to imported goods and are a condition of the sale of imported goods.

(c) The statement is correct. Where there is no requirement in the contract for independent inspection and the inspection is carried out by foreign supplier on his own and is not required for the purpose of fulfilling the condition of the contract, then such charges incurred on inspection are not includible in assessable value [*Bombay Dyeing & Mfg.* v. *CC* 1997 (90) ELT 276 (SC)].

Question 3

ABC Ltd. imported a machine at FOB value of Rs. 34,00,000. The FOB value included Rs.4,00,000 attributable to post-importation activities to be called by the seller. Additional expenses of ABC Ltd. included:

Particulars	*Amount (Rs.)*
Raw Material supplied by ABC Ltd.	*10,00,000*
Freight	*1,60,000*
Demurrage charges	*10,000*
Lighterage and barge charges	*30,000*
Transportation charges from port of entry to Inland container	*50,000*
Cost of insurance	*1,00,000*

Compute the assessable value based on Rule 3 read with Rule 10 of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, assuming amount attributable to post-importation activities is not payable as a condition of the sale of imported goods.

Answer

Computation of Assessable Value of Machine imported by ABC Ltd.

Particulars	*Amount in Rs.*
FOB Value	34,00,000
Less : Post importation Activities	(4,00,000)
FOB value as per Customs Act	30,00,000
Add : Raw material supplied by ABC Ltd.	10,00,000
Transport cost	1,60,000
Demurrage	10,000
Lighterage & barge	30,000
Insurance	1,00,000
CIF value as per Customs Act	43,00,000
Add : Landing Charges @ 1% of CIF	43,000
Assessable Value	43,43,000

Working Notes

1. As per rule 3(1), value of imported goods shall be transaction value adjusted in accordance with provisions of Rule 10.
2. Rule 10 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 requires additions of various expenses. As per rule 10 expenses 1 to 5 have been added. 1% landing charges are added to CIF value to get the assessable value.
3. As per Rule 10(2), transportation cost from port of entry to inland container depot does not form part of cost of transport.

Question 4

Following particulars are available in respect of consignment of goods imported:

Particulars	*Amount (US $)*
Cost at the factory of the exporter:	*20,000*
Carriage/freight/insurance upto the port of shipment in the exporter's country	*400*
Charges for loading on to the ship at the shipping port	*100*
Freight charges of the ship for transport upto the Indian port	*1,200*

Compute the assessable value for the purpose of levy/payment of customs duty.

Answer

Computation of Assessable Value

	US Dollars
Cost at the Factory of the exporter	20,000
Add:	
Carriage/freight/insurance upto the port of shipment in the exporter's country	400
Charges for loading on to the ship at the shipping port	100
FOB	20,500
Add:	
Freight charges of the ship for Transport upto the Indian Port	1,200
Insurance @ 1.125% of FOB	231
CIF value as per Customer Act	21,931
Add:	
Landing charges @ 1% of CIF	219
Assessable Value	22,150

Note:

To be converted into INR as per exchange rate notified by CBEC under section 14(3)(a) of the Customs Act.

Question 5

Following particulars are available in respect of certain goods imported into India: FOB price: US$30,000

Exchange rate:

Notified by RBI Rs. 62 = US$1

Notified by CBEC Rs. 60 = US$1

Compute the assessable value as per the Customs Act, 1962 and the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

Answer

In the information given FOB Price is = 30,000 US Dollars. For the purpose of determination of Assessable value CIF price/cost forms the basis.

(a) Information regarding the cost of freight i.e. cost of transportation upto the Indian Port is not available. As such 20% of FOB Price is to be added towards

cost of transportation as per Rule 10(2)(a) and (i) proviso of the Customs valuation (Determination of Value of Imported Goods) Rules, 2007.

(b) Cost of insurance is not available. As such 1.125% of FOB Price is to be added as per Rule 10(2)(c) and proviso (iii).

(c) Loading, unloading and handling charges associated with the delivery of the imported goods at the place of importation as Rule 10(2)(b) should be added. These charges otherwise known as landing charges shall be 1% of (FOB Value + Transportation Cost + Insurance cost) in other words 1% of CIF Value under proviso (ii) under Rule 10(2).

As per Explanation (a) to Section 14(2) the rate of exchange as determined by the CBEC is to adopted for conversion into Indian rupees. Assessable value in the case referred is worked out in accordance with the above provisions.

Particulars	*Amount (US $)*
FOB value	30,000
Add : Transportation @ 20% of FOB	6,000
Insurance @ 1.125% of FOB	337.5
CIF value	36,337.5

Particulars	*Amount (Rs.)*
CIF Value (@ rate notified by CBEC) 36,337.5 x 60	21,80,250
Add: Landing charges @ 1%	21,802.50
Assessable Value	2,02,052.50

Question 6

A commodity is imported into India from a country covered by a notification issued by the Central Government under section 9A of the Customs Tariff Act, 1975. Following particulars are made available:

(i) CIF value of the consignment : US $ 25,000

(ii) Quantity imported: 500 kgs.

(iii) Exchange rate applicable : Rs. 60=US$1(as notified by CBEC)

(iv) Basic customs duty : 20%

(v) Education and secondary and higher education cess as applicable

As per the notification, the anti-dumping duty will be equal to the difference between the cost of commodity calculated @ US $ 70 per kg and the landed value of the commodity as imported. Appraise the liability on account of normal duties, cess and the anti-dumping duty. Assume that only 'basic customs duty' (BCD) and education and secondary and higher education cess are payable.

Answer

Particulars		*Amount (Rs.)*
CIF cost of 500 Kgs. (US $ 25,000 x 60)	15,00,000	
Add: Landing charges @ 1%	15,000	
Assessable Value	15,15,000	
Basic Customs Duty (BCD) @ 20% of Assessable Value	3,03,000	
Education Cess @ 2% of BCD	6,060	
SAH Education Cess @ 1% of BCD	3,030	
Liability on account of normally applicable duties and cess		3,12,090

Computation of Anti-dumping duty	
Value of imported goods (US $ 35,000(Note 1) x 60)	21,00,000
Landed cost ((Assessable value + Liability of normal duty)	18,27,090
Anti-Dumping duty (value of imported goods – landed cost)	2,72,910

Note:

1. Value of imported goods: 500 Kgs @ US$ 70 per kg = US $ 35,000. This is to be converted into INR at rate notified by CBEC

Question 7

Compute the assessable value and customs duty payable from the following information:

XYZ Ltd. has imported equipment from Germany. It has given the following particulars:

Particulars	*Amount (in Euros)*
FOB value of equipment	*8,000*
Air freight	*2,500*
Design and development charges paid in UK	*500*
Insurance charges have been actually paid but details are not available	
Commission payable to local agent @ 2% of FOB, in Indian Rupees	

Other information available include:

(a) On the Date of bill of entry 24.10.2015 (Rate BCD 10%; Exchange rate as notified by CBEC Rs. 76 per Euro)

(b) On the Date of arrival of aircraft 20.10.2015 (Rate of BCD 20%; Exchange rate as notified by CBEC)

(c) Additional duty leviable under section 3(1) of the Customs Tariff Act, 1975 is 12.5%

(d) Additional duty leviable under section 3(5) of the Customs Tariff Act, 1975 is as applicable

Answer

Computation of assessable value and duty thereon

Particulars	*Amount*
FOB value	8,000 Euros
Add: Design and development charges [Note 1]	500 Euros
Total	8,500 Euros
Total in rupees @ Rs. 76 per Euro [Note 2]	Rs. 6,46,000.00

Particulars	*Amount (Rs.)*
FOB value excluding commission	6,46,000.00
Add: Local agency commission [Note 1] (2% of 8000 Euros) = 160 Euros × Rs. 76	12,160.00
FOB value as per customs	6,58,160.00
Add: Air freight (6,58,160 x 20%) [Note 3]	1,31,632.00
Add: Insurance @ 1.125% of customs FOB [Note 4]	7,404.30
CIF Value	797,196.30
Add: Landing charges @ 1% of CIF value [Note 5]	7,971.96
Assessable value	8,05,168.26
Add: Basic custom duty @ 10% [Note 6]	80,516.82
Total	8,85,685.09
Add: Additional duty leviable under section 3(1) @ 12.5%	1,10,710.64
Add: Education cess and SHEC (2 % + 1% of custom duty) 3% of Rs.80,516.82	2415.5
Total for additional duty leviable under section 3(5)	9,98,811.23
Additional duty u/s 3(5) payable @ 4% [Note 7]	39,952.45
Total duty payable (Rs. 80,516.82 + Rs. 1,10,710.64 + Rs. 2415.5 + Rs. 39,952.45)	2,33,595.41

Notes:

1. Design and development charges paid in UK and commission paid to local agent (since it is not buying commission) are includible in the assessable value [Rule 10 of the Customs (Determination of Value of Imported Goods) Rules, 2007]
2. The rate of exchange notified by the CBEC on the date of presentation of bill of entry has been considered [Section 14 of the Customs Act, 1962].
3. If the goods are imported by air, the freight cannot exceed 20% of FOB price [Second proviso to rule 10(2) of the Customs (Determination of Value of Imported Goods) Rules, 2007].
4. Where the insurance charges are not ascertainable, such cost is taken as 1.125% of FOB value of the goods [Clause (iii) of the first proviso to Rule 10(2) of the Customs (Determination of value of Imported Goods) Rules, 2007].
5. Even if there is no information regarding landing charges, still they are charged @ 1% of CIF value [Clause (ii) of first proviso to rule 10(2) of the Customs (Determination of Value of Imported Goods) Rules, 2007].
6. Section 15 of the Customs Act, 1962 provides that rate of duty shall be the rate in force on the date of presentation of bill of entry or the rate in force on the date of arrival of aircraft, whichever is later.
7. Additional duty leviable under section 3(5) of the Customs Tariff Act, 1975 is charged @ 4% of the value of the imported article.

Question 8

The assessee-importer imported certain goods from a foreign supplier, who is holding 40% equity in assessee's company. The department has rejected the transaction value contending that the price was influenced by relationship. Is the action of the customs department justified? Explain with reference to decided case law(s).

Answer

No, the action of the department is not justified. Merely because the foreign supplier held 40% equity in the assessee company, the same would not mean that assessee and foreign supplier are related. There is no mutuality of interest as held by the *Supreme Court in Explosives Systems (I) Ltd. (2008) 224 ELT 343 (SC)* as the importer did not hold any equity in the supplier company. Even if two parties are related to each other, it will not amount to undervaluation by itself. The same will depend on the facts and circumstances of each case *CC v. Clariant (I) Ltd. (2007) 210 ELT 481 (SC).*

As per Rule 3(3) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 transaction value can be accepted even if buyer and seller are related; if -

a) examination of circumstances show that relationship has not affected the selling price; or
b) buyer demonstrates that the price is similar to identical or similar goods sold to unrelated buyers in India or deductive value or computed value of identical or similar goods.

Question 9

RI is an indenting agent of an Italian company. The agreement between the parties provides for payment of 20% commission on the imported equipments supplied by RI to users in India. However, in respect of RI's own requirements of the equipment supplied by the Italian company, no commission was payable as there was to be no value addition by the indenting agent. The department wants to enhance the value of the imports by 20% as according to them the Indenting Agent is a "Related person". Examine briefly, whether the stand taken by the department is correct with reference to Section 14 of the Customs Act, 1962 and Rule 10 of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 regarding "cost and services" and Rule 2(2) regarding "Related persons".

Answer

Imported goods are valued to levy customs duty as per Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 and Section 14 of the Customs Act, 1962. Rule 2(2) defines the term 'Related person' and according to Rule 3 if the sale is to a related person, then transaction value shall be accepted only if the relationship does not affect the price.

Applying the test laid down in Rule 2(2), it cannot be said that indenting agent is a related person. Also, the terms of the agreement provide for the payment of commission only when the agent sells the goods to others and not for the goods which he keeps for himself. Further, the commission of 20% cannot be added to the value of the imported goods as the rule specifically states that only the costs and services which are paid by the buyer, and not included in the price, are to be added to the price paid for the goods. Accordingly, the action of the department is not correct as it is not consistent with section 14 and Rule 10 of the Rules.

Question 10

M/s Marwar Industries imported finishing agents, dye - carriers, printing paste etc. to be used for manufacture of textile articles. The importer claimed exemption for additional duty of customs (CVD) leviable under section 3 of the Customs Tariff Act, 1975, on the ground that there was an exemption for excise duty in respect of said goods which were to be further used in the same factory for manufacture of textile articles. The Department contended that CVD is payable on the ground that the goods which were to be used must also be manufactured in the same factory which is not so in the case of M/s. Marwar Industries. Comment upon the contention of Department, with reference to a decided case law, if any.

Answer

The contention of the Department is not legally valid. The Supreme Court in a similar caseof *CCus. v. Malwa Industries Ltd. (2009) 235 ELT 214 (SC),* held that literal meaning should be avoided if it leads to absurdity. When the goods are imported, obviously, the same would not be manufactured in the same factory and therefore, it would become impossible to apply the provision of section 3(1) of the Customs Tariff Act, 1975. It was observed that the object of countervailing duty (CVD) is that importer should not be placed

at a more advantageous position *vis-a-vis* purchaser/manufacturer of similar goods in India.

Considering the purpose of exemption, it was held that same factory means imported goods should be used in factory belonging to importer wherein the manufacturing activity takes place. Hence, CVD exemption will be available to imported goods.

Question 11

Assessable value of an item imported is Rs. 2,00,000. Basic customs duty is 10%, additional duty of customs leviable under section 3(1) of the Customs Tariff Act is 12.5%, education cesses is 2 % and SHEC is 1% on duty. Additional duty of customs leviable under section 3(5) of the Customs Tariff Act is exempt. Compute the amount of total customs duty payable. Also, state the amount of CENVAT credit available to the importer and how can it be utilized by him.

Answer

Computation of customs duty payable

	Particulars	*Amount (Rs.)*
1.	Assessable Value	2,00,000
2.	Basic Customs Duty (BCD) @ 10%	20,000
3.	Sub-total	2,20,000
4.	Additional duty u/s 3(1) of the Customs Tariff Act @ 12.5% of Rs. 2,20,000	27,500
5.	Education Cess and SHEC @ 3% (2% +1%) on BCD	600
6.	Total customs duty payable [(2) + (4) + (5)]	48,100

CENVAT credit of additional duty of customs leviable under section 3(1) of the Customs Tariff Act, 1975 [CVD] of Rs. 27,500 will be available to the importer. The CVD of Rs. 27,500 will be available as CENVAT credit for payment of excise duty or service tax as provided in CENVAT Credit Rules, 2004. Education cess and SHEC paid on imported goods will not be available as CENVAT credit.

Part III - Warehousing

Question 1

Clearly mention the relevant date in the following cases of goods warehoused under bond:

(i) Rate of exchange, when goods are removed for home consumption.

(ii) Rate of duty, when goods are removed for home consumption.

(iii) Rate of duty if the goods are not removed from warehouse within the permissible period.

Answer

(i) The relevant date for rate of exchange is the date on which the bill of entry is presented for warehousing under section 46 of the Customs Act, 1962 and not when bill of entry is presented under section 68 for clearance from warehouse.

(ii) As per section 15(1)(b) of the Customs Act, 1962 rate of duty as prevalent on date of presentation of bill of entry for home consumption for clearance from warehouse is applicable and not the rate prevalent when goods were removed from customs port.

(iii) Goods which are not removed within the permissible period are deemed to be improperly removed on the day they should have been removed. Thus, duty applicable on such date i.e. last date on which the goods should have been removed is relevant and not the date on which the goods were actually removed.

Question 2

Write a short note on special warehouses under section 58A.

Answer

Section 58A has been enacted vide Finance Act, 2015 to provide for a new category of warehouses (special warehouses). These warehouses shall be entitled to store specific classes of goods, which have been notified under sub-section (2) of section 58A (Notification No.66/16 – Cus (NT) dated 14th May 2016). These warehouses shall be under the lock of customs. An existing licensee or any new applicant shall be required to apply for a license under Special Warehouse Licensing Regulations, 2016, if they propose to store or continue to store goods notified under notification 66 /16-Cus (NT) dated 14th May 2016 namely, goods stored for duty free shops/airline/ship/diplomatic stores. Here again, a transitional period of three months has been provided so as to allow existing arrangements to continue and enable a smooth and orderly transition.

Question 3

Mention the situation when the imported goods are warehoused but are not deemed to be warehoused under the Customs Act, 1962.

Answer

Under section 49 of the Customs Act, 1962, in case of any imported goods, whether dutiable or not, entered for home consumption, where the Assistant Commissioner of

Customs or Deputy Commissioner of Customs is satisfied on the application of the importer, that the goods cannot be cleared within a reasonable time, the goods pending clearance, may be permitted to be stored for a period, not exceeding 30 days in a public warehouse, or in a private warehouse, if facilities for deposit in a public warehouse are not available; Such goods shall not be deemed to be warehoused goods for the purposes of the Customs Act and accordingly the provisions of Chapter IX shall not apply to such goods.

Question 4

Mention the maximum period for which goods are allowed to be warehoused but not deemed to be warehoused under the Customs Act, 1962.

Answer

Under section 49 of the Customs Act, 1962, Assistant Commissioner of Customs or Deputy Commissioner of Customs may permit the imported goods to be stored for a period not exceeding 30 days in a public warehouse, or in a private warehouse if facilities for deposit in a public warehouse are not available; the commissioner may further extend by a period of 30 days at a time.

Question 5

What is the maximum period allowed to an importer under section 47 of the Customs Act, 1962 to pay the duty after the return of bill of entry to him?

Answer

Under section 47 of the Customs Act, 1962, the maximum period allowed to an importer to pay duty is within two days excluding holidays from the date on which the bill of entry is returned to him for payment of duty.

Question 6

What will be the impact on the customs duty if the goods are:

(i) damaged inside the warehouse before clearance for home consumption.

(ii) destroyed in the warehouse before clearance for home consumption.

(iii) destroyed after clearance from warehouse.

Answer

(i) When the goods are damaged inside the warehouse, an abatement in customs duty, on resultant loss in value, is provided through section 22 of Customs Act. Section 22 contemplates that for claiming abatement of duty, the damage (not deterioration) should occur at any time before clearance of the imported goods for home consumption from the warehouse. However, the damage should not be attributable to the importer. It should be proved to the satisfaction of Assistant Commissioner or Deputy Commissioner of Customs that the imported goods have actually suffered damages. The claim for abatement is not tenable unless the importer factually proves the damage. The following equation provides the way to calculate the abatement of duty.

Duty after damage/ Duty before damage = Value after damage/Value before damage

(ii) When the goods are destroyed in the warehouse before clearance for home consumption, customs duty will be remitted as per the provisions of section 23 of Customs Act. Section 23(1) applies when the goods have been lost (otherwise than as a result of pilferage) or destroyed in entirety i.e. whole or part of goods is lost once for all. The goods cease to exist and cannot be retrieved. The loss is generally on account of natural causes such as fire, flood etc., and no human element is present as under Section 13. The loss or destruction may occur at any time before clearance for home consumption. The loss/destruction has to be proved to the satisfaction of Assistant Commissioner or Deputy Commissioner.

(iii) As per the discussion made in (ii) above it is clear that remission of duty is possible only when destruction occurs before clearance for home consumption. In case of destruction after clearance from a warehouse, no remission of duty is possible.

Question 7

Shobha imported certain goods in March, 2015. An 'into bond' bill of entry was presented on 14th March, 2015 and goods were cleared from the port for warehousing. The order permitting the deposit of goods in warehouse for 6 months was issued on 21st March, 2015. Shobha did not clear the imported goods even after the warehousing period got over on 20th September, 2015. She did not obtain any extension of time as well. A notice was issued under section 72 of the Customs Act, 1962 demanding duty and other charges. Shobha cleared the goods on 10th December, 2015. Examine the applicability of rate of exchange and rate of duty and other charges payable with the help of a decided case law.

Answer

As per Section 14, the assessable value is to be computed as per the exchange rate in force on the date on which into-bond bill of entry for warehousing is filed under section 46 of the Act, hence, the rate of exchange in force on 14th March, 2015 will be taken.

It was held in *Kesoram Rayon v. CC(1996) 86 ELT 464 (SC) and SBEC Sugars Limited v. UOI 2011 264 ELT 492 (SC)* that when warehousing period expires without extension thereof, the date on which warehousing period comes to an end will be the date of deemed removal and the rate of duty prevalent on that date shall be applicable for determining customs duty. Therefore, the date of expiry of warehousing period, i.e., 20th September, 2015 will be the date of deemed removal and rate of duty prevalent on that date shall be applicable on removal of goods.

It is a case of improper removal of warehoused goods as prescribed in section 72(1), hence all penalties, and other charges are also payable in respect of such goods.

Question 8

Shubham imported certain goods in November, 2015 and an 'into bond' bill of entry was presented on 28th November, 2015. Assessable value was US$1,00,000. Order permitting

the deposit of goods in warehouse for 3 months was issued on 2nd December, 2015. Shubham neither obtained extension of warehousing period nor cleared the goods within the permitted warehousing period of 1st March, 2016. Only after a notice was issued under section 72 of the Customs Act, 1962 demanding duty and other charges, Shubham removed the goods on 15th April, 2016. Compute the amount of duty payable by Shubham while removing the goods from warehouse, assuming that no additional duty or special additional duty is payable. Following information is provided:

	28.11.2015	***01.03.2016***	***15.04.2016***
Rate of exchange per US $	*Rs. 46*	*Rs. 45*	*Rs. 44*
Rate of basic customs duty	*15%*	*10%*	*5%*

What would be applicable rate of exchange? What would be applicable rate of duty?

Answer

The relevant rate of exchange will be the rate in force on the date on which 'into bond' bill of entry is presented. Subsequent change is not relevant. Hence exchange rate relevant is 1 US $ = Rs. 46 on 28.11.2015.

In *Kesoram Rayon v. CC (1996) 86 ELT 464,* it was held that goods which are not removed from the warehouse within the permissible period are deemed to be improperly removed on the last date on which goods should have been removed. Hence, the applicable rate of duty is 10%, i.e. on 01.03.2016, the last date when the period was over.

Relevant rate of Exchange =Rs. 46

Applicable rate of duty = 10%

1. Assessable value US$ 1,00,000 x Rs. 46 = Rs. 46,00,000
2. Customs Duty @ 10% = Rs. 4,60,000
3. *Add : EC@2% & SHEC@1% of Customs Duty =* Rs. *13,800*
4. Total customs duty payable = Rs. 4,73,800

Question 9

KK Mills imported certain goods and kept them in warehouse. However, the goods were not removed from the warehouse at the expiration of the statutory time period during which such goods were permitted under section 61 of the Customs Act, 1962 to remain in a warehouse. The assessee sought to relinquish the title to such goods under the proviso to section 68. However, the department contended that since the goods were deemed to be improperly removed from the warehouse under section 72(1)(b) considering the overstay of such goods in the warehouse, the case would not fall under section 68 and thus proviso to section 68 could not be invoked; and the assessee was liable to pay full amount of duty.

Discuss, in light of a decided case law, if any, whether contention of the department is tenable in law.

Answer

No, the contention of the Department is not tenable in Law. The owner of any warehoused goods may at any time before an order for clearance of goods for home consumption has been made in respect of such goods, relinquish his title to the goods upon payment of rent, interest charges and other charges and penalties that may be payable in respect of the goods and upon such relinquishment, he shall not be liable to pay duty thereon-proviso to section 68.

The High Court in a similar case of *J K Cement Works* v. *CCE &Cus.* (2008) 223 ELT 138 (Raj.) observed that it is immaterial for the purpose of invoking the proviso that the goods remained in warehouse beyond permitted time limit. The High Court explained that it is not necessary to fulfill conditions for clearance of warehoused goods prescribed in main provisions of Section 68 to invoke the proviso because if the importer was able to pay full duty, the question of exercise of option for relinquishment would not arise.

Thus, M/s KK Mills is not required to pay duty on relinquishment of title to the goods.

Question 10

The assessee imported capital goods and deposited them in the warehouse. The said goods were not removed from the warehouse within the period permitted under section 61(1)(c) i.e. one year. Subsequently, the assessee filed an application for relinquishment of title of such warehoused goods. The Department contended that since the assessee did not file an application for extension of warehousing period before the expiration of five years period fixed under section 61(1)(c), after expiration of the said period, the goods could no longer be termed as warehoused goods. Therefore, the assessee lost its title to the same and consequently, it lost its right to relinquish its title thereto. It was further claimed that the relinquishment of title to the said goods ought to have been made by the assessee before the expiration of the warehousing period and not thereafter and therefore the goods were deemed to have been improperly removed from the warehouse. Consequently, the assessee became liable to pay duty, penalty and interest with respect to the said goods as provided under section 72(1)(b) of the Customs Act, 1962. Discuss, whether the contention of the Department is correct, by referring to case law, if any.

Answer

The facts of the given case are similar to the facts of the case of *Commissioner Customs v i2 Technologies Software (P) Ltd. 2007 (217) ELT 176 (Kar.)* The High Court, while dismissing the Department's appeal observed that the owner of the goods (importer) though loses control over the goods when he deposits them in the warehouse, but he does not lose his title or ownership to such goods so long as they remain in the warehouse either during the continuance of the warehousing period or even after its expiration. Therefore, the High Court rejected the Department's contention that on the expiration of the warehousing period or on the expiration of extended warehousing period, the owner of the goods loses

his title in respect of such goods and consequently, also loses his right to relinquish his title to such warehoused goods.

The High Court elaborated that on a plain reading of the provisions of section 23(2), 47, 68 and the proviso to section 68 of the Customs Act, 1962, it is clear that the owner of warehoused goods has the right to relinquish his title to goods at any time before an order for clearance of goods for home consumption has been made in respect thereto. There is no prohibition on relinquishing the title to such goods after the expiration of the warehousing period or after the expiration of the extended period. The High Court pointed out that the provisions of section 23(2) and proviso to section 68 make it clear that upon relinquishment of his title to any imported goods, including the warehoused goods, the owner of such goods shall not be liable to pay duty thereon and when the owner is not liable to pay duty, the question of paying any interest on the duty and penalty would not arise. Therefore, in the instant case, the Department's contention is not correct.

Question 11

A company imported certain goods and warehoused them initially for a period of one year. The company surrendered the goods and the auction of the goods was duly advertised. However, subsequently the company made a request for permission to re-export the goods under section 69(1) of the Customs Act, 1962 and for cancellation of the auction sale. The request was not granted and the goods were auctioned. The company contends that it is entitled to withdraw the offer of surrender subsequently and hence, the auction was not valid. Examine in the light of decided case law, if any.

Answer

The proviso to Section 68, which envisaged relinquishment of title to the goods by the owner of the warehoused goods at any time before an order for clearance of goods for home consumption has been made in respect of such goods, does not envisage subsequent withdrawal of such surrender or relinquishment. The Supreme Court has held in *Union of India and Others v. Shakti LPG Ltd. and another, 18th February 2008,*that the mere fact that the company withdrew its offer of surrender would not make any difference to its cause. The company having surrendered its title in the goods could not contend that this surrender had been withdrawn subsequently. Thus, the company's claim is not valid.

Part IV- Duty Drawback

Question 1

Distinguish between 'Duty drawback under section 74' and 'Duty drawback under section 75' of the Customs Act, 1962.

Answer

Duty Drawback provisions are contained in Section 74 and section 75 of the Customs Act, 1962. The points of distinction between the two are as under:

S. No	*Section 74*	*Section 75*
1.	Applicable on Re-exportation of goods in same form.	Applicable on Export of goods in different form.
2.	The rules cover Customs duty only.	The rules cover Customs duty and Central Excise duty.
3.	Re-export of Imported Goods (Drawback of Customs Duties) Rules 1995 are applicable.	Customs and Central Excise Duties and Service Tax Drawback Rules, 1995 are relevant.
4.	Comparison of import value with export value is irrelevant.	Comparison of Import value and export value is an eligibility criterion.
5.	There is no need for sale or repatriation of export sale proceeds.	The export proceeds must be realized and brought to India within the period stipulated by RBI Regulations.
6.	Re export must be within the stipulated time.	No time limit prescribed.
7.	Maximum drawback is at 98% of import duty paid.	The maximum drawback is 1/3 i.e. 33.33% of market value.
8.	Available on baggage also.	Not available for baggage.
9.	Eligible even on used goods.	Used goods are not eligible.
10.	Goods should be identifiable to the satisfaction of proper officer.	No need to establish the identity.

Question 2

State briefly the provisions under the Customs Act, 1962 relating to duty drawback on re-export of goods.

Answer

Section 74 of the Customs Act, 1962, deals with duty drawback on re-export of goods. When imported goods on which duty has been paid on importation are exported, 98% of the customs duty will be paid back as drawback on satisfaction of the following conditions:

1. Goods must be easily identified.
2. Proper Officer makes an order permitting clearance for loading of the goods for exportation.
3. If goods are exported as baggage, the owner of the baggage makes a declaration of its contents to the proper officer which will be considered as entry for export and such officer permits clearance of the goods for exportation.
4. If exported through post, the Proper Officer makes an order for clearance for export.
5. The goods are entered for export within two years from the date of payment of duty on the importation thereof.

Question 3

What is the minimum and maximum rate or amount of duty drawback prescribed under the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995 made under section 75 of the Customs Act, 1962? Explain with a brief note.

Answer

Minimum rate of duty drawback - Rule 8(1) of Customs, Central Excise Duties and Service Tax Drawback Rules, 1995 provides that no amount or rate of drawback shall be determined in respect of any goods, the amount or rate of drawback of which would be less than one per cent of the F.O.B. value thereof, except where the amount of drawback per shipment exceeds five hundred rupees.

Maximum rate of duty drawback - Rule 8A of Customs, Central Excise Duties and Service Tax Drawback Rules, 1995 provides that the drawback amount or rate shall not exceed one third of the market price of the export product.

Question 4

Write a short note on Duty Drawback on exports under Customs Act, 1962.

Answer

The duty drawback scheme is presently administered by the Directorate of Drawback in the Ministry of Finance. Drawback on exports is sanctioned and paid by the concerned Commissioner of Customs or Central Excise incharge of the port/airport/Land Customs Station through which the goods are exported, at the rates determined by the Directorate.

These drawback rates are fixed either for a class of products manufactured in the country which are available to all exporters and are known as All-industry Rates or for a product of a particular manufacturer known as Brand Rate.

All industry drawback rates are fixed by the Directorate of Drawback. It is possible to fix all industry rates only for some standard products. It cannot be fixed for special type of products. In such cases, brand rate is fixed under rule 6. The manufacturer has to submit an application with all details to the Commissioner Central Excise. Such application must be made within 60 days of export. All industry rates are fixed on average basis.

In case the manufacturer or exporter finds that the (a) duty-drawback as per all industry rate is less than 80% of the duties paid by him (b) rate is not less than 1% of FOB value of product except when amount of drawback per shipment is more than Rs. 500 (c) export value is not less than the value of imported material used in them. In such cases, he can apply for fixation of special brand rate to the Commissioner of Central Excise and Customs. He can apply under Rule 7 for fixation of Special Brand Rate, within 30 days from export.

Question 5

What percentages have been fixed as the rates at which drawback of import duty shall be allowed in respect of goods which were used after their importation?

Answer

The reduced rates of drawback have been prescribed for the goods used after importation, these are given below:

Sr. No.	*Period between the date of clearance for home consumption and the date when the goods are placed under control of Customs for export*	*% of import duty to be paid as drawback*
1.	Not more than 3 months	95%
2.	More than 3 months but not more than 6 months	85%
3.	More than 6 months but not more than 9 months	75%
4.	More than 9 months but not more than 12 months	70%
5.	More than 12 months but not more than 15 months	65%
6.	More than 15 months but not more than 18 months	60%
7.	More than 18 months	Nil

However, the duty drawback is not available for used wearing apparels, tea chests, exposed cinematography film passed by Board of Film Censors in India, unexposed photographic films, paper and plates and X-Ray films.

Question 6

Calculate the amount of drawback available under section 74 of the Customs Act, 1962 in the following three separate cases.

(i) X imported computers for office use and paid Rs. 5,00,000 as import duty. The computers are re-exported after 13 months.

(ii) Z imported wearing apparel and paid Rs. 20,000 as import duty. These are re-exported after 6 months

Answer

(i) Drawback rate for goods used for more than 12 months but not more than 15 months as notified by the Central Government is 65%. Hence, amount of drawback = Rs. 5,00,000 x 65% = Rs. 3,25,000.

(ii) No drawback is available on wearing apparel on export after their use.

Question 7

On 1st October, 2015, M/s Desktop Ltd. imported certain laptops from France for merely testing in India, the same were exported to Germany on 30th April, 2016 after testing. Compute the duty drawback available on the imported laptops.

Answer

As decided in the case of Seljegat Printer, in Re 2002 (143) ELT 719 (GOI), even if goods are merely tested, though not used, it will be treated as used after importation. Thus, duty drawback will be reduced to 75%, as the laptops will be considered as used for 7 months.

Question 8

M/s PK Ltd. client loaded a machine on the vessel for export. He has paid import duty and central excise duty on the components used in the manufacture. The vessel set sail from Mumbai but runs into trouble and sinks in the Indian Territorial Waters. The Customs department refuses to grant duty drawback for the reason that the goods have not reached their destination. Examine the validity of the Department's contention under citing case law, if any.

Answer

Rule 2(a) of the Customs, Central Excise Duties & Service Tax Drawback Rules, 1995 provides that "drawback", in relation to any goods manufactured in India, and exported, means the rebate of duty or tax, as the case may be, chargeable on any imported materials or excisable materials used or taxable services used as input services in the manufacture of such goods.

Rule 2(c)of the said Drawback rules *inter alia* provides that "export" means "taking out of India to a place outside India". Section 2(27) of the Customs Act, 1962 provides that India includes the territorial waters of India.

In case of *CC v. Sun Industries 1988 (35) ELT (241),* the Supreme Court held that the expression "taking out to a place outside India" would also mean a place in high seas, if that place is beyond territorial waters of India. Therefore, the goods taken out to the high seas outside territorial waters of India would come within the ambit of expression "taking out to a place outside India".

The emphasis in the aforementioned judgment was on the movement of the goods outside the territorial waters of India. It is then that an export may be said to have been taken place. In the instant case, the vessel sunk within territorial waters of India and therefore there is no export.

Accordingly, no duty drawback shall be available in this case. Similar decision was given by the Supreme Court in the case of *UOI v. Rajindra Dyeing & Printing Mills Ltd. 2005 (180) ELT 433 (SC).*

Question 9

Mention with reasons where will the appeal/revision application lie against the order passed by the Commissioner of Customs (Appeals) rejecting the application for drawback.

Answer

In terms of Sections 129A (1) of Customs Act, any person aggrieved by decision or order of Commissioner of Customs (Appeals) may file an appeal to CESTAT. However, appeal cannot be filed before CESTAT if the matter relates to Duty Drawback.

However, under Section 129DD of the Customs Act, the appeal against the order of Commissioner (Appeals), in cases of duty drawback lies with the Central Government which is the Revision Authority (instead of CESTAT). Further, the Revision Authority may refuse to admit an application if differential duty, fine and penalty involved does not exceed Rs. 5,000.

Part V - Miscellaneous Provisions

Question 1

Briefly mention the provisions about temporary detention of baggage in the Customs Act, 1962.

Answer

As per Section 80 of the Customs Act, where:

(i) the baggage of a passenger contains any article which is dutiable or import of which is prohibited; and

(ii) in respect of which a true declaration has been made under Section 77, the proper officer may, at the request of the passenger detain such article for the purpose of being returned to him on his leaving India and if for any reason, the passenger is not able to collect the article at the time of leaving India, the article may be returned to him through any other passenger authorized by him leaving India. The Article may be sent as cargo consigned in the name of the passenger.

Question 2

What are the conditions governing refund of import duty under section 26A of the Customs Act, 1962? Explain briefly.

Answer

Section 26A of Customs Act, makes provision for refund of import duty paid if goods are found defective or not as per specifications. Conditions governing the refund are as under:

(i) The imported goods are found to be defective or not in conformity with the specifications and they should not have been reworked or repaired or used after import.

(ii) The goods should be identified to the satisfaction of the AC/DC of Customs as the goods which were imported.

(iii) The importer had not claimed drawback under any other provision of this Act.

(iv) Goods should either be re-exported or abandoned or destroyed in the presence of the proper officer within 30 days from the date on which goods were imported (the period can be extended upto three months).

(v) Application for refund should be made within six months from the relevant date in prescribed form and manner.

Question 3

Write a note on 'refund of export duty.' Is doctrine of unjust enrichment applicable to it?

Answer

Where on exportation of any goods, any duty has been paid, it is refundable under the provisions of section 26 of Customs Act subject to following conditions:

(i) The goods are returned otherwise than by way of resale.

(ii) Goods are re-imported within one year from the date of re-exportation.

(iii) An application for refund is made before the expiry of six months from the date on which the proper officer makes an order for clearance of goods.

Doctrine of unjust enrichment does not apply to refund of export duty as this refund is under section 26 of Customs Act.

Question 4

Distinguish between Transit and Transshipment of goods under Customs Act, 1962.

Answer

The basic difference between transit and transshipment is that in 'transit' goods continue to be on same vessel, while in transshipment, goods are transferred to another vessel / vehicle. Section 53 dealing with transit provide that any goods imported in any conveyance will be allowed to remain on the conveyance and to be transited without payment of customs duty, to any place out of India or any customs station. However, all these goods must be mentioned in import manifest or import report submitted by person in charge of conveyance. Under section 54 of Customs Act, transshipment means transfer from one conveyance to another [The conveyance may be vehicle, ship or aircraft]. Such transshipment may be to any major port or airport in India. The following points detail the distinction between transit and transshipment:

Sr. No.	*Transit Goods under section 53*	*Transhipment of Goods under Section 54*
1.	Goods are lying in the ship at an intermediate port.	Goods are transferred at the intermediate port.
2.	Only import manifest has to be submitted for entry.	Bill of Transshipment/declaration is also required for transshipment.
3.	Transit is allowed in every port normally.	Transshipment is allowed in specified ports only.
4.	No supervision is required for transit goods.	Transshipmenttakes place under supervision of proper officer.
5.	No additional conditions or formalities are required.	Specific conditions are imposed if goods are deliverable at Indian port.
6.	Only one conveyance is involved in transit goods and the same carries the goods to the port of clearance.	At least two conveyances are involved in transshipment and the transferee ship reaches the destination port.

Question 5

An importer filed bill of entry after 60 days of filing Import General Manifest. The Deputy Commissioner of Customs imposed a penalty of Rs. 10,000 by endorsement on the bill of entry. Since importer wanted to clear the goods he paid the penalty. Can penalty be imposed for late filing of bill of entry? Examine the issue in the light of relevant statutory provisions.

Answer

The Customs Act, 1962 does not prescribe any statutory time limit for filing Bill of Entry. However, under section 48 of the Customs Act, 1962, if imported goods are not cleared within 30 days from the date of unloading, goods can be disposed off by the custodian. Therefore, since no offence is committed by late filing of bill of entry, penalty cannot be imposed for the same. However, the custodian after giving notice to the importer and with the approval of the proper officer can sell the goods.

In the instant case, the importer can file an appeal before Commissioner (Appeals) since endorsement of penalty on the bill of entry can be considered as part of assessment.

Question 6

Distinguish between "First Appraisement and Second Appraisement."

Answer

First Appraisement or goods based assessment means, assessment of goods after the goods are examined. This system is resorted to only in exceptional cases where it is not possible for the Appraiser to determine the value or classification of the goods or for any other reason on the basis of the documents as produced by the importers.

Second Appraisement or document based means making the assessment on the basis of the declaration made by the importers on the strength of documents such as invoice, catalogue, literature showing the composition and use, price lists, etc., as produced by the importers. Under this system, the goods are examined after assessment and collection of duty.

Question 7

Super Ltd. is registered under Project Import Regulations, 1986 for import of power equipments at concessional rate to implement a project for setting-up of a power plant. It imported a gas turbine and generator under the Project Import Regulations, 1986, but before these could reach the project site, these were lost/destroyed in the sea within India.

The department denied project import concession under the heading 9801 and demanded full duty, as the goods were not used in the project. Discuss in the light of decided case law, whether the demand made by the department is tenable in law.

Answer

The facts of the present case are similar to the case of *CCEx. v. LancoKondapalli Power Pvt. Ltd.* (2011) 268 ELT 76(SC), wherein the apex court held that the goods were irretrievably lost and were not available for the purpose for which they were imported. Merely because the goods were not destroyed in the presence of the customs officers, that would not

disentitle the goods from the project import rate of duty under Heading 9801 of the Customs Tariff. Hence Sun Power Ltd. is entitled to pay duty at concessional rate under the Project Import Regulations.

Thus, the demand made by the Department is not tenable in law.

Question 8

Baluja Ltd. imported a consignment of metal bars during July, 2015 by sea, weighing 2,800 tons from U.K. A bill of entry for home consumption was filed and an order for clearance was passed by the Assistant Commissioner.

The company paid the applicable duty. Thereafter, delivery was taken and on examination by the company's representatives; it was found that only 2,000 tons of metal bars were available at the dock though duty was paid for the entire lot of 2,800 tons. Since there was no short landing of the cargo, the short delivery of 800 tons was also supported by the weightment certificate issued to the company by the port trust authorities.

The company made a representation to the customs department for appropriate relief under the Customs Act, 1962. Examine in the light of the provisions of Customs Act.

Answer

As per Section 23 of Customs Act, where the imported goods have been lost without pilferage or destroyed at any time before clearance for home consumption, duty on such goods would be remitted. Here 'loss' means that the loss is forever and there is no possibility of tracing it or recovering it.

In the given case 800 metric tons of metal bars have been lost in the custody of port trust after the order for clearance was passed and duty payment was made. The weightment certificate issued by Port Trust Authorities also substantiates the same. Baluja Ltd. is therefore entitled to remission of the duty on the lost goods i.e. 800 tons, under Section 23 of the Customs Act.

Question 9

In a search conducted in the office premises of Cavin Ltd., large quantity of rough diamonds were recovered. It was found that these were imported without a license. After adjudication, penalty was imposed on Cavin Ltd. and goods were confiscated. An option was given to the company to redeem goods on payment of redemption fine and customs duty at appropriate rate. During the relevant period, there was an exemption notification in respect of these goods. Cavin Ltd. claimed benefit of the exemption notification for payment of customs duty. Discuss in the light of a decided case, whether Cavin Ltd.'s contention is correct.

Answer

The facts of the case are similar to that of *M. Ambalal & Co.* v. *Commissioner of Customs (2011)* where it was observed that the wordings of the exemption notification were clear that the benefit of the exemption envisaged is for those goods that are imported. According to Section 2(25) of the Customs Act 'imported goods' have been defined to mean "...any goods brought into India from a place outside India but does not include goods which have

been cleared for home consumption." It is necessary that the above definition is read along with Section 11, Section 111 and Section 112 of the Act, which provide for detection of illegally imported goods and prevention of the disposal thereof, confiscation of the goods and conveyances and imposition of penalties respectively. Under Section 111(d) of the Act, any goods which are imported contrary to any prohibition imposed by or under this Act or any other law for the time being in force shall be liable for confiscation.

In this case, the goods which have been seized cannot be imported into India without a license under the Import Control Act and therefore goods so imported cannot, be treated to be lawfully "imported goods" within the definition of that term in Section 2(25) of the Act. Therefore, Cavin Ltd. shall not be entitled to the benefit of the notification. Thus, contention of Cavin Ltd. is not correct.

Question 10

The assessee, an EOU, wrongly claimed an exemption. However, before claiming the same, it sought a clarification from the Development Commisisoner. The Development Commissioner replied in favour of the assessee quoting a letter of Ministry of Commerce. Thereafter, the assessee claimed the exemption on import. The Department issued a show cause notice under section 28(4) of the Customs Act, 1962, demanding duty for the period during which the exemption was wrongly claimed invoking extended period of limitation of 5 years on grounds that the assessee had misutilised the exemption and had sought clarification from a wrong authority. Is the action of Department justified in light of the provisions of the Customs Act, 1962 ? Discuss with the help of decided case law.

Answer

The facts of the given case are similar to that of Uniworth Textiles Ltd. v. CCE, wherein, the Supreme Court while rejecting the contention of the Department made the following observations:

The Section imposes a limitation period of one year within which the concerned authorities must commence action against an importer/assessee in case of duties not levied, short-levied or erroneously refunded. It allows the said limitation period to be read as five years only in some specific circumstances, viz. collusion, willful misstatement, suppression of facts or deliberate default. Mere non-payment of duties is not equivalent to collusion or willful misstatement or suppression of facts. Further, the bonafide intent of assessee EOU is proved by its act of seeking clarification from Development Commissioner.

Thus, the department is not justified in issuing the show cause notice under section 28(4) of Customs Act in the given case.

Question 11

Rupesh was the director of Ved Alloys Pvt. Ltd. till 16th May, 2015. On 18th July, 2015, Customs Authority issued notice to the former director, i.e., Rupesh seeking to attach his properties for recovery of the dues of the company.

Revenue contended that as per the provisions of section 179 of the Income-tax Act, 1961 and section 18 of the Central Sales Tax Act, 1956 in case of a private company, where any tax dues of the company under relevant statutes cannot be recovered, every person who

was director of the said company at any time during the period for which tax is due shall be jointly and severally liable for the payment of tax.

On this base, the Customs Authority has invoked provisions of section 142 of the Customs Act, 1962.

Answer

The facts of the case are similar to *Anita Grover* v. *CCE* [2012-TIOL-1049-HCDEL-CUS] wherein, the High Court elucidated that it was only the defaulter against whom steps might be taken under Rules. The defaulter was the person from whom dues were recoverable under the Act. In the present case, it was the company who was the defaulter. There was no averment that the company had been or was being wound up. Thus, juristic personality of an existing company and its former director were certainly separate; the dues recoverable from the former could not, in the absence of a statutory provision, be recovered from the latter. There was no provision in the Customs Act, 1962 corresponding to section 179 of the Income Tax Act, 1961 or section 18 of the Central Sales Tax which might enable the Revenue authorities to proceed against directors of companies who were not defaulters.

Thus, the Customs Authority was not justified in its action. The property of Rupesh, a former director of a company cannot be attached for recovering dues from the Company.

Question 12

Mention the categories of persons who can be searched by the proper officer of customs under section 100 of the Customs Act, 1962.

Answer

Under Section 100 of the Customs Act, 1962, the proper officer of the Customs, where he has reason to believe that a person has secreted any goods, liable to confiscation or any documents thereto, he may search such persons. The categories of persons that could be searched in this respect are: -

(i) any person who has landed from or is about to board, or is on board any vessel within the Indian Customs waters;

(ii) any person who has landed from or is about to board, or is on board a foreign going aircraft;

(iii) any person who has got out of, or is about to get into, or is in vehicle, which has arrived from, or is to proceed to any place outside India;

(iv) any person not included in clauses (a), (b) or (c) who has entered or is about to leave India;

(v) any person in a customs area.

Question 13

Mention the amount which is required to be deposited mandatorily before filing an appeal before the Commissioner (Appeals) and CESTAT under the Customs Act, 1962.

Answer

As per section 129E of the Customs Act, the Tribunal or the Commissioner (Appeals), as the case may be, shall not entertain any appeal,-

(i) Under section 128(1), unless the appellant has deposited 7.5% of the duty demanded or penalty imposed or both, in pursuance of a decision or an order passed by an officer of customs lower in rank than the Commissioner of Customs;

(ii) against the decision or order referred to in section 129A(1)(a), unless the appellant has deposited 7.5% of the duty demanded or penalty imposed or both, in pursuance of the decision or order appealed against;

(iii) against the decision or order referred to in section 129A(1)(b), unless the appellant has deposited 10% of the duty demanded or penalty imposed or both, in pursuance of the decision or order appealed against.

Provided that the amount required to be deposited under this section shall not exceed rupees ten crores. Further, the provisions of this section shall not apply to the stay applications and appeals pending before any appellate authority prior to the commencement of the Finance (No. 2) Act, 2014.

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7

Advance Ruling, Settlement Commission and Appellate Procedure

Question 1

What are the objectives of setting up of the Settlement Commission under the Central Excise and Customs Law?

Answer

The provisions of Settlement Commission under Central Excise and Customs Law were introduced vide Finance Act, 1998. Under this, cases are settled by the commission at the instance of the assessee who wants to accept liability without contesting the case. The basic objectives of setting up of the Settlement Commission are:-

(i) To provide an alternate channel for dispute resolution for the assessee;

(ii) To expedite payments of Customs, Central Excise and Service Tax involved in disputes by avoiding costly and time consuming litigation process;

(iii) To provide an opportunity to the tax payers to come clean who may have evaded payments of duty;

(iv) To serve as a forum for the assessee to apply for settlement of their cases, on the basis of true and complete disclosure of their duty liability by them;

(v) To encourage quick settlement of disputes and save the business from the worries of prosecution in certain situations.

Question 2

Explain briefly the provisions relating to Settlement Commission.

Answer

The various provisions in respect of Settlement Commission are briefly discussed as under:-

(i) Application only if a 'case' is pending : Application to Settlement Commission can be made only when a 'case' is pending before adjudicating authority on date of application in accordance with section 32E(1) read with section 31(c) of Central Excise Act. The term **'case'** means any proceeding under Central Excise Act or any other Act for the levy, assessment and collection of excise duty, pending before an adjudicating authority on the date on which an application under section 32E(1) is made.

(ii) **Amendment of section 32E putting certain restrictions :** No application can be made if proper records are not maintained in daily stock register or when there is clandestine removal of goods. The additional amount of duty accepted by the applicant as payable **shall be more than** Rs.**3 lakhs.** The appellant is required to pay duty admitted to be payable by him along with interest.

(iii) **Application for settlement only once in life time :** Section 32-O of the Central Excise Act provides that application for settlement can be made only once during the life time of the applicant. However, w.e.f. 08-05-2010 it has provided that the said provision of one time application applies only in respect of cases as specified in section 32-O(1). In other cases, repeated application can be submitted.

(iv) **Cases involving classification or valuation can not be taken :** According to thirdproviso to section 32E(1) applications involving interpretation of the classification of excisable goods under Central Excise Tariff Act 1985 can not be taken by Settlement Commission.

(v) **Application 180 days after seizure :** If any excisable goods or books of account or other documents have been seized, application for settlement can be made only 180 days after such seizure.

Question 3

Who can make an application for advance ruling under the Central Excise, Customs and Service Tax laws?

Answer

The following person can make an application for the advance ruling under the Central Excise, Customs and Service Tax laws:

(i) (a) a non-resident setting up a joint venture in India in collaboration with a non-resident or a resident; or

(b) a resident setting up a joint venture in India in collaboration with a non-resident; or

(c) a wholly owned subsidiary Indian company, of which the holding company is a foreign company, who or which, as the case may be, proposes to undertake any business activity in India:

(ii) a joint venture in India; or

(iii) a resident falling within any such class or category of persons, as the Central Government may, by notification in the Official Gazette, specify in this behalf, and which or who, as the case may be, makes application for advance ruling under sub-section (1) of section 23C or sub-section (1) of 28H;

Question 4

Explain briefly the advantages of advance ruling scheme under the Central Excise, Customs and Service Tax laws.

Answer

The advance rulings scheme under the Central Excise, Customs and Service Tax laws has the following advantages:

(i) It ensures clarity and certainty of the tax liability under the Central Excise, Customs and Service Tax laws in advance in relation to an activity (means import or export under the Customs Act, production or manufacture of goods under the Central Excise Act and service to be provided under Finance Act – Service Tax) proposed to be undertaken by the applicant.

(ii) Finality and thereby avoidance of protracted litigation.

(iii) Speedy decisions.

(iv) Inexpensive process.

(v) Transparency.

Question 5

Who is an authorized representative for the purpose of appearance before an officer under section 35Q under Central Excise Act, 1944?

Answer

Section 35Q of the Central Excise Act 1944, prescribes that any party to a dispute may otherwise than when required by the Tribunal to attend personally for examination on oath, can appear through an authorised representative who may be:

(a) His relative or regular employee; or

(b) Custom House Agent; or

(c) Any legal practitioner who is entitled to practice in any civil court; or

(d) Any person who has acquired such qualifications as the Central Government may prescribe by rules made in this behalf. The Central Government has since prescribed the qualifications under Rule 12 of the Central Excise (Appeals) Rules, 2001.

For the purposes of clause (c) of Sub-section (2) of Section 35Q, an authorised representative shall include a person who has acquired any of the following qualifications being the qualifications specified under clause (c) to Rule 12 of the Central Excise (Appeals) Rules, 2001, namely:

(a) Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 (38 of 1949); or

(b) Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959 (23 of 1959);or

(c) Company Secretary within the meaning of the Company Secretaries Act, 1980 (56 of 1980) who has obtained a certificate of practice under Section 6 of that Act; or

(d) Post-graduate or an Honours degree holder in Commerce or a post-graduate degree or diploma holder in Business Administration from any recognised university; or

(e) A person formerly employed in the Department of Customs and Central Excise or Narcotics and has retired or resigned from such employment after having rendered service in any capacity in one or more of the said departments for not less than ten years in the aggregate, can act as an authorised representative.

Question 6

Briefly explain the matters in respect of which an appeal can be made before Customs, Excise and Service Tax Appellate Tribunal (CESTAT).

Answer

Any person aggrieved by any of the following orders may appeal to the Customs, Excise and Service Tax Appellate Tribunal (CESTAT) against such order:

(a) A decision or order passed by the [Commissioner] of Central Excise as an adjudicating authority;

(b) An order passed by the [Commissioner] (Appeals) under Section 35A ;

(c) An order passed by the Central Board of Excise and Customs constituted under the Central Boards of Revenue Act, 1963 (54 of 1963) (hereafter in this Chapter referred to as the Board) or the Appellate [Commissioner] of Central Excise under Section 35, as it stood immediately before the appointed day;

(d) An order passed by the Board or the [Commissioner] of Central Excise, either before or after the appointed day, under Section 35A, as it stood immediately before that day.

Provided that no appeal shall lie to the Customs, Excise and Service Tax Appellate Tribunal (CESTAT) in respect of any order referred to in clause (b) if such order relates to loss of goods in transit, rebate of duty of excise on goods exported, goods exported outside India (except to Bhutan) without payment of duty, credit of any duty allowed to be utilised towards payment of excise duty on final products under the provisions of this Act or the rules made there under and such order is passed by the Commissioner (Appeals) on or after the date appointed.

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8

Promissory Estoppel in Fiscal Laws, Tax Planning and Management

Question 1

Briefly explain the meaning tax planning with reference to Central Excise Laws.

Answer

Tax planning, with reference to Central Excise laws, refers to reducing the incidence of duty to the minimum and to ensure due compliance with statutory provisions. In fact, a proper tax planning exercise in Central Excise Law demands:

(i) An in-depth knowledge of substantial provisions;

(ii) A thorough knowledge of procedural formalities;

(iii) A continuous follow-up of various Exemptions Notifications;

(iv) Awareness to various Court Rulings; and

(v) Ability to reason out and argue one's point of view.

At the outset, it is a wiser part of discretion to avoid basing tax planning on very tenuous reasoning and controversial interpretations. At the same time when the rulings of the Courts carry considerable conviction it would not be advisable to ignore them. Wherever the planning is done on premises which may not find a favour with the Courts or the legislature ultimately, it is desirable to make suitable provisions in the accounts to meet the duty liability that may arise in future for past transactions. Alternatively, while entering into contract of sale of goods, a manufacturer may do well to provide in the contract note that, should additional demand of duty be made by the Government on him, the same would be recovered from the purchaser (this is however subject to the advisability of including such term from a purely commercially strategic point of view).

Question 2

Briefly explain the requirements of Promissory Estoppel.

Answer

The following are the requirement of Promissory Estoppel :

(1) There is a pre-existing contractual relationship.

(2) One party to that contract makes a clear promise that they will not fully enforce their legal rights (under that contract).

(3) The promisor intends that promise be relied upon and promisee does in fact rely upon it.

(4) It would be inequitable for promisor to go back on (resile from) their promise.

Promissory estoppel is not limited only to cases where there is some contractual relationship or other preexisting legal relationship between the parties. The principle can be applied even when the promise is intended to create legal relations or affect a legal relationship which will arise in future. Promise need not be expressed; it can be implied from circumstances.

Question 3

Briefly explain the concept of tax planning with reference to "Customs Act and Exemption Notifications".

Answer

Under the Customs Act, 1962 (Section 25 of the Act), the power has been conferred on the Central Government to exempt certain goods from the levy of customs duty. An importer has to necessarily keep a proper track of exemption notifications. The exemptions notifications may either be without any reference to any given time period or may be with reference to a particular period. In the former case, the exemption notification can be withdrawn at any time by Central Government. It is therefore necessary to envisage this eventually while negotiating contracts for sale of goods after their import into India, because Customs Duty liability will increase the cost of import which should normally be reflected in selling price. Even if the imported goods are not to be sold but are to be captively consumed, the levy of import duty by withdrawing the exemption granted earlier would have the effect of increasing the cost of production. If the imported goods are Plant and Machinery even then its effect would be to increase the cost of project. Even in a case where exemption has been given for a given period of time, the Central Government may withdraw the exemption notification before the expiry of the given period of time. To take an example, an exemption notification issued on 1.10.2016 effective up to 1.10.2020, may be withdrawn by the Government before 1.10.2020, with the result an importer who placed an order for import of goods in the hope that they are exempted from duty may be faced with the shocking problem to pay the duty because the exemption notification has been withdrawn before 1.10.2020. Now the question is, whether such a withdrawal of exemption before the expiry of normal period up to which it must have run can be challenged on the ground of promissory estoppel. The Judicial view seems to be that promissory estoppel cannot be pleaded against the Government, because withdrawal of the exemption notification under Section 25 is in public interest and such a withdrawal is a legislative function. These aspects must be borne in mind whenever any goods are imported on the basis of an exemption notification.

Question 4

Briefly explain the scope of tax planning with reference to "Customs Act and Duty Drawback"

Answer

In case of exports, the point at which the export activity gets completed is a matter of subtle importance while claiming for duty drawback. Various judicial forums has discussed about when does export actually takes place, i.e. whether on passing into the control of Customs Department or on reaching of the same to the buyer located beyond the territorial waters of India. As based on judicial decisions, once the export goods pass into the control of the Customs Department they no longer remain in the control of the exporter and hence, the export is deemed to be completed.

After the export goods pass into the control of Customs Department and the goods have been boarded on the ship or have been kept for boarding on the ship, there may be a loss or destruction due to fire or action of the sea or due to any other cause. Further, there may be a case that though the goods are safely boarded on the ship, but before they cross the territorial waters of India, there may be loss or damage to the goods on board or the whole ship may be lost. In such situations, it is proper to cite judicial rulings wherein some of the High Court declared that export is complete when the export goods pass to the customs control notwithstanding the fact that thereafter they get lost or destroyed before crossing the territorial waters of India.

Question 5

Briefly explain the scope of tax planning with reference to "Excise concessions on export of excisable goods".

Answer

Exporters of excisable goods are entitled to several benefits. Under the schemes available in the Excise Law, the exporter of excisable goods can avail following facilities:

(a) To export excisable goods on payment of excise duty and to claim refund of such duties subsequent to the export.

(b) To export the goods without paying excise duty but on the basis of a bond being executed to fulfil the obligation to export.

(c) To claim rebate of duty paid on excisable goods used as inputs in the manufacture of goods which are exported.

(d) To process excisable goods required as inputs for manufacture of goods to be exported, without paying duty on such inputs.

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9

Service Tax Introduction and Administration

Question 1

List out the activities / transaction specifies as "declared services" under Service Tax Laws.

Answer

Under the Service tax laws, the following activities / transactions are declared to be covered as 'service'. Such activities include :–

(a) Renting of immovable property;

(b) Construction of a complex;

(c) Temporary transfer or permitting the use or enjoyment of any intellectual property right;

(d) Development, design, programming, customisation, adaptation, upgradation, enhancement, implementation of information technology software;

(e) Agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;

(f) Transfer of goods by way of hiring, leasing, licensing or in any such manner without transfer of right to use such goods;

(g) Activities in relation to delivery of goods on hire purchase or any system of payment by Instalments;

(h) Service portion in the execution of a works contract;

(i) Service portion in an activity wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity.

Question 2

X is a technical consultant to many companies. He has been providing technical services to A Ltd. since 2006. On July 10, 2016, A Ltd. has paid Rs. 10 Lakh to X on his promise of not providing similar technical services to any other business entity for a period of 10 years.

(a) Is X liable to pay service tax on Rs. 10 lakhs

(b) If not, justify. If, yes, calculate the tax liability of X.

Answer

Rs. 10 lakh is consideration received by Mr. X for agreeing to the obligation to refrain from an act, which is a declared service under section 66E of Finance Act, 1994.

Since, Service Tax is not separately collected; it will be assumed that it is included in Rs. 10 Lakh.

Particulars	*Amount (Rs.)*
Gross amount received by Mr. X	10,00,000
Value of Service (10,00,000 x 100 / 115) excluding Service Tax	8,69,565
Service tax @ 15%	1,30,435

Question 3

Mr. Xavier is a well-known singer. Cine society of Chennai awarded him a life time achievement award on June 1, 2016 in the form of a memento and a cheque of Rs. 25 Lakhs. Determine the Service tax liability of Mr. Xavier.

Answer

An award received in consideration over a life time or a singular achievement carried out independently without reciprocity to the amount to be received does not compromise an activity for consideration. Thus, it is not chargeable to service tax.

Question 4

Mention the relevant date for determination of rate of service tax, value of taxable service and rate of exchange, if any, under the provisions of the Finance Act, 1994.

Answer

Section 67A of the Finance Act, 1994 mentions that the rate of service tax, value of a taxable service and rate of exchange, if any, shall be the rate of service tax or value of a taxable service or rate of exchange in force or as applicable at the time when the taxable service has been provided or agreed to be provided.

Further, rule 11 was inserted in Service Tax Rules, 1994 vide Notification No.19 /2014-Service Tax DT. 25/08/2014 according to which the rate of exchange for determination of value of taxable service shall be the applicable rate of exchange as per the generally accepted accounting principles on the date when point of taxation arises in terms of the Point of Taxation Rules, 2011. As amended by Notification No. 24/2016-Service Tax dated April 13, 2016

Therefore, the rate of exchange to be considered shall be as per generally accepted accounting principles (GAAP) on the date on which point of taxation arises as per Point of Taxation Rules, 2011.

Question 5

A charitable society is engaged in running internationally renowned schools. It allowed other schools to use its name, logo and motto and as a consideration thereof it received collaboration fees from such schools which comprised of a non refundable amount and annual fee. The schools were required to observe certain obligations / terms and in-impeachable confidentiality. Department contended that the petitioner was engaged in providing franchise service and accordingly issued show cause notice proposing to recover service tax along with interest and penalty. Examine the validity of the Departmental action with reference to a decided case, if any.

Answer

The facts of the given case are similar to the case of *Mayo College General Council* v. C*CEx. (Appeals)* 2012 (28) STR 225 (Raj) wherein, the High Court held that when the petitioner permitted other schools to use their name, logo and motto, it clearly tantamounted to providing 'franchise service' to the said schools and if the petitioner realized the 'franchise' or 'collaboration fees' from the franchise schools, the petitioner was duty bound to pay service tax to the Department. Therefore, in view of the above-mentioned ruling of the High Court, the action of the Department is valid in law.

Question 6

State, with reasons in brief, whether the following are liable to service tax:

(a) Services rendered to associated enterprise.

(b) Services rendered by a sub-contractor.

(c) Services provided to a developer of a special economic zone.

(d) Services rendered to the Reserve Bank of India.

(e) Services provided to a diplomatic mission for their personal use.

Answer

(a) Services rendered to associated enterprises: In transactions between associated enterprises value of taxable service shall include any amount credited or debited, as case may be, to any account, whether called 'suspense account' of a person liable to pay service tax.

(b) Services rendered by a sub-contractor: Services provided by a subcontractor are subject to service tax.

(c) Services provided to a developer of a special economic zone: Such services are not subject to service tax.

(d) Services rendered to Reserve Bank of India: Services provided to RBI is subject to Service Tax. However, services provided to RBI (where service tax is payable by the recipient of service under reverse charge basis) is not taxable.

(e) Services provided to a diplomatic mission for their personal use: All taxable services provided to diplomatic mission agents or career consular officers posted in foreign diplomatic missions or consular posts in India for their personal use are exempted from service tax.

Question 7

Pipal Infotech, while retaining the copyright with it, is selling information technology software as Shrink wrap licensed based software for Multiple user.

In terms of end user license agreement, the contract is given for customised development of software, delivered online or downloaded on the internet. Discuss, in the light of case law, if any, whether the transaction may be called as 'sale' or 'deemed sale'? Also examine whether the transaction is liable to service tax.

Answer

The facts of the case of Pipal Infotech are similar to the case of *Infotech Software Dealers Association* v. *Union of India* where it was held that although the software is goods, whether the transaction amounts to sale or service would depend upon the individual transaction.

In the case of Pipal Infotech, the developer has retained the copyright of software, the dominant intention was to transfer to the subscribers or members, only the right to use the software while the sale requires the transfer of goods as well as the right to use them. Thus, a license to use software which does not involve the transfer of 'right to use' would neither be a transfer of title to goods nor be a deemed sale of goods. Here, the activity would fall in the definition of 'service' under the declared service category specified in clause (f) of section 66E of the Finance act, 1994.

As held in the case of Infotech Software Dealers Association v. Union of India that, when the transaction between the assessee and customer is such that the software is not sold, then such arrangement amounts to provision of service and therefore will be liable to service tax.

Question 8

Briefly explain the basic rule of place of provision of Services (POPS) as defined in rule 3 under Service Tax Laws.

Answer

The basic rule of Place of Provision of Services (POPS) as defined in rule 3 under Service Tax Laws, as per which the place of provision of Services shall be :

- The location of the recipient of service.
- In case the location of the service receiver is not available in the ordinary course of business, the place of provision shall be the location of the provider of service.

The Principal effect of this rule is that:

A. If the location of service receiver is not available, location of service provider is the place of provision of service;

B. If the service receiver is located outside taxable territory, however service provider is located in the taxable territory, then the service will deemed to be provided in the taxable territory and service tax will be payable.

Under normal circumstances, a service provider is liable to pay service tax. However, if he is located outside the taxable territory and the place of provision of service is in the taxable territory, the person liable to pay service tax is service receiver in the taxable territory.

Question 9

Mr. Sharman, a resident of Srinagar is planning to construct a house in New Delhi. He got the architectural drawings made from one renowned architect, Maqbool, who is a resident in Jammu. Examine whether service tax is liable to be paid in this case.

Answer

Here, service provider and service receiver, both reside in Jammu & Kashmir and the service tax is not applicable to Jammu & Kashmir. Thus, Place of Provision of Services Rules, 2012 shall be applied to determine the location of service. According to Rule 5 of Place of Provision of Services Rules, 2012, in case of services provided directly in relation to an immovable property, place where the immovable property is located or intended to be located is the place of provision of service.

In the given case, Mr. Sharman (service receiver) and Maqbool (service provider) both are from Jammu & Kashmir, which is a non taxable territory for Service Tax. However, the property in connection to which the service is provided is located in New Delhi, which is a taxable territory. Since, preparing architectural drawings is a service directly related to immovable property, thus in the light of the aforementioned provisions, the service provided by Maqbool is liable to service tax.

Question 10

Airport Authority of India (AAI) awarded a contract for construction of an airport in Port Blair to Shobhit Construction Ltd., for Rs. 1 crore on 01.01.2015. Are the services of Shobhit Construction Ltd. subject to service tax ? If so, determine the amount of service tax payable.

Answer

As per mega exemption Notification No. 25/2012 dated 20.06.2012, services by way of construction of an airport were exempt from services. However, the exemption was withdrawn with effect from 1.4.2015. However, a new entry vide Sr. No. 14A has been inserted after Sr. No. 14 in the Notification No. 25/2012-STas amended by notification No. 09/2016- ST dated 1st March, 2016 and the exemption is being restored till 31.03.2020. This is subject to the conditions that these services by way of construction, erection, etc. of original works pertaining to an airport and port should have been provided under a contract which had been entered into prior to 01.03.2015 and subject to production of

certificate from the Ministry of Civil Aviation or Ministry of Shipping, as the case may be, that the contract had been entered into prior to 01.03.2015 and on which appropriate stamp duty, where applicable, had been paid prior to that date.

Therefore, the services of Shobhit Construction Ltd. are not subject to service tax.

Question 11

Comment on the applicability of service tax, in the following cases, during the month of July, 2016:

(i) Service provided by a private transport operator to Boys Higher Secondary School in relation to transportation of students to and from the school.

(ii) Transport of foodstuff, agricultural produce, chemical fertilizers and newspaper registered with the Registrar of Newspapers by a goods transport agency in a goods carriage.

(iii) Services provided by the Indian Institutes of Management for providing two year full time residential Post Graduate Programmes in Management to which admissions are made on the basis of Common Admission Test (CAT).

(iv) Transportation of postal mails or mail bags by a vessel.

Answer

(i) Exempt. Services provided to an educational institution by way of transportation of students are exempt from service tax vide Notification No. 25/2012 ST dated 20.06.2012.

(ii) Exempt. Services provided by a goods transport agency by way of transportation of foodstuff, agricultural produce, chemical fertilizers and newspaper registered with the Registrar of Newspapers, in a goods carriage are exempt from service tax vide Notification No. 25/2012 ST dated 20.06.2012.

(iii) Exempt. Services provided by Indian Institute of Managment by way of admission *tto wo year full time residential Post Graduate Programmes in Management to which admissions are made on the basis of Common Admission Test (CAT* are exempt from service tax vide Notification No. 25/2012 ST dated 20.06.2012.

(iv) Exempt. Transportation of postal mails or mail bags by a vessel is exempt from service tax vide Notification No. 25/2012 ST dated 20.06.2012.

Question 12

Comment on the applicability of service tax, in the following cases, during the month of July, 2016:

(i) *Services provided by way of vehicle parking to general public in a shopping mall.*

(ii) *Exhibiting movies on television channels.*

(iii) *Admission to entertainment events or access to amusement facilities.*

Answer

(i) Taxable. Services provided by way of vehicle parking to general public are exempt from service tax. but not when leased out which is usually the case in shopping malls

(ii) Taxable. The benefit of exemption in relation to services provided by way of transfer of copyrights of cinematograph films is available only when such films are exhibited in a cinema hall or theatre. Therefore, exhibition of cinematograph films on television channels is taxable [Notification No. 25/2012 ST dated 20.06.2012 as amended].

(iii) Taxable. Finance Act 2015 provides that Service Tax shall be levied on the service provided by way of access to amusement facility providing fun or recreation by means of rides, gaming devices or bowling alleys in amusement parks, amusement arcades, water parks and theme parks. Service tax shall also be levied on service by way of admission to entertainment event of concerts, pageants, musical performances concerts, award functions and sporting events other than the recognized sporting event, if the amount charged is more than ₹ 500 for right to admission to such an event. Hence, based on the above amendment it is clear that, access to amusement park is taxed without any limit.

Further, admission to entertainment events such as concerts, pageants, musical performances concerts, award functions and sporting events in excess of 500/- will be subject to service tax on full consideration.

Question 13

Discuss leviability of service tax on the monthly contribution collected from members to be used by residents welfare association for the purpose of making payments to the third parties in respect of commonly used services or goods.

Answer

In a residential complex, monthly contributions collected from members, used by the Resident Welfare Association (RWA) for the purpose of making payments to the third parties, in respect of commonly used services or goods like, for providing security service for the residential complex, maintenance or upkeep of common area and common facilities like lift, water sump, health and fitness centre, swimming pool, payment of electricity bill for the common area and lift, etc are exempted from service tax.

This is *vide* Notification No. 25/2012-ST which specifically exempts service provided by an unincorporated body or a non–profit entity registered under any law for the time being in force such as RWAs, to its own members. However, a monetary ceiling has been prescribed for this exemption, calculated in the form of five thousand rupees per month per member contribution to the RWA, for sourcing of goods or services from third person for the common use of its members.

Question 14

On 20th July 2016, Parul Ltd. renders certain taxable services to Varun Ltd. amounting Rs. 40,000. On 31st January, 2016, Parul Ltd receives Rs.30,000 in full settlement.

What is the Service Tax payable? It is given that Varun Ltd. has incurred hotel bills of Rs. 3,708 on behalf of Parul Ltd. Calculate the service tax liability by Parul Ltd.

Answer

Value of Taxable Service is Rs. 30,000 plus consideration received in kind as per the Valuation Rules. Service tax payable is given below:

Computation of Service tax Liability of Parul Ltd.

Particular	*Amount*
Value of taxable service (on invoice basis)	30,000
Hotel expenses borne by Varun Ltd (consideration for service)	3,708
Total Value of Taxable Services	33,708
Service tax @ 15%	5,056

Question 15

Explain briefly the exemption provided to small services providers under the Service Tax Laws.

Answer

Government has issued the Notification No. 33/2012, which provides the exemption to small service providers on the basis of their turnover. Accordingly, any service provider who provides taxable service (excluding the value of exempted services) of the total value of Rs. 10 lakh or less in the previous financial year is eligible to claim exemption of small service provider in the current financial year.

Small service provider can claim 100% exemption from service tax of total value of taxable services (excluding the value of exempted services) provided upto Rs. 10 Lac during the current financial year. If the total services provided during the financial year are exceeds Rs. 10 lakh then such excess over Rs. 10 lakh shall be chargeable to service tax.

The exemption however, does not apply in two cases:

1. If service is provided under a brand name- A service provided under a brand name or trade name of others, whether registered or not, is not eligible to exemption. Brand name or, trade name can be a mark, symbol, logo, monogram, label, etc.
2. If the receiver of service tax is liable to pay the service tax- In certain cases the receiver of service is liable to pay the service tax and not the provider of service. The

receiver is not eligible to exemption for such service. This is also known as reverse charge.

Question 16

X is a software engineer. He also works as an insurance agent on part time basis. Value of taxable service provided by him is given below:

Particular	*Amount (Rs.) 2014-2015*	*Amount (Rs.) 2015-2016*
Software consultancy	*8,00,000*	*8,50,000*
Insurance agent commission	*4,00,000*	*5,00,000*

In the case of insurance commission, entire service tax is paid by the insurance company under reverse charge mechanism. Can X claim the benefit of small service provider of threshold exemption of Rs.10,00,000 for the year 2015-16?

Answer

Even though the tax on the commission received by the Insurance agent is payable by the insurance company under reverse charge mechanism, insurance agent commission will be included in calculating value of taxable service for the financial year 2014-15.

Thus, aggregate value of taxable service provided by X during the financial year 2014-15 will be Rs. 12,00,000 because of which he cannot claim the exemption available to small service provider in the financial year 2015-16.

Computation of Service tax payable by X for the Financial Year 2015-16

Particulars	*Amount (Rs.)*
Software consultancy	8,50,000
Insurance agent commission (insurance company will pay tax @ 15 % of Rs. 5,00,000 under reverse charge mechanism)	Nil
Service tax @ 15%	1,27,500

Question 17

Aadesh Ltd. commenced its business on 21st November, 2015 in Kolkata. It has provided/availed following services upto 31st March, 2016. Determine its service tax liability for the Financial Year 2015-16:

(1) Taxable services provided under its own brand name: Rs. 9 lakh

(2) Taxable services provided under brand name of other person: Rs. 3.6 lakh

(3) Declared services provided eligible for 40% abatement as per valuation rules: Rs. 4 lakh

(4) Services wholly exempt under Notification No. 25/2012 dated 20-06-2012: Rs. 6 lakh

The assessee is ready to opt for any exemption available to it under service tax law.

Answer

Computation of service tax liability of Aadesh Ltd. for the F.Y 2015-16

Particulars	*Amount (Rs.)*
Taxable services provided under its own brand name (Note 2)	9,00,000
Declared services (Note 3)	2,40,000
Services wholly exempt under Notification No. 25/2012	-
Value of taxable services	11,40,000
Less: Exemption for small service providers (Note 1)	(10,00,000)
Taxable services liable to service tax	1,40,000
Add: Services provided under brand name of other person (Note 2)	3,60,000
Total Taxable services	5,00,000
Service tax payable @ 15% (inclusive of Swatch Bharat and Krishi Kalyan Cess)	75,000

Notes:

1. Taxable services of aggregate value not exceeding Rs. 10 lakh in any financial year are exempted from service tax, if the aggregate value of taxable services rendered does not exceed Rs. 10 lakh in the preceding financial year. Since, Aadesh Ltd. has started rendering services in the financial year 2015-16, it will be eligible for the exemption for small service providers as the aggregate value of taxable services rendered in the preceding financial year 2014-15 is 'Nil' (less than Rs. 10 lakh) [Notification No. 33/2012 ST dated 20.06.2012].

2. Exemption for small service providers is not available in respect of taxable services provided under a brand name of another person. However, services provided under own brand name are eligible for such exemption [Notification No. 33/2012 ST dated 20.06.2012].

3. Service includes declared services [Section 65B(44) of the Finance Act, 1994]. Service tax is charged on the value of services determined as per section 67 of the Finance Act, 1994 read with Service Tax (Determination of Value) Rules, 2006.

Therefore, value of declared services determined as per Valuation Rules will only be charged to service tax.

Question 18

Subhash Ltd. availed services of goods transport agency and paid freight of Rs. 2 lakh in June, 2016, determine the service tax liability.

Answer

Service tax payble on taxable services received under reverse charge	*Amount (Rs.)*
Freight paid to goods transport agency	2,00,000
Less: Abatement @ 70% (Rs. 2,00,000 x 70%)	(1,40,000)
Taxable services of goods transport agency	60,000
Service tax payable @ 15% (inclusive of Swatch Bharat Cess)	9,000

Abatement of 70% of the amount charged by the goods transport agency (GTA) is available [Notification No. 26/2012 S.T dated 20.06.2012] as amended.

Question 19

'Agrawal Agro Products' furnishes the following details with respect to the services provided by them in the month of December, 2015:

Particulars	*Amount (Rs.)*
Supply of farm labour	*58,000*
arehousing of biscuits	*1,65,000*
le of rice on commission basis	*68,000*
aining of farmers on use of new pesticides and fertilizers developed through scientific research	*10,000*
nting of vacant land to a farm	*1,31,500*
sting undertaken for soil of a farm land	*1,21,500*
asing of vacant land to a dairy farm	*83,500*

Further, it is given that, 'Agrawal Agro Products' has provided services of Rs. 16,18,000 during the Financial Year 2014-15.

Compute the service tax liability of 'Agrawal Agro Products' for the month of July, 2016. Assume that point of taxation in respect of all the activities mentioned above falls in the month of December, 2016 itself. Service tax has been charged separately, wherever applicable.

Answer

Computation of service tax payable by Agrawal Agro Products for December 2015

Sl. No.	*Particulars*	*Amount (Rs.)*
(i)	Supply of farm labour [Note 1]	-
(ii)	Warehousing of biscuits [Note 4]	1,65,000
(iii)	Sale of rice on commission basis [Note 2]	68,000
(iv)	Training of farmers on use of new pesticides and fertilizers developed through scientific research [Note 1]	-
(v)	Renting of vacant land to a stud farm [Note 3]	1,31,500
(vi)	Testing undertaken for soil of a farm land [Note 1]	-
(vii)	Leasing of vacant land to a dairy farm [Note 3]	-
	Total	3,64,500
	Service tax @ 15%	54,675

Notes:

(1) Clause (d) of negative list of services [section 66D] covers services relating to agriculture or agricultural produce by way of *inter alia* –

(i) supply of farm labour

(ii) services provided by a commission agent for sale or purchase of agricultural produce

(iii) agricultural extension services. Agriculture extension means application of scientific research and knowledge to agricultural practices through farmer education or training.

(iv) agricultural operations directly related to production of any agricultural produce including testing.

(2) Services relating to agriculture or agricultural produce by way of inter alia services provided by a commission agent for sale or purchase of agricultural produce are covered under clause (d) of section 66D. However CBEC vide *Circular*

*No.177/03/2014– ST dated 17.02.20*14, has clarified that the definition of agricultural produce under section 65(5) of the Finance Act, 1994 covers 'paddy'; but excludes 'rice'. Hence, sale of rice on commission basis will be taxable.

(3) Services relating to agriculture or agricultural produce by way of renting or leasing of vacant land are covered under clause (d) of section 66D. Agriculture means the cultivation of plants and rearing of all life-forms of animals, except the rearing of horses, for food, fibre, fuel, raw material or other similar products. Thus, leasing of vacant land to a dairy farm will be included in the negative list but renting of vacant land to a stud farm will be outside the purview of negative list.

(4) Loading, unloading, packing, storage or warehousing of agricultural produce is covered under clause (d) of Section 66D. However, agricultural produce means any produce of agriculture on which either no further processing is done or such processing is done as is usually done by a cultivator or producer which does not alter its essential characteristics but makes it marketable for primary market. Thus, warehousing of biscuit will be taxable as biscuit is not an agricultural produce.

(5) Agrawal Agro Products has provided services of Rs. 16,18,000 during the FY 2014-15, thus it is not eligible to small service providers exemption provided under *Notification No. 33/2012 ST dated 20.06.2012* in the FY 2015-16.

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10

Procedural Aspects and Adjudication under Service Tax

Question 1

Mention the rates of interest payable on delayed payment of service tax under section 75 of the Finance Act, 1994.

Answer

Earlier, rate of interest was charged on delayed payment of service tax, which has been supersessioned by Notification No. 13/2016-ST whereby, the Central Government, for delayed payment of any amount as service tax in the situation mentioned fixes the rate of simple interest per annum

Accordingly, the rate of interest shall be as under:

Serial Number	*Situation*	*Rate of simple interest*
1.	Collection of any amount as service tax but failing to pay the amount so collected to the credit of the Central Government on or before the date on which such payment becomes due.	24 per cent.
2.	Other than in situations covered under serial number 1 above.	15 per cent

Question 2

Mention the maximum amount of penalty imposable under service tax law for failure to take registration as per section 69 of the Finance Act, 1994.

Answer

Section 77 of the Finance Act, 1994 has specified a substantial penalty for non registration. It provides that where a person who is liable to pay service tax, or required to take registration, fails to take registration in accordance with the provisions of section 69 or rules made under this Chapter shall be liable to pay a penalty which may extend to ten thousand rupees.

Question 3

X Ltd., provider of software development services had turnover of not more than Rs. 50,00,000 during the financial year 2015-16 till October 1, 2016. During the financial year 2015-2016, its turnover was Rs. 40,00,000.

X Ltd. Wants to pay service tax on receipt basis till September 30, 2016. Find out the service tax payable by X Ltd. On the basis of given information:

Particulars	*Sep 2016* *Amount (Rs.)*	*Oct 2016* *Amount (Rs.)*
Amount outstanding on 31st August, 2016 collected during September 2016	*6,10,000*	-
Invoice value of taxable service rendered in September/October	*20,00,000*	*19,00,000*
Advance received and service to be provided in January 2017 (including service tax)	*3,50,000*	*7,00,000*
Advance received on 31st August and service to be provided in following months	*20,000*	*18,000*

X Ltd. has CENVAT credit on input service amounting Rs. 80,000 and Rs. 40,000 in the month of September and October respectively. Calculate service tax liability for X Ltd. for the month of September and October ?

Answer

By virtue of rule 6(1) of Service Tax Rules, in some cases, the taxpayer has an option to pay service tax on "payment basis". This option is available only when the following two conditions are met:

(a) Service provider is an individual, LLP or partnership firm; and

(b) Turnover of service provider in the previous year pertaining to taxable service is less than Rs.50 Lakh.

Since, X Ltd. is a company; it doesn't satisfy the first condition. Consequently, it will have to pay service tax on the basis of invoice or payment, whichever is earlier.

Computation of Service tax Liability of X Ltd.

Particulars	*Sep 2016* *Amount (Rs.)*	*Oct 2016* *Amount (Rs.)*
Amount outstanding on 31st August, 2015 collected during September 2016 (It was subject to service tax in the month in which invoice is issued, not taxable again at the time of receipt)	-	-
Invoice value of taxable services rendered in the given month	20,00,000	19,00,000
Advance received and service to be provided in January 2017 (to be taxable on payment basis)(Note)	3,04,347	6,08,696
Total value of Taxable services	23,04,347	25,08,696
Service tax @ 15% (Note)	3,45,652	3,76,304
Less: CENVAT credit	(80,000)	(43,000)
Net service tax payable	2,65,652	3,33,304

Note:

1. The net value of service = Advance received x 100/115

Question 4

Whether a manufacturer of excisable goods, who has paid service tax under reverse charge on freight, can take credit of such service tax paid, if such transportation servicehas been used for bringing the inputs to the factory of manufacturer?

Answer

As per rule 2(l) of CENVAT Credit Rules, 2004, inward transportation of inputs or capital goods and outward transportation up to the place of removal are eligible input services for a manufacturer. Thus, service tax paid on inward freight by the manufacturer under reverse change can be availed as CENVAT credit since such transportation service has been used for inward transportation of inputs.

Question 5

Can CENVAT credit be availed on the basis of the supplementary invoice issued by a service provider of support service? Would your answer be different if the above supplementary invoice was issued consequent upon additional amount of tax becoming recoverable from the concerned provider of business support services on account of short-

payment by reason of fraud with intent to evade payment of service tax? Explain in terms of provisions of CENVAT Credit Rules and Service Tax Rules.

Answer

Clause (bb) of sub-rule (1) of rule 9 of CENVAT Credit Rules, 2004 provides that CENVAT credit can be availed on the basis of a supplementary invoice, bill or challan issued by a provider of output service, in terms of the provisions of Service Tax Rules, 1994. Thus, CENVAT credit can be availed on the basis of supplementary invoice in respect of business support services received.

However, rule 9(1)(bb) also specifies that CENVAT credit in relation to supplementary invoice, bill or challan shall not be available if the additional amount of tax became recoverable from the provider of service on account of non-levy or non-payment or short levy or short-payment by reason of fraud, collusion or wilful mis-statement or suppression of facts or contravention of any of the provisions of Finance Act or the rules made there under with the intent to evade payment of service tax. Therefore, when the supplementary invoice is issued consequent upon additional amount of tax becoming recoverable from the concerned provider of business support services on account of short-payment by reason of fraud with intent to evade payment of service tax, CENVAT credit cannot be availed on the basis of such supplementary invoice.

Question 6

List any two advantages derived by exporters of taxable services.

Answer

The advantages that can be derived by exporters of taxable services are:

(i) They can claim rebate of service tax or duty paid on input services or inputs, as the case may be, used in providing the service that is exported in terms of rule 6A(2) of the Service Tax Rules, 1994; or

(ii) They can claim refund of CENVAT credit under rule 5 of the CENVAT Credit Rules, 2004.

It may be noted that out of the above two benefits, only one can be obtained at a time i.e., both the benefits cannot be availed at the same time.

Further, if the exporter of taxable services is also providing taxable service in India (i.e., partly exporting services and partly providing taxable services in India), he can export services without payment of service tax and utilise CENVAT credit for payment of service tax on services provided in taxable territory (i.e., India). This is the hassle free and most simple option. Thus, actually there are three benefits, but assessee can select only one of them.

Question 7

What is the point of taxation in respect of services under reverse charge mechanism?

Answer

The first Proviso to rule 7 of the Point of Taxation Rules (POTR) has been amended to provide that point of taxation in respect of reverse charge will be the payment date or the first day that occurs immediately after a period of three months from the date of invoice, whichever is earlier.

Question 8

Suman Ltd. imported business support services from Green Ltd. of USA on 13.03.2016. The relevant invoice for US$ 1,20,000 was raised by Green Ltd. on 8.04.2016. Suman Ltd. makes the payment against the said invoice on 22.4.2016. Determine the point of taxation.

Also determine the point of taxation, if Suman Ltd. had made payment on 27.07.2016.

Answer

In case of taxable services provided by any person which is located in a non-taxable territory and received by any person located in the taxable territory, person liable to pay service tax is the recipient of such service *[Notification No. 30/2012 ST dated 20.06.2012]*. Hence, Suman Ltd. is liable to pay service tax (i.e. under reverse charge mechanism).

Since, the importing company i.e Suman Ltd. makes the payment within the three months from the date of invoice, the point of taxation will be date of payment i.e. 22.04.2016.

In case Suman Ltd. makes payment on 27.07.2016 i.e. after three months from the date of invoice, point of taxation will be the date immediately following the said period of three months. Thus, point of taxation will be on 09.07.2016.

Question 9

X Ltd. provides business exhibition services in Allahabad. From the information given below find out service tax liability of X Ltd. for the month of October 2016:

Particulars	*Rs.*
Amount received inclusive of service tax	*Amount (Rs.)*
Amount received during October 2016 for services rendered during July, 2016	*6,59,594*
Amount received during October, 2016 for services rendered during June, 2016	*4,84,100*
Amount received during October 2016 for services rendered during July, 2016	*19,19,220*
Advance received on October 20, 2016 (no service rendered up to October 31, 2016)	*1,00,000*

Amount received exclusive of service tax	*Amount (Rs.)*
Service completed on October 6, 2016 and invoice issued on October 16, 2016 [payment not received up to October 31, 2016; however, Rs. 5,00,000 (inclusive of service tax) was received in advance on September1, 2016]	*10,72,000*
Service completed on October 18, 2016 and invoice issued on October 31, 2016 (payment not received up to October 31, 2016)	*5,15,000*

All the invoices were issued invoice within 14 days from the date of completion of service.

Answer

In the case of X Ltd. point of taxation will be on accrual basis.

Calculation of Service tax liability for X Ltd.

Particulars	*Value inclusive of Service Tax (Rs.)*	*Value before service tax (Rs.)*	*Service tax @ 15% (Rs.)*
Amount received during October, 2016 for service rendered during July, 2016 (Rs. 6,59,594 is inclusive of service tax)	6,59,594	5,73,560	86,034
Amount received during October 2016 for services rendered during June, 2016 (Rs. 4,84,100 is inclusive of service tax)	4,84,100	4,20,957	63,143
Amount received during October 2016 for services rendered during July, 2016 (Rs. 19,19,220 is inclusive of service tax)	19,19,220	16,68,887	2,50,333
Value of invoice issued in the month of October 2016 (Rs. 10,72,000 + Rs. 5,15,000 =15,87,000, exclusive of service tax).	18,25,050	15,87,000	2,38,050
Advance received during October 2016 but service not rendered (inclusive of service tax)	1,00,000	86,957	13,044

Less :			
Advance received on February 1, 2016 and adjusted against invoices issued during March 2016	(5,00,000)	(4,34,783)	(65,217)
Total Value	44,87,964	39,02,578	5,85,387

Thus, total Service Tax liability of X is Rs. 5,85,387.

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11

Goods and Service Tax – Concept and Development

Question 1

What are the major deficiencies of VAT system in India?

Answer

The major deficiencies of VAT system in India are as under:

(1) There is lack of uniformity in the rates of VAT in different States. Distortion occurs on account of different rates of VAT, composition Scheme, exemptions, difference in classification of goods, etc.

(2) Central Sales Tax is not integrated with the State VAT. Therefore, it is difficult to put the purchases from other States at par with the purchases within the State. Consequently, the advantage of neutrality is confined only for purchases within the State.

(3) For complying with the VAT provisions, the accounting cost increases which may not be commensurate with the benefit to traders and small firms.

(4) VAT is paid at various stages and not at last stage. This has increased the requirement of working capital and the interest burden.

(5) As a result of introduction of VAT, the administrative cost to the States has increased on account of number of dealers going up significantly.

Question 2

Highlight the benefits of GST.

Answer

GST or Goods and Services Tax is considered as a major tax policy reform in India as it simplifies the whole indirect tax procedure by mak ing India a single unified market, thereby minimizing compliances for people at all ends and making tax collection a much simpler process. It also makes it easier for the administration to certify that the taxes have been paid properly and duly collected. For consumers, it ensures benefit through reduction in prices, incentivizing greater consumption by providing set off of inputs. Under GST, the taxation burden will be divided equitably between manufacturing and services through a lower tax rate by increasing the tax base and minimizing exemptions. GST will be is levied only at the destination point, and not at various points (from manufacturing to retail outlets).

Question 3

What all taxes will the GST replace as the single umbrella tax ?

Answer

GST would subsume the following:

Central Taxes

a. service tax;

b. central excise duty;

c. Additional Duties of Excise (Goods of Special Importance);

d. excise duty levied under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955;

e. Additional Duties of Excise (Textiles and Textile Products)

f. additional customs duty (countervailing duty or CVD);

g. special additional duty of customs (SAD);

h. central surcharges and cesses.

State Taxes

(a) state VAT;

(b) central sales tax;

(c) entertainment tax not levied by local bodies;

(d) luxury tax;

(e) taxes on lottery, betting, and gambling;

(f) tax on advertisements;

(g) state cesses and surcharges related to supply of goods and services;

(h) entry tax not levied by local bodies.

(i) State Surcharges and Cesses so far as they relate to supply of goods and services

(j) Purchase tax

Question 4

Who all are exempted from GST?

Answer

As per the proposal supply of Alcoholic Liquor for human Consumption is exempt from GST.

Further, the GST Council shall revisit whether the exemption is to be extended to the following:

(i) petroleum crude;

(ii) high speed diesel;

(iii) motor spirit (petrol);

(iv) natural gas;

(v) aviation turbine.

Question 5

Give the highlights of Constitutional (101st Amendment) Act,2016 with respect to Goods and Service Tax.

Answer

Highlights of the Constitution (One Hundred And First Amendment) Act, 2016 : The Constitution (One Hundred And First Amendment) Act, 2016 received the assent of the President on the 8th September, 2016.

- *Amendment of Constitution*: The Bill seeks to amend the Constitution to introduce the goods and services tax (GST). Consequently, the GST subsumes various central indirect taxes including the Central Excise Duty, Countervailing Duty, Service Tax, etc. It also subsumes state value added tax, octroi and entry tax, luxury tax, etc.
- *Concurrent powers for GST*: The Bill inserts a new Article in the Constitution to give the central and state governments the concurrent power to make laws on the taxation of goods and services.
- *Integrated GST (IGST)*: Only the centre may levy and collect GST on supplies in the course of inter-state trade or commerce. The tax collected would be divided between the centre and the states in a manner as prescribed by law, on the recommendations of the GST Council.
- *GST Council*: The President must constitute a Goods and Services Tax Council within sixty days of this Act coming into force. The GST Council aim to develop a harmonized national market of goods and services. The GST Council is to consist of the following three members: (i) the Union Finance Minister (as Chairman), (ii) the Union Minister of State in charge of Revenue or Finance, and (iii) the Minister in charge of Finance or Taxation or any other, nominated by each state government.
- *Functions of the GST Council*: These include making recommendations on: (i) taxes, cesses, and surcharges levied by the centre, states and local bodies which may be subsumed in the GST; (ii) goods and services which may be subjected to or exempted from GST; (iii) model GST laws, principles of levy, apportionment of IGST and principles that govern the place of supply; (iv) the threshold limit of turnover below which goods and services may be exempted from GST; (v) rates including floor rates with bands of GST; (vi) special rates to raise additional resources during any natural calamity; (vii) special provision with respect to Arunachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand; and (viii) any other matters. Resolution of disputes: The GST Council may decide upon the modalities for the resolution of disputes arising out of its recommendations.

- *Restrictions on imposition of tax*: The Constitution imposes certain restrictions on states on the imposition of tax on the sale or purchase of goods. The Bill amends this provision to restrict the imposition of tax on the supply of goods and services and not on its sale.
- *Additional Tax on supply of goods*: An additional tax (not to exceed 1%) on the supply of goods in the course of inter-state trade or commerce would be levied and collected by the centre. Such additional tax shall be assigned to the states for two years, or as recommended by the GST Council.
- *Compensation to states*: Parliament may, by law, provide for compensation to states for revenue losses arising out of the implementation of the GST, on the GST Council's recommendations. This would be up to a five year period.
- *Goods exempt*: Alcoholic liquor for human consumption is exempted from the purview of the GST. Further, the GST Council is to decide when GST would be levied on: (i) petroleum crude, (ii) high speed diesel, (iii) motor spirit (petrol), (iv)natural gas, and (v) aviation turbine fuel.

Question 6

Why is Dual GST required? How will the transaction of goods and services be taxed under Central GST (CGST) and State GST (SGST)?

Answer

India is a federal country where both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. Both the levels of Government have distinct responsibilities to perform according to the division of powers prescribed in the Constitution for which they need to raise resources. A dual GST is, therefore, in keeping with the Constitutional requirement of fiscal federalism.

The Central GST and the State GST would be levied simultaneously on every transaction of supply of goods and services except the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits. Further, both would be levied on the same price or value unlike State VAT which is levied on the value of the goods inclusive of CENVAT. Question 7

Question 7

How will imports and exports be taxed under GST regime?

Answer

GST on export would be zero rated. In case of imports, both CGST and SGST will be levied on import of goods and services into the country. The incidence of tax will follow the destination principle and the tax revenue in case of SGST will accrue to the State where the imported goods and services are consumed. Full and complete CENVAT credit will be available on the GST paid on import on goods and services.

Question 8

What is IGST? How will it be calculated under the GST regime?

Answer

Inter state Goods and Services Tax or IGST will replace CST. The scope of IGST Model is that Centre would levy IGST which would be CGST plus SGST on all inter-State transactions of taxable goods and services with appropriate provision for consignment or stock transfer of goods and services. The inter-State seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases.

The Exporting State will transfer to the Centre the credit of SGST used in payment of IGST. The Importing dealer will claim credit of IGST while discharging his output tax liability in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information will also be submitted to the Central Agency which will act as a clearing house mechanism, verify the claims and inform the respective governments to transfer the funds.

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12

Value Added Tax : Introduction and Procedural Aspects Introduction

Question 1

Mention the methods which are generally used for computation of VAT.

Answer

VAT can be computed by using any of the three methods detailed below:

1. *Subtraction method* : Under this method the tax rate is applied to the difference between the value of output(tax exclusive sales) and the cost of input (tax exclusive purchases).
2. *Addition method* : Under this method, value added is computed by adding all the payments that are payable to the factors of production and business expenses (viz., wages, salaries, interest payments, etc.).
3. *Input Tax Credit method* : Under this method, it entails set-off of the tax paid on inputs from tax collected on sales. Indian states opted for tax credit method, which is similar to Cenvat. (output tax- input tax)

Question 2

State with reasons in brief whether the following statements are correct or incorrect with reference to the provision of value added tax

(i) It is permitted to issue 'tax invoice' inclusive of VAT i.e. aggregate of sales price & VAT without showing breakup of the same.

(ii) A registered dealer is compulsorily required to get its books of accounts audited under VAT laws of different States irrespective of limit of turnover.

Answer

(i) Incorrect

Reason: One of the requirements under the contents of the tax invoice is that rate and amount of tax charged in respect of taxable goods should be distinctly shown in the 'tax invoice', in order to claim input credit.

(ii) Incorrect

Reason: Different States have determined different turnover limits above which a registered dealer will have to get its books of accounts audited under VAT laws.

Question 3

What is VAT invoice? What are the mandatory provisions to be complied with while issuing a VAT invoice by a registered dealer? Briefly explain the importance of a VAT invoice.

Answer

VAT invoice is a document providing details of goods sold along with price, tax charged and other details as may be prescribed .VAT invoice is issued by a dealer authorized under the Act.

Mandatory provisions to be complied with:

(a) Every registered dealer whose turnover of sales exceeds the specified amount shall issue to the purchaser a serially numbered tax invoice, cash memo or bill with the prescribed particulars.
(b) The VAT invoice shall be dated and signed by the dealer or his regular employee.
(c) The dealer shall keep a counterfoil or duplicate of such VAT invoice duly signed and dated.

Importance of VAT Invoice

Invoices are crucial documents for administering VAT. In the absence of invoices, VAT paid by the dealer earlier cannot be claimed as set off. The importance of a VAT invoice can be gauged from the following:-

(i) It helps in determining the input tax credit;
(ii) It prevents cascading effect of taxes;
(iii) It facilitates multi-point taxation on the value addition;
(iv) It promotes assurance of invoices;
(v) It assists in performing audit and investigation activities effectively;
(vi) It helps in checking evasion of tax.

Question 4

Explain the expression 'zero rating' with reference to VAT.

Answer

Zero Rating means that VAT payable on sale of a commodity is fixed at 0%. Though apparently, it looks similar to an exempted transaction, there is a significant difference between the two. Under the Zero rated sales, prior stage tax is set off against the 0% tax paid, and effectively the entire tax paid on purchases is eligible for refund. In such cases, credit will be available on the inputs i.e. credit will not have to be reversed. Generally, export sales are zero rated and thereby, exporters are granted refund of taxes paid by them on their inputs. Exporters gain significantly due to the 'Zero Rating'.

As per para 2.5 of White Paper on State-Level VAT, export sales are zero rated, i.e. though sales tax is not payable on export sales, credit will be available of tax paid on inputs. In respect of sale to EOU/SEZ, there will be either exemption of input tax or tax paid will be refunded to them within three months.

Question 5

Sudeep Traders, a registered dealer under the local VAT law, having stock of goods purchased from outside the State, wishes to opt for the composition scheme. Advise the dealer whether it is possible? Will the VAT chain be broken if the dealer opts for the said scheme?

Answer

A registered dealer whose turnover does not exceed Rs. 50 lakhs in the last financial year is generally entitled to avail the composition scheme. However, the following are not eligible for this scheme:

(i) a manufacturer or a dealer who sells goods in the course of inter-state trade or commerce.

(ii) a dealer who sells goods in the course of import into or export out of the territory of India.

(iii) a dealer transferring goods outside the state otherwise than by way of sale or for execution of works contract.

Sudeep trader is not covered under any of the above so he has the option to avail the scheme.

The VAT chain will be broken if the dealer opts for the scheme, as he will not be entitled for input tax credit. Likewise, the person who purchases goods from him shall not get any tax credit for the purchases.

Question 6

Compute the invoice value to be charged and amount of tax payable under VAT by a dealer who had purchased goods for Rs. 1,20,000 and after adding for expenses of Rs. 10,000 and profit of Rs. 15,000 had sold out the same. The rate of VAT on purchases and sales is 12.5%.

Answer

Computation of VAT Payable

	Amount (Rs.)
Goods Purchased for	1,20,000
(Input VAT @ 12.5% = Rs. 15,000)	
Add: Expenses	10,000
Add: Profit	15,000
Total	1,45,000
Add: Output VAT @ 12.5%	18,125
Invoice Value	1,63,125

VAT Payable = Output Tax- Input Tax

= Rs. 18,125- Rs. 15,000

= Rs. 3,125

Question 7

Mention the purchases in respect of which input tax credit is not available to the purchasers under the VAT law.

Answer

Following are the purchases for which input tax credit is not available under VAT law :

1. *Dealers* : Purchases from unregistered dealers or registered dealers under composition scheme;
2. *Notified goods* : Purchases of goods notified by State government;
3. *Invoice* : When purchase invoice is not available or it does not show tax amount separately/in case of a valid irregularity in the invoice;
4. *Purpose / use* : Purchase of goods
    a) For manufacture of exempted goods: No credit if final product is exempt. Credit of tax paid on inputs is available only if tax is paid on final products. Thus, when final product is exempt from tax, credit will not be availed. If availed, it will have to be reversed on pro-rata basis;
    b) For personal use/consumption;
    c) For providing free of charge as gifts;
    d) For giving as free samples;
    e) Destroyed by fire/stolen/lost.
5. *Place* : Goods
    a) Imported from Outside India; high sea purchases;
    b) Purchased/received (on sale or on stock transfer) from Other States;
6. *Return* : Goods purchased and returned within specified period;
7. *Automobile* : Purchase of automobile, spare parts or accessories from other than dealer.

Question 8

Radheshyam is a trader in Delhi who has purchased certain goods from Haryana for Rs. 4,00,000 and paid central sales tax (CST) @ 2%. He has sold all the goods in Delhi for Rs. 6,00,000 plus VAT @ 12.5%.

He has purchased certain goods in Delhi for Rs. 5,00,000 and paid VAT @ 12.5% and all the goods were sold by him under inter-State sale to some persons in Uttar Pradesh for Rs. 7,00,000 plus central sales tax @ 2%. Determine the VAT payable.

Answer

Computation of VAT Payable

	Amount (Rs.)	*Amount (Rs.)*
Purchases from Haryana that were sold in Delhi	4,00,000	
Add: CST @ 2%	8,000	4,08,000
Sale Value	6,00,000	
Add: VAT @ 12.5%	75,000	6,75,000
Purchases from Delhi that were sold in U.P		
Purchase Price	5,00,000	
Add: VAT @ 12.5%	62,500	5,62,500
Sale Value	7,00,000	
Add: CST @ 2%	14,000	7,14,000
Total Output VAT		75,000
Less: VAT Credit		(62,500)
Net VAT Payable		12,500

Question 9

Compute the net VAT liability of Ramesh using the information given below ;

Particulars	*Amount(Rs.)*
Raw material purchased from foreign market (including duty paid on imports @ 20%)	*12,000*
Raw material purchased from local market (including VAT charged on the material @4%)	*20,800*
Raw material purchased from neighboring state (including CST paid on purchases @ 2%)	*7,140*

Storage, transportation cost and interest	*2,500*
Other manufacturing expenses incurred	*600*

Ramesh sold the goods to Rajul and earned profit @ 10% on the cost of production. VAT rate on sale of such goods is 12.5%.

Answer

Computation of VAT liability

Particulars	*Amount(Rs.)*
Raw material purchased from foreign market (Note 1)	12,000
Add: Raw material purchased from local market (Note 2)	20,000
Raw material purchased from neighboring state (Note 3)	7,140
Storage, transportation cost and interest	2,500
Other manufacturing expenses incurred	600
Cost of production	42,240
Add: Profit @10% on Rs.42,240	4,224
Sale Price	46,464
VAT @ 12.5% on sales	5,808

Computation of net VAT Payable

Particulars	*Amount (Rs.)*
VAT on sale price	5,808
Less : Set-off of VAT on purchases	
On imports	0
On local purchases	(800)
Net VAT payable	5,008

Notes

1. Since, the duty paid on imports is not a State VAT; it will form part of cost of input.
2. VAT charged by the local suppliers is Rs. 800. Since, the credit of this would be available, it shall not be included in the cost of input.
3. Credit/set-off for tax paid on inter-State purchases (inputs) is not allowed.

Question 10

Compute the VAT liability of Mr. Krishna, from the following particulars.

Particulars	*Amount (Rs.)*
Purchase price of the inputs purchased from the local market (inclusive of VAT)	*26,000*
VAT rate on purchases	*4%*
Storage cost incurred	*250*
Transportation cost	*950*
Goods sold at a profit margin on cost of such goods	*5%*
VAT rate on sales	*12.50%*

Answer

Computation of net VAT liability

Particulars	*Amount (Rs.)*
Purchase price of the inputs (inclusive of VAT)	26,000
Less : VAT paid on purchases	(1,000)
Purchase price of the inputs (excluding VAT)	25,000
Add: Storage cost	250
Add: Transportation cost	950
Cost price of the goods	26,200
Add: Profit @ 5% of Cost Price	1,310
Sale price before VAT	27,510
VAT @ 12.5%	3,438.75
Less: VAT paid on purchases	(1,000)
VAT liability of Mr. Krishna	2,438.75

Question 11

Meera Ltd. sold goods to Radha Ltd. of Mumbai at the rate of Rs. 1,800 per unit. He paid CST at the rate of 2% on that product and freight of Rs. 60. Radha sold the goods to Krishna Ltd. of Mumbai at the rate of Rs. 2,200 per unit and charged 12.5% VAT. Krishna Ltd. sold goods to a consumer at the rate of Rs. 3,000 per unit and charged VAT at the rate of 12.5%. Compute VAT liability of Radha Ltd. and Krishna Ltd.

Answer

Particulars	*Amount in Rs.*		
	Meera Ltd.	*Radha Ltd.*	*Krishna Ltd.*
Purchase Price	*-*	*1,896*	*2,475*
For Radha Ltd. (1,800 + 36 +60)			
For Krishna Ltd. (2,200+275)			
Sales Price	*1,800*	*2,200*	*3,000*
CST @ 2%	*36*	*-*	*-*
Freight	*60*	*-*	*-*
VAT Payable on Sales Price	*-*	*275*	*375*
Sales Price	*1,896*	*2,475*	*3,375*
Input Credit	*N.A.*	*Nil*	*275*
Net VAT Liability	*-*	*275*	*100*
(VAT Payable – Input Credit)			

Note:

No input tax credit of CST will be available.

Question 12

The following are details of purchases, sales etc. affected by Z & Co. a registered dealer for the year ending 31 March, 2016.

Particulars	*Amount*
Purchase of Raw Material within State, 1000 units inclusive of VAT at 4% (Fully utilized for manufacturing of taxable goods)	*5,20,000*
Interstate purchases of raw materials, inclusive of CST at 2%	*2,04,000*

Import of raw material, inclusive of custom duty of Rs. 35,000	*4,35,000*
Capital goods purchases on May 1, 2015 inclusive of VAT levy at 12.5% (input credit to be spread over 2 years)	*4,50,000*
Other manufacturing expenses	*1,50,000*
Sale of taxable goods within state inclusive of VAT at 12.5%	*9,00,000*
Sale of goods within the state exempt from levy of VAT	*1,60,000*

Compute the VAT liability of the dealer for the year ending 31 March, 2016.

Answer

No information is available whether capital goods were utilised for manufacture of taxable as well tax-free goods, or only for manufacture of taxable goods or only for manufacture of tax free goods. Therefore, VAT liability under the following three situations are given below:

Particulars	*Situation 1 (Capital Goods were utilized for manufacture of taxable as well as tax free goods)*	*Situation 2 (Capital goods were utilized for manufacture of taxable goods only)*	*Situation 3 (Capital goods were utilized for manufacture of tax free goods only)*
Output tax on sale of goods (9,00,000 x 12.5/112.5)	1,00,000	1,00,000	1,00,000
Output tax on sale of exempted goods	Nil	Nil	Nil
Total output tax	1,00,000	1,00,000	1,00,000
Less : Input credit on raw material	20,000	20,000	20,000
Less : Input credit on capital goods (Note 3)	20,833.33	25,000	Nil
VAT Liability	59,166.66	55,000	80,000

Notes:

1. CST paid on inter state purchases is not eligible for input tax credit.
2. Imported raw material is not eligible for input credit.
3. Input Tax credit on capital goods = 4,50,000*12.5/112.5= 50,000
   (a) situation 1 = 50,000/2*(8,00,000/9,60,000)

(b) situation 2 = 50,000/2*100% as Capital Goods were utilized for manufacture of taxable goods only.

(c) situation 3 = No credit would be allowed as the capital goods were utilized for the manufacture of tax free goods only.

Question 13

The particulars regarding sale, purchase, etc., of Raja Udyog for the last quarter of the year 2015-16 are as under :

Particulars	*Amount Rs.*
1. Purchases of raw material within the State :	
(i) Taxable @ 1%	*40,00,000*
(ii) Taxable @ 4%	*60,00,000*
(iii) Taxable @ 12.5%	*10,00,000*
2. Sale of goods manufactured from raw material purchased @ 4% tax rate :	
(i) Taxable sale within the State (tax rate 4%)	*20,00,000*
(ii) Exempted sale within the State (manufactured from Raw Material taxable @ 4%)	*10,00,000*
(iii) Sale in the course of inter-State trade or commerce (CST rate 2%) (manufactured from Raw Material taxable @ 4%)	*10,00,000*
3. Sale of raw material purchased @ 1% tax rate	*44,00,000*
4. Goods manufactured from the raw material purchased @ 12.5% tax rate were given on lease.	*12,00,000*

The deemed sale price of such goods is Rs. 12,00,000 taxable @ 12.5%. You may assume that input tax credit of tax paid on raw material used in manufacture of leased goods is available immediately.

Compute the amount of value added tax (VAT) payable by Raja Udyog for the relevant quarter. There was no opening or closing inventory. How can they utilise the balance of input tax credit, if any ?

Answer

Calculation of VAT liability of Raja Udyog for the last quarter of the year 2015-16

Particulars	*Amount in Rs.*	*Amount in Rs.*
A. Output tax payable		
1. Taxable sales within state taxable @ 4% (20,00,000 x 4%)	80,000	
2. Exempted Sale within state	-	
3. Sale of raw material taxable @ 1% (44,00,000 x 1%)	44,000	
4. On deemed sale - leased goods @ 12.5% (12,00,000 x 12.5%)	1,50,000	2,74,000
B. Input Tax credit available		
1 On raw material purchased (tax @ 1%) (40,00,000 x 1%)	40,000	
2 On raw material purchased (tax @ 4%) (45,00,000 x 4%)	1,80,000	
3 On raw material purchased (tax @12.5%)	1,25,000	(3,45,000)
C. Net VAT Payable (A-B)		(71,000)
D. CST passable in the course of inter-state tax (10,00,000 x 2%)	20,000	20,000
E. Tax Credit to be carried forward to the next quarter		(51,000)

Notes:

A

1. VAT payable @ 4% on the sales within state
2. VAT is not payable on exempted sales
3. VAT payable on sale of raw material @ 1%
4. VAT payable @ 12.5% on the deemed sale price is eligible for set off against input tax credit

B

1. Tax paid @ 1% on raw material purchased from within state could be set off against the output tax liability

2. Since whole of the goods manufactured from raw material purchased @ 4% are not taxable sales, input credit will be available only in proportion to the sales which are taxable. Therefore, total sales will be reduced by the value of exempted sales. Therefore:

   Total Sales = Rs. 40,00,000

   Less : Exempted sales= Rs. 10,00,000

   Taxable sales= Rs. 30,00,000

   Thus, proportion of taxable sales:

   Taxable sales out of total sale of goods manufactured from raw material purchase @ 4% / Total sales (taxable @ 4%) = 30,00,000/40,00,000= ¾ of the total sales

   Value of purchases eligible for input tax credit = 3/4 x Total purchases (taxable @ 4%)

   = 3/4 x 60,00,000 = 45,00,000

C Tax paid @ 12.5% on raw material purchased from within state could be set off against the output tax liability

D. CST paid in the course of inter-state sale @ 2% is eligible to be adjusted against input tax credit or in other words Input Tax Credit can be set off against CST payable on inter-state sales.

Question 14

Mr. Rajesh is a registered dealer and gives the following information. You are required to compute the net tax liability and total sales value under value added tax:

Rajesh sells his products to dealers in his State and in other States. The profit margin is 15% of cost of production and VAT rate is 12.5% of sales.

(i) Intra State purchases of raw material Rs. 2,50,000/- (excluding VAT @ 4%)

(ii) Purchases of raw materials from an unregistered dealer Rs. 80,000/- (including VAT @ 12.5%)

(iii) High seas purchases of raw materials are Rs. 1,85,000/- (excluding custom duty @ 10% of Rs. 18,500)

(iv) Purchases of raw materials from other States (excluding CST @ 2%) Rs. 50,000/-

(v) Transportation charges, wages and other manufacturing expenses excluding tax Rs. 1,45,000/-

(vi) Interest paid on bank loan Rs. 70,000/-

Answer

Computation of net VAT liability and total Sale Value

	Rs.
Intra-State purchases of raw material (excluding VAT Rs. 10,000)	2,50,000
Purchases of raw materials from unregistered dealer (Refer Note 1)	80,000
High seas purchases of raw materials (Refer Note 2)	2,03,500
Purchase of raw materials from other States (Refer Note 3)	51,000
Transportation charges, wages and manufacturing expenses	1,45,000
Cost of Production	7,29,500
Add: Profit margin 15%	1,09,425
	8,38,925
Add : VAT @ 12.5%	1,04,866
Total Sales value	9,43,791

Computation of VAT Liability

VAT on above Sales Price @ 12.5%		1,04,866
Less: Set off of VAT on purchases:	Nil	
From high seas	10,000	
From intra-state (Refer Note 4)	Nil	
From inter state	Nil	
From unregistered dealer		10,000
Net VAT Payable		94,866

Notes:

1. Input tax credit is not available on the purchases of raw materials from unregistered dealer. Hence, VAT paid thereon is a part of cost of production.
2. Duty paid on high seas purchases i.e., imports is not a State VAT, so the input tax credit is not available in respect of the same and it is a part of cost of production.
3. Set-off of tax paid on inter-state purchases is not allowed.

4. Tax on intra-State purchases is Rs. 10,000. As credit of the same will be available, it is not included in the cost of production.
5. Interest on loan has been excluded for calculating the cost of production on the presumption that the loan is availed for purposes other than working capital.
6. It has been assumed that the entire production is sold.

Question 15

Briefly discuss the availability of input tax credit under VAT in respect of stock transfer.

Answer

Stock transfers to a branch or consignee are the norms of trade and it could be both inter-state and intra-state. Inter-state sales are covered by Central Sales Tax Act, 1956. However, in case of stock/branch transfer, goods move from one State to another, but there is no 'sale' thus stock transfer/branch transfer is not subject to tax since there is no 'sale'.

Thus, the tax paid on inputs used in the manufacture of finished goods which are stock transferred or purchased goods which are stock transferred, is available as input tax credit after retention of 2% of such tax by the concerned state government. Accordingly, Input tax paid in excess of 2% on stock transfers to other states will be eligible for tax credit.

Further, intra-state sales / transfer of goods are covered by local VAT and where goods are transferred by a dealer to its own branch which is its additional place of business, there are no VAT implications.

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