

# **GUIDELINE ANSWERS**

## **PROFESSIONAL PROGRAMME**

**JUNE 2018**

**MODULE 3**



**THE INSTITUTE OF  
Company Secretaries of India**

**भारतीय कम्पनी सचिव संस्थान**

**IN PURSUIT OF PROFESSIONAL EXCELLENCE**

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These answers have been written by competent persons and the Institute hope that the **GUIDELINE ANSWERS** will assist 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 the Institute is not in any way responsible for the correctness or otherwise of the answers compiled and published herein.

In answers to the questions based on case study, the students may write any other alternative answer with valid reasoning.

The Guideline Answers contain information based on the Laws/Rules relevant for the Session. Students are expected to be well versed with the amendments in the Laws/Rules made upto **six** months prior to the date of examination.

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(i)

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**NOTE** : Guideline Answers of the last Sessions may require updation in the light of changes and references given below :

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PROFESSIONAL PROGRAMME

**UPDATING SLIP**

**ADVANCED TAX LAWS AND PRACTICE**

MODULE – 3 – PAPER 1

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<i>Examination Session</i>	<i>Question No.</i>	<i>Updatons required in the answers</i>
All Previous Sessions	—	<p>The Income Tax, GST and Customs Laws are subject to changes by the Annual Finance Acts. In order to update all the answers, the students are advised to refer to the latest law keeping in mind the following amendments for December 2018 examination.</p> <ul style="list-style-type: none"><li>(i) For Direct taxes, Finance Act, 2017 is applicable.</li><li>(ii) Applicable Assessment year is 2018-19 (previous year 2017-18).</li><li>(iii) For Indirect taxes<ul style="list-style-type: none"><li>(a) Goods &amp; Services Tax &amp; Customs Law is applicable for professional programme.</li><li>(b) All the rules upto 1st June, 2018 shall be applicable.</li></ul></li><li>(iv) Students are also required to update themselves on all the relevant Circulars, Clarifications, Notifications, issued by CBDT / CBIC/ Central Government etc. which became effective, on or before 6 months prior to the date of the respective examination.</li></ul> <p>The questions based on case laws, in conflict with the latest law be treated as of academic interest only.</p>

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(ii)

**UPDATING SLIP**

**DRAFTING, APPEARANCES AND PLEADINGS**

MODULE – 3 – PAPER 2

<i>Examination Session</i>	<i>Question No.</i>	<i>Updates required in the answers</i>
All Previous Sessions	—	Provisions of Companies Act, 2013.

(iii)

**UPDATING SLIP**

**BANKING LAW AND PRACTICE**

MODULE – 3 – ELECTIVE PAPER 9.1

<i>Examination Session</i>	<i>Question No.</i>	<i>Updates required in the answers</i>
All Previous Sessions	—	All relevant amendment pertaining to Banking Laws and Notification/Circulars issued thereunder upto 6 months prior to the date of examination.

(iv)

**UPDATING SLIP**

**CAPITAL, COMMODITY AND MONEY MARKET**

MODULE – 3 – ELECTIVE PAPER 9.2

<i>Examination Session</i>	<i>Question No.</i>	<i>Updates required in the answers</i>
All Previous Sessions	—	In accordance to amended Regulations covering Capital Commodity and Money Market.

(v)

**UPDATING SLIP**

**INSURANCE LAW AND PRACTICE**

MODULE – 3 – ELECTIVE PAPER 9.3

<i>Examination Session</i>	<i>Question No.</i>	<i>Updates required in the answers</i>
All Previous Sessions	—	All notifications issued by Insurance Regulatory and Development Authority of India (IRDA).

(vi)

**UPDATING SLIP**

**INTELLECTUAL PROPERTY RIGHTS — LAW AND PRACTICE**

MODULE – 3 – ELECTIVE PAPER 9.4

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<i>Examination Session</i>	<i>Question No.</i>	<i>Updates required in the answers</i>
All Previous Sessions	—	In accordance with revised laws, rules under TRIPs and World Intellectual Property Organization (WIPO) and National Intellectual Property Rights Policy.

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(vii)

**UPDATING SLIP**

**INTERNATIONAL BUSINESS - LAWS AND PRACTICES**

MODULE – 3 – ELECTIVE PAPER 9.5

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<i>Examination Session</i>	<i>Question No.</i>	<i>Updates required in the answers</i>
All Previous Sessions	—	In accordance with revised laws and rules under WTO, IMF, UNCTAD, etc, if any. Foreign Direct Investment Policy, 2017. Foreign Trade Policy 2015-20.

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**PROFESSIONAL PROGRAMME EXAMINATION**

JUNE 2018

**ADVANCED TAX LAWS AND PRACTICE**

*Time allowed : 3 hours*

*Maximum marks : 100*

**NOTE :** 1. Answer ALL Questions.

2. All the references to sections mentioned in Part - A of the Question Paper relate to the Income-tax Act, 1961 and relevant Assessment Year 2018-19, unless stated otherwise.
3. Working notes should form part of the answer.

**PART A**

**Question 1**

- (a) (i) State the period of holding for considering the shares in a private limited company to be treated as long-term capital asset. (1 mark)
- (ii) An assessee has purchased a car for business purposes on 10th June, 2016 for ₹10 lakhs. This is the only asset in the block of assets. In the previous years 2016-17 and 2017-18, 25% of the usage of car was for personal purposes. What is the depreciation allowable for the assessment year 2018-19 ? You may take the rate of depreciation as 15%. (2 marks)
- (iii) Vikas, a resident in India, has received dividend of ₹13 lakhs from A Ltd., an Indian company, on which the company has paid DDT under section 115-O of the Income-Tax Act, 1961. He has incurred expenditure of ₹1 lakh for earning such dividend. What is the tax payable by him in respect of such dividend income ? (2 marks)
- (b) State with brief reason, whether the following relate to tax planning, tax avoidance or tax evasion :
  - (i) Setting up of a liaison office in India by a foreign company, instead of a full fledged establishment to run its business activities in India.
  - (ii) Investment in bonds approved for purposes of section 54EC.
  - (iii) Businessman claiming depreciation on a refrigerator purchased for residential use.
  - (iv) Visiting a foreign country for certain number of days to reduce the number of days of stay in India.
  - (v) Assessee has two residential houses. He wants to sell a vacant site purchased 6 years back. To avail exemption under section 54F, he gifts a residential house to his major son. (1 mark each = 5 marks)
- (c) Explain in the context of provisions contained under the Income-Tax Act, 1961, the Income test and the Assets test with reference to passive foreign investment company. (5 marks)

**Answer 1(a)(i)**

The period of holding of shares of a private limited company to be treated as Long Term Capital Assets is 24 Months.

**Answer 1(a)(ii)****Calculation of Depreciation on Car allowable for AY 2018-19**

<i>Particulars</i>	<i>Amount (Rs.)</i>	<i>Amount (Rs.)</i>
Purchase price of Car		10,00,000
Less : Depreciation @ 15% for PY 2016-17	1,50,000	
Depreciation not allowable for personal use (25%)	(37,500)	(1,12,500)
Written Down value as on 01.04.2017		8,87,500
Less : Depreciation @ 15% for PY 2017-18	1,33,125	
Depreciation not allowable for personal use (25%)	(33,281)	99,844

*Note :* The Car after the purchase being used for business purpose 75% and personal purpose 25%. Therefore depreciation allowable as per section 32 read with section 37(1) is 75% of the depreciation to be calculated @ 15% on the value of the car.

**Answer 1(a)(iii)**

As per section 115BBDA, where a resident shareholder, being an Individual, HUF or a Firm, receives dividends in excess of Rs. 10 Lakhs from Indian Company / Companies on which dividend distribution tax has been paid u/s 115-O, exemption u/s 10(38) will only be available upto Rs. 10 lakhs and excess amount will be charged to tax @ 10% plus education cess.

No deduction will be allowed for any expenditure incurred in respect of earning such dividend income.

Thus, in the given case, amount exempt u/s 10(38) is Rs. 10 lakhs only and on the balance amount of Rs. 3 lakhs, tax payable is Rs. 300000 \* 10.30 % = Rs. 30900.

**Answer 1(b)**

- (i) Setting up of a liaison office in India by a foreign company, instead of a full fledged establishment to run its business activities in India is to reap the benefit of the DTAA instead of coming under the provisions of section 9 of the Income tax Act, and thus is an act of Tax Planning.
- (ii) Investment in Bonds approved u/s 54EC will reduce tax liability relating to Capital Gains. It is an act of Tax Planning.
- (iii) Businessman claiming depreciation on a refrigerator purchased for residential

use is an act of Tax Evasion because of wrongly claiming depreciation on personal assets by showing as business assets.

- (iv) Visiting a foreign country to reduce the number of days of stay in India is a measure of Tax avoidance with regard to residential status, which may have impact on the taxability total income.
- (v) Gifting a house property to major son with a view to come within the eligibility norms of an exemption section is though legally permissible but is an act of Tax Avoidance.

### Answer 1(c)

#### Income Test

- Under the Income test, a foreign corporation is considered a Passive Foreign Investment Company 'PFIC' if 75% or more of the foreign corporation's gross income for the taxable year consist of passive income.
- Passive income includes dividends, interest, royalties, rents, annuities, net gains from certain commodities transactions, net foreign currency gains, income equivalent to interest, payment in lieu of dividends, income from notional contracts and income from certain personal service contracts.

#### Assets Test

- Under the Assets test, a foreign corporation is considered a PFIC if 50% or more of the foreign corporation's assets produce or are held to produce passive income. In applying the Assets Test, the fair market value of the assets is generally used worked out on FMV method.
- The general exception is a foreign corporation that is not publically traded and is a controlled foreign corporation, which must use the adjusted basis (the basis method) of its assets in applying the Assets Test. A tax payer may also elect to utilize the basis method, but, once this is done, may not change back to the FMV method without IRS content.

**Attempt all parts of either Q. No. 2 or Q. No. 2A**

#### Question 2

- (a) *Shakshitha Pvt. Ltd., furnishes the following summarized position of its profit and loss account and pertinent additional information thereto, for the year ended 31-3-2018 :*

*(All amounts are ₹ in lakhs)*

(i) Net profit as per books	26
(ii) Share income from an AOP	6
<i>Expenditure debited in books for earning such income</i>	<i>0.8</i>
(iii) Provision for income-tax	2

(iv) CSR expenditure debited to P & L Account 14

(v) Royalty received relating to business  
(Chargeable at 10%) 6

(vi) The brought forward business loss and depreciation are as under :

	As per books	As per IT Act
Business loss for AY 2017-18	4	12
Depreciation	3	11

(vii) The members as well as their shares in the AOP in which Shakshitha Pvt. Ltd. is a member, are specific and determinate.

(viii) In the current year, the depreciation charged as per books is the same as that of the one allowable as per Income-Tax Act, 1961, before considering the provisions of section 32(2).

Compute the book profits of the company and the tax on book profits under section 115JB for the AY 2018-19.

The company is not an Ind-As compliant company. (5 marks)

(b) Answer the following questions in the context of provisions contained under the Income-Tax Act, 1961 by taking each an independent case of Advance Ruling:

(i) Applicability of advance ruling and to whom the same is binding. (2 marks)

(ii) When can the advance ruling be void ? (1 mark)

(iii) Fees to be paid and form to be filed for obtaining the advance ruling. (2 marks)

(c) From the following particulars relating to Mrs. Sridevi for the assessment year 2018-19, compute the deduction available under Chapter VI-A of the Income-Tax Act, 1961 :

	₹
Gross total income	11,90,000

Above includes the following :

Short-term capital gains from sale of listed shares	50,000
Long-term capital gains from sale of vacant site	1,50,000
Winnings from crossword puzzles (gross)	90,000

**Other information :**

Contribution to PPF in the name of son, a software engineer	80,000
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Stamp paper and registration expenses relating to residential house purchased during the year	85,000
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Donation to National Defence Fund	40,000
Donation given to Bhhodhan Charitable Trust recognised for section 80G purposes	80,000
	(5 marks)

**OR (Alternate question to Q. No. 2)**

**Question 2A**

- (i) What is Advance Pricing Agreement (APA) under section 92CC of the Income-Tax Act, 1961 ? Discuss and explain the validity and the binding nature of APA.

(5 marks)

- (ii) On 11.5.2017, Rama Ltd purchased its own shares having face value of ₹10. Amount offered to shareholders was ₹80 per share. Total amount distributed by Rama Ltd on buy back of 15,000 shares is ₹13,50,000. These shares were issued in the year 2004-05 at a premium of ₹15. Kaka one of the shareholder holding 1,500 shares (cost of acquisition ₹25 per share, year of acquisition 2007-08) got ₹1,35,000. Determine tax consequences in the hands of Kaka (Shareholder) and Rama Ltd. under section 115QA for AY. 2018-19, assuming shares are unlisted.

(5 marks)

- (iii) Bharani Exports Ltd (BEL), has a SEZ unit in 8th year of its operation. 90% of its export sales are to Lovely LLC of USA, which has guaranteed the loan of ₹100 crore taken by BEL. Export sales turnover for the year is ₹300 crore. There is no DTA sales. The Assessing officer, after examination of the records, concluded that the assessee BEL had failed to maintain proper records of the international transactions, computed the ALP and made an addition of ₹32 lakhs to the income returned. He also proposes to levy penalty. The assessee seeks your advice on the proposed action of the AO. Advise suitably.

Can the assessee claim deduction under section 10AA in respect of the addition of ₹32 lakhs made on account of transfer pricing adjustments ?

BEL has not entered into any Advance Pricing Agreement (APA). (5 marks)

**Answer 2(a)**

**Computation of Book Profits u/s 115JB of Shakshita Pvt Ltd.  
Assessment Year (2018-19)**

Sr. No.	Particulars	Rs. in Lakhs
(i)	Net Profit as per books	26
(ii)	Share income from an AOP (This is not an AOP which pays tax at the maximum marginal rate. Hence no adjustment is required)	-
	Expenditure debited in books for earning such income (Not Allowed)	-

(iii)	Provision for Income tax	2
(iv)	CSR expenditure debited to P&L Rs. 14 Lakhs (no need to add back this expenditure for MAT)	-
(v)	Royalty received relating to business (to be considered separately, as it is taxed at special rate of 10%). Hence to be deducted.	(6)
	Total	22
	Less : lower of brought forward losses or depreciation as per books	(3)
	Book Profits	19

#### Calculation of Tax Payable

<i>Particulars</i>	<i>Tax Payable (Rs. in Lakhs)</i>
Royalty @ 10% of Rs. 6 Lakhs	0.6
Other Income @ 18.50 %	3.515
Total	4.115
Add : EC + SHEC @ 3%	.12345
Total tax payable as per MAT u/s 115JB	4.23845

#### Answer 2(b)

- (i) The advance ruling pronounced by the Authority for Advance Ruling (AAR) under Section 245R shall be binding only:
  - (a) On the applicant who had sought it;
  - (b) In respect of the transactions in relation to which the ruling had been sought; and
  - (c) On the Principal Commissioner or Commissioner, and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction.
- (ii) Advance Ruling pronounced under section 245R will be void ab initio if:
  - (a) the AAR finds on a representation made to it by the Principal Commissioner or otherwise that an advance ruling has been obtained by the applicant by fraud or misrepresentation of facts; and
  - (b) the AAR by an order declares such advance ruling to be void ab initio.

(iii)

<i>Applicant</i>	<i>Form No.</i>
Non Resident	34C
Resident	
• Any resident seeking advance ruling in relation to transaction with Non-Resident	34D
• Any public sector company	34E
• Any resident in relation to his tax liability arising out of one or more transaction valuing Rs. 100 crore or more in total which has been undertaken or proposed to be undertaken	34DA
• Resident / Non-resident and he seeks advance ruling in respect of impermissible avoidance arrangement	34EA

Fees of Rs. 10,000 or such fee as may be provided under rule 44E whichever is higher is to be paid alongwith the application as per section 245Q(2).

**Answer 2(c)****Computation of Deduction available under chapter VI-A for AY 2018-19 to Mrs. Sridevi**

<i>Particulars</i>	<i>Amount (Rs.)</i>	<i>Amount (Rs.)</i>
Gross Total Income		1190000
<i>Less : Items to be excluded</i>		
Short-term capital gains from sale of listed securities	(50000)	
Long term capital gains from sale of vacant site	(150000)	
Winning from crossword puzzle	(90000)	(290000)
<b>Gross total income for the purpose of Chapter VI-A</b>		<b>900000</b>
<b>Section 80C</b>		
Contribution to PPF	80000	
Section 80CCD(1)		
Stamp paper and registration fees relating to residential house	85000	
Total	165000	
Restricted to	150000	(150000)
<b>Adjusted Gross total income for deduction 80G</b>		<b>750000</b>

**Section 80G**

Donation to National defence fund	100%	40000
Donation given to Bhoodhan charitable trust recognized for section 80G	80000	
First Level restriction 10% of adjusted total income	75000	
Allowable deduction is 50% of above	37500	37500
<b>Deduction allowable VI-A (Rs. 150000+40000+37500)</b>		<b>227500</b>

**Answer 2(A)(i)**

Advance Pricing Agreement (APA) as per section 92CC is an agreement entered into between a taxpayer and a taxing authority (Board) on an appropriate transfer pricing methodology for fixing the arm's length price 'ALP' for a set of transactions over a fixed period of time in future.

The Advance Pricing Agreement shall be valid for a period as specified in the Advance Pricing Agreement. However, this period will not be more than 5 consecutive previous years.

*Advance Pricing Agreement shall be binding on:*

- the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and
- on the Principal Commissioner or Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

However the advance pricing agreement shall not be binding if there is a change in law or facts having bearing on the agreement so entered into.

**Answer 2(A)(ii)**

**Tax Liability of Kaka (Shareholder) :** As share of Rama Limited are unlisted, Kaka is not chargeable to tax for Capital Gains which is exempt under section 10(34A) of the Income Tax Act, 1961.

**Tax Liability of Rama Limited as per section 115QA**

<i>Particulars</i>	<i>Amount (Rs.)</i>
Amount paid to shareholders at the time of buyback (Rs. 90*15000)	1350000
<i>Less :</i> Amount received at the time of issue of share (Rs. 25*15000)	(375000)
Distributed Income to shareholders because of buy back	975000
Tax on distributed income @ 20%	195000
Surcharge @ 12%	23400

Tax and Surcharge	218400
Add : EC + SHEC @ 3% on Tax and Surcharge	6552
Tax liability u/s 115QA	224952

*Note* : The offered price was Rs. 80 /- per share but actual amount paid for 15000 shares is Rs. 13,50,000 which gives the rate per share as paid by the company of Rs. 90/- per share.

### Answer 2(A)(iii)

The action of the assessing officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since BEL had committed various defaults, as briefed hereunder, in respect of which penalty, is imposable.

- (i) Failure to report any international transaction or any transaction, deemed to be an international transaction or any specified domestic transaction, to which the provision of Chapter-X applies would attract penalty @ 200% of the amount of tax payable, since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).
- (ii) Failure to maintain requisite records as required under section 92D in relation to international transaction shall be subject to penalty u/s 271AA @ 2% of the value of each international transaction.
- (iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA of Rs. 1 Lakh.

The assessing officer shall give an opportunity of being heard to the assessee with a notice as to why the arm's length price should not be determined on the basis of material or information or documents in the possession of the Assessing Officer.

The assessee cannot claim deduction u/s 10AA in respect of the additions of Rs. 32 lakhs made the AO on account of transfer pricing adjustments.

## PART B

### Question 3

- (a) *Particulars relating to import of product Z by Mr. Prahalad on 23-12-17 from Antwerp, Belgium to the Chennai airport, are given hereunder :*

<i>FOB value of the Product</i>	<i>\$ 10,000</i>
<i>Cost of transport, loading, unloading and handling charges associated with the delivery of the imported goods to the place of importation</i>	<i>\$ 2,500</i>
<i>Insurance</i>	<i>\$ 1,000</i>
<i>Unloading charges at Chennai airport</i>	<i>₹ 34,000</i>
<i>Exchange rate notified by CBEC on 23-12-17</i>	<i>1\$ = ₹64</i>

Exchange rate notified by RBI on 23-12-17 1\$ = ₹ 64.50

Basic customs duty 10%

Ascertain the assessable value and the amount of duty payable by Mr. Prahalad.  
(5 marks)

(b) State with brief reasons, whether the following statements are true or false in the light of the provisions contained in the Customs Act, 1962 :

(i) Customs area includes a warehouse; (3 marks)

(ii) A beneficial owner of imported goods is a person on whose behalf the goods are being imported. (2 marks)

(c) XYZ Ltd, having its head office at Mumbai, is registered as Input Service Distributor (ISD). It has three units in different cities situated in 'Mumbai', 'Jabalpur' and 'Delhi' which are operational in the current year. XYZ Ltd. furnishes the following information for the month of July 2017 :

- CGST paid on services used only for Mumbai Unit : ₹ 3,00,000
- IGST, CGST & SGST paid on services used for all units : ₹ 12,00,000
- Total turnover of the units for the previous financial year is as follows :

Unit	Turnover (₹)
Total Turnover of three units	₹ 10,00,00,000
Turnover of Mumbai unit	₹ 5,00,00,000
Turnover of Jabalpur unit	₹ 3,00,00,000

Determine the credit to be distributed by XYZ Ltd. to each of its three units.  
(5 marks)

(d) Siddarth Transports Ltd., is running a regular tourist bus service, carrying passengers and goods from Coimbatore, Tamil Nadu to Trivandrum, Kerala, with effect from 1st August, 2017. Discuss whether such inter-state movement of various modes of conveyance carrying goods or passengers or both, between distinct persons as specified in section 25(4) of the CGST Act, 2017 [except in cases where such movement is for further supply of the same conveyance], is leviable to IGST. (5 marks)

(e) Bharghav Pesticides Ltd., a domestic company, intends to start a business in Kolkata, involving supply of certain goods, mostly meant for foreign buyers in China. There is some difficulty in the classification of the goods. Can the company seek advance ruling from the Authority for Advance Ruling formed under CGST Act, 2017 in respect of the issue of classification of goods ? Can the company also seek ruling on issues involving place of supply ? (5 marks)

**Answer 3(a)****Computation of assessable value and total tax & duty payable by Mr. Prahalad in respect of import of product Z**

<i>Particulars</i>	<i>Value</i>
FOB value of the product	\$ 10,000
Cost of transport, loading, unloading and handling charges associated with the delivery of the imported goods to the place of importation, restricted to 20% of FOB Value (20% of \$ 10,000)	\$ 2,000
Insurance (Actual)	\$ 1,000
CIF Value	\$ 13,000
Unloading charges at Chennai airport (Not to be added) (Landing charges are not to be added to the CIF Value in view of the amendment in rule 10(2) of the CVR vide Notification No. 91/2017- Cus (NT) dated 26.09.2017)	Nil
	<i>Rs.</i>
Exchange rate notified by CBEC 1\$=Rs 64 is to be considered for arriving at the assessable value of imported product (13,000 * 64)	8,32,000
Basic customs duty at 10%	83,200
Add : E.Cess @ 2% & SHEC @ 1% of custom duty	2,496
Value for the purpose of levying integrated tax	9,17,696
Add : Integrated tax leviable under section 3(7) [Assuming GST @12%]	1,10,124
<b>Total duty &amp; tax payable</b>	<b>1,95,820</b>

**Alternate Answer 3(a)****Computation of assessable value and total tax & duty payable by Mr. Prahalad in respect of import of product Z**

<i>Particulars</i>	<i>Value</i>
FOB value of the product	\$ 10,000
Cost of transport, loading, unloading and handling charges associated with the delivery of the imported goods to the place of importation, restricted to 20% of FOB Value (20% of \$ 10,000)	\$ 2,000
Insurance (Actual)	\$ 1,000
CIF Value	\$ 13,000
Unloading charges at Chennai airport (Not includible)	

(Landing charges are not to be added to the CIF Value in view of the amendment in rule 10(2) of the CVR vide Notification No. 91/2017- Cus (NT) dated 26.09.2017)	Nil
	Rs.
Exchange rate notified by CBEC 1\$=Rs 64 is to be considered for arriving at the assessable value of imported product (13,000 * 64)	8,32,000
Basic customs duty at 10%	83,200
Add : E.Cess @ 2% & SHEC @ 1% of custom duty	2,496
<b>Total duty &amp; tax payable</b>	<b>85,696</b>

*Note :* Since the IGST Rate is not given, in the Question, Student may calculate custom duty by assuming IGST Rate i.e. 5%, 12%, 18% or 28%.

### Answer 3(b)(i)

**The given statement is True.**

The definition of customs area as provided under section 2(11) of the Customs Act, 1962 has been amended vide the Taxation Laws (Amendment) Act, 2017 to include within its ambit a warehouse also.

Consequent to the above, the customs area is now defined to mean the area of a customs station or a warehouse and includes any area in which imported goods or export goods are ordinarily kept before clearance by customs authorities.

### Answer 3(b)(ii)

**The given statement is True.**

Subsequent to the insertion of new section 2(3A) in the Customs Act, 1962 vide the Finance Act, 2017, the beneficial owner has been defined to mean any person on whose behalf the goods are being imported or exported or who exercises effective control over the goods being imported or exported.

### Answer 3(c)

#### Input Tax Credit to be distributed by XYZ Ltd. a registered ISD on different Units for July, 2017

Particulars	Credit to be distributed (Amount in Rs.)			
	Total Credit	Mumbai	Jabalpur	Delhi
CGST paid on the services used for Mumbai office only	300000	300000	-	-
IGST, CGST and SGST paid on the services used for all units in operation during the year (see note)	1200000	600000	360000	240000
<b>Total</b>	<b>1500000</b>	<b>900000</b>	<b>360000</b>	<b>240000</b>

*Note :* The input-tax credit has been distributed on all the units on the pro-rata basis of the turnover of each of the Units in the ratio of 5:3:2.

**Answer 3(d)**

The legal provisions in GST laws are as under:

- (a) **As per Section 24(1) of the CGST Act**, persons making any inter-State taxable supply shall be required to be registered under this Act.
- (b) **As per Section 25(4) of the said Act** a person who has obtained or is required to obtain more than one registration, whether in one State or Union territory or more than one State or Union territory shall, in respect of each such registration, be treated as distinct persons for the purposes of this Act.
- (c) **Schedule I of the said Act** specifies situations where activities are to be treated as supply even if made without consideration which also includes supply of goods or services or both between related persons or between distinct persons as specified in Section 25, when made in the course or furtherance of business.
- (d) **Section 7(2) of the CGST Act** envisages that activities or transactions undertaken by the Central Government, a State Government or any local authority in which they are engaged as public authorities, as may be notified by the Government on the recommendations of the Council, shall be treated neither as a supply of goods nor a supply of services.

The issue of inter-state movement of goods like movement of various modes of conveyance, between distinct persons as specified in section 25(4) of the said Act, not involving further supply of such conveyance, including trucks, buses, etc., (a) carrying goods or passengers or both; or (b) for repairs and maintenance, [except in cases where such movement is for further supply of the same conveyance] was discussed in GST Council's meeting held on 11th June, 2017 and the Council recommended that such inter-state movement shall be treated 'neither as a supply of goods or supply of service' and therefore not be leviable to IGST.

In view of above, the inter-state movement of goods like movement of various modes of conveyance, between distinct persons as specified in section 25(4) of the CGST Act including TRUCKS, BUSES, TRAINS, TANKERS, TRAILERS, VESSELS, AIRCRAFT ETC., may not be treated as supply and consequently IGST will not be payable on such supply.

*(Reference in this regard may be made to Circular No. 1/1/2017 IGST dated 07.07.2017)*

**Answer 3(e)****Advance Ruling**

Advance ruling under GST can be sought by a registered person or a person desirous of obtaining registration under GST law [Section 95(c) of the CGST Act, 2017]. Therefore, it is not mandatory for a person seeking advance ruling from the AAR formed under CGST Act, 2017 to be a registered person.

Section 97(2) of the CGST Act, 2017 enjoins that the questions/ matters on which the advance ruling can be sought for determining the classification of any goods or services or both. Therefore, the Company can seek the advance ruling for determining the classification of goods proposed to be supplied.

Determination of place of supply is not one of the specified questions/ matters on which advance ruling can be sought under section 97(2). Further, section 96 of the CGST Act, 2017 provides that AAR constituted under the provisions of a SGST/ UTGST Act shall be deemed to be the AAR in respect of that State/ Union territory.

Thus, AAR is constituted under the respective State/ Union Territory Act and not under the Central Act. This implies that ruling given by AAR will be applicable only within the jurisdiction of the concerned State/ Union territory.

It is also for this reason that the question on determination of place of supply can not be raised with the AAR. Hence, the applicant cannot seek the advance ruling for determining the place of supply of the goods proposed to be supplied by the applicant.

**Attempt all parts of either Q. No. 4 or Q. No. 4A**

**Question 4**

- (a) From the following details pertaining to Ashwathama, a registered dealer engaged in purchase and sale of goods, ascertain the GST liability (SGST/CGST/IGST) for the month of November, 2017 :

Particulars	Amount (₹)
Sale price charged to customers within State (excluding GST)	12,50,000
Commission charged to buyers	12,000
Packing and forwarding expenses incidental to sale	18,000
Weighment charges, shown separately in invoices	9,500

Prompt payment discount, indicated in invoice 1%, if payment made within 1 month. All buyers of goods have availed the discount.

The rates of taxes for the goods supplied are as under :

Particulars	Rate	
CGST	9%	
SGST	9%	
IGST	18%	(5 marks)

- (b) Jayakumar Textiles Ltd., purchased a machinery on 12th August, 2017 for ₹12 lakhs (excluding GST). The company put the machinery to use after the purchase and availed input tax credit for the eligible amount.

The machinery was sold as second hand machinery on 14th May, 2018 for ₹9 lakhs. During purchase as well as sale of the machinery, the GST rate applicable was 18%. Assuming that there was no change in legal position after November, 2017, discuss the steps which Jayakumar Textiles Ltd., is required to take at the time of sale of the secondhand machine. Briefly state the statutory provisions involved. (5 marks)

- (c) Compute the assessable value of an imported product (as on 11-12-2017), in the following independent situations :

Case 1

Particulars	Figure (Euro €)
FOB value	2,000
Freight, loading, unloading and handling charges associated with the delivery of the imported goods to the place of importation	Not known
Insurance charges	20

Case 2

Particulars	Figure (Euro €)
FOB value	2,000
Sea freight, loading, unloading and handling charges associated with the delivery of the imported goods to the place of importation	100
Insurance charges	Not known

(5 marks)

**OR (Alternate question to Q. No. 4)**

**Question 4A**

- (i) AB Ltd. imported Super Kerosene Oil (SKO) and stored it in a warehouse. An ex bond bill of entry for home consumption was filed and duty was paid as per the rate prevalent on the date of presentation of such bill of entry and the order for clearance for home consumption was passed. On account of highly combustible nature of SKO, the importer made an application to permit the storage of such kerosene oil in the same warehouse until actual clearance for sale/use. The application was allowed. However, the rate of duty increased when the goods were actually removed from the warehouse. The department demanded the differential duty. The company challenged the demand. Whether it will succeed? Discuss briefly, taking support of decided case(s), if any. (5 marks)
- (ii) Balram, a registered supplier, furnishes the following details pertaining to the month of October, 2017 (first month of starting of business) :

Particulars	Amount (₹)
Purchases of goods within the State	8,00,000
Purchases of goods from outside the State	10,00,000
Inter State Sales	6,00,000
Intra State Sales	12,50,000

The rates of taxes for the goods supplied are as under :

Particulars	Rate
CGST	6%
SGST	6%
IGST	12%

Compute the GST payable by the supplier Balram for the month of October, 2017. (5 marks)

(iii) In the context of 'Clear first, Pay later' concept evolved under the customs law, state the objectives of the concept and the persons who are eligible to avail this facility. (5 marks)

#### Answer 4(a)

#### Determination of GST Liability of Ashwathama for the month of November, 2017

Particulars	Amount (Rs.)
Sale price charged to customers within State (excluding GST)	12,50,000
Add: Commission charged to buyers [See Note 1]	12,000
Packing and forwarding expenses incidental to sale [See Note 1]	18,000
Weighment charges, shown separately in invoices [See Note 1]	9,500
	<b>12,89,500</b>
Less: Prompt payment discount, indicated in invoice 1% [See Note 2]	12,500
Value of taxable supply	12,77,000
SGST at 9%	1,14,930
CGST at 9%	1,14,930
Total GST Payable (SGST + CGST)	<b>2,29,860</b>

#### Notes:

- As per Section 15 of the CGST Act, 2017, all incidental expenses like commission, packing & forwarding, weighment charges will form part of the taxable supply.
- Prompt payment discount is deductible, since it is known at the time of supply.

**Answer 4(b)**

Section 18(6) of the CGST Act, 2017 read with rule 40(2) the CGST Rules, 2017 provide that if capital goods or plant and machinery on which input tax credit has been taken are supplied outward by the registered person, he must pay an amount that is the higher of the following:

- (a) Input tax credit taken on such goods reduced by 5% per quarter of a year or part thereof from the date of issue of invoice for such goods, or
- (b) Tax on transaction value.

Jayakumar Textiles Ltd. is required to take the steps in the light of above provisions for payment of tax at the time of sale of second hand machinery. The amount payable on sale of machinery shall be:

<i>Particulars</i>	<i>Amount (Rs.)</i>	<i>Amount (Rs.)</i>
Input tax credit taken on machine (1200000 x 18%)		2,16,000
<i>Less</i> : Input tax credit to be reversed @ 5% per quarter for the period of use of machine from August, 2017 to May, 2018		
(i) For the year 2017-18 = (216000 x 5%) x 3 Qtrs.	32,400	
(ii) For the year 2018-19 = (216000 x 5%) x 1 Qtr.	10,800	43,200
Amount required to be paid as per (a) above		1,72,800
Tax leviable on transaction value (900000 x 18%)		
as per (b) above		1,62,000
Amount payable towards sale of machine being higher of Rs. 1,72,800/- and Rs. 1,62,000/-		1,72,800

**Answer 4(c)****Case 1**

<b>Particulars</b>	<b>Euro €</b>
FOB Value	2,000
<i>Add</i> : Cost of transport, loading, unloading and handling charges associated with the delivery of the imported goods to the place of importation [20% of FOB value in terms of first proviso to rule 10(2) of CVR]	400
Cost of insurance	20
Assessable value [CIF value]	2,420

**Case 2**

<b>Particulars</b>	<b>Euro €</b>
FOB Value	2,000
<i>Add:</i> Cost of sea transport, loading, unloading and handling charges associated with the delivery of the imported goods to the place of importation [includible in terms of rule 10(2)(a) of CVR]	100
Insurance [1.125% of sum of FOB value of the goods in terms of third proviso to rule 10(2) of CVR]	22.50
Assessable value [CIF value]	2,122.50
Assessable Value rounded off	2,123

**Answer 4A(i)**

**Yes, the Company will succeed.**

The facts of the given situation are similar to the case of *CCus vs. Biecco Lawrie Ltd.* 2008 (223) ELT 3 (SC) wherein the Supreme Court has held that where duty on the warehoused goods is paid and out of charge order for home consumption is made by the proper officer in compliance of the provisions of Section 68, the goods allowed to be retained for storage in the warehouse as permitted under Section 49 of the Customs Act are not treated as warehoused goods and importer would not be required to pay anything more.

Section 49 of the Customs Act, 1962 inter alia provides that imported goods entered for home consumption if stored in a public warehouse, or in a private warehouse on the application of the importer and if the same cannot be cleared within a reasonable time, shall not be deemed to be warehoused goods for the purposes of this Act, and accordingly the provisions of Chapter IX shall not apply to such goods.

**Answer 4A(ii)**

**Computation of GST Liability of Balram  
for October 2017**

<i>Particulars</i>	<i>Amount (Rs.)</i>
Inter-State Sales (12% on 600000)	72000
<i>Less:</i> ITC on Purchases of goods from outside the State of Rs. 10,00,000 (12% on 10,00,000)	120000
Excess credit in IGST available for set off	48000

<i>Particulars</i>	<i>SGST (Rs.)</i>	<i>CGST (Rs.)</i>
GST on Intra State Sales (1250000 x 6% each for SGST & CGST)	75000	75000
Less : Input tax credit on purchases of goods from within state (800000 x 6% each for SGST & CGST)	48000	48000
Balance liability of tax payable	27000	27000
Less : Credit in IGST available for cross set off	21000	27000
Balance tax payable	6000	Nil

**Answer 4A(iii)****“Clear first, Pay later” concept under custom laws****(A) Objectives**

- (i) “Clear first, pay later” is a mechanism facilitating deferred payment of customs duty.
- (ii) It is a mechanism which delinks duty payment and customs clearance.
- (iii) The aim is to have a seamless wharf to warehouse transit in order to facilitate just-in-time manufacturing. This scheme is in force w.e.f. 16th November, 2016.
- (iv) It is a trade facilitation move wherein benefits are extended to the entities who have demonstrated strong internal control systems and willingness to comply with the laws administered by the CBEC.

**Eligible Persons**

- (i) Central Government has permitted importers certified under Authorized Economic Operator programme as AEO (Tier-Two) and AEO (Tier-Three) being eligible importers to make deferred payment of import duty under the clear first, pay later mechanism.
- (ii) The CBEC has rolled out the AEO (Authorized Economic Operator) programme, as a part of ease of doing business focus of Government of India.

**Question 5**

- (a) *Vinod, a supplier of goods in Vadodara furnishes the following particulars pertaining to supplies likely to be effected by him during the third and fourth quarters of the FY 2017-18 :*

*Value of supply of goods chargeable to GST* ₹ 18 lakhs

*Goods to be supplied to World Health Organization, Ahmedabad office* ₹ 4 lakhs

*All supplies will be within the State only. He desires to know whether he should get himself registered for GST purposes. Advise him suitably. (3 marks)*

- (b) Harivallabh, a registered supplier, rendered taxable service for ₹ 2 lakhs on 1-11-2017. The tax invoice was raised on 9-12-2017. Payment was received the next day. Ascertain the time of supply for GST purposes. (3 marks)
- (c) State the due dates for payment of deferred customs duty under 'Clear first, Pay later' system evolved under the Customs Act, 1962. (3 marks)
- (d) State the Form Number and the due date for its filing under CGST Act, 2017 of the return by :
- a composition scheme taxable person
  - a registered person deducting tax at source
  - an input service distributor. (1 mark each = 3 marks)
- (e) Briefly explain provisions related to e-way bill as per CGST Act, 2017 relating to:
- What is e-way bill and when it is being required ? (1 mark)
  - What is its validity period ? (2 marks)

**Answer 5(a)****Computation of total supplies of Vinod**

Particulars	Rs. (in Lakhs)
Value of Supply of goods chargeable to GST	18
Goods to be supplied to World Health Organisation [Though this is an exempt SUPPLY BUT INCLUDIBLE for ascertaining aggregate turnover]	4
Aggregate Turnover	22

It is to be noted that aggregate turnover would include, Taxable Supplies, Exempt Supplies, Zero Rated Supplies and Inter State Supplies, but not supplies through the Reverse Charge Mechanism route.

Since the aggregate turnover during third and fourth quarter of 2017-18 of Mr. Vinod exceeds Rs. 20 lakhs, he is advised to apply for registration under GST laws.

**Answer 5(b)**

Tax Invoice should have been issued by Mr. Harivallabh within 30 days from the date of providing of service on 01-11-2017.

Tax invoice issued/raised on 09-12-2017, this has been issued beyond the stipulated time limit.

The time of supply as per section 13 of CGST Act, 2017 would be 01.11.2017 i.e. earliest of the following:

- Date of provision of service (01.11.2017)
- Date of receipt of payment (10.12.2017)

**Answer 5(c)**

The due dates for payment of deferred Customs duty are –

<i>S. No.</i>	<i>Goods corresponding to bill of entry returned for payment from</i>	<i>Due date of payment of duty, inclusive of the period (excluding holidays) as mentioned in section 47(2)</i>
1.	1st day to 15th day of any month	16th day of that month
2.	16th day till the last day of any month other than March	1st day of the following month
3.	16th day till the 31st day of March	31st March

**Answer 5(d)**

<i>Tax Payer</i>	<i>Form No. to be filed</i>	<i>Due date of Filing Return</i>
(i) Composition scheme taxable person	GSTR-4	18th of month next to relevant quarter
(ii) Registered person deducting tax at source	GSTR-7	10th of next month
(iii) Input Service Distributor	GSTR-6	3rd of next month

**Answer 5(e)**

(i) E-way bill is an electronic way bill for movement of goods which is generated on the GSTN portal. It is required when a “movement” of goods is of more than Rs. 50,000 in value. A registered person cannot move goods without an e-way bill.

(ii) The validity period of e-way bill is tabulated as under :

<i>Distance</i>	<i>Validity Period</i>
Upto 100 kms	One day
For every 100 kms or part thereof thereafter	One additional day

**Question 6**

(a) Answer the following with reference to GST (Compensation to States) Act, 2017:

(i) Projected Growth Rate

(ii) Base year

(iii) Projected Revenue for any year

(iv) Calculation and release of compensation

(v) Objective of GST (Compensation to States) Act, 2017

(1 mark each=5 marks)

(b) Briefly define the following terms as per CGST Act, 2017 :

- (i) Adjudicating Authority (2 marks)
- (ii) Aggregate Turnover (2 marks)
- (iii) Exempt Supply (1 mark)

(c) Hema Lubricants Ltd., filed an appeal before the Appellate Tribunal against the order of the Appellate Authority, wherein the issue was revolving around the place of supply.

*The Tribunal decided the issue against the company and in favour of the department. The company is of the firm opinion that its view is correct and hence there is need to take the issue to an appellate forum higher than the Appellate Tribunal.*

*As the Company Secretary, dealing with indirect tax matters, advise the company about filing of appeal before the appropriate forum. (5 marks)*

#### Answer 6(a)

**(i) Projected Growth Rate**

The projected nominal growth rate of revenue subsumed for a State during the transition period shall be fourteen percent (14%) per annum.

**(ii) Base Year**

For the purpose of calculating the compensation amount payable in any financial year during the transition period, the financial year ending 31st March, 2016 shall be taken as the base year.

**(iii) Projected Revenue for any year**

The projected revenue for any year in a State shall be calculated by applying the projected growth rate over the base year revenue of that State.

*Illustration* : If the base year revenue for 2015-16 for a concerned State, calculated as per section 5 is one hundred rupees, then the projected revenue for financial year 2018-19 shall be as follows:

$$\text{Projected Revenue for 2018-19} = 100 (1 + 14/100)^3.$$

**(iv) Calculation and release of compensation**

The compensation payable to a state has to be provisionally calculated and released at the end of every two months, which shall be finally calculated for every financial year after the receipt of final revenue figures, as audited by Comptroller and Auditor General of India.

**(v) Objective**

The objective behind providing compensation to the states is for the loss of revenue arising on account of implementation of the Goods and Services Tax (GST) in pursuance of the provisions of the Constitution (One Hundred and First Amendment) Act, 2016.

**Answer 6(b)(i)****Adjudicating Authority**

“Adjudicating Authority” means any authority, appointed or authorized to pass any order or decision under this Act, but does not include the Central Board of Excise and Customs, the Revisional Authority, the Authority for Advance Ruling, the Appellate Authority for Advance Ruling, the Appellate Authority and the Appellate Tribunal.

Adjudicating authority thus includes Principal Commissioner of Central Tax, Commissioner of Central Tax, Additional Commissioner of Central tax, Joint/Deputy/ Assistant Commissioner of Central Tax etc.

**Answer 6(b)(ii)****Aggregate Turnover**

“Aggregate Turnover” means the aggregate value of all taxable supplies (excluding the value on inward supplies on which tax is payable by a person on reverse charge basis), exempt supplies, exports of goods or services or both and inter-state supplies of persons having the same Permanent Account Number, to be computed on all India basis but excludes Central Tax, State Tax, Union Territory Tax, Integrated Tax & Cess.

**Answer 6(b)(iii)****Exempt Supply**

Exempt Supply means supply of any goods or services or both which attracts nil rate of tax or which may be wholly exempt from tax under section 11, or under section 6 of the Integrated Goods & Services Tax Act, and includes non-taxable supply.

**Answer 6(c)**

Where the supplier or the department is not satisfied with the order passed by the State Bench or Area Benches of the Appellate Tribunal, appeal can be filed before the High Court if the High Court is satisfied that such an appeal involves a substantial question of law [Section 117(1) of the CGST Act, 2017]

Nevertheless, appeal against orders passed by the National Bench or Regional Benches of the Tribunal can be filed only before the Supreme Court and not before High Court.

As per section 109(5) of the Act, only the National Bench or Regional Bench of the Tribunal can decide appeals where one of the issues involved relates to the place of supply.

Since the issue involved in the given case relates to the place of supply, the appeal in case would have been decided by the National Bench or Regional Bench of the Tribunal.

Consequently, Hema Lubricants Ltd., will have to file an appeal before the Supreme Court and not with the High Court.

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## **DRAFTING, APPEARANCES AND PLEADINGS**

*Time allowed : 3 hours*

*Maximum marks : 100*

**NOTE :** *Answer ALL Questions.*

### **Question 1**

*Comment on the following :*

- (a) A will does not require to be registered.*
- (b) A Power of Attorney must be strictly construed.*
- (c) Amino attestendi*
- (d) A debtor cannot claim or take advantage of non-payment of consideration for assignment. (5 marks each)*

#### **Answer 1(a)**

##### **A Will does not require to be registered**

A Will is a most solemn document. It also a sacred document as a dead person entrusts to a living person the carrying out of his wishes and desires. A will is valid in the eyes of law even if it is not registered. A handwritten will is also acceptable. According to Section 18(c) of the Registration Act, 1908, registration of Will is not mandatory. It is optional. However a registered Will has certain advantages. Any testator may, either personally or by duly authorized agent deposit with any Registrar his Will in a sealed cover super scribed with the name of the testator and that of his agent (if any) and with a statement of the nature of the document as per Section 42 of Registration Act, 1908. The testator, or after his death any person claiming as executor or otherwise under a Will, may present it to any Registrar or Sub Registrar for registration under section 40 of the Registration Act, 1908.

#### **Answer 1(b)**

##### **A Power of Attorney must be strictly construed**

As a general rule, a power of attorney should be construed strictly and general words must be interpreted in the light of the special powers, although they include incidental powers necessary for carrying out the authority. The general words used in the subsequent clauses of a power of attorney must be read with the special or specific powers given in the earlier clauses and cannot be construed so as to enlarge the restricted powers mentioned in the powers of attorney. Regard must be had to the recitals, if any, as showing the scope and object of the power, as such recitals will control any general terms in the operative part of the instrument. Any power which has not been expressly delegated should not be implied. Where an authority is given to do particular acts, followed by general words, the general words are restricted to what is necessary for the performance of the particular acts.

**Answer 1(c)*****Amino attestandi***

It is one of the usual parts or components of deed in general. After attestation clause, signatures of the executants of the documents and their witnesses attesting their signatures follow. It is essential that the attesting witness should have put his signature, amino attestandi, intending for the purpose of attesting that he has seen the executant sign or has received from him, a personal acknowledgement of his signature.

**Answer 1(d)****A debtor cannot claim or take advantage of non-payment of consideration for assignment**

An assignment is a form of transfer of property and it is commonly used to refer the transfer of an actionable claim or a debt or any beneficial interest in movable property. A debtor cannot claim or take advantage of non-payment of consideration for assignment. Section 130 of the Transfer of Property Act, 1882 specifically lays down that an assignment of an actionable claim may be with or without consideration. Passing of the property in the assigned property does not depend on the payment of consideration.

***Attempt all parts of either Q. No. 2 or Q. No. 2A*****Question 2**

*Explain the following :*

- (a) *Statement of a case by Appellate Tribunal to the Supreme Court of India under the Income Tax Act, 1961.*
- (b) *Interlocutory orders*
- (c) *Objects of Pleadings*
- (d) *Extinction of a Trust.* (4 marks each)

***OR (Alternate question to Q. No. 2)*****Question 2A**

*Explain the following :*

- (i) *Legality of a written deed for performing a promise in near future.*
- (ii) *Utility of arbitration*
- (iii) *Electronic or e-contracts*
- (iv) *Building contracts* (4 marks each)

**Answer 2(a)****Statement of a case by Appellate Tribunal to the Supreme Court of India under the Income Tax act, 1961**

Section 257 of the Income-Tax Act, 1961 makes provisions for reference of a case by the Appellate Tribunal to the Supreme Court. It lays down if, on an application made

under Section 256 of the Income-Tax Act, 1961, the Appellate Tribunal is of the opinion that, on account of a conflict in the decisions of High Courts in respect of any particular question of law, it is expedient that a reference should be made direct to the Supreme Court, the Appellate Tribunal may draw up a statement of the case and refer it through its President direct to the Supreme Court.

### **Answer 2(b)**

#### **Interlocutory orders**

Interlocutory refers to an order, sentence, decree, or judgment, given in an intermediate stage between the commencement and termination of a cause of action, used to provide a temporary or provisional decision on an issue. After the suit is instituted by the plaintiff and before it is finally disposed off, the Court may make interlocutory orders as may appear to the court to be just and convenient. The power to grant Interlocutory orders can be traced to Section 94 of Code of Civil Procedure, 1908. Interlocutory orders may take various shapes depending upon the requirement of the respective parties during the pendency of the suit. Applications for appointment of Commissioner, Temporary Injunctions, Receivers, payment into court, security for cause etc.

### **Answer 2(c)**

#### **Objects of Pleadings**

The sole object of a pleading is that each party may be alive to the questions that are about to be argued in order that they have an opportunity of bringing forward such evidence as may be appropriate to the issues. The rules of pleading and other ancillary rules contained in the Code of Civil Procedure, 1908 have one main object in view to find out and narrow down the controversy between the parties concerned. The pleadings are to be so framed as not only to assist the party in the statement of his case but the court in its investigation of the truth between the litigants.

### **Answer 2(d)**

#### **Extinction of a Trust**

A trust is extinguished:

- (a) when its purpose is completely fulfilled; or
- (b) when its purpose becomes unlawful; or
- (c) when the fulfilment of its purpose becomes impossible by destruction of the trust property or otherwise; or
- (d) when the trust, being revocable, is expressly revoked.

### **Answer 2A(i)**

#### **Legality of a written deed for performing a promise in near future**

Deed is the term normally used to describe all the instruments by which two or more persons agree to effect any right or liability. A deed is a writing on paper, vellum or parchment, sealed, and delivered, whereby an interest, right or property passes, or an obligation binding on some persons is created or which is in affirmance of some act

whereby an interest, right or property has been passed. In Halsbury's Laws of England, a deed has been defined as an instrument written on parchment or paper expressing the intention or consent of some person or corporation named therein to make (otherwise than by way of testamentary disposition, confirm or concur in some assurance of some interest in property or of some legal or equitable right, title or claim, or to undertake or enter into some obligation, duty or agreement enforceable at law or in equity or to do, or concur in some other act affecting the legal relations or position of a party to the instrument or of some other person or corporation, sealed with the seal of the party, so expressing such intention or consent and delivered as that party's act and deed to the person or corporation intended to be affected thereby. A deed is a present grant rather than a mere promise to be performed in the future.

### **Answer 2A(ii)**

#### **Utility of Arbitration**

Civil litigation takes years and years to settle simple disputes. Arbitration is a means devised to quick and economical settlement of a dispute between two contracting parties, who also agree as part of the main agreement to refer dispute or difference arising out of or touching upon the terms and conditions of the agreement to a third person to give his judgement, which shall be binding on both the parties. Thus, arbitration is a method to ensure settlement of disputes and helps in saving time and money.

### **Answer 2A(iii)**

#### **Electronic or e-contracts**

Electronic or e-contract is the result of advances made in science and technology. It refers to contracts that are not proper or parchment based but in the digital or electronic format. It is a contract formed in the course of e-commerce by the interaction of two or more parties using electronic means, including but not limited to email, interaction with electronic agents such as computer programmes and internet based agreements. Electronic Contracts are also covered by the provisions of the Contract Act, 1872, and hence the concepts of offer and acceptance, free consent and consideration will be applicable. In addition, e-contracts are also governed by the provisions of the information Technology Act, 2000. The conventional law relating to contracts is not sufficient to address all the issues, The Information Technology Act solves some of the peculiar issues that arise in the formation and authentication of electronic contracts.

### **Answer 2A(iv)**

#### **Building Contracts**

Building contracts, being legal documents, have to be drawn in accordance with the provisions of the Indian Contract Act, 1872. Such an agreement or contract must be drawn in accordance with the provisions of the Act. All the essential ingredients of a contract, such as, a proposal, its acceptance, its due communication to the proposer, lawful consideration, lawful purpose and competence of parties to the contract etc. must be duly satisfied and ensured while drafting such contracts. It is essential to ascertain not only the legal position or condition of each of the parties to the contract but also that each person signing the document has necessary capacity to contract. Amongst others, the building contract must clearly describe the full names, addresses and capacities of

each of the contracting parties, property, comprise construction details, time lines for completion, clauses for default, payment schedules, responsibility for obtaining municipal permits and so on.

**Attempt all parts of either Q. No. 3 or Q. No. 3A**

**Question 3**

*Distinguish between the following :*

- (a) *Habeas corpus and Quo warranto*
- (b) *Release and re-conveyance of mortgaged assets*
- (c) *Compounding and consent orders*
- (d) *Power of Attorney and Letter of Authority* (4 marks each)

**OR (Alternate question to Q. No. 3)**

**Question 3A**

*Write notes on the following :*

- (i) *Shareholders' agreements*
- (ii) *Plaint structure*
- (iii) *Court craft*
- (iv) *Habendum* (4 marks each)

**Answer 3(a)**

***Habeas corpus***

The writ of *habeas corpus* is a remedy available to a person who is confined without legal justification. The words "Habeas Corpus" literally mean "to have a body". This is an order to let the Court know on what ground he has been confined and to set him free if there is no legal justification for his detention. This writ has to be obeyed by the detaining authority by production of the person before the Court.

***Quo warranto***

The writ of *quo warranto* is prayed, for an inquiry into the legality of the claim which a person asserts to an office or franchise and to oust him from such position if he is an usurper. The holder of the office has to show to the Court under what authority he holds the office. This writ is issued when the office is of a public and of a substantive nature; the office is created by a Statute or by the Constitution itself; and the respondent must have asserted his claim to the office. The fundamental basis of the proceedings of *quo warranto* is that the public has an interest to see that no unauthorised person usurps a public office. It is a discretionary remedy which the court may grant or refuse.

**Answer 3(b)**

Release of any of the mortgaged assets or reconveyance of the mortgaged property could be done by a registered document in case the mortgage has been created in the form other than equitable mortgage by deposit of title deeds by a registered deed of

mortgage. In those cases where release or reconveyance of mortgaged property covered under equitable mortgage is sought by the mortgagor, the same could be done by releasing the relevant title documents and re-depositing the remaining title deeds by rewriting the memorandum for creation of equitable mortgage. On redemption of equitable mortgage all the title deeds could be released by the mortgagee to the mortgagor by personal hand delivery and against accountable receipts from the mortgagor.

### **Answer 3(c)**

#### **Compounding**

Compounding means that the accused and the complainant have come to terms and the dispute between the parties has been settled amicably or adjusted by agreement and the complainant agrees not to prosecute the accused. The accused and the complainant then make a joint application to the court that the parties have come to terms and the case may not be proceeded with. Generally, offences which are of a private nature and relatively not serious are made compoundable.

#### **Consent Orders**

Consent Order means “an order settling administrative or civil proceedings between the regulator and a person (Party) who may prima facie be found to have violated securities laws.” The Administrative/Civil enforcement actions include issuing directions, suspension or cancellation of certificate of registration, imposition of monetary penalty, pursuing suits and appeals in courts and Securities Appellate Tribunal (SAT). It may settle all issues or reserve an issue or claim, but it must precisely state what issues or claims are being reserved. Consent Order provides flexibility of wider array of enforcement and remedial actions.

### **Answer 3(d)**

#### **Power of Attorney**

According to Section 2(21) of the Indian Stamp Act, 1899, “Power of Attorney” includes any instrument (not chargeable with fee under the law relating to Court fees for the time being in force) empowering a specified person to act for and in the name of the person executing it”. It is governed by the provisions of the Power of Attorney Act, 1882. The law pertaining to powers of attorney are based on the principles of agency as contained in the Contract Act, 1872. A power of attorney can either be general or specific.

#### **Letter of Authority**

A letter of authority is nothing but a power of attorney. They are executed on plain paper and not on stamp paper. Usually, these are issued for collection of some documents, papers, dividend, interest etc, by one person on behalf of another. By and large, the law relating to power of attorney will also apply to the letters of authority.

### **Answer 3A(i)**

#### **Shareholders' Agreements**

Shareholders' agreements (SHA) are quite common in business. In India shareholder's agreement have gained popularity and currency only lately with bloom in newer forms of businesses. It is a contractual arrangement between the shareholders of a company

describing how the company should be operated and the defining inter-se shareholders' rights and obligations. Shareholders' Agreements are the result of mutual understanding among the shareholders of a company to which, the company generally becomes a consenting party. Sometimes, they are also referred to as share purchase agreements or investment agreements.

### **Answer 3A(ii)**

#### **Plaint Structure**

A suit is instituted by filing a plaint, which is the first pleading in a civil suit. It is a statement of the plaintiff's claim and its object is simply to state the grounds upon, and the relief in respect of which he seeks the assistance of the court.

Order VII of the Civil Procedure Code, 1908 deals with plaint. As per Order VII, R.1 CPC, every plaint must contain the following things:

- (a) the name of the Court in which the suit is brought;
- (b) the name, description and place of residence of the plaintiff;
- (c) the name, description and place of residence of the defendant, so far as they can be ascertained;
- (d) where the plaintiff or the defendant is a minor or a person of unsound mind, a statement to that effect;
- (e) the facts constituting the cause of action and when it arose;
- (f) the facts showing that the Court has jurisdiction;
- (g) where the plaintiff has allowed a set-off or relinquished a portion of his claim, the amount so allowed or relinquished; and
- (h) a statement of the value of the subject-matter of the suit for the purposes of jurisdiction and of court fees, so far as the case admits;
- (i) the relief which the plaintiff claims;
- (j) verification of the plaint.

### **Answer 3A(iii)**

#### **Court Craft**

Court Craft /Advocacy is learned when a professional enter the practicing side of the profession. It is necessary for them to learn art of advocacy or court craft for effective delivery of results to their clients when they act as an authorized representative before any tribunal or quasi-judicial body. Technical and legal knowledge about the area in which Company Secretaries are acting is essential. Better their knowledge, the better their advocacy skills and the greater their impact. Good advocacy or negotiating skills will not compensate for lack of appropriate knowledge.

### **Answer 3A(iv)**

#### **Habendum**

Habendum is a part of deed which states the interest, the purchaser is to take in the property. The genesis of this clause can be traced to gratuitous transfer of property in

ancient England. It usually starts with the words “THE HAVE AND TO HOLD”. The habendum limits the estate mentioned in the parcels. The transferee is again mentioned in the clause for whose use the estate is conveyed. Whatever precedes the habendum is called the premises.

#### Question 4

*In the light of judicial pronouncements, discuss the following :*

- (a) *A restriction which is not specified in the Articles of Association is not binding either on the company or the shareholders.*
- (b) *Surrender of lease is not a transfer but a mere yielding up by the lessee of his interest under the lease to the lessor by mutual agreement.*
- (c) *Transfer of immovable property by way of sale can be effected only by a deed of conveyance.*
- (d) *Articles of Association regulate the internal management of a company.*

*(4 marks each)*

#### Answer 4(a)

While shareholders' agreements are enforceable in England regardless of whether they have been incorporated in the articles of association of the company, in India courts have either refused to recognize clauses in shareholders agreements or, even when consistent with company legislation, enforced such clauses only if they have been incorporated in the articles of association of the company. In a series *VB Rangaraj vs. VB Gopalakrishna* (AIR 1992 SC 453) the courts have held that in case of any conflicts between the articles and shareholders agreement, the former will always prevail.

#### Answer 4(b)

Surrender of lease is not a transfer but mere yielding up by the lessee of his interest under the lease to the lessor by mutual agreement. It is in effect merger of the estate of the lessee into the reversion. It is not a transfer or an assignment of any right or estate within the meaning of Section 5 of the Transfer of Property Act [*Makhanlal v. Nagendranath*, (1933) 60 Cal 379]. A surrender must be made with clear intention to yield up as mere non-payment of rent for years together or abandonment of the site does not amount to surrender. (*Misri Lal v. Durga Narain*, AIR 1940 All. 317) It may be expressed or implied. A surrender may be oral, if accompanied by delivery of possession.

#### Answer 4(c)

Usually a transaction of a sale of immovable property involves two documents, e.g., Agreement to sell and the Conveyance Deed i.e. sale deed. But with only a Sale Deed the transaction of sale can be completed. In *Suraj Lamp & Industries Pvt Ltd. v. State of Haryana* the Supreme Court of India observed that it has become common practice to effect transfers of immovable property by way of either general power of attorney (GPA) sales or sale agreement, GPA or will transfers in order to evade, inter-alia, the payment of duties, taxes and other fees payable on transfer and registration. The Apex Court held that such transactions are illegal and cannot be recognized as valid under law. The Apex Court further observed that a transfer of immovable property by way of sale can be

effected only by a deed of conveyance. In the absence of a deed of conveyance, duly stamped and registered, no right, title or interest in an immovable property can be transferred.

#### Answer 4(d)

The Articles of Association of a company are its internal rules and regulations that are framed to manage its internal affairs. Just as the Memorandum of Association contains the fundamentals conditions upon which a company is allowed to be incorporated, so too the articles are the internal regulations of the company (*Guinness vs. Land Corporation of Ireland* 22 Ch.D 348, 381). It is referred to as the magna carta of the company. It regulates the domestic management of the company and creates rights and obligations between the members and the company [*SS Raj Kumar vs. Perfect Castings Private Limited* (1968)]. It is the bye-laws of the company.

#### Question 5

- (a) *It is incumbent upon a party in possession of best evidence on the issue involved to produce such evidence and if such party fails to produce the same, an adverse inference is liable to drawn against such party. Explain. (4 marks)*
- (b) *A group of fashion designers, Akshita, Haritha and Hemalatha propose to form a Limited Liability Partnership (LLP). They seek your professional guidance on the drafting of the following clauses in the LLP Agreement :*
- (i) *Admission of new partner*
  - (ii) *Extent of liability of the LLP*
  - (iii) *Arbitration (6 marks)*
- (c) *Draft a Specimen Deed of Assignment of a Patent. Assume data. (6 marks)*

#### Answer 5(a)

The statement is true and has been upheld by the courts. In *Ms Shefalli Bhaargava vs. Indraprastha Apollo Hospital and another* 2003 NCJ 787 (NC), the Court has observed that it is incumbent upon a party in possession of best evidence on the issue involved is a complex or difficult one, Court cannot constitute itself into an expert body and contradict the claim/proposition on record unless there is something contrary on the record by way of expert opinion, to produce such evidence and if such party fails to produce the same, an adverse inference is liable to be drawn against such party. The Court will be justified in drawing an adverse inference against that party. This is also known as the doctrine or rule of adverse influence.

#### Answer 5(b)

The model Clauses in the LLP agreement are as follows:

- (i) *Admission of new partner :*
- No Person may be introduced as a new partner without the consent of all the existing partners. Such incoming partner shall give his prior consent to act as Partner of the LLP.

- Capital Contribution of the new partner may be tangible, in-tangible, movable or immovable property and the incoming partner shall bring minimum Contribution of Rs ..... (Rupees ..... only).
- Profit Sharing Ratio (PSR) of the incoming partner will be in proportion to his capital contribution in the LLP

(ii) *Extent of Liability of the LLP*

- The LLP is not bound by anything done by a partner in dealing with a person if –
  - (1) the partner in fact has no authority to act for the LLP in doing a particular act; and
  - (2) the person knows that he has no authority or does not know or believe him to be a partner of the LLP.

(iii) *Arbitration*

- All disputes between the partners or between the Partners and the LLP arising out of the LLP Agreement which cannot be resolved in terms of this LLP Agreement shall be referred for arbitration as per the provisions of the Arbitration and Conciliation Act, 1996 (26 of 1996).

**Answer 5(c)**

**A Specimen of Deed of Assignment of a Patent**

THIS DEED OF ASSIGNMENT is made on this..... day of..... between AB son....., resident of..... (hereinafter called the “assignor”, which term shall include his heirs, executors and assigns) of the one part and CD, son of..... resident of..... (OR IN THE ALTERNATIVE IF THE PATENTEE ASSIGNEE IS A COMPANY)..... and..... Co. Ltd. (hereinafter called the “assignee”/“company” incorporated under the Companies Act having its Registered Office at.....) of the other part under the terms and conditions set hereunder:

WHEREAS the assignor has invented a process for the manufacture of..... which was duly registered and entered in the Register of Patents bearing No..... dated..... and duly sealed in the Patent Office:

AND WHEREAS the company is a company limited by shares incorporated under the Companies Act, on..... with an Authorised Share Capital of Rs..... divided into..... Equity Shares of Rs..... each;

AND WHEREAS it had been agreed between the parties to this Deed that in consideration of the assignment to be made by the assignor of his rights under the said Patent to the Company in the terms mentioned hereunder, for the sum of Rs..... (Rupees.....) to be satisfied by allotment of..... Equity Shares to the assignor and/or his nominees as fully paid up:

AND WHEREAS the directors of the Company in part-performance of the said agreement resolved in a Board meeting held on the..... to allot the requisite

number of Equity Shares at the direction of the assignor as specified in the Schedule attached hereto:

**NOW THIS DEED OF ASSIGNMENT WITNESSES:**

That in consideration of the premises and in accordance with the agreement aforementioned and on payment of the sum of Rs..... (Rupees.....) satisfied by the allotment of..... Equity Shares in the Company as specified in the Schedule attached hereto at the direction of the assignor by the Company, each Share being credited as fully paid up (the allotment of which shares credited as aforesaid the assignor hereby acknowledges) the assignor, as beneficial and sole owner, hereby assigns unto the Company his title to the said patent and all benefits and advantages accruing therefrom and all rights and privileges attached thereto to hold unto the Company absolutely.

The assignor covenants with the Company that he has not assigned or otherwise dealt with the said patent and that his title to the said patent subsists and that he has done nothing to prejudice the rights of the Company as transferee thereof to use the said patent exclusively.

The assignor further covenants with the Company that he shall join the Company in applying to the Central Government or other authority at the expenses of the Company, for extension of the said patent and shall do his utmost in obtaining such extension to ensure for the benefit of the Company and shall do nothing to prevent the Company from securing the extension and user of the patent in the manner prescribed by law, without the payment of any further consideration by the Company to the assignor.

The assignor further covenants with the Company that if during the currency of the said patent and the operation of the Company as a going concern, the assignor shall discover, invent or make any improvements in respect of the said invention or shall discover any other process or method for the manufacture of....., he will disclose the same to the Company and explain the new method of discovery to the Company and at the cost of the Company give such full particulars and exhibit and make such experiments as may enable the Company to make practical use of such method and discovery and join the Company in applying for patent for such new invention at the option of the Company and do all other acts and execute all such deeds as may be requisite therefor to vest in the Company all rights, title and interest in such new invention or improvement for the use and benefit of the Company.

IN WITNESS WHEREOF the parties aforesaid have set their respective hands in the presence of the witnesses hereunder.

Witness: Assignor

Witness: Assignee/Company

*Note* : In case the assignee is not a company the word 'assignee' will be substituted for 'company' and other suitable modifications will have to be made.

**Question 6**

(a) *Aviksh is the owner of a flat (Flat No. 304, admeasuring 1500 sq. ft.) in Poornaprajna Co-operative Housing Society Ltd.; the ownership of the said flat*

*is evidenced by Share Certificate No. PP 37. Aviksh now proposes to sell this flat to Sudharshini for a total consideration of ₹45 lakh. It is agreed that ₹15 lakh would be paid as earnest money at the time of execution of agreement to sell and the balance amount of ₹30 lakh would be paid upon execution of the deed of conveyance.*

*Draft an agreement to sell based on the above facts. Assume other data, where necessary. (8 marks)*

*(b) Explain the provisions of Appeal under Civil Procedure Code, 1908. What points are to be considered while drafting an appeal ? (8 marks)*

### **Answer 6(a)**

#### **Agreement to Sell**

THIS AGREEMENT OF SALE executed on the \_\_\_\_\_ day of \_\_\_\_\_ 2018, between

Mr. Aviksh, S/o \_\_\_\_\_ aged, \_\_\_ years, resident of \_\_\_\_\_ having Aadhar Number \_\_\_\_\_ hereinafter called the vendor of the one part and

Ms. Sudharshini, daughter of \_\_\_\_\_ aged \_\_\_ years, resident of \_\_\_\_\_ having Aadhar Number \_\_\_\_\_ hereinafter called the purchaser of the other part,

(The expressions “vendor” and “purchaser” wherever they occur in these presents, shall unless the context otherwise admits, also mean and include their respective heirs, executors, administrators, legal representatives and assigns).

WHEREAS the vendor is the sole and absolute owner of the Flat No. 304, admeasuring 1500 sq.ft. in Poornaprajna Co-operatives Housing Society Limited; the ownership is evidenced by Share Certificate No. PP 37, morefully described in Schedule hereto and hereinafter referred to as Schedule Property:

AND WHEREAS it is agreed that the vendor shall sell and the purchaser shall purchase the said property free of all encumbrances as per terms and conditions as hereinafter agreed:

#### **NOW THIS AGREEMENT OF SALE WITNESSETH AS UNDER:**

1. The Total consideration payable for the Schedule property shall be Rs. 45 lakhs (Rupees Forty Five lakhs only) free of all encumbrances.
2. The purchaser has paid toady a sum of Rs. 15 Lakhs (Rupees Fifteen Lakhs only) by way of earnest money for the due performance of this agreement, the receipt of which the vendor hereby admits and acknowledges.
3. The time for performance of the agreement shall be \_\_\_\_\_ months or such other mutually agreed date. It is agreed that time is the essence of this agreement.
4. The purchaser shall pay the balance amount of Rs. 30 Lakhs (Rupees Thirty Lakhs only) to the vendor at the time of registration of the conveyance deed.
5. The vendor agrees that he will deliver vacant possession of the property to the purchaser before registration of the conveyance deed.

6. The vendor shall execute the conveyance deed in favour of the purchaser or his nominee as the purchaser may require. The vendor shall hand over all the title deeds of the property to the purchaser or an advocate nominated by him within \_\_\_\_\_ days from the date of this agreement for scrutiny of title and the opinion of the vendor's advocate regarding title to the property shall be final and conclusive. The purchaser shall duly intimate the vendor about the approval of title within \_\_\_\_\_ days after delivering the title deeds to him or to his advocate.
7. The vendor shall not sell, dispose off or alienate the property on and from this date and in case of any breach hereof, this agreement to sell shall be voidable at the option of the purchaser.
8. If the purchaser commits a breach of the agreement, he shall forfeit the earnest amount of Rs. 15 lakhs (Rupees Fifteen Lakhs) paid by her to the vendor.
9. If the vendor commits a breach of the agreement, the vendor shall refund the earnest money of Rs. 15 lakhs (Rupees Fifteen lakhs) paid to him by the purchaser.
10. Nothing contained in paras 8 and 9 above shall prejudice the rights of the parties hereto specific performance of this agreement of sale/purchase.

IN WITNESS WHEREOF the vendor and the purchaser have set their respective hands to the agreement of sale/purchase on the day, month and the year above written, in the presence of the following witnesses:

Witnesses:

(1)

(2)

Sd/- Vendor

Sd/- Purchaser

#### **Schedule of Property**

Flat No. 304, admeasuring 1500 sq.ft. in Poornaprajna Co-operatives Housing Society Limited, the ownership is evidenced by Share Certificate No. PP 37. Bound on

North is \_\_\_\_\_

South is \_\_\_\_\_

East is \_\_\_\_\_

West is \_\_\_\_\_

#### **Answer 6(b)**

“Appeal” has not been defined in the Code of Civil Procedure, 1908 yet any application made by a party to an appellate forum asking it to set aside or revise a decision of a subordinate forum. A right of appeal is not a natural or inherent right but is a creature of a statute. It is the statute alone to which the Court must look to determine whether a

right of appeal exists in a particular instance or not. The right of appeal is not a matter of procedure, but is a substantive right and can be taken away only by a subsequent enactment, if it says so expressly or by necessary intendment and not otherwise.

An appeal may be divided into 3 parts :

- Formal part known as memorandum of appeal
- Material part or grounds of appeal
- Relief sought for

The memorandum of appeal must contain the name of the court in which it is filled, the number of the appeal and year in which it is filled. Then follows the names and address of the parties concerned. Thereafter, the grounds of appeal may be listed out.

While drafting the grounds of appeal,

- Grounds of objection should be written distinctly and specifically;
- They should be written concisely;
- They must not be framed in a narrative or argumentative form; and
- Each distinct objection should be stated in a separate ground and the grounds should be numbered consecutively.

It is an established practice to mention in the memorandum of the appeal, the relief sought by the appellant. It may be signed by the appellant himself or by his counsel. If there are several appellants and no counsel, it need to be signed by all of them. It is not required to be verified.

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**BANKING LAW AND PRACTICE**  
(Elective Paper 9.1)

Time allowed : 3 hours

Maximum marks : 100

**NOTE:** Answer **ALL** Questions.

**Question 1**

The following are the data of Shri Vigneshwar and Company Ltd. for the two years ended on 31-3-2017 and 31-3-2018 :

**Shri Vigneshwar and Company Ltd.**  
**Balance Sheet for the year ended on 31st March**

(Amount in ₹ 000's)

	2018	2017
<b>Assets :</b>		
Cash	1,26,000	1,14,000
Short—term investment	42,000	20,000
Debtors	60,000	50,000
Stock	38,000	28,000
Long-term investment	28,000	44,000
Machinery	2,00,000	1,40,000
Buildings	2,40,000	80,000
Land	14,000	14,000
<b>Total</b>	<b>7,48,000</b>	<b>4,90,000</b>
<b>Liabilities &amp; Equity :</b>		
Accumulated depreciation	1,10,000	60,000
Creditors	40,000	30,000
Bills Payable	20,000	10,000
Secured Loans	2,00,000	1,00,000
Share Capital	2,20,000	160,000
Share Premium	24,000	---
Reserves and Surplus	1,34,000	1,30,000
<b>Total</b>	<b>7,48,000</b>	<b>4,90,000</b>

**Shri Vigneshwar and Company Ltd.**  
**Income Statement for the year ended on 31st March 2018**

		(Amount in ₹ 000's)
Sales		2,40,000
Cost of goods sold		1,34,800
Gross Profit		1,05,200
Less :	Operating expenses	
	Depreciation-Machinery	20,000
	Depreciation—buildings	32,000
	Other expenses	<u>40,000</u>
		<u>92,000</u>
Net Profit from Operations		13,200
Gain on sale of long-term investment		<u>4,800</u>
<b>Total</b>		<b>18,000</b>
Less : Loss on sale of machinery		2,000
<hr/> <b>Net Profit</b>		<hr/> <b>16,000</b>

Note : The proceeds from the sale of machinery were ₹ 6,000.

From the data and details given above you are required to prepare :

- (a) Statement of sources and uses of Working Capital Funds. (25 marks)
- (b) Schedule of changes in working capital. (5 Marks)
- (c) Statement of sources and uses of cash. (10 Marks)
- (d) In the context of Vigneshwar and Company Ltd., please explain in brief the points of differences when it is taken to be not a company but a partnership Firm. (10 Marks)

**Answer 1(a)**

**Statement of Sources and Uses of Working Capital for the year ended on 31st March, 2018**

**Shri Vigneshwar and Company Ltd.**  
**Statement of Sources and Uses of Working Capital**  
**for the year ended on 31st March, 2018**

(Amount in Rs. 000's)

<u>Sources :</u>	
Working Capital from operations {WN (i)}	65,200
Sale of long-term investment	20,800
Sale of machinery	6000

Secured loans	1,00,000	
Share Capital	60,000	
Share Premium	<u>24,000</u>	<b>2,76,000</b>
Uses :		
Purchase of Machinery	70,000	
Purchase of Building	1,60,000	
Payment of Dividend	<u>12,000</u>	<b>2,42,000</b>
Increase in working Capital		<b>34,000</b>

*Working Notes (all the figures given in working notes are amount in thousand)*

(i) Working Capital from operations in found as follows:

<b>Net Profit</b>	<b>16,000</b>	
<i>Add :</i> Depreciation on		
Machinery	20,000	
Buildings	32,000	
Loss on sale of machinery	<u>2,000</u>	70,000
<i>Less :</i> Gain on sale of long-term investment		4,800
Working Capital from operations		<b>65,200</b>

- (ii) The comparative Balance Sheet indicates that long-term investments have decreased by Rs. 16,000, which is due to the sale of investments. On sale, a gain of Rs.4,800 is made. This means that the long-term investment must have been sold for cash of Rs. 20,800 (Rs.16,000 + Rs.4,800).
- (iii) The proceeds from the sale of machine, Rs. 6,000, have been reported as source of working capital.
- (iv) Secured loan increased by Rs. 1,00,000; thus providing working capital.
- (v) Share Capital together with share premium has contributed a working capital of Rs.84,000 (Rs.60,000 + Rs. 24,000).
- (vi) During the year working capital was utilized to acquire machinery of Rs.70,000. The opening balance of machinery account is Rs.1,40,000. After the sale of machinery costing Rs. 10,000, this balance at the close of the year should have been Rs.1,30,000. But the closing balance is Rs.2,00,000, which implies that machinery worth Rs.70,000 was acquired and funds were used.
- (vii) The cost of machinery sold has been worked out:

The accumulated depreciation has increased by Rs.50,000 (Rs.1,10,000-Rs.60,000). If we subtract depreciation on buildings, Rs.32,000, we are left with

the closing balance of accumulated depreciation of Rs. 18,000 for machinery. During the year depreciation provided on machinery is Rs.20,000. This means that the accumulated depreciation on machinery sold was Rs.2,000 (Rs.20,000-Rs. 18,000) which must have been written off at the time of the sale of machinery. The cost of machinery sold is : Sale proceeds, Rs. 6,000 plus accumulated depreciation, Rs.2,000, plus loss, Rs.2,000, i.e., Rs. 10,000.

- (viii) The increase in building by Rs. 1,60,000 is a purchase , using working capital funds.
- (ix) The net profits are Rs.16,000 , but the reserve has increased by Rs.4,000 only. This means that the difference, Rs. 12,000 (Rs.16,000 - Rs.4,000) must have been paid as cash dividends to the shareholder.

**Answer 1(b)****Schedule of Working Capital Changes***(Amount in Rs. 000's)*

	<i>Increase</i>	<i>Decrease</i>
<b>Current Assets :</b>		
Cash	12,000	
Short-term investments	22,000	
Debtors	10,000	
Stocks	10,000	
<b>Current Liabilities :</b>		
Creditors		10,000
Bills Payable		10,000
Increase in working Capital		34,000
	<b>54,000</b>	<b>54,000</b>

**Answer 1(c)****Statement of Sources and Uses of Cash  
For the year ended on 31st March, 2018***(Amount in Rs. 000's)*

<b>Sources :</b>		
Cash from operations	65,200	
Sale of long-term investments	20,800	
Sale of Machinery	6,000	
Secured Loans	1,00,000	
Share Capital	60,000	
Share Premium	24,000	<b>2,76,000</b>

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**Uses:**

Purchase of Machinery	70,000	
Purchase of Buildings	1,60,000	
Payment of dividend	12,000	
Purchase of marketable securities	<u>22,000</u>	2,64,000
Increase in cash		12,000

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**Working Note**

**Cash from operations is found as follows:**

(Amount in Rs. 000's)

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<b>Net Profit</b>	16,000	
<i>Add :</i> Depreciation - Machinery	20,000	
Depreciation- Building	32,000	
Loss on sale of Machinery	2,000	
Increase in Creditors	10,000	
Increase in Bills Payable	<u>10,000</u>	<b>90,000</b>
<i>Less :</i> Gain on sale of Long Term Investments	4,800	
Increase in Debtors	10,000	
Increase in Stock	<u>10,000</u>	<b>24,800</b>
<b>Cash from Operations</b>		<b>65,200</b>

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**Answer 1(d)**

The major distinction between a Company and a Partnership Firm can be summarized as under:

(a) *Registration*

Registration of a Company is compulsory under the Companies Act, 2013. Registration of a Partnership is not compulsory under the Indian Partnership Act, 1932.

(b) *Number of Members/Partners*

Minimum of two in case of a One Company, and of two hundred in case of a private company, one person can be a Director and a minimum of seven and no limit on maximum number of members in case of a public company.

Minimum number of two persons required to form a partnership. The maximum number is ten for banking business and twenty for any other business.

(c) *Legal Status*

A company has a legal existence separate from its own members and is viewed

as a separate legal person from its members. A firm does not have a separate legal existence different from its own partners.

(d) *Ownership of Property*

The property of the company is owned by the company itself and not its members as the company has a separate legal existence. The property of the firm is owned by the partners themselves and not by the firm as a firm does not have a separate legal existence different from its own partners.

(e) *Management*

The company is managed by a Board of Directors elected by the shareholders. A partnership is managed by the partners except the dormant and sleeping partners.

(f) (i) *Perpetual Existence*

A company has a perpetual existence, whereas a partnership does not have a perpetual existence.

(ii) *Contracts*

A member of the company can contract with the company. A partner cannot contract with the partnership firm.

(g) *Liability*

Except in case of a company with unlimited liability, the liability of the members of the company is limited. The liability of partners in a partnership is unlimited.

(h) *Transfer*

A transferee of shares in a company becomes a member of the company and the consent of all members is not required to become a member. A person can become a partner in a partnership firm with the consent of all the parties.

(i) *Death*

The death of any or all members of the company does not determine (end) the existence of the company. Death of a partner dissolves the partnership deed, unless the partnership deed provides otherwise.

(j) The members of a company are not the agents of each other or of the company.

Every partner of a firm is an agent of the other.

**Question 2**

(a) *Explain the reasons in brief for the following statements in the context of practices prevailing under the banking :*

(i) *Additional credit facilities are not extended by the bank to wilful defaulters or group defaulters.*

(ii) *A board resolution is obtained by the bank from a company ratifying the excess drawings permitted to the company, in case drawings in excess of the limit are permitted.*

(iii) *While creating equitable mortgage, nothing in writing should be obtained from the person creating the mortgage.*

- (iv) *A very high current ratio is not a welcome sign.*
- (v) *DSCR of less than 1 is not considered good for sanction of Term Loans (generally the norm is 2 : 1).*

*(3 marks each = 15 marks)*

(b) *Explain the following statements by giving brief reasons in the context of provisions-contained under Banking Regulation Act and the prevalent banking practice by referring the provisions of Negotiable Instrument Act ?*

- (i) *Paying banker is not concerned with the account payee crossing.*
- (ii) *Even though a contract with a minor is void, the bank opens a savings bank account in the name of a minor.*
- (iii) *Insolvency proceedings are not initiated against minors.*
- (iv) *Reserve Bank of India (RBI) has asked banks to make available 'no frills' account.*
- (v) *A term deposit receipt is paid on the succeeding working day to a holiday whereas a bill of exchange is paid on the preceding working day.*

*(2 marks each = 10 marks)*

(c) *Ganesh has taken a loan of ₹5 million against mortgage of a commercial property valued at ₹20 million. The KYC and credit information collected during the opening of the account showed that Ganesh was a real estate developer and also a trader in commodities. He has declared an average income of ₹3 million during the last three years. He has also been maintaining a current account with the same bank. After six months of taking the loan, Ganesh came with a request to pre-close the loan account. Bank calculated the amount to be repaid and add the pre-closure penalty and as per the instructions of the customer, transfer the amount from his current account. After about two months, the customer again comes and requested for a loan of ₹10 million against mortgage of the same property.*

*In the backdrop of above, explain how the situation will be dealt with by the bank.*

*(5 marks)*

### **Answer 2(a)**

- (i) *Wilful defaulters are those who have not effected repayment of the loans despite generating profits by diverting funds. They do not follow the terms and conditions of the advance and are not desirable/dependable customers. RBI has also advised that the borrower whose name appears in the list of wilful defaulters released by them should not be financed for at least 5 years from the date of the release . In this case of group borrowers, non payment by one/two borrowers affect the group image and pose problems for the bank in renewal/recovery of the loan.*
- (ii) *As per Section 179(3) and 180(1)(c) of the Companies Act, 2013 the power to borrow is vested with the Board of Directors, they should exercise this power by means of resolutions passed at meeting of the Board. Any excess drawings*

have to be authorised by a board resolution. Otherwise, it will not be binding on the company; Further also it may also not bind the company even if the excess drawings have been liquidated subsequently.

- (iii) If any instrument is signed by the mortgagor while he creates an equitable mortgage, it may be contended that the mortgage is a registered mortgage. It is inadmissible as evidence, as no stamp duty has been paid on it. The documents has not been registered with Registrar of Assurances. Therefore nothing in writing be obtained from the person who is creating an equitable mortgage.
- (iv) Current Ratio is the index of the borrower's liquidity. If the ratio is very high it will put the bank on the alert as it may be due to inefficient working capital management, manipulation in the quality/valuation of stocks, large concentration of unsold goods/unrealised book debts, etc have taken place.
- (v) DSCR is the ratio of annual cash accruals to the amount of term loan instalments and DPG instalments payable in the year. Cash accruals should be adequate to provide for fluctuations in business, increased margin for working capital, etc. If it is less than 1, the cash accruals are not sufficient to meet term loan instalments and DSCR is not adequate, thereby the repayment will be affected.

#### **Answer 2(b)**

- (i) The 'Account Payee' crossing is a mandate to the collecting banker; the Bank has to ensure that the cheque is not collected for a third party. This mandate is not addressed to the paying banker. However, it is to be noted that it is banking practice for the paying banker to return cheques if third party endorsements are found on them as payment may be found as 'not in due course'.
- (ii) To enable minors to get their 'Necessaries' in life as well as to encourage thrift in them; the ceiling on the deposits is comparatively low. The Bank takes a calculated commercial decision. Withdrawal is restricted to the minor only against his receipt and hence receipt of the moneys cannot be denied by him.
- (iii) A contract with a minor is void as per Section 11 of the Indian Contract Act, 1872. This protection is given, to the minor to ensure that he will not incur any liability by way of debts. An insolvent is a person who is incapable of entering into contracts. As a minor cannot enter into a contract for debts he cannot be declared insolvent.
- (iv) To make banking services accessible to more people RBI has advised that such accounts should have "nil" or "very low" minimum balances. The prescription of high minimum balance by some banks has led to the exclusion of large number of people from the banking arena. It will act as a level playing field among foreign/ private banks and public sector banks.
- (v) Under Section 25 of Negotiable Instrument Act, if a bill of exchange falls due on a holiday, it is deemed to be due on the immediately preceding working day. This uniform rule helps business people to discharge their liabilities on the due date as also arrange for banking transactions smoothly. The Banks pay interest for the holiday if the TDR matures on a holiday in terms of RBI instructions, as the benefit of funds is enjoyed by the banks. Hence, the TDR is payable on the

next working day. It is also to be noted that if the term deposit is repaid the previous working day, the customer will lose one day's interest, which will affect his benefit

### Answer 2(c)

At the time of lending, the banker enquires from the borrower the purpose for which he seeks the loan. Banks do not grant loans for each and every purpose—they ensure the safety and liquidity of their funds by granting loans for productive purposes only, viz., for meeting working capital needs of a business enterprise. Loans are not advanced for speculative and unproductive purposes like social functions and ceremonies or for pleasure trips or for the repayment of a prior loan. Loans for capital expenditure for establishing business are of long-term nature and the banks grant such term loans also.

In present case, first of all, it has to be seen how the current account was funded for the earlier pre-closure. If these were through cash deposits or other deposits that cannot be connected to his business or personal finance, then Bank have to file a Suspicious Activity Report (SAR). If the funding is through genuine business receipts or transparent personal financial transactions, you may seek further clarifications from the customer through normal queries like the purpose of taking the loan, how he intends to repay, etc., and if you are satisfied with the responses, go ahead with the transactions in the usual course of business.

### Question 3

*“Akshay” wants to take a loan of ₹ 10,000 from “Bharat”, but “Bharat” does not know “Akshay” very well and fears that “Akshay” may not return the money. “Chandar” is a good friend of “Akshay”. “Chandar” tells “Bharat” that if “Akshay” does not return the money to “Bharat”, “Chandar” will personally, pay it to “Bharat”. Under this assurance by “Chandar” to “Bharat”, “Bharat” lends the money to “Akshay”. On the date on which the money was to be returned, “Akshay” fails to pay back ₹ 10,000. Can “Bharat” now, demand this money from “Chandar”? Respond in detail in the context of the relevant provisions of the law. Support your answer with a decided case law, if any.* (5 marks)

### Answer 3

Yes, he can. The contract, described above is called a Contract of Guarantee. This contract involves three persons. Under the above illustration, “Akshay” is the Principal Debtor, “Bharat” is the Creditor. “Chandar” is the Surety. Therefore, in the above scenario, “Chandar” shall pay to “Bharat” Rs. 10,000/-.

However, it is important to note that the contract does not end here. “Bharat” can, after he has paid the amount to “Chandar”, claim the same amount from “Akshay”. This is the unique feature of a Contract of Guarantee. There are actually two separate agreements each between two of the parties. The first is an express contract between the person standing guarantee (surety) and the person to whom the guarantee is made (creditor). The second agreement is between the person who is being guaranteed (principal debtor) and the surety and this is an implied contract.

The essence of guarantee is that a guarantor agrees to discharge his liability in the happening of one event, i.e., when the principal debtors fails in his duty. The surety

should undertake to perform the promise or discharge the liability of a third person in case of his default. A contract of guarantee must be supported by consideration and consideration between the creditor and principal debtor is a valid and good consideration for the guarantee given by the surety. Injunction against encashment of bank guarantee without establishing fraud or irretrievable injustice not granted (*Dodsai Ltd. Vs. Krishak Bharati Co-operative Ltd.*). An unconditional irrevocable bank guarantee provides, inter alia, for encashment on demand without demur.

#### Question 4

*While closing its books of account on 31<sup>st</sup> March, 2018, a branch of commercial bank finds that :*

- (i) On a Term Loan of ₹ one lakh fifty thousand, quarterly interest due on 29<sup>th</sup> September, 2017, 29<sup>th</sup> December, 2017 and 29<sup>th</sup> March, 2018 has not been received and served. (2 marks)*
- (ii) The outstanding balance of an overdraft account has been continuously in excess of the sanctioned limit of ₹ one lakh since 14<sup>th</sup> May, 2017 till 31.03.2018. (2 marks)*
- (iii) ₹75,000, the amount of discounted bill was due on 17<sup>th</sup> February, 2018 but the same has not been received and the bill was dishonoured. (1 mark)*

*Explain with reasons which of the abovementioned credit facilities will be treated as NPA on 31<sup>st</sup> March, 2018.*

#### Answer 4(i)

According to the guidelines of the Reserve Bank of India, a term loan is to be treated as a Non-Performing Asset (NPA) if interest and/or instalment of principal remains overdue for a period of more than 90 days. In the given case, interest due on 29<sup>th</sup> March, 2018, has not become overdue for a period of more than 90 days but interest due on 29<sup>th</sup> December, 2017 and interest due on 29<sup>th</sup> September, 2017 have become overdue for periods of more than 90 days. Hence, the term loan is to be treated as NPA on 31<sup>st</sup> March, 2018.

#### Answer 4(ii)

As per the guidelines of the Reserve Bank of India, an overdraft account is treated as NPA if it remains out of order for a period of more than 90 days. One of the ways, an overdraft account may become out of order is that it remains continuously in excess of the sanctioned limit. In the instant case, the overdraft account has been out of order for more than 90 days. Hence, it is to be treated as NPA.

#### Answer 4(iii)

As per the relevant guidelines of the Reserve Bank of India, bills purchased and discounted are treated as NPA if they remain overdue and unpaid for a period of more than 90 days. In the present case, the discounted bill has not yet remained overdue for more than 90 days. Hence, it is not to be treated as NPA.

**Question 5**

*Vinayak maintains an account with the bank. A court attachment order for ₹ 10,000 on the account is received. State the action that will be taken in the following situations :*

- (i) *Vinayak also maintains a joint account with Geetha (his wife) and the credit Balance in the account is ₹ 1,000.*
- (ii) *Vinayak has tendered ₹ 5,000 for purchase of a draft.*
- (iii) *A credit voucher for ₹ 3,000 being collection of cheque realized has been released.*
- (iv) *Vinayak's current account has been overdrawn by ₹ 2,500.*
- (v) *Vinayak has tendered a clearing cheque for ₹ 2,000 which will be presented in clearing on next day. (1 mark each = 5 marks)*

**Answer 5**

- (i) As the attachment order is in the sole name of Vinayak, the joint account is not attached.
- (ii) Only debts 'owing and accruing due' to the judgement debtor at the hands of the Bank are attached by a Garnishee order. The amount tendered for purchase of a draft is entrusted for a specific purpose, and therefore, cannot be considered a debt; hence it is not attachable.
- (iii) If at the time of the receipt of the Garnishee Order, the proceeds of the cheque sent for collection have been realized, this amount would also have to be included in the balance.
- (iv) In the instant case, as no amount is owed to Vinayak, the account is not attached.
- (v) The clearing cheque will be presented in clearing only the next day, and, therefore, it is a future credit. Thus is not attached.

**Question 6**

*Choose the correct answer with reason (s)/justification in each case, out of the given alternatives :*

- (i) *Money Laundering refers to :*
  - (a) *Transfer of assets/cash from one account to another.*
  - (b) *Conversion of illegal money through banking channels.*
  - (c) *Conversion of cash into gold for hoarding.*
  - (d) *Conversion of assets into cash to avoid income tax.*
- (ii) *While opening an account in the name of a company, the most important document to be seen is :*
  - (a) *List of employees/directors of the company.*

- (b) *List of promoters/shareholders of the company.*
- (c) *Memorandum and Articles of Association of the company.*
- (d) *Instructions of the Registrar of Companies.*
- (iii) *The objective/s of the USA Patriot Act is/are :*
  - (a) *Establish minimum procedures to identify verifications when new customer opens accounts.*
  - (b) *Cross check account holder names against all government lists of known or suspected terrorist organizations.*
  - (c) *Create internal AML policies and procedures and institute training programmes.*
  - (d) *All the above.*
- (iv) *In terms of the Banking Regulation Act, records means :*
  - (a) *Account opening forms*
  - (b) *Vouchers*
  - (c) *Ledgers / Registers*
  - (d) *All the above*
- (v) *At what point the Politically Exposed Persons (PEP) check is done :*
  - (a) *At the first point of customer interaction*
  - (b) *At the Account Services Level*
  - (c) *At the Central Account Services Level*
  - (d) *One-month after the account is opened.*

(1 mark each = 5 marks)

**Answer 6(i)**

- (b) *Conversion of illegal money through banking channels.*

**Answer 6(ii)**

- (c) *Memorandum and Articles of Association of the company.*

**Answer 6(iii)**

- (d) *All of the above.*

**Answer 6(iv)**

- (d) *All of the above.*

**Answer 6(v)**

- (a) *At the first point of customer interaction.*



**CAPITAL, COMMODITY AND MONEY MARKET**  
(Elective Paper 9.2)

Time allowed : 3 hours

Maximum marks : 100

**NOTE:** Answer **ALL** Questions.

**Question 1**

*Parimal Pharma Ltd. sold its few brands to another pharmaceutical company namely Areva Ltd. for a sum of ₹6,000 crore.*

*Number of options were available to Parimal Pharma Ltd. to deploy these funds to generate profits for the company.*

*A team was constituted to decide and finalize the following proposals :*

- (I) ₹2,000 crore shall be invested in the equity of various companies as a strategic partner.*
- (II) ₹1,500 crore shall be used to provide inter-corporate loans as to provide yield of 12%.*
- (III) ₹1,500 crore shall be used to buy back its own equity shares having face value of ₹10 each at a price of ₹3,000 per share (present market price of ₹2,400 per share) being 10% of the paid up equity share capital of the company by way of tender route wherein promoters also intend to participate.*

*Promoters hold 75% equity shares in the company.*

- (IV) ₹500 crore were allocated to a team which will actively participate in capital and commodity market to generate a return of 15%.*

**Proposal I(a)** *₹2,000 core shall be invested in the equity of various companies as a strategic partner :*

- (i) ₹500 crore were invested in a listed company and after one year the investment was sold at a profit of 35%.*
- (ii) ₹1,000 crore were invested in a unlisted company by purchasing 5 crores shares of ₹10 each at a premium of ₹190 each. The company came out with a public offer and all these shares were offered for sale in the public offer at a premium of ₹240 per share. Issue was subscribed and the proceeds were received by the company after deducting a sum of ₹15 crore towards expenditure.*
- (iii) The remaining investment of ₹500 crore was made in PQR Ltd. by purchasing 2 crore shares at an average price of ₹250. These shares were sold in a block deal at the rate of ₹235 per share in the NSE.*

*Calculate the total profit/loss made for the above said activities of investments.*

*(8 marks)*

**Proposal II (b)** ₹1,500 crore shall be used to provide inter-corporate loans to provide yield of 12% :

- (i) ₹1,000 crore were given to A Class Ltd. @ 10 percent per annum. Amount was received with interest at the end of a year. Parimal Ltd. waived the interest for 6 months and the loan was sold with a hair cut of 40%.
- (ii) ₹500 crore were given to Z Ltd. @ 20% p.a. Interest was received for 6 months. The company became a defaulter and the case against the Z Ltd. was filed with NCLT. Parimal Ltd. waived the interest for 6 months and the loan was sold with a hair cut of 40%.

Calculate profit/loss made by the department. (8 marks)

**Proposal III (c)** ₹1,500 crore shall be used to buy back its own equity shares having face value of ₹10 each at a price of ₹3,000 per share (present market price of ₹2400 per share) being 10% of the paid up equity share capital of the company by way of tender route wherein promoters also intend to participate. Promoters hold 75% equity shares in the company.

- (i) Prepare a Board note to be placed in the Board Meeting. (5 marks)
- (ii) Mention stepwise procedure to be adopted. (5 marks)
- (iii) State the reservation to be made for small shareholders together with the relevant statutory provisions thereon. (3 marks)
- (iv) Calculate the total share capital in numbers as well as amount and also the number of shares held by promoters. (3 marks)

**Proposal IV (d)** ₹500 crore were allocated to a team which will actively participate in capital and commodity market to generate a return of 15% :

- (i) 1,00,000 nifty future were purchased @ ₹10,485 and equivalent nifty call at the strike price of ₹10,500 was sold @ ₹80. At the end of the month nifty closed at 10,455. Calculate profit/loss. (3 marks)
- (ii) 1,00,000 shares of Symphosis Ltd. were purchased at an average price of ₹1,200 in the cash market and the equivalent amount of shares was sold in the derivative market at ₹1,208. At the end of the month the shares were sold at an average price of ₹1250 and the future was also settled at ₹1250. Calculate profit/loss in the transaction. (3 marks)
- (iii) Call option of Surf Ltd. were purchased for 1,00,000 shares at the strike price of 1300 @ ₹26 and call option of 2,00,000 shares at the strike price of 1400 were sold @ ₹9. At the end of the month the price of Surf Ltd. was settled at ₹1,320. Calculate profit/loss. (3 marks)

- (iv) Call option of Honda Ltd. at the strike price of ₹3,500 was sold for ₹46 for 1,00,000 shares. Put option for equivalent number of shares at the same strike price was also sold for ₹54. At the end of the month the price was settled at 3,640. Calculate profit/loss in the transaction. (3 marks)
- (v) Call option of Excellent Cement Ltd. at the strike price of ₹1,500 was purchased at ₹45 for 1,00,000 shares. Put option for equivalent number of shares at the same strike price was also purchased for ₹54. At the end of the month the price was settled at ₹1,740. Calculate profit/loss in the transaction. (3 marks)
- (vi) Presuming that the activities of this team generates similar kind of profit for 12 months, what shall be the profit/loss in percentage terms on the investment made by this team. (3 marks)

**Answer 1****Proposal I(a)(i)**

Investment	INR 500 Crores
Profit @35%	INR 175 Crores

**Proposal I(a)(ii)**

Bought - 5 Crore Shares @ 200	INR 1000 Crores
Sold - 5 Crore Shares @ 250 (In a Public Offer)	INR 1250 Crores
Expense Incurred	INR 15 Crores
Net Received Income	INR 1235 Crore
<b>Profit Made INR 1235-1000 Crore = INR 235 Crores</b>	

**Proposal I(a)(iii)****Investment in PQR Limited**

Bought - 2 Crore Shares @ 250	INR 500 Crores
Sold - 2 Crore Shares @ 235	INR 470 Crores
Net Loss in the Deal	INR 30 Crore

**Total Profit/ Loss Account**

1. Profit = INR 175 Crore
2. Profit = INR 235 Crore
3. Loss = INR 30 Crore

**Net Profit = INR 175 (+) 235 (-) 30 = INR 380 Crore**

**Proposal II(b)(i)**

Loan to A Class Limited	INR 1000 Crores
Interest Earned @ 10% for 6 Months	INR 50 Crores
Company Waived the Interest for Next 6 Months	
Loan Sold at the Hair Cut of 40%	
Hair Cut @ 40%	INR 400 Crore
Net Amount Received	INR 600 Crore
Net Loss (INR 400 Crore – INR 50 Crore)	INR 350 Crore

**Proposal II(b)(ii)**

Loan to Z Limited	INR 500 Crores
Interest Earned @ 20% for 6 Months	INR 50 Crores
Company Waived the Interest for Next 6 Months	

**Loan Sold at the Hair Cut of 40%**

Hair Cut @ 40%	INR 200 Crores
Net Amount Received	INR 300 Crores
Net Loss: INR 200 – 50 Crores	INR 150 Crores

**Loss on Loan to A Class Limited = INR 350 Crore**

**Loss on the Loan given to Z Limited = INR 150 Crore**

**Net Loss to the Department = INR 500 Crore**

**Proposal III(c)(i)****Broad Note**

The company has surplus fund. The company can declare one time high dividend. However due to the sale to the bonds, the turnover and profitability from its manufacturing operations might come down.

In this scenario, it is suggested that

- Instead of dividend, the company can opt out for buy-back of shares.
- This will revert the state of the receipt by many of the shareholders including the promoters.
- The share capital will come down. So that the company need to serve less paid up share capital
- It would not change the voting pattern of the shareholders in percentage terms.
- The company shall be able to maintain the EPS on that paid up capital.

Submitted for discussion.

**Proposal III(c)(ii)****Stepwise Procedure**

- a. Appeal/Submission in the Board Meeting.
- b. Resolution by Shareholders to Approve the Buy-Back.
- c. An amendment to its intention of Buy-Back in the newspaper.
- d. Notice to the Stock Exchange of Board Meeting
- e. A decision to be approved for quantum as well as for price.
- f. Fixing record date for the purpose of entitlement determination for the purpose of Buy-Back.
- g. On the receipt of clearance from SEBI, one should send letter of offer.
- h. Open an escrow account.
- i. After the receipt of sums, decide on the acceptance of board on over subscription.
- j. Make Payment in escrow accounts.
- k. Advertisement funding details of receipt of application/acceptance and also give details of charges in the shareholding pattern in different agencies.

**Proposal III(c)(iii)****Reservation for Small Shareholders**

Number of Shares to be purchased under Buy Back

$$= \text{INR } 1500 \text{ Crores} / 3000 = 50,00,000$$

It means that total share to be purchased under Buy Back = 50,00,000

Thus the total number of shares outstanding = 5 crore (Buy Back being 10% of total outstanding)

15% should be reserved for the small shareholders =  $50,00,000 \times 0.15 = 7,50,000$  Shares or INR 225 Crores

Entitlement - To be decided on the record date based on shares held.

All the share-holders holding the shares in the market value of less than INR 2 lacs as on record date shall be deemed as Small Shareholders.

**Proposal III(c)(iv)**

Number of Shares to be purchased under Buy Back

$$= \text{INR } 1500 \text{ Crores} / 3000 = 50,00,000$$

Total Number of Shares to be purchased under Buy Back/0.10

$$= 50,00,000/0.1 = 5,00,00,000$$

In amount terms = INR 50 Crores (5 Crore x 10)

Promoters Equity : 75% that is 75% of 5 crores = 3.7 crores (sum of 10 each)

Total Amount = INR 37.50 Crores.

**Proposal IV(d)(i)**

1,00,000 Nifty Future Purchase	@ 10, 485
1,00,000 Nifty Future Sale	@ 10,455
Net Loss in the Purchase and Sale	INR 30 Per Nifty
Total Loss (1,00,000 x 30)	INR 30,00,000

Nifty Call of 10,500 Strike Price was sold at INR 80.

Since the price settled at less than 10,500, the company carried at the due money.

Profit reached on 1,00,000 Nifty @ 80 = INR 80,00,000/-

Net Position

Profit on Call = INR 80,00,000

Loss on Nifty Future = INR 30,00,000

**Net Profit on this Transaction – INR 50,00,000**

**Proposal IV(d)(ii)**

Cost of 1,00,000 Share of Symphosis = 1,00,000 x 1200 = INR 12,00,00,000

Shares Sold @ 1250 = 1,00,000 x 1250 = INR 12,50,00,000

Net Profit (i) = INR 50,00,000

Symphosis Sold the shares in Derivative Market = @1208

Shares Purchased in Derivative Market = @1250

Total Loss = 1,00,000 x 42 (ii) = INR 42,00,00

**Net Profit and Loss in the Transaction**

Profit in Cash Market (i) = INR 50,00,000

Loss in Derivative Market (ii) = INR 42,00,000

**Net Profit = INR 8,00,000**

This is called arbitrage.

**Proposal IV(d)(iii)**

Call Option Purchase @ 26 on a Strike Price of 1300

Purchase Price Per Option = 26

Future settled @ 1320

Hence may receive at the Strike Price of 1300 = 20

**Loss Per Option = 6**

**Net Loss on 1,00,000 @6 = INR 6,00,000**

2,00,000 options were sold at the strike price of INR 1400 @ 9

Price settled at 1320, which is less than strike price. All the sale value of option will be profit.

**On 2,00,000 Shares @ INR 9 = INR 18,00,000**

**Net Profit/Loss**

Loss on Option Purchase = INR 6,00,000

Profit on Sale of Options = INR 18,00,000

**Net Profit = INR 12,00,000**

**Proposal IV(d)(iv)**

Call Option of Honda Ltd. At the Strike Price of INR 3500 sold @ 46

Price Settled @ 3640

Amount Per Option to be paid 3640-3500 = 140

Loss Per Option = 94

**Loss of 1,00,000 Shares = INR 94,00,000**

Put Option of Honda Limited at Strike Price of 3500 are sold @ 54

Since the price settled at 3640, no money was to be paid after the out option.

Profit Per Option = INR 54,00,000

Loss on Call Option = INR 94,00,000

**Net Loss on this Transaction = INR 40,00,000**

**Proposal IV(d)(v)**

Excellent Cement Ltd. Purchased the Call Option at the strike price of 1500 = @ 45

Price settled at 1740.

Amount to be received per option = 1740 – 1500 = INR 240

**Net Profit per Option = INR 240-45 = INR 195**

**Total Profit per Option = INR 195 x 1,00,000 = INR 1,95,00,000**

Put Option purchased at the strike Price of 1500 @ 54.

Since the Price settled at 1740, no amount was received against the Put Option.

Loss per Option = 54

Net Loss on 1,00,000 per option = INR 54,00,000

**Total Profit/Loss**

Profit on Call Option = INR 1,95,00,000

Loss on Put Option = INR 54,00,000

**Net Profit of Transaction = INR 1,41,00,000**

**Proposal IV(d)(vi)**

In Aggregate the Profit is –

**Net Profit or Loss for each activity**

Net Profit	=	INR 50,00,000
Net Profit	=	INR 8,00,000
Net Profit	=	INR 12,00,000
Net Loss	=	INR 40,00,000
Net Profit	=	INR 1,41,00,000
Total Profit by Department in One Month	=	INR 1,71,00,000
Profit for Total 12 Months	=	INR 20,52,00,000

**In percentage term on an investment of INR 500 Crores in a year = 4.104%**

**Question 2**

- (a) *A company by way of resolution authorised foreign participation in the equity share capital of the company to the extent of 74%. After obtaining all necessary approvals this was implemented and share of foreign participation reached to the extent of 74% of the total paid up capital of ₹500 crore divided into 50 crore shares of ₹10 each. The foreign participants could not purchase further shares of the company after it reached its limit.*

*Due to issue of sweat equity shares, the paid up share capital of the company increased from ₹500 crore to ₹600 crore divided into 60 crore shares of ₹10 each, resulting into the reduction of foreign participation in equity share capital in percentage terms.*

*In what way the company can further allow foreign participation in the equity capital of the company and to what extent so that it can again reach to the limit of 74% of the total paid up share capital of the company.*

*As a Company Secretary, prepare a Board note giving complete calculation and the procedure involved in this case. The note must also include whether leakage of the information will be a matter of Insider Trading in terms of various regulations.*

*(10 marks)*

- (b) *You are a financial consultant and advisor providing advice to the investors. M.M. Khanna an investor approached you and presented the following facts :*
- (1) He has an investment of ₹50 lakh in various equity schemes of Mutual Funds with an option of dividend pay-out.*
  - (2) On an average he gets ₹3.50 lakh as dividend per annum besides appreciation.*
  - (3) He is a retired person and need this money to meet his expenditure.*
  - (4) He has learnt that Government has introduced 10% dividend distribution tax on the dividend paid by mutual funds as it is to be paid by various companies at the time of making payment.*

*In this scenario, MM Khanna seek your advice on the following points :*

- (i) What is the dividend distribution tax and whether as a senior citizen he will get an exemption from this tax ?*
  - (ii) Will it be deemed as a tax deducted at source and can he claim this as advance tax paid by him ?*
  - (iii) What will be the impact on his investment in mutual funds due to this dividend distribution tax ?*
  - (iv) What is the alternative available so that he gets money from time to time to meet his day to day expenditures and his investments do not attract dividend distribution tax also.*
  - (v) In case he switch over to any Debt Scheme of Mutual Fund on dividend/ interest payment basis, will it be beneficial for him in tax savings. (10 marks)*
- (c) Board Meeting of Trust Bank was to take place at 2.00 p.m. on 23rd October, 2017 to take on record the results for the quarter ending 30th September, 2017. There was sharp movement in stock price of Trust Bank from 11 a.m. onwards on 23rd October 2017.*

*The matter came to the notice of NSE (National Stock Exchange).*

*On enquiry, it was noted that son of an Independent Director who was in possession of agenda of the Board Meeting, flashed the results on whatsapp group. Hence the people in that particular whatsapp group were in possession of results before the Board Meeting.*

*In this scenario offer your comments :*

- (i) Who are the people against whom the SEBI can take an action under SEBI (Prohibition of Insider Trading) Regulations, 2015 ?*
- (ii) Steps to be taken by Managing Director to avoid such type of violation in future.*
- (iii) Prepare a note as a Company Secretary for the management on this matter and also suggestons to the management so that such type of violation does not take place in future. (10 marks)*

### **Answer 2(a)**

In order to attract the employees, the company makes a scheme to offer sweat equity to the employees. In fact there is wealth creation amongst the employees due to sweat equity.

### **Board Note:-**

- The Management of the Company is preferential wherein the share of the Premier is 10%
- Due to its performance, foreign participation remains very high and the limit of 74% is fully held by foreign participants.

In 2010, the foreign participants was:-

Paid Up Capital -	INR 500 Crore
Foreign Participants @ 74%	INR 370 Crore

- Given the fact, that the limit was reached, foreign participants were not allowed to purchase share of the company from the share market.
- Now the paid up share capital has increased to INR 600 Crore and thus foreign participants can increase their shares to INR 424 Crores i.e. by INR 74 Crore.
- It means foreign participants can buy shares from the share market to the extent for the limit of INR 74 Crore, that is around 7,40,00,000 shares of INR 10 each.
- Necessary approval from RBI, NSE, BSE and other authorities can be taken as a procedural matter.
- It does not require approval from shareholders.
- Due to the demand of the stock of the foreign participants, the share will be purchased from the share market and there will be purchase movement of share price as soon as the participants of foreign participants will be allowed.
- Since, it is a price sensitive information, all the rules of confidentiality and permissions of various regulations of Insider Trading shall be adhered too.

### **Case Study**

Bringing the figures, this is the case of HDFC Bank, wherein foreign participation was allowed. The price of HDFC Bank in the share market was up sharply, the day the trading was opened in the share market. Regularly the stocks kept a strong vigilance and participation of foreign participants, which gets stopped during the trading hour at 1:30 PM. This was a unique case in the history of stock market in India, wherein the interest of foreign participants was at peak. Thanks to the excellent performance of HDFC Bank.

### **Answer 2(b)(i)**

There was no dividend distribution tax on the equity schemes of Mutual Funds.

Dividend Distribution Tax means that whatsoever the dividend is declared by the Equity Scheme of Mutual Fund, 10% of dividend amount payable shall be allocated as the Dividend Distribution Tax and to be deposited with the Tax Authorities. The dividend amount so received by the holder of units shall be tax free.

There is no provision of any exemption for senior citizens. The tax is payable by Mutual Funds and the dividend so received by all the unit holders is tax free in their hands.

### **Answer 2(b)(ii)**

This will not be deemed as tax deducted at source and shall not be deemed as advance tax. However dividend in the hands of unit holders irrespective of age will be tax free and will not attract any taxes.

**Answer 2(b)(iii)**

Yes, there will be impact on the investment in mutual fund, which could be understood by simple example.

Suppose, an investor hold 10,000 units in HDFC Small Cap Fund and the NAV on the date of declaration. The record rate of the dividend is Rs. 30. Dividend declared is INR 3 per unit. In this case, INR 0.30 has to be departed as the tax deducted at source.

NAV	–	INR 30
Dividend	–	INR 3
Dividend Distribution Tax	–	INR 0.30
NAV after Dividend	–	INR 26.70

Before the Dividend Distribution Tax, the NAV would have been INR 27. As such the value of Investment shall go down to the extent of Dividend Distribution Tax.

**Answer 2(b)(iv)**

The best alternative is to convert the investment from dividend payment to Guarantee Scheme. Option may be taken of SWP (Systematic Withdrawal Plan). It means a specific amount shall be withdrawn from the equity scheme of Mutual Funds and shall be credited back to the account of the investor. Whether it is dividend or withdrawal, it comes from the investment of investors only and as such one has to be prudent in taking decisions.

**Answer 2(b)(v)**

It shall not be beneficial to switch over to a debt scheme, because the Dividend Distribution Tax in Debt Scheme of Mutual Fund is much higher than the Dividend Distribution Tax in Equity Scheme of Mutual Funds.

**Answer 2(c)(i)**

SEBI can take action against the company, CEO, Company Secretary, Independent Directors, also against the Son of the Independent Director.

CEO and Company Secretary failed to keep the confidentiality. Independent Director should have kept the agenda under Lock and Key and it was his basic responsibility to maintain the confidentiality.

Son of Independent Director is not supposed to go through the Agenda Papers and on Top of it, circulation of results on WhatsApp Group is certainly not desirable.

**Answer 2(c)(ii)**

It is the Managing Director who gets the result and can make changes based on the understanding of the company. He could have taken decision to keep the results with him only and could have placed in the meeting instead of circulation.

**Answer 2(c)(iii)**

The Company Secretary should not have circulated the results along with the Agenda. Normally, in these circumstances, results are given to the Board only at time of discussion of the popular items in the Board Meeting.

*Note* : Quarterly, results of the company is quite sensitive. Our company is listed and also trades in the derivative market.

It is suggested that item of quarterly results shall be placed on the table at the time of discussion of the particular agenda item.

### Question 3

*Ram intends to invest ₹10 lakh for a period of one year. He is in the tax bracket of 30%. He has been given the following options :*

- (i) *Fixed deposit with a bank with interest of 8%.*
- (ii) *Debt fund of a mutual fund with expected return of 7%.*
- (iii) *Inflation index bond with a return of 3% over and above inflation assuming that inflation will be 4.5%.*
- (iv) *Tax free bond with a coupon of 6.8%.*

*Provide your advise with complete calculation of each instrument. (5 marks)*

### Answer 3

- (i) Interest on Fixed Deposit of INR 10,00,000

@8%	=	80,000
Tax @30%	=	24,000
Net Income	=	INR 56,000

- (ii) Debt Fund of Mutual Fund

@7%	=	70,000
Tax@30%	=	21,000
Net Income	=	INR 49,000

No Indirect Tax Benefit Available

- (iii) Inflation Index Bond

@4.5% + 3% = 7.5%	=	75,000
Total Tax@30%	=	22,500
Net Income	=	INR 52,500

- (iv) Tax Free Bond

@6.8	=	68,000
Tax	=	NIL
Net Income	=	INR 68,000

Thus the Tax Free Bond @6.8% shall be most beneficial for Ram in the present circumstances.

**Question 4**

A composite index was made with a base of 100. Parameters were fixed for making investment in stock based on sector as under :

Banking and Finance	30%
Information Technology	20%
Metals	20%
Real Estate	10%
FMCG	10%
Pharmaceuticals	10%

Returns derived from these Stocks/Sectors after the end of one year are given below :

Banking & Finance	20%
Information Technology	Nil
Metals	30%
Real Estate	10%
FMCG	15%
Pharmaceutical	(-) 25%

Calculate the index value.

(5 marks)

**Answer 4****Calculation**

Banking and Finance	30 @ 20%	6
Information technology	20 @ Nil	Nil
Metals	20 @ 30%	6
Real Estate	10 @ 10%	1
FMCG	10 @ 15%	1.5
Pharmaceuticals	10 @ (-)25%	(-) 2.5
Total Value		12

**Hence the Index Value at the end of the Year shall be 112**

**Question 5**

Purushottam has a daughter, Laxmi who is 18 years old. He intends to give 500 grams of gold at the time of her wedding. The wedding is likely to take place after 7 years. The current price of gold is ₹ 3,000 per gram. He has sufficient money at

*present and desires to keep safe from any future price rise in the gold. As a professional, advise Purushottam on making investment of ₹15 lakh so as to achieve his objectives. (5 marks)*

**Answer 5**

In the present circumstances, following options are available to Purchase:

- (i) Purchase of Physical Gold.
- (ii) Purchase of Gold Mutual Fund.
- (iii) Purchase of Exchange Traded Gold Fund.
- (iv) Purchase in the Commodity Market.
- (v) Purchase of Sovereign Gold Bond.

Purchase of Physical Gold requires security.

Gold Mutual Funds will have an express of around 2% charged as Management Fees.

Exchange Traded Gold Fund will also have management fees of about 1% and further dealings is also to be paid at the time of sale or purchase.

In the commodity market, one can do so just by paying the margin and involved surplus money in debt. However, it has lot of hassles.

Sovereign Gold Bond is a scheme involved by Government of India. Wherein you get Gold Bond at INR 50 for per gram plus the interest of 2.5 on your investment. On redemption you get the money at prevailing gold price.

For Purshottam, Investment in the Sovereign Gold Bond shall be most ideal.

**Question 6**

*An offence is committed under section 175, 178 and 179 of the Indian Penal Code, 1860 related with Commodity Market. The Forward Market Commission of India conducted criminal trial in the matter and held the accused guilty for committing offence. Is Forward Market Commission of India justified in its action ? (5 marks)*

**Answer 6**

No Forward Market Commission is not justified in its action.

The Commission shall be deemed to be a civil court and when any offence described in section 175, 178 and 179 of Indian Penal Code, 1860 is committed in view of the commission, the commission may after recording the facts constituting the offence shall forward the case to a magistrate having jurisdiction to try the same and the Magistrate to whom such case is forwarded shall proceed to hear the complaint against the accused.

**INSURANCE LAW AND PRACTICE**  
**(Elective Paper 9.3)**

Time allowed : 3 hours

Maximum marks : 100

**NOTE:** Answer **ALL** Questions.

**Question 1**

*X is an individual, non-Indian, non-citizen and non-resident of India and controls a group of organizations engaged in the financial sector located outside India. He intends to set up a life insurance company in India and after due diligence has decided to align himself with an Indian Company. The negotiated terms and conditions of the joint venture agreement are as under :*

- (i) The authorised capital of the company will be ₹150 crore and the issued and paid up capital ₹100 crore. (4 marks)*
- (ii) The capital will be divided into equity and cumulative preference shares in equal measure. The Preference shares will carry a dividend of 8% pa. (4 marks)*
- (iii) The proposed insurance company will also issue 9 year secured debentures carrying an interest rate of 11% p.a. The issue will be of ₹25 crore, the whole of which will be subscribed to by the companies controlled by X. (4 marks)*
- (iv) Two companies controlled by X will hold 30% and 25% of the issued equity shares of the proposed company. (4 marks)*
- (v) The Indian Company, who is a partner in the joint venture, together with associated organisations will hold 45% of the proposed issued equity in the new company. (4 marks)*
- (vi) Preference shares of the face value of ₹20 crore will be held equally by X and the Indian partners. (4 marks)*
- (vii) The proposed insurance company will also carry out health insurance business in addition to life insurance business in India. (5 marks)*
- (viii) It is agreed to between X and the Indian partners that the CEO of the proposed insurance company will be an expatriate (non—Indian) who will be in control of the insurance business. (5 marks)*
- (ix) The Indian insurance company, when setup, proposed to appoint a British Citizen as the actuary. (5 marks)*
- (x) The proposed insurance company plans to recruit a number of persons from the Indian market, train them in the marketing of insurance products and appoint them as agents for marketing of the policies. (5 marks)*
- (xi) As part of the understanding between X and the Indian promoter, there is a*

*proposal to invest 10% of the net premium every year in the group companies owned and controlled by X. (6 marks)*

*On the basis of the above understanding, an application seeking registration of an Indian insurance company has been made to the Insurance Regulatory and Development Authority of India.*

*What will be the approach of the authority to this proposal ? Comment with the necessary explanations with respect to the relevant statutory provisions as applicable against all the points as mentioned above from (i) to (xi).*

### **Answer 1**

The setting up of an insurance company in India is governed by the Insurance Act, 1938, IRDA, 1999 and other related Acts. The proposed company intends to carry out Life Insurance Business and Health Insurance Business in India where the partners are a non Indian and an India partner. As required they have to set up a public limited company in India (comply with all the requirements of the Companies Act, 2013). As per the present rules the foreign shareholding cannot exceed 49%. The registration is 2 stage process R1 and R2. Every company desirous of seeking insurance business registration from IRDAI has to first apply in Form R1 giving all the details as required therein to IRDAI. Once R1 is approved which is based on the due diligence of the proposed management and fulfilling of the other criteria for authorized capital, paid up capital etc. Once R1 is accepted and approved the proposed company can proceed to file form R2 in details and then on being satisfied for all the aspects of the company as required under the Act(s), IRDAI will grant a certificate of registration to the applicant company to carry on the insurance business in India.

- (i) Every insurer carrying on insurance business in India shall have a minimum paid up capital of Rs. 100 crores for life insurance and general insurance business. The proposed company while applying to IRDAI is keeping the authorized share capital at Rs. 150 crores and the issued and paid up capital at Rs. 100 crores which is well within the stipulated requirements of the Act. Hence this condition would be acceptable to the authority.
- (ii) The Act earlier required that "the capital of an insurance company shall consist of only Equity Share Capital and no other forms of capital are allowed. However as per amendments made in 2015, insurance companies are allowed to issue total quantum of preference shares and debentures not exceeding 25% of the equity share capital. Further, there is a progressive decrease in the proportion in which the instruments are included as part of the capital (for the purposes of calculation of "Available Solvency Margins") for the final five years prior to maturity of such instruments.

Here the proposal is to divide the total capital into equity and preference shares in equal measure, i.e., 50% of equity and 50% of preference share capital. As per the Act this is not allowed and hence the proposed company is required to make necessary amendments on the proposed capital structure to comply with total cap of 25% of equity capital for total of preference shares and debentures. The company must have paid up equity capital of Rs. 100 crores.

- (iii) As stated above the company has to have a cap of 25% of equity capital for preference capital and debentures. Thus the company needs to rework out the amounts of preference capital and debentures to meet the requirements as stipulated by the law. This it is not advisable to consider the proposal of issuing 11% Secured Debentures for 9 years of value of Rs. 25 crores to be held by group company of X.
- (iv) As per the present law the maximum holding allowed to a foreign partner for insurance business is 49% (with up to 26% foreign investment being under the automatic route) hence the proposal of X company holding total 55% (30% and 25% by two companies of X) will not be permitted. Hence the proposal have to be revised and maximum 49% can be the company holding.
- (v) The Indian partner in an insurance business company is required to hold minimum 51% of the total share capital in the new company would not be approved by the Authority.
- (vi) The quantum of preference capital will have to be reworked by both the partners of the proposed company to comply with the requirements of the capital structure as stipulated by the law as it is more than 25% of the equity capital

Based on the above, the proposed company of X and the Indian partner need to review the proposal and rework the whole proposal and arrive at a new joint venture agreement to proceed further with IRDAI to get the certificate of registration.

- (vii) The proposal to carry out the health insurance business in addition to the life insurance business in India will be acceptable to the authorities as long as other conditions of grant of registration are suitably complied with by the proposed company.

#### **Registration and Scope of Health Insurance Business**

- (a) Health Insurance products may be offered only by entities with a valid registration granted to carry on Life Insurance or General Insurance or Health Insurance Business under the Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations 2000 as amended from time to time.
- (b) Life Insurers may offer long term Individual Health Insurance products i.e., for term of 5 years or more, but the premium for such products shall remain unchanged for at least a period of every block of three years, thereafter the premium may be reviewed and modified as necessary.

Provided that a life insurer may not offer indemnity based products either Individual or Group. All existing indemnity based products offered by life insurers shall be withdrawn as specified under these Regulations.

Provided also that no single premium health insurance product shall be offered under Unit Linked platform.

- (c) General Insurers and Health Insurers may offer individual health products

with a minimum tenure of one year and a maximum tenure of three years, provided that the premium remains unchanged for the tenure.

- (d) Group Health Policies may be offered by any insurer for a term of one year except credit linked products where the term can be extended up to the loan period not exceeding five years.

Provided General Insurers and Health Insurers may also offer Credit Linked Group Personal Accident policies for a term extended upto the loan period not exceeding five years. Provided further, notwithstanding the provisions of Regulation 4 (b) of these Regulations, Life Insurers may offer Group Health Insurance Policies as specified in Regulation (3) (d).

- (e) Group Personal Accident Policies may be offered by General Insurers and Health insurers with term less than one year also to provide coverage to specific events. Other Insurance Products offering Travel Cover and Individual Personal Accident Cover may also be offered for a period less than one year.
- (f) Overseas or Domestic Travel Insurance policies may only be offered by General Insurers and Health Insurers , either as a standalone product or as an add-on cover to a health or personal accident policy.
- (viii) The proposal to appoint an expatriate (non Indian) as CEO of the proposed insurance company will also be acceptable as long as other conditions of the management structure of the proposed company are fulfilled as required under the law.
- (ix) As per the Appointed Actuary Regulations, 2000 the person to be appointed as an Appointed Actuary of Life Insurance Company in India shall be :
- a. Ordinarily resident in India,
  - b. A fellow member of an affiliate member in accordance with the Actuaries Act, 2006.
  - c. An employee of life insurer in case of life insurance business etc.

Now if the Britisher who is proposed to be appointed as the Appointed Actuary of the proposed life insurance business company in India fulfills the requirements as stipulated under the Act, the authority will permit such appointment otherwise not.

- (x) Recruitment of persons from Indian market and training them for marketing of insurance products as agents of the company will also be permitted if these persons to be appointed as agents of the company fulfill the requirements to be appointed as agents. They are required to be provided with practical training, pass the exams conducted by IRDAI for life insurance agents, pay the prescribed fees as required and obtain the certificate to act as Life insurance agents.
- (xi) The understanding between X and the Indian promoter to invest 10% of the net premium every year in group companies owned and controlled by X will not be allowed as these fall under Prohibited investments as per section 27A(5) and

27C of the Insurance Act, 1938. These are companies outside India and hence investments in these companies are not allowed. If these companies were in India the total limit for investment in such companies is set at 5% of the aggregate funds of the insurer.

Thus based on our observations, the terms and conditions of the understanding have to be reviewed and revised to meet the requirements of the Insurance Act, 1938 and the IRDAI provisions to get the certificate of registration for Life Insurance Business in India.

## Question 2

*A is a horse-owner and races his horses. He has been racing horses, all of which are insured comprehensively by a general insurance company.*

*One of the insured horses which has won many races for A in the past, had of late, due to various factors including age, been on a losing streak and had lost at the recent three races and A had lost large amount of money because of this. Suddenly, this horse, which was insured for ₹25 lakhs, fell sick and died soon thereafter, the cause of death was indicated to be colic, a common killer disease of horses.*

*A made a claim on the insurance company for ₹25 lakhs and incidental expenses. The insurer after due enquiry passed the claim and paid to A the amount of ₹25 lakhs as claim.*

*One year after such payment was made, due to persistent newspapers reporting and on the basis of police investigation conducted in similar cases, it was noticed that some race horses which had become old and were losing races, were systematically killed by the owners through the help of a syndicate which had been retained by the owners. Y was arrested by the police in this regard as the main culprit who had poisoned the horses and enabled the owners to collect the insurance money. On examination, Y revealed the names of the horses that he had killed through poisoning and their respective owners. A was also included in the list. It was ascertained that death by electrocution could be disguised as death caused by colic.*

*On the basis of this investigation and report, the insurer who had paid 25 lakhs to A wants to reopen the claim.*

*Arising out of the above move, the following issues arise for consideration which you are required to deal—*

- (i) Can the insurance company which had already taken due measures to ensure the acceptance of the claim, go back on its settlement and recall the case. (10 marks)*
- (ii) As a responsible underwriter how would the insurer evaluate the risk factors while accepting the proposal for a cover ? (5 marks)*
- (iii) Is moral hazard present in this case ? (5 marks)*
- (iv) Can you estimate the damage compensation liability of A ? (10 marks)*

**Answer 2(i)**

The Insurance company has relied upon the facts and documents submitted by A and made the payment of the claim for death of the horse. Insurance is a contract of utmost good faith and the company relied on all the facts as given by the claimant. However on getting further information about the actual facts as reported in the press and police investigation in the matter the insurance company is entitled to go back to its settlement and recall the case. The insurance company can only recall the case by taking A in the court putting proper evidences against A then only the company gets back the payment given to A.

Moreover A owns many horses and out of so many horses only one of those horses dies due to colic also puts a question mark on the intents. Besides the statement given by Y also indicates towards death of horses of other horse owners who planned the electrocution with Y and made claims to their insurance companies for such horses that were old and losing in the horse races.

All these facts point towards the malafide intentions of the insured and thus insurance company can now reopen the case.

**Answer 2(ii)**

As a responsible underwriter the insurer while accepting the proposal for a cover must look into the past practices of such horse owners. The company should:

- (a) Get a track record of the races these horses have won or lost in the past.
- (b) Character and past track record of the owner of the horses.
- (c) Cost of the horse and market report of the horse if available.
- (d) What does horse mortality insurance cover.
- (e) How much claim to be given at the time of death of a horse.
- (f) Proper Documents to be prepared.

The company can carry out thorough investigation on these and such other matters before accepting such proposals for cover.

**Answer 2(iii)**

Yes, moral hazard is present in this case. The owner of the horse Mr. A who owned a number of horses and was vary regular participant in the horse races was losing on this horse in the horse races. Since the horses were insured with suitable amount of coverage he planned the death of the horse to make a claim for its death due to horse disease colic. Since these horses were no more remunerative, owners of such horses employed people like Y to kill these horses to make insurance claims. These are all examples of fraud and misrepresentation and hence moral hazard. This case gives the clarity of fraud and cheating the insurance company to recover the loses indulge in losing the horse race, that is why, moral hazard is present in this case

**Answer 2(iv)**

Financially A will be liable to repay to the insurance company :  
Amount of claim paid: Rs. 25,00,000

Incidental claims paid (if any)

Incidental expenses incurred by the insurance company for the investigation and other such matters

Besides these financial liability the company can also take A to the court for fraud and misrepresentation where he could be convicted for manipulating the death of the horse under the relevant provisions of the procedure code.

### Question 3

*Describe the steps taken by the Indian insurance regulator to protect the interests of the policy-holders. (5 marks)*

### Answer 3

Indian insurance regulator namely, Insurance Regulatory and Development Authority of India (IRDAI) has put forth many measures to protect the policyholders' interests. Insurers have been told to strengthen their grievance redress procedures, consumer complaint resolving procedures where they are found weak.

An important step taken by IRDA is that it has made it compulsory that each company forms a Policyholder Protection Committee in the Board of Directors. This is part of the Corporate Governance guidelines issued by IRDA and will have the effect of ensuring that insurers' internal systems are monitored effectively at the highest level of the company, that is, the Board.

IRDAI has made a regulation for Protection of Policyholders' Interests Regulations, 2017.

These regulations are aimed to protect the policyholders from undue inconvenience, fraud and similar matters. These Regulation cover:

- (a) Board approved policy for protection of interests of policyholders
- (b) Point of sale
- (c) Products on offer/ products withdrawn
- (d) Proposal for insurance
- (e) Matters to be stated in life insurance policy

### Question 4

*Under international supervisory guidelines prescribed by the International Association of Insurance supervisors, one of the requisite parameters for a home regulator is to be operationally independent, transparent and accountable.*

*Does the Indian insurance regulator comply with this requirement ? Discuss.*

*(5 marks)*

### Answer 4

One of the core principles internationally adopted by International Association of Insurance Supervisors (IAIS) is to ensure the Regulators' Independence and make its

role transparent and accountable. All the home supervisors in the area that are members of IAIS to ensure that the supervisor adhere to the accepted and recognized cannons of supervisory procedure. The independence of the regulator is one of these.

Independence of the regulator can be ensured broadly in two main areas- the technical and the financial administrative areas. As far as IRDAI is concerned both these areas have been recognized and ensured to be adopted either by law or by procedure.

As regards the technical area, the authority is to consist of members, directors from various areas of technical attainments and proficiency. The members including the Chairman who enjoys supervising powers of the Authority itself are appointed by the Central Government on the basis of fit and proper criterion. Professional qualifications and experience are necessary.

The IRDAI enjoys complete freedom in the matter of regulating the business of insurance in India. It also has the powers to grant registration to the new players. The powers to make regulations to govern the market are wholesome except that the regulations have to be placed before the advisory committee which is appointed by the Chairman of the Authority. The Act clearly states that in all technical matters the decision of the Authority is final. There can be no interference from the government. In all administrative matters, the Government after hearing the Authority can express its views. The Authority will produce an Annual Report that has to be presented to the Parliament.

As regards financial freedom, the Authority does not receive any grant from the Government. The Authority has been permitted by the Act to raise and levy fees as percentage of the premium income of the insurers which is used for its administration and maintenance. Here again the maximum of such fees has been laid down that enables the Authority to be free from the influence of any large or significant insurer.

It is thus seen that the enactment of the Insurance and the IRDA Act has ensured the independence of the Authority from the influence of the Government and also of the insurers.

#### **Question 5**

*Do you agree to the proposition that life insurance in addition to being a provision for the benefit of an individual and his family also acts as a social and economic welfare product ? Elucidate. (5 marks)*

#### **Answer 5**

The immediate effect of a life policy taken by an individual accrues to the beneficiary on the death of the insured. The beneficiary could be the spouse, the members of the family or even partners or company in case of key man policies. These claims available to the beneficiaries on the death of the insured help to meet the priority needs of such people like marriage expenses, education expenses of the children or even day to day needs of the family so that the society as a whole gets indirectly benefits of such payments.

Besides the above, the life insurance companies have a big role to play. The Life insurance companies which collect the savings of a person and convert into wealth. The

functions of life insurance company helping social and economic welfare of the nation may be discussed as Under :

- (a) *Saving Institution* : Life Insurance companies both promote and mobilize savings in the country. The exemption provided to the tax payers under the income tax laws provide further incentive to higher income persons to save through life insurance policies. The total volume of insurance business has been growing with the awareness of the insurance benefits and this has been resulting in more savings in the nation and consequent creation of wealth.
- (b) *Term Lending Institution* : Life Insurance companies also function as a large term financing institution in the country. The annual net accrual of investible funds from life insurance business (after making all kinds of payments and liabilities to the policy holders) and net income from investments are quite large. These are used in term lending to the corporate borrowers of the industry and these help in growth of the industry in the country.
- (c) *Investment Institutions* : Life Insurance companies including LIC of India are big investor of funds in the government sector. Under the law the life insurance companies including LIC of India are required to invest certain percentage of their accruals in government and other approved securities. These life insurance companies also make funds available to the private sector through investment in shares, debentures and loans. LIC of India also plays a significant role in developing the business of underwriting of new issues.

The International Association of Insurance Supervisors (IAIS) noted that by investing in bonds and other securities issued by financial institutions, insurance companies provide “an important contribution to the financial soundness of banks and more broadly to financial stability. In a similar fashion insurers are also allocating capital to the real economy by purchasing debt securities of industrial companies or through real estate investments.”

- (d) *Stabiliser in the share market* : LIC acts as a downward stabilizer in the share market. The continuous inflow of new funds enables LIC to buy in the share market when the market is weak. However LIC does not sell in the market when the market is high as it needs to always keep investing in the high inflow of funds.
- (e) *Biggest employers in the economy* : Life Insurance companies are one of the biggest employers. They employ large number of staff for their day to day operations. In addition to the staff they also provide employment to intermediaries like agents, brokers, sub brokers and other outsourcing companies who take care of some of their operations outside their offices.
- (e) *Expanding business* : Whether businesses are launching a new product, signing a new sales contract or purchasing a new company, the business needs assurances that the other party is conducting business in good faith. Insurance provides the necessary protection, in case business doesn't proceed as planned.

Likewise, businesses would be reluctant to hire new employees if not for workers'

compensation insurance, which protects the employer while providing the employee with income when an accident temporarily puts the employee out of work.

### **Question 6**

*Do you agree with the statement that the roles played by a third party administrator and a surveyor in the matter of after-sales service of an insurance product are the same ? Discuss. (5 marks)*

### **Answer 6**

A surveyor and a Third Party Administrator (TPA) both come into picture for a claim settlement purpose for insurance products but their roles are quite different.

The Primary responsibility of a Surveyor is to estimate the liability of the loss incurred by the policyholder who has take insurance cover, to enable the assurance company to arrive at the amount to be indemnified to the policyholders under the terms of the insurance contract. A surveyor has to be a qualified person both academically as well as technically with experience in the field in which he is required to offer his services for survey.

Surveyors come into the picture when estimated losses are in excess of Rs50,000 for a motor insurance claim and over Rs1 lakh in other insurance claims, such as for fire or marine insurance.

Third Party Administrator (TPA) is a person (generally a company) complying with certain requirement as stipulated under the Act. TPAS are appointed by an insurance company to render services in connection with health insurance business. TPAS are also required to deal with the claim settlement process in case of health insurance policies but they do not act like surveyors as they do in case of general insurance business.

A person can act as a TPA only with a valid licence issued by IRDAI to perform the functions of a TPA. It is generally only a company registered under the Companies Act which is allowed the licence to act as a TPA. The main object of the Memorandum of the company should provide for carrying out of the business as TPA in the health services. Further engaging in any other business than IPA is prohibited. The company must have minimum paid up capital of Rs.1 crore at all times.

Thus the role of surveyor for a general insurance (motor, marine and fire) and role of TPA for health insurance come under after sales services of the insurers and before and during the settlement of claim. Prima facie the roles look to be the same, but functionally their roles are quite different. The surveyor only assesses the quantum of the claim and reports to the insurer whereas the TPA besides offering health related services also processes the documents for the health insurance claims and communicates with the insured on behalf of the insurer.

## INTELLECTUAL PROPERTY RIGHTS – LAW AND PRACTICE (Elective Paper 9.4)

Time allowed : 3 hours

Maximum marks : 100

**NOTE:** Answer **ALL** Questions.

### Question 1

*Read and analyze the case study and answer the questions given at the end :*

*India is the world's largest producer of tea, with a total production of 846 million kgs in the year 2002, supplying about 31 per cent of the world's favourite hot drink. Among the teas grown in India, Darjeeling tea offers distinctive characteristics of quality and flavour, and also has a global reputation for more than a century. Broadly speaking, there are two factors which have contributed to such an exceptional and distinctive taste, namely geographical origin and processing. Darjeeling tea has been cultivated, grown and produced in tea gardens in a well-known geographical area — the Darjeeling district in the Indian state of West Bengal — for over one and a half centuries. The tea gardens are located at elevations of over 2000 metres above mean sea level.*

*Even though the tea industry in India lies in the private sector, it has been statutorily regulated and controlled by the Ministry of Commerce since 1933 under various enactments culminating in the Tea Act, 1953. The Tea Board of India (Tea Board) was set up under this Act. A major portion of the annual production of Darjeeling tea is exported, the key buyers being Japan, Russia, the United States, United Kingdom and other European Union (EU) countries such as France, Germany and the Netherlands.*

#### **Efforts made by the Tea Board to ensure the supply of genuine Darjeeling tea**

*In order to ensure the supply and genuine Darjeeling tea, a compulsory system of certifying the authenticity of exported Darjeeling tea was incorporated into the Tea Act, 1953 in February 2000. The system makes it compulsory for all the dealers in Darjeeling tea to enter into a licence agreement with the Tea Board of India on payment of an annual licence fee. The terms and conditions of the agreement provide, inter alia, that the licensees must furnish information relating to the production and manufacture of Darjeeling tea and its sale, through auction or otherwise. The Tea Board is thus able to compute and compile the total volume of Darjeeling tea produced and sold in the given period. No blending with teas of other origin is permitted. Certificates of origin are then issued for export consignments under the Tea (Marketing and Distribution Control) Order, 2000, read with the Tea Act, 1953. Data are entered from the garden invoices (the first point of movement outside the factory) into a database, and the issue of the Certificate of Origin authenticates the export of each consignment of Darjeeling tea by cross-checking the details. The customs authorities in India have instructed, by circular, all customs checkpoints to check for the certificates of origin accompanying the Darjeeling tea consignments and not to allow*

*the export of any tea as 'Darjeeling' without this certificate. This ensures the sale-chain integrity of Darjeeling tea until consignments leave the country.*

### **Legal protection at domestic level**

#### **Certification Trade Mark Registration**

*In order to provide legal protection in India, Tea Board registered the 'Darjeeling logo' and also the word 'Darjeeling' as Certification Trade Marks (CTMs) under the Trade and Merchandise Marks Act, 1958 (now the Trade Marks Act, 1999).*

#### **GI registration**

*The Tea Board has also applied for the registration of the words 'Darjeeling' and 'Darjeeling logo' under the Geographical Indications of Goods (Registration and Protection) Act, 1999 (the Act) which came into force with effect from 15 September 2003, in addition to the CTMs mentioned above.*

#### **Under the Act :**

- (a) No person shall be entitled to institute any proceeding to prevent or recover damages for the infringement of unregistered geographical indications.*
- (b) A registration of geographical indications shall give to the registered proprietor and all authorized users whose names have been entered in the register the right to obtain relief in respect of infringement of the geographical indications. However, authorized users alone shall have the exclusive right to the use of the geographical indications in relation to the goods in respect of which the geographical indications are registered.*
- (c) A registered geographical indication is infringed by a person who, not being an authorized user thereof,*
  - (i) uses such geographical indications by any means in the designation or presentation of goods that indicates or suggests that such goods originate in some other geographical area other than the true place of origin of the goods in a manner which misleads the public; or*
  - (ii) uses any geographical indications in such a manner which constitutes an act of unfair competition including passing off in respect of registered geographical indications; or*
  - (iii) uses another geographical indication to the goods which, although literally true as to the territory, region or locality in which the goods originate, falsely represents to the public that the goods originate in the region, territory or locality in respect of which such registered geographical indications relate.*
- (d) The purpose of the Global Indications of Goods (Registration and Protection) Act, 1999 is to create a public register, and*
- (e) The Act confers public rights.*

#### **Status of registration of Global Indications (GI) :**

*The registration of the marks applied for by the Tea Board has not yet been granted.*

*The Registrar has, however, after examining the application for registration filed by the Tea Board advertised for any expression of opposition. It is only after considering opposition, if any, that the Registrar may decide to register the GI of the Tea Board.*

### **Reasons of GI protection at domestic level and export markets**

*The reasons for the need for additional protection for GI over and above the CTM has been set out by the chair of the Tea Board as follows :*

- *When CTM registration is not accepted in a jurisdiction where protection is sought, for example, France for Darjeeling;*
- *because GI registration is necessary to obtain reciprocal protection of a mark mandate under EU Regulation 2081/92; and*
- *registration gives clear status to a GI, indicating a direct link with geographical origin.*

*Quite apart from the aforesaid reasons the Act in India has also been enacted in order to comply with its obligation under the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which requires WTO members to enact appropriate implementation legislation for GI.*

### **Steps taken at international level**

- (i) *Registration of Darjeeling tea and logo In order to protect 'Darjeeling' and 'Darjeeling logo' as GI, the Tea Board registered the marks in various countries, including the United States, Canada, Japan, Egypt, United Kingdom and some other European countries, as a trade mark/CTM. In this context it is relevant to note that on 3 August 2001 the UK Trade Registry granted registration of the word 'Darjeeling' as of 30 March 1998 under the UK Trade Marks Act 1994. The United States has also accepted the application of the Tea Board for the registration of 'Darjeeling' as a CTM in October 2002.*
- (ii) *The appointment of International Watch Agency In order to prevent misuse of 'Darjeeling' and the logo, the Tea Board has since 1998 hired the services of Compumark, a world wide watch agency. Compumark is required to monitor and report to the Tea Board all cases of unauthorized use and attempted registration. Pursuant to Compumark's appointment, several cases of attempted registrations and unauthorized use of 'Darjeeling' and Darjeeling Logo have been reported.*
- (iii) *The assistance of overseas buyers In order to ensure the supply of genuine Darjeeling tea, the Tea Board has sought the help of all overseas buyers, sellers and Tea Councils and Associations insofar as they should insist on certificates of origin to accompany all export consignments of Darjeeling tea.*

### **Local and external players and their roles**

*The Tea Board, the sole representative of tea producers in India, is responsible for the implementation of the government's regulations and policies. It is vested with the authority to administer all stages of tea cultivation, processing and sale (including the Darjeeling segment) through various orders issued by the government. It works in close co-operation with the Darjeeling Planters Association, which is the sole*

producers' forum for Darjeeling tea. Both the Tea Board and the Darjeeling Planters Association (DPA) have been involved at various levels in protecting and defending the 'Darjeeling tea' and 'Darjeeling logo'. The primary objects are (i) to prevent misuse of the word 'Darjeeling' for tea sold worldwide; (ii) to deliver the correct product to the consumer; (iii) to enable the commercial benefit of the equity of the brand to reach the Indian tea industry and ultimately the plantation worker; (iv) to achieve international status similar to champagne or Scotch whisky in terms of both brand and equity and governance/administration.

The Tea Board assumed the role of complainant in making and filing opposition or other legal measures whenever cases of unauthorized use or attempted or actual registration of Darjeeling and Darjeeling logo were brought to its notice. Such legal measures are generally taken where negotiation failed. For instance, in February 2000 in Japan, the Tea Board filed an opposition against Yutaka Sang yo Kabushiki Kaisa of Japan for registration of the trade mark 'Darjeeling Tea' with the map of India, the International Tea KK of Japan for registration of Darjeeling Women device in Japan under class 30/42 (tea, coffee and cocoa) and against Mitsui Norin KK for the use in advertising of the 'Divine Darjeeling' logo. These opposing parties defended the invalidation action filed against them.

Some disputes relating to Darjeeling tea have been settled through negotiation undertaken by the Tea Board of India with the foreign companies concerned with the help of their respective governments. Thus, the Tea Board with the help of the Indian government continues to negotiate with France at various levels over the activities of the French trademark authorities. Moreover BULGARI, Switzerland agreed to withdraw the legend 'Darjeeling Tea fragrance for men' pursuant to legal notice and negotiations.

In one of the cases in France, the Tea Board put the applicant Comptoir des Parfums (which advertised in March 1999) on notice, and drew its attention to the prior rights and goodwill in the name of Darjeeling as the GI for tea, requiring it to withdraw its application voluntarily. Based on the correspondence, the applicant consented to the amendment of all specifications of goods by the addition of 'all those goods being made of Darjeeling tea or recalling the scent of Darjeeling tea'. The amendment proposed by the applicant was found by the examiner to be descriptive of the goods in question.

'The Tea Board of India feels that a partnership with the buyers in the major consuming countries such as Germany, Japan and the United Kingdom would be the only long term solution to the problem of possible passing off.' However, it strongly opposes any attempt at individual registration in the case of private labels or its misuse in specific overseas jurisdictions.

#### **Challenges faced and the outcome**

The Tea Board has faced a series of hurdles, challenges and difficulties in the protection and enforcement of the word 'Darjeeling' and of the Darjeeling logo. Some of the major challenges faced by the Tea Board's effort to protect 'Darjeeling' and the Darjeeling logo in Japan, France, Russia, the United States and other countries are given below :

- (i) *Unauthorized use and registration of Darjeeling Tea and logo in Japan* In the first case the Tea Board filed an invalidation action against International Tea

*KK, a Japanese company, over the registration of the Darjeeling logo mark, namely, Darjeeling Women 'serving tea/coffee/coca/soft drinks/fruit juice' in the Japanese Patent Office (JPO) on 29 November 1996 with the trademark registration number 3221237. The impugned registration was made notwithstanding the registration in Japan of the identical Darjeeling logo mark by the Tea Board, with the trademark registration number 2153113, dated 31 July 1987. The Tea Board also filed a non-use cancellation action. On 28 August 2002 the JPO Board of Appeal held that the pirate registration was invalid because it was contrary to public order and morality. With regard to the Tea Board's non-use cancellation action, the JPO decided that International Tea KK had not furnished sufficient evidence to substantiate its use of registration and thereby allowed the appeal of the Tea Board.*

*In the second case, the Tea Board opposed the application for 'Divine Darjeeling' in class 30 (Darjeeling tea, coffee and cocoa produced in Darjeeling, India) filed by Mitsui Norin KK of Japan advertised on 29 February 2000. The opposition was mainly on three grounds, namely (i) 'divine' is a laudatory term and accordingly the mark for which protection is sought is merely 'Darjeeling', which is clearly non-distinctive;*

- (ii) 'Divine Darjeeling' is misleading insofar as 'coffee and cocoa produced in Darjeeling' are concerned, all the more so because the district of Darjeeling does not produce coffee or cocoa;*
- (iii) Darjeeling tea qualifies as a geographical indication under international conventions including TRIPS and ought to be protected as such in Japan, a member of TRIPS.*

*The JPO Opposition Board dismissed the invalidation action filed by the Tea Board of India primarily on the ground that the mark 'Divine Darjeeling' as a whole was not misleading or descriptive of the quality of goods. However, the non-use cancellation action succeeded, because the registered proprietor was not able to place on record adequate evidence to prove the use of the mark in Japan.*

*In yet another case, the Tea Board brought an invalidation action against Japanese trade mark registration of 'Darjeeling tea' with a map of India in class 30 by Yutaka Sangyo Kabushiki Kaisa, on the ground that the registration was contrary to public order and morality. This action was rejected on the ground that 'the written English characters "Darjeeling tea" and the map of India for the goods of Darjeeling tea are used as an indication of the origin and quality of Darjeeling tea and will not harm the feelings of the Indian people'. However, the non-use cancellation action filed by the Tea Board succeeded, because the registered proprietor was not able to place on record sufficient evidence to prove the use of the mark in Japan.*

*A perusal of these decisions reveals that the JPO did not decide the contention of the Tea Board relating to the TRIPS Agreement, which requires WTO members to provide the legal means to prevent the use of a GI for goods originating in a geographical area other than the true place of origin in a manner which misleads the public to constitute an act of unfair competition. Indeed, non-disposal of the argument that the procedural guidelines of WTO be followed dilutes the effect of the TRIPS Agreement.*

### **Other instances of defending GI against developed countries**

- (i) **France** : While the India system protects French GIs, France on the other hand does not extend similar or reciprocal protection to Indian GIs. Thus French law does not permit any opposition to an application for a trademark similar or identical to a GI if the goods covered are different from those represented by the GI. The owner of the GI can take appropriate judicial proceedings only after the impugned application has proceeded to registration. The net effect of such a provision has been that despite India's protests, Darjeeling has been misappropriated as a trademark in respect of several goods in class 25, namely, clothing, shoes and headgear. The French Examiner — even though he found evidence in favour of the Tea Board of India (i) on sufficient proof of use of 'Darjeeling' tea in France, and (ii) that the applicant had slavishly copied the name Darjeeling in its application — held that the respective goods 'clothing, shoes, headgear' and 'tea' are not of the same nature, function and intended use, produced in different places and sold through different networks. The Examiner also held that even if the applicant has slavishly copied the Tea Board's Darjeeling logo (being the prior mark), the difference in the nature of the respective goods is sufficient to hold that the applicant's mark may be adopted without prejudicing the Tea Board's rights in the name 'Darjeeling'. In another case the Tea Board opposed the application against the advertised marks for Darjeeling in classes 5, 12 and 28 by Dor François Marie in France. The French Examiner rejected the Tea Board's opposition and held that the respective goods did not (i) have the same nature, function and intended use; and (ii) share the same distribution circuits. However, he held that although the applicant's mark constituted a partial reproduction of the Tea Board's prior figurative registration for the Darjeeling logo, the designated goods lacked similarity to that of the Tea Board's prior marks and the logo, therefore, may be used as a trademark without prejudicing the prior rights of the Tea Board.
- (ii) **Russia** : The Tea Board filed an application for unauthorized use by a company of the word 'Darjeeling'. This application was objected to on the ground of conflict with an earlier registration of the identical word by a company named 'Akotus'. The Russian Patent Office overruled the objection and accepted the application of Tea Board for the word 'Darjeeling'.
- (iii) **United States** : The Tea Board is opposing an application filed by its licensee in United States to register 'Darjeeling nouveau' ('nouveau' is the French for 'new') relating to diverse goods and service such as clothing, lingerie, Internet services, coffee, cocoa and so on in respect of first flush Darjeeling tea. The registration application is under consideration even though 'Darjeeling' is already registered under US CTM law.
- (iv) **Other countries** : In several cases the Tea Board opposed attempted registration and unauthorized use of the word 'Darjeeling' in Germany, Israel, Norway and Sri Lanka before the Patent Office of the country concerned.

### **Costs of protection and enforcement for the industry and the government**

Another major challenge faced by the Tea Board relates to legal and registration expenses, costs of hiring an international watch agency and fighting infringements in overseas jurisdictions. Thus during the last four years, the Tea Board has spent

*approximately US\$ 200,000 for these purposes. This amount does not include administrative expenses including the relevant personnel working for the Tea Board, the cost of setting up monitoring mechanisms, software development costs and so forth. It is not possible for every geographical indication right holder to incur such expenses protection. Further, like overseeing, monitoring and implementing GI protection, the high cost of taking legal action can prevent a country from engaging a lawyer to contest the case, however genuine and strong the case may be. Moreover, lack of expertise in the proper handling of highly complex legal language is another challenge to be met.*

### **Lessons for others**

*The Tea Board appears to be not satisfied with the policy as well as the approach of the patent authority in Japan and France. In order to deal with the situations described above, India, along with several other member countries of the WTO, wants to extend the proposed register for GI to include products or goods, other than wines and spirits, which may be distinguished by the quality, reputation or other characteristics essentially attributable to their geographical origin.*

*The main advantage would be to develop a multilateral system of notification and registration of all geographical indications. In this connection, a joint paper has recently been submitted to the TRIPS Council. The Doha Ministerial Declaration under paragraphs 12 and 18 also provides a mandate for the issue of providing a higher level of protection to GIs to products other than 'wines and spirits' to be addressed by the TRIPS Council. According to the Tea Board, (i) extension of protection under Article 23 for products other than wines and spirits is required where no legal platform exists to register a GI or a CTM which is a TRIPS obligation, for example Japan; (ii) once the scope of protection is extended it would not be necessary to establish the credentials/reputation of a GI before fighting the infringement of similar 'types', 'styles', or 'look-alikes'; and (iii) additional protection would rectify the imbalance created by the special protection of wines and spirits.*

*The experience in defending GI in France, the United States and Japan further strengthens the Tea Board's perspective on the subject. Despite a registration of 'Darjeeling' as a GI in France, the Tea Board was unsuccessful in defending it because French law does not permit any opposition to an application for a trade mark, similar or identical to a GI. Likewise, India's efforts to protect Darjeeling' in Japan did not succeed because the prefix 'Divine' has not gained currency in the Japanese language. From the experiences described above, it is felt that it is high time to evolve a rule that no application for registration of a GI of the same or similar goods or products or even similar type, style or look-alike already registered in that country be ordinarily entertained by the competent authority of the country concerned. Further, the GI status and apprehended or actual violation of GI should be published at both domestic and international levels. Moreover, adequate steps should be taken to evolve rules and procedures for GI or CTM registration in all the member countries of the WTO. This would prevent conflict to a great extent. Finally, a vigilance cell should be established to check the violation and misuse of the GI of any product.*

### **Questions :**

- (a) How does 'Darjeeling Tea' satisfy the criteria of geographical indications under the Geographical Indication of Goods (Registration and Protection) Act, 1999 ?

*Why was a compulsory system of certifying the authenticity of exported Darjeeling Tea incorporated into the Tea Act, 1953 in 2000 ?* (10 marks)

- (b) *In case the Government of India is interested to protect the 'Darjeeling Tea' under the Geographical Indications of Goods (Registration and Protection) Act, 1999, how can an application be filed and what should be the contents of the application ? Explain in the context of the case study.* (10 marks)
- (c) *Elaborate the unauthorised use and registration of Darjeeling Tea and logo in Japan and defending GI against developed countries.* (10 marks)
- (d) *What was Doha Ministerial Declaration under paragraphs 12 and 18 and what did Tea Board experience in defending GI in France, the USA and Japan ?* (10 marks)
- (e) *What are the initiatives taken by Tea Board of India to ensure geographical indications (GI) protection to 'Darjeeling Tea' ?*

*What measures would you suggest to pave way for enhanced protection of Intellectual Property Rights (IPRs) in the context of 'Darjeeling Tea' ?* (10 marks)

#### **Answer 1(a)**

The term "Geographical indication" is defined in section 2(1)(e) of the Geographical Indications of Goods (Registration and Protection) Act, 1999 as:

"Geographical Indication, in relation to goods, means an indication which identifies such goods as agricultural goods, natural goods or manufactured goods as originating, or manufactured in the territory of a country, or a region or locality in that territory, where a given quality, reputation or other characteristic of such goods is essentially attributable to its geographical origin and in case where such goods are manufactured goods one of the activities of either the production or of processing or preparation of the goods concerned takes place in such territory, region or locality, as the case may be."

In the case of Darjeeling Tea, the key features which make it eligible to be granted registration and thus protected under the GI Act, 1999 are:

- i. It offers distinctive characteristics of quality and flavor.
- ii. It has a global reputation for more than a century.
- iii. It has been cultivated, grown and produced in tea gardens in a well-known geographical area — the Darjeeling district in the Indian state of West Bengal for over one and a half centuries.
- iv. It has the tea gardens which are located in the district of Darjeeling at elevations of over 2000 metres above sea level.

In order to ensure the supply of genuine Darjeeling tea, a compulsory system of certifying the authenticity of exported Darjeeling tea was incorporated into the Tea Act, 1953, in the month of February, 2000. The system made it compulsory for all the dealers of Darjeeling tea to enter into a licence agreement with the Tea Board of India on payment of an annual license fee. The terms and conditions of the agreement provide, *inter alia*,

that the licensees must furnish information relating to the production and manufacture of Darjeeling tea and its sale, through auction or otherwise. The Tea Board is thus able to compute and compile the total volume of Darjeeling tea produced and sold in the given period. No blending with teas of other origin is permitted. Certificates of origin are then issued for export consignments under the Tea (Marketing and Distribution Control) Order, 2000, read with the Tea Act, 1953. Data is entered from the garden invoices (the first point of movement outside the factory) into a database, and the issue of the certificate of origin authenticates the export of each consignment of Darjeeling tea by cross-checking the details. Furthermore, the Customs Authorities under their circular have made it mandatory to check at each checkpoint the Certificate of Origin in respect of each Darjeeling Tea Consignment. Thus, ensuring the sale-chain integrity of Darjeeling Tea until the consignment leaves the country.

### **Answer 1(b)**

#### **Filing of Application**

- i. An application for the registration of a Geographical Indication by the Government of India can be made in triplicate in Form GI – 1(A) for single class and in GI – 1 (C) for multiple classes.
- ii. A Convention Application shall be made in triplicate in Form GI – 1(B) for single class and in GI – 1 (D) for multiple classes.
- iii. Power of Attorney, if required.
- iv. The application shall be signed by the applicant or his agent.
- v. The application is to be made to the Registrar of Geographical Indications.

#### **Contents of Application**

As provided in Section 11 of the GI Act, 1999, an application for registration of a GI should include the requirements and criteria for processing a GI application as specified below:

- A statement as to how the geographical indication serves to designate the goods as originating from the concerned territory of the country or region;
- The class of goods to which the GI shall apply;
- The geographical map of the territory or locality in which goods are originate or manufactured;
- The particulars of appearance of the geographical indication;
- Particulars of the producers;
- An affidavit of how the applicant claims to represent its interest in the GI;
- The standard benchmark for the use or other characteristics of the GI;
- The particulars of special characteristics;
- Textual description of the proposed boundary;
- The growth attributes in relation to the GI pertinent to the application;
- Three certified copies of the map of the territory, region or locality;

- Particulars of special human skill involved, if any;
- Full name and address of the association of persons or organization seeking registration;
- Number of producers; and
- Particulars of inspection structures, if any, to regulate the use of the GI. [Rule 32].

On receipt of the application, a number is allotted. Thereafter, the examiner scrutinizes the application to check whether it meets the requirements of the GI Act and the Rules. Deficiencies, if any, found through a preliminary examination would be communicated by the Examiner to the Applicant. The deficiencies need to be complied within the time limit mentioned in the communication. [Rule 31]

Upon compliance of the deficiencies, the Registrar shall ordinarily constitute a Consultative Group of experts (not more than seven representatives) to ascertain the correctness of the particulars furnished in the Statement of Case. The Consultative Group is chaired by the Registrar of Geographical Indications. [Rule 33]

After issuance of the Examination Report, submissions of the applicant would be considered. If no further objection is raised, the application would be accepted and published (within three months of acceptance) in the Geographical Indications Journal. [Rule 34 & 38]

After advertisement of a Geographical Indication in the Geographical Indications Journal, any person may within three months oppose the registration of an application for GI. This period may be extended by a period, not exceeding one month, by making an application to the Registrar along with the prescribed fee. Such an application for extension shall be filed before the expiry of the period of three months. The Notice of Opposition shall be filed only before the Registrar of Geographical Indications at Chennai. [Section 14, Form GI-2]

#### **Answer 1(c)**

In a case, the Tea Board had filed an invalidation action against International Tea KK, a Japanese Company, over the registration of the Darjeeling logo mark, namely, Darjeeling women 'serving tea/coffee/coca/soft drinks/fruit juice' in the Japanese Patent Office (JPO) on 29th November 1996 with the trademark registration number 3221237. The impugned registration was made notwithstanding the registration in Japan of the identical Darjeeling logo mark by the Tea Board of India, with the trademark registration number 2153713, dated 31st July 1987. The Tea Board had also filed a non-use cancellation action. On 28th August 2002, the JPO Board of Appeal had held that the pirate registration was invalid because it was contrary to public order and morality. With regard to the Tea Board's non-use cancellation action, the JPO decided that International Tea KK had not furnished sufficient evidence to substantiate its use of registration and thereby allowed the appeal of the Tea Board.

In another case, the Tea Board had filed its opposition in respect of an application for registration of 'Divine Darjeeling' under class 30 (Darjeeling Tea, Coffee and Cocoa product in Darjeeling, India) filed by Mitsui Norin KK of Japan advertised on 29th February 2000. The grounds of opposition were:

- (a) 'Divine' is a laudatory term and accordingly the mark for which protection is sought is merely 'Darjeeling', which is clearly non-distinctive;

- (b) 'Divine Darjeeling' is misleading insofar as 'coffee and cocoa products in Darjeeling' are concerned, all the more so because the district of Darjeeling does not produce coffee or cocoa;
- (c) Darjeeling tea qualifies as a geographical indication under international conventions including TRIPS and ought to be protected as such in Japan, a member of TRIPS.

The Opposition application filed by Tea Board was however dismissed by the JPO Opposition Board stating that the mark 'Divine Darjeeling' as a whole was not misleading or descriptive of the quality of goods.

In yet another case, the Tea Board brought an invalidation action against the act of trade mark registration of 'Darjeeling tea' with the map of India in class 30 by a Japanese company, Yutaka Sangyo Kabushiki Kaisa, on the ground that the registration was contrary to the public order and morality. The action was however rejected on the ground that 'the written English characters 'Darjeeling tea' and 'Map of India' for the goods of Darjeeling tea are used as an indication of the origin and quality of Darjeeling tea and will not harm the feelings of the Indian People'. However, the non-use cancellation action filed by Tea Board succeeded, because the registered proprietor was not able to place on record sufficient evidence to prove the use of the mark in Japan.

A perusal of these decisions reveals that the JPO did not decide the contention of the Tea Board of India relating to the TRIPS Agreement, which requires WTO members to provide the legal means to prevent the use of a GI for goods originating in a geographical area other than the true place of origin in a manner which misleads the public to constitute an act of unfair competition. Indeed, non-disposal of the argument that the procedural guidelines of WTO be followed dilutes the effect of the TRIPS Agreement.

**Indian Legal System** protects French GIs, while France on the other hand does not extend similar or reciprocal protection to Indian GIs. Thus, French law does not permit any opposition to be made to an application for registration of a trademark similar or identical to a GI if the goods covered are different from those represented by the GI. The owner of the GI can take appropriate judicial action only after the impugned application has proceeded for registration. The net effect of such a provision has been that despite India's protests, 'Darjeeling' has been misappropriated as a trade mark in respect of several goods in class 25, namely, clothing, shoes and headgear in France. The French Examiner — even though he found evidence supporting the case made out by the Tea Board of India:

- (i) on sufficient proof of use of 'Darjeeling' tea in France, and
- (ii) that the applicant had slavishly copied the name 'Darjeeling' in its application — held that the respective goods falling in the category of 'clothing, shoes, headgear' and 'tea' respectively are not of the same nature, function and intended use, produced in different places and sold through different networks.

The Examiner also held that even if the applicant has slavishly copied the Tea Board's Darjeeling logo (being the prior mark), the difference in the nature of the respective goods is sufficient to hold that the applicant's mark may be adopted without prejudicing the Tea Board's rights in the name 'Darjeeling'.

**Russia** : The Tea Board had filed an application for unauthorized use by a company of the trade mark 'Darjeeling'. This application was objected to on the ground of conflict with an earlier registration of the identical word by a company named 'Akorus'. The Russian Patent Office overruled the objection and accepted the application of Tea Board of India for the use of the trade mark 'Darjeeling'.

**United States** : In a case, the Tea Board was opposing an application filed by its licensee in United States to register 'Darjeeling nouveau' ('nouveau' is the French for 'new') relating to diverse goods and service such as clothing, lingerie, Internet services, coffee, cocoa and so on in respect of first flush Darjeeling tea. The registration application is under consideration even though 'Darjeeling' is already registered under US CTM law.

**Other countries** : Quite apart from the above, in several cases the Tea Board of India opposed attempted registration and unauthorized use of the word 'Darjeeling' in Germany, Israel, Norway and Sri Lanka before the Patent Office of the country concerned.

#### **Answer 1(d)**

Paragraph 12 and 18 of the Doha Ministerial Declaration relates to the extension of the additional protection for Geographical Indications to products other than 'Wines' and 'Spirits'. According to paragraph 12 and 18 of the Doha Ministerial Declaration and the decision of the Trade Negotiation Committee (TNC) of 1st February 2002, the issue of 'extension' of the protection of Geographical Indications for 'Wines' and 'Spirits' to Geographical Indications for other products shall be addressed in the regular meetings of the TRIPS Council on a priority basis. Paragraphs 12 and 18 thus provide a mandate for the issue of "providing a higher level of protection to GIs to products other than 'wines and spirits' to be addressed by the TRIPS Council". According to the Tea Board,

- i. Extension of protection under Article 23 for products other than wines and spirits is required where no legal platform exists to register a GI or a CTM which is a TRIPS obligation, for example Japan;
- ii. Once the scope of protection is extended it would not be necessary to establish the credentials/reputation of a GI before fighting the infringement of similar 'types', 'styles', or 'look-alikes'; and
- iii. Additional protection would rectify the imbalance created by the special protection of Wines and Spirits.

Despite the registration of 'Darjeeling' as a GI in France, the Tea Board was unsuccessful in defending it because French law does not permit any opposition to an application for a trade mark, similar or identical to a GI. Likewise, India's efforts to protect 'Darjeeling' in Japan did not succeed because the prefix 'Divine' has not gained currency in the Japanese language.

It is felt that it is high time to evolve a rule that no application for registration of a GI of the same or similar goods or products or even similar type, style or look-alike already registered in that country be ordinarily entertained by the competent authority of the country concerned. Further, the GI status and apprehended or actual violation of GI should be published at both domestic and international levels. Moreover, adequate steps should be taken to evolve rules and procedures for GI or CTM registration in all the member countries of the WTO. This would prevent conflict to a great extent. Finally, a

vigilance cell should be established to check the violation and misuse of the GI of any product.

**Answer 1(e)**

The Tea Board of India took the following initiatives to ensure Geographical Indication (GI) Protection to 'Darjeeling Tea':

- (i) The compulsory system of certifying the authenticity of exported Darjeeling tea. With this it has made it compulsory for all the dealers in Darjeeling tea to enter into a license agreement with the Tea Board of India.
- (ii) The Tea Board registered the 'Darjeeling logo' and also the word 'Darjeeling' as Certification Trade Mark (CTMs) under the (Indian) Trade and Merchandise Marks Act, 1958 (now the 'Trade Marks Act, 1999').
- (iii) The Tea Board of India has also applied for the registration of the words 'Darjeeling' and 'Darjeeling logo' under the Geographical Indications of Goods (Registration and Protection) Act, 1999.
- (iv) In order to protect 'Darjeeling' and 'Darjeeling logo' as a GI, the Tea Board of India registered the marks in various countries.
- (v) The Tea Board hired the services of a worldwide agency COMPUMARK, to check and prevent the misuse of 'Darjeeling' and Darjeeling logo. For example a company called 'Bulgari' from Switzerland agreed to withdraw its application to use the tag 'Darjeeling Tea fragrance for men'. Several such cases were settled through negotiations.
- (vi) The Tea Board has sought the help of all overseas buyers, sellers and Tea Council and Associations to insist on Certificates of Origin to accompany all export consignments of Darjeeling tea.

To protect against the violations of its Intellectual Property Rights, an organization should ensure the protection of its trade secrets in a foreign country also. Every company has to take certain important and crucial measures to ensure protection to its trade secrets.

It may be prudent for the companies to conduct an intellectual property audit to identify the protectable business information. This will help the companies to assess the value of the information useful for their business. The intellectual property audit is the starting point for the development of a trade secrets protection programme.

Once the audit is complete, the next step is to determine appropriate level of security necessary to protect different types of trade secrets.

If a trade secret is well protected, there is no term of protection. Trade secret protection can, in principle, extend indefinitely and in this respect offers an advantage over patent protection, which lasts only for a specified period.

The Tea Board of India feels that a partnership with the buyers in the major consuming countries such as Germany, Japan and the United Kingdom would be the only long term solution to the problem of possible passing off.' However, it strongly opposes any attempt

at individual registration in the case of private labels or its misuse in specific overseas jurisdictions. Governments of several countries working together have a prominent role to play in resolving disputes. Recently, India and the United States have led the way in this regard by establishing “an annual high-level Intellectual Property (IP) Working Group with appropriate decision making and technical level meetings as a part of the trade policy forum.” Similarly, India could look at treaties like the Hague Treaty on Industrial Designs to strengthen its IPR regime.

In the context of protection of any misuse or wrongful use of ‘Darjeeling Tea’ or any deceptively similar trade name or mark which is applied to a product not belonging to that region which holds a right over it under the GI Act, 1999, it is necessary that a concerted effort be made by all the nations as also the concerned International Organizations, especially the TRIPS, to ensure that there is no violation committed in their respective territory of the rights of others.

## **Question 2**

*Read and analyze the following case study and answer the questions given at the end :*

*A Dutch SME produces their additives in China under the name Roi Jaguar. Their General Manager in China is tasked with making sure that the brand is protected in accordance with Chinese law. At one point, the Chinese General Manager leaves the company. Soon after he leaves, the Dutch SME discovers a very similar product on the Indian market called Roi Lynx. Both brands thus exist with the same word followed by the name of a species of big cat.*

*After some research, the Dutch SME, finds out that after quitting the job, its former General Manager has started competing against it with very similar products. Also, after consulting the China IPR SME Helpdesk, the SME finds out that the former General Manager has registered the trademarks of the company in China in his own name instead of under the Dutch company in China.*

*The situation escalates due to some other related outstanding issues for which the former General Manager still demands certain payments. The Dutch company refuses, so the former General Manager goes to the local Authority of Industry and Commerce (AIC) and shows them the trademark certificate of Roi Jaguar, which results in the AIC confiscating the infringing products of the Dutch SME that carry the name Roi Jaguar. As the Chinese trademark registration is in the name of the former General Manager, and the Dutch SME does not have the legal right to the name Roi Jaguar, the former General Manager legally closes down the business of the Dutch SME with regard to the brand Roi Jaguar.*

*The trademark registration carried out by the former General Manager was done in badfaith due to his existing relationship with the Dutch SME. The Dutch SME thus filed for a trademark cancellation as the trademark was registered in bad faith, and then subsequently applied for the trademark itself.*

*After first having filed the trademark cancellation, which temporarily stopped infringement of the Roi Jaguar trademark, the Dutch SME continued to produce the product, but under a different product name. Before the new product name was used, the company checked that there were no conflicting trademarks that had*

*already been registered in China, with regard to additives for that new name. The Dutch SME then registered the wordmark, logo and the Chinese character name of the new product. Once the cancellation was concluded and the trademark was applied for in the Dutch SME's name, the Dutch SME was able to put its products under the Roi Jaguar name back on the market.*

**Lessons learned**

- *Be on top of trademark registrations in China, and make sure the registration of the trademark is conducted in your own company name.*
- *Draft your contracts with care and with the assistance of legal professionals and translators to make sure that all terms, conditions and obligations are clear for both parties.*

Questions :

- (a) *How was the former General Manager successful in legally closing down the business of the Dutch SME with regard to the brand Roi Jaguar in China ?*  
(10 marks)
- (b) *Explain how was Dutch SME able to put its products under the Roi Jaguar name in Chinese market.*  
(10 marks)
- (c) *If tomorrow the Dutch SME operates in India by registering its trademark in India and someone infringes its trademark, then how will the Dutch SME get relief in suits for infringement/passing off under the Indian law quoting relevant case law, if any.*  
(10 marks)

**Answer 2(a)**

After quitting his job the former General Manager of the Dutch SME had started competing against it with very similar products. When Dutch SME consulted the China IPR SME Helpdesk, the SME discovered the fact that the General Manager had got the trademark of the company in China registered in his own name instead of getting it registered in the name of the Dutch company in China.

The former General Manager went to the local Authority of Industry and Commerce (AIC) and showed them the trademark certificate of Roi Jaguar registered in his own name, which resulted in the AIC confiscating the infringing products of the Dutch SME that carried the name Roi Jaguar. As the Chinese trademark registration was in the name of the former General Manager, and the Dutch SME did not have the legal right to use the trade mark of Roi Jaguar, the former General Manager succeeded in getting the business of the Dutch SME closed down legally with regard to the brand Roi Jaguar.

The case study points out in the lessons learned that in China, (i) Be on top of trademark registrations in China, and make sure that the registration of the trademark is carried out in your own company's name. (ii) Draft the contracts with care and with the assistance of legal professionals and translators to make sure that all terms, conditions and obligations are clear for both the parties.

**Answer 2(b)**

The system of international registration of Trade Marks is governed by the Madrid Agreement and Protocol, which are open to any State which is a party to the Paris

Convention for the Protection of Industrial Property. The system of international registration has several advantages for trademark owners.

The Trade Mark registration carried out by the former General Manager in his own name was done in bad-faith and with mala fide intentions taking advantage of his existing relationship with the Dutch SME. The Dutch SME thus filed for a Trade Mark cancellation as the Trade Mark was registered in bad faith, and then subsequently applied for the Trade Mark in its name itself.

After first having filed the Trade Mark cancellation application, which temporarily stopped the activity of infringement of the 'Roi Jaguar' trademark, the Dutch SME continued to produce the product, but under a different product name. Before the new product name was used, the company checked that there were no conflicting Trade Marks that had already been registered in China, with regard to additives for that new name. The Dutch SME then got registered the word mark, logo and the Chinese character name of the new product in its own name. Once the cancellation was concluded and the Trade Mark was applied for in the Dutch SME's name, the Dutch SME was able to put its products under the 'Roi Jaguar' trade name back in the market.

### **Answer 2(c)**

The relief in the suit could be realized under Civil Litigation. It says that a suit can be instituted either under the law of passing off or for trade mark infringement under the Trade Marks Act, 1999 depending on whether the Trade Mark is unregistered, pending registration or registered respectively. Meaning thereby, if the Trade Mark is not registered in India then the remedy available is under the 'Law of Passing off' and if the Trade Mark is registered then the statutory remedy available under the Trade Marks Act, 1999 can be availed. The important aspects of the legal action are as follows:

- *Jurisdiction and Venue* : The suit for passing off and/or infringement can be instituted either in the District Court or in the High Court depending on the valuation of the suit and the pecuniary jurisdiction of the Courts. Apart from the pecuniary jurisdiction, the other aspect which needs to be taken care of while deciding the appropriate forum for the suit is the territorial jurisdiction of the court. The suit can be filed in the court which has territorial jurisdiction over the place where the rights holder or one of the rights holders actually and voluntarily reside or work for gain or carry on its business.
- *Elements of the Complaint* : In the complaint, the rights holder is required to demonstrate that: (a) the alleged infringing act involves a mark that is identical or similar to a trade mark of the rights holder; (b) the infringing representation of a trade mark is being used in connection with goods or services and might lead to confusion in the mind of general public regarding the origin of the infringing goods/services; (c) the unlawful act interfered with the trade mark holder's rights of exclusive use of the trade mark and caused the rights holder consequent economic loss.

Section 135 of the TM Act, 1999 expressly stipulates that the relief which a Court may grant in any suit for infringement or for passing off referred to in Section 134 includes injunction (subject to such terms, if any, as the court thinks fit) and at the option of the plaintiff, either damages or an account of profits, together with or without any order for the delivery up of the infringing labels and marks for destruction or erasure.

According to Section 28(1) of the Act, the registration of a trade mark ensures exclusive right to the registered proprietor to use of the registered trade mark and the right to obtain relief in respect of infringement of the trade mark. Only a registered proprietor or registered user can institute a suit for infringement against an identical or deceptively similar mark to his registered trade mark according to Section 27(1).

A Registered trade mark owner does not have an exclusive right to operate the identical/ nearly similar mark against another registered trade mark owner.

In the landmark judgement *Clinique Laboratories LLC and Anr vs. Gufic Limited and Anr*, the court held that a suit for infringement by a registered trade mark owner/proprietor is certainly maintainable against another registered trade mark owner/proprietor. It was further held that Section 124(5) of the Act also allows the grant of an interim injunction in such suits for infringement.

### Question 3

*To qualify for the grant of a patent under the Patents Act, 1970, the invention must be non-obvious. But determining whether an invention is non-obvious is one of the most difficult tasks in patent law. Discuss. (5 marks)*

### Answer 3

For the purposes of grant of a Patent to an invention, the determining as to whether an invention is non-obvious or not, i.e. determining whether it involves an inventive step or not, is one of the most difficult tasks in the Patent law. The mere coalition of two or more things without exercise of inventive ingenuity is not a subject matter for a patent. It is an invention if the process or manufacture of an article requires some ingenuity or has an inventive step.

However, simplicity is not necessarily an objection for securing a patent for an invention. Even if the product and/or the process may be perfectly simple and very common, yet there may be an invention, if the inventor has developed a variant, which will render it more useful. After all, a disposable razor, a safety pin and a retractable tape measure all seem obvious now, yet none of these items were obvious at the time they were invented. The point of view from which it needs to be ascertained as to whether a particular invention is 'non-obvious' or not is that of a person skilled in the particular art to which the invention relates.

An invention which has an inventive step, however small, but having regard to the condition of the state-of-the-art in the particular field on the date of filing or the priority date of the application for patent, whichever is earlier constitutes a step forward and may be a subject matter for a patent. Thus, one must review the scope and content of the prior art existing in the particular field to determine if the invention is non-obvious. Secondly, consideration must be given to the differences or enhancement carried out between the Prior Art and the Invention at hand. Thirdly, as already stated, if the invention would be obvious to a person having primary skill in the art to which the invention pertains, it cannot be patented.

The Supreme Court in the case of *Bishwanath Prasad Radhey Shyam v. Hindustan Metal Industries* interpreted the term inventive step. In this case, the court opined that

'obviousness' has to be strictly and objectively judged. The test laid down by the court to determine obviousness was:

'Had the document been placed in the hands of a competent craftsman (or engineer as distinguished from a mere artisan), endowed with the common general knowledge at the 'priority date', who was faced with the problem solved by the patentee but without knowledge of the patented invention, would he have come up with the invention in question'

Simply put, according to the test, what has to be determined is whether at the time the invention was made, any other person skilled in the same field as the invention could have come up with the same invention, if faced with the same problem.

#### **Question 4**

*Sonar Industries, proprietor of registered design, obtained an ad interim injunction restraining TRISHA International from manufacturing portable table fans with a design that was allegedly an obvious or colourable imitation of Sonar's registered design for such fans. Sonar Industries also alleged that TRISHA International was guilty of piracy of its registered design.*

*TRISHA International contended striking features of the registered design could not be viewed in isolation. It added that configuration and ornamentation of its table fan design were dissimilar.*

*Will TRISHA International succeed in getting the ad interim injunction vacated ?  
Give reasons in support of your answer. (5 marks)*

#### **Answer 4**

'Design' refers to the features of shape, configuration, pattern or ornamentation which can be judged by the eye in the finished products.

Section 22 of the Design Act 2000 provides the legal proceedings to be followed in case of Piracy of Registered Design.

One of the below remedies can be sought against the accused:

- (i) Paying to the registered proprietor of the design a sum not exceeding twenty-five thousand rupees recoverable as a contract debt provided that the total sum recoverable in respect of any one design shall not exceed fifty thousand rupees; and
- (ii) Recovery of damages for any such contravention, and an injunction against the repetition thereof, to pay such damages as may be awarded and to be restrained by injunction accordingly

Not every resemblance is actionable and imitation does not mean duplication. An obvious imitation is one which immediately strikes one as being so like the original registered design as to be almost indistinguishable. In contrast, the word 'fraudulent' presupposes knowledge of the registered design.

To ascertain infringement, the two products need not be placed side by side, but rather examined from the point of view of a customer with average knowledge and imperfect recollection. The main consideration is whether the broad features of shape, configuration and pattern are similar to one another (*Veeplast v. Bonjour*, 2011).

The Designs Act, 2000 grants protection only for the appearance of the article which appeals to and is judged by the eye.

In a case, the Calcutta High Court held as below:

“Novelty resided in the design as a whole and not in its component parts. The striking features of the registered design could not be viewed in isolation. Components such as mounting brackets being mechanical devices could not be considered as a part of the design as registered in the Certificate of Registration.”

Thus, the question whether TRISHA International's portable table fan is an obvious imitation of Sonar's registered design has to be determined solely by the test of an eye. As the shape, configuration and ornamentation of TRISHA's portable table fan design were clearly dissimilar to those of Sonar's registered design, no prima facie case of piracy has been made out by Sonar.

### Question 5

*A law journal copy-edited a court judgment. It sought copyright by establishing amount of skill, labour and capital put in the inputs of the copy-edited judgment. It was contested on the ground that judicial pronouncements are in the public domain and that their publication does not infringe the copyright.*

*Will the law journal succeed in its copyright of a copy-edited judgment? Give reasons in support of your answer. (5 marks)*

### Answer 5

A matter having similar facts was decided by the Supreme Court in the case titled *Eastern Book Company & Ors. vs. D.B. Modak & Anr.* [Appeal (civil) 6472 of 2004, D/12/12/2007 (AIR 2008 Supreme Court 809,810)]. As per the judgment, the judicial pronouncements of the Apex Court would be in the public domain and its reproduction or publication would not infringe the copyright law. That being the position, the copy-edited judgments would not satisfy the requirement of being a work which is to be protected by the copyright law merely by establishing some amount of skill, labour and capital put in the inputs of the copy-edited judgments since the original or innovative thoughts contained in the judgment carrying the creativity are completely excluded from being subject to a copyright.

Accordingly, the original or innovative thoughts are necessary to establish copyright in the authors' work. The principle that where there is common source the person relying on it must prove that he actually went to the common source from where he borrowed the material, employing his own skill, labour and brain and he did not copy, would not apply to the judgments of the courts because there is no copyright in the judgments of the court, unless so made by the court itself. To secure a copyright for the judgments delivered by the courts, it is necessary that the labour, skill and capital invested should be sufficient to communicate or impart to the judgment printed in some journal some quality or character which the original judgment did not possess and which differentiates the original judgment from the printed one. The Copyright Act is not concerned with the original idea but with the expression of thought. Copyright has nothing to do with originality or literary merit.

Copyrighted material is that what is created by the author by his own skill, labour and investment of capital, maybe it is a derivative work which gives a flavor of creativity. The copyright work which comes into being should be original in the sense that by virtue of selection, co-ordination or arrangement of pre-existing data contained in the work, a work somewhat different in character is produced by the author. To claim copyright in a compilation, the author must produce the material with exercise of his skill and judgment which may not be creativity in the sense that it is novel or non-obvious, but at the same time it is not a product of mere labour and capital. The derivative work produced by the author must have some distinguishable features and flavor to raw text of the judgments delivered by the court. The trivial variation or inputs put in the judgment would not satisfy the test of copyright of an author.

Adding, in the copy-edited version the cross-citations to the citation(s) already given in the original text; adding names of cases and cross-citations where only the citation of the case is given; adding citation and cross-citations where only name of the case is given; inserting citation in case history where only the title and year of the impugned/earlier order is given; presenting in their own style the cases when they are cited repeatedly in the judgment; providing precise references to the quoted matter in the judgment by giving exact page and paragraph number as in the original case source/treatise/reference material; adding margin headings to quoted extracts from statutes/rules, etc., when they are missing from the original text of the judgment; adding the number of the Section/Rule/Article/paragraph to the extract quoted in the original text; adding the names of Judges on whose behalf opinion given ; adding ellipsis “.....” to indicate breaks in quoted extract; supplying the matter inadvertently missed in quoted extracts in the original text of the judgment; changing the text as per corrigenda issued, etc. etc., does not give the Law Journal copyright in the copy-edited judgement.

### Question 6

*An Indian automobile company is interested in joint venture arrangement with a foreign company. It has, however, little knowledge about Due-diligence of intellectual property rights in a corporate transaction.*

*Advise the company regarding :*

- (i) the purpose IP due diligence serves, and*
- (ii) the scope of IP due diligence.* *(5 marks)*

### Answer 6

#### Purpose of IP Due Diligence

1. IP due diligence is a part of a comprehensive due diligence audit that is carried out to assess the financial, commercial and legal benefits and risks linked to a target company's IP portfolio, typically before it is bought or invested in.
2. It provides detailed information that may affect the price or other key elements of a proposed transaction or even aborting the further consideration of the proposed transaction.
3. It provides a basis for assessing the risk and value of relevant IP assets in a proposed acquisition or sale of intellectual property

**Scope**

IP due diligence generally seeks to:

1. Identify and locate IP assets, and then assess the nature and scope of the IP to evaluate their benefits and allocate risks associated with the ownership or use of the relevant IP assets; in particular, it seeks to determine whether the relevant IP is free of encumbrances for its intended business use(s).
2. Identify problems in and barriers to the transfer, hypothecation or securitization of the IP assets under consideration.
3. Identify and apportion between the two parties the expenses incident to the transfer of IP assets under consideration.

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## INTERNATIONAL BUSINESS LAWS AND PRACTICES (Elective Paper 9.5)

Time allowed : 3 hours

Maximum marks : 100

**NOTE:** Answer **ALL** Questions.

### Question 1

Case Study :

#### GLOBAL STRATEGY AT LENOVO

*It has been observed that “the global company’s greatest single advantage can be its global strategy. A global strategy is built on an information system that scans the world environment to identify opportunities, trends, threats and resources. When opportunities are identified, the global company adheres to the three principles : It leverages its skills and focusses its resources to create superior perceived value for customers and achieve competitive advantage. The global strategy is a design to create a winning offering on a global scale. This takes great discipline, much creativity, and consistent effort. The reward is not just success — it is survival.”*

*The world’s top personal computer (PC) producers are Lenovo, HP, Dell and Acer. Lenovo is the top world-wide PC vendor, ahead of rivals HP and Dell. Lenovo is based in China and generates, more than 38 billion dollars in total sales. It holds about 33 percent of the PC market in China, 15 percent in North America, and 20 percent in other countries. Lenovo has experienced rapid growth, even during periods of soft global demand.*

*When Lenovo was founded in modest circumstances in 1984, no one imagined that it would evolve into a FORTUNE GLOBAL 500 Company with a presence in 160 countries. Today, from regional headquarters in each of Beijing, China and Raleigh, North Carolina, Lenovo offers desktops, laptops, tablets, work stations, servers, and mobile phones to customers across the globe.*

#### COMPANY STRATEGY

*The PC industry has reached maturity, especially in the advanced economies. Computers have become commodities, and their profit margins are thin. The industry is global, which means firms compete with each other, and cater to customer needs, on a global scale. PC firms are under pressure to ensure company survival and success.*

*Key to Lenovo’s success in ensuring organisational learning to optimise the firm’s value-chain activities continuously. Lenovo uses mergers and acquisitions (M&As) to acquire needed knowledge and other assets from partner firms and to expand into markets world-wide. In 2005, Lenovo acquired the personal computer (PC) business of IBM. The deal instantly established Lenovo as the number three PC maker world-wide. In 2011, Lenovo formed a merger with NEC, the largest PC vendor in Japan, to access the huge PC market better.*

*The merger increased Lenovo's scale economies in manufacturing and marketing. In 2014, Lenovo acquired the tele-communications firm Motorola Mobility. This provided Lenovo with a strong footing in the global smartphone business. Lenovo follows a protect-and-attack strategy. While protecting its core business, especially the Chinese market. Lenovo is aggressively growing its market value/share in emerging markets and advanced economies. It is rapidly growing new product categories such as tablets and smartphones. The push into emerging markets benefits from Lenovo's deep knowledge of doing business in China. Lenovo now obtains about twenty percent of its revenues from emerging markets outside China.*

*Senior management emphasises global innovation, global products and branding, global human resources, and creation of a corporate culture conducive to global success. These strategies are examined in detail as under :*

#### GLOBAL INNOVATION

*The acquisition of IBM's PC business allowed Lenovo to tap world class technological knowhow. It leverages top-notch innovative capabilities from research and development facilities in Beijing, Raleigh and Yokohama, Japan. Lenovo is a leading PC developer. Each facility has its own distinctive talent capability. Lenovo owns more than six thousand five hundred patents (all international patents). BUSINESS WEEK ranked Lenovo one of the "Top 50 Most Innovative Companies". It constantly invests in research and development (R&D) for breakthrough technologies and innovative products. Lenovo can count on capital infusions from China's Government, which maintains partial ownership in the firm.*

*At the annual Consumer Electronics Show in Las Vegas (USA), Lenovo has unveiled many products, including a Windows-based smartphone, a half-tablet, a half-notebook, a Smart TV, and a thin and lightweight ultrabook PC. Lenovo's market research capability enables the firm to foresee better what consumers desire in information technology products. For example, Lenovo's Yoga is an ultra-thin PC that doubles as a tablet.*

*Lenovo is increasingly on the leading edge of green technologies. ThinkPad PCs are built from upto 30 percent post-consumer content, using recycled material such as old water-jugs. PCs meet the latest high-energy efficiency standards and rank high on eco-friendliness. PCs are shipped in 100 percent recycled packaging that can be tossed into a recycling bin.*

#### GLOBAL PRODUCTS AND BRANDING

*In developing its products, Lenovo emphasises modular architecture — suppliers manufacture interchangeable components and modules, which are then snapped into PC cases rolling down assembly lines. The same parts — power supply units, processors, graphics cards, hard drives, and others — can be used to produce various PC models. Interfaces are standardised to facilitate production of PCs that are simultaneously differentiated but use standard parts and components. This minimised the cost of manufacturing computers and of designing new ones. Products are standardised world-wide, but elements such as keyboards and software are standardised and customised to respond to local language needs.*

*Marketing also responds to local conditions. For example, Lenovo is the most popular*

*PC brand in rural China, where the firm established a complex distribution network extending to small cities and towns. Prices are adapted to fit the buying power of low-income consumers. Lenovo adjusts marketing to fit local traditions. In rural China, the firm markets wedding computer, which come in red, the luckiest colour to the Chinese. Rural families often pool their money to buy a bride and groom their first PC as a wedding gift.*

*By purchasing IBM's PC business, Lenovo acquired the IBM brand name and the ThinkPad product brand. Lenovo leveraged the IBM name to build brand awareness on a global scale. Lenovo's "For Those Who Do" global branding campaign is engaging consumers world-wide. The firm is leveraging the power of global social media to target marketing campaigns to youth 18 to 25 years old. Its retailing websites look identical world-wide but are adopted for language differences.*

#### GLOBAL HUMAN RESOURCES

*Lenovo worked hard to integrate Chinese business methods with an international workforce of 27,000 employees. Blending the distinctive national and organisational culture of IBM required hiring managers with a global mindset and strong international background. Lenovo recruits globally savvy executives from other high-tech firms and hires talented graduates of top universities to incubate them as future company leaders.*

*Lenovo created a global training programme that provides accelerated development opportunities for employees. The firm's human resources group works with managers to construct career maps and pipelines for every high-potential employee. All employees are asked to examine their career aspirations and the training they need to attain their goals. The career maps are linked to job slots around the world, and employees have much latitude to achieve their dreams. Lenovo employees are ambitious, and senior management is serious about helping them develop their careers.*

#### GLOBAL CULTURE

*In 1994, Lenovo's founder, Liu Chuanzhi, forecast that the firm would become a great, global company. At the time, there were very few global Chinese firms, and Chuanzhi's strategic vision stood out. It is Lenovo's strategic vision that draws so many talented managers to work for the firm. Aiming to foster a global spirit, Lenovo's executive team meetings rotate among Beijing, Hong Kong, Singapore, Paris and North Carolina. The firm's official language is English.*

*Senior management has instituted processes aimed at socialising young managers into the Lenovo organisational culture. Nationality does not matter. If an employee demonstrates capability and vision, there are no limits. Socialisation creates broad, tacitly understood rules for appropriate action by managers at all levels in global operations. Lenovo managers become well acquainted with the firm's culture and goals. Wherever they operate, managers feel a strong connection to the firm. This guides decisions on company activities and facilitates global knowledge exchange. Connectedness builds trust and cooperation. It encourages communication and interaction. It facilitates integration and assimilation of new knowledge and capabilities. Lenovo management values the diversity of global cultures and the*

*learning that accrues from foreign business environments. Key employees need to function with a global mind-set and cosmopolitan values.*

#### **MANUFACTURING AND VALUE-CHAIN MANAGEMENT**

*Lenovo concentrates manufacturing at sites in China, Argentina, India, Mexico and Poland. Production in these low-cost countries generates cost efficiencies and economies of scale. Regional headquarters in the United States of America and operations in low-cost countries helps diversify sales across advanced economies and emerging markets. While investing huge sums in research and development (R&D) and innovative product features, senior management maintains a sharp focus on keeping manufacturing costs low. Sourcing of parts and components is done on a global scale. Sourcing from hundreds of high-quality suppliers ensures flexibilities in logistics and production.*

*The diversity of partners and international environments helps Lenovo acquire new technical and managerial knowledge, new product ideas, improved research and development (R&D), and better partnering skills. Lenovo leverages the power of global information systems to share important knowledge among the firm's subsidiaries world-wide.*

*Lenovo aims for a leadership position in which it attains a double-digit share in each of the markets where it does business. Management also aims to maintain a sharp focus on its customers, providing them with the most innovative products world-wide.*

*Referring to the above case study, answer the following questions :*

- (a) What is the nature of Lenovo's international strategy ? How does the company use its strategy to succeed in the global marketplace ? (4+6=10 marks)*
- (b) What are the characteristics of Lenovo's organisational culture ? How does the company's organisational culture help in achieving its international goals. (5+5=10 marks)*
- (c) What strategies does Lenovo employ to maximise company efficiency and flexibility ? Justify your answer. (10 marks)*
- (d) What are the pressures Lenovo faces for global integration ? What advantages does global integration bring to Lenovo ? (5+5=10 marks)*
- (e) The founder of Lenovo forecast that the firm would become a great global company.*

*List the actions and decisions which Lenovo management has taken over the years to evolve into a Fortune Global 500 Company. (10 marks)*

#### **Answer 1(a)**

In the initial stages of globalisation, a firm may not be in a position to opt for either global strategy or multidomestic strategy for its overseas business. They adopt international strategy which involves creating an international division and exporting the products through that division to those countries where the products are needed. At this

stage of globalisation, a company is really focused on the domestic market and just exporting what is demanded abroad. Lenovo follows a protect-and-attack strategy. While protecting its core business, especially the Chinese market. Lenovo is aggressively growing its market its market value/share in emerging markets and advanced economics.

### **Success in Global Marketplace**

Lenovo is rapidly growing in new product categories such as tablets and smartphones. Banking upon its deep knowledge of doing business in China, Lenovo is expanding its business aggressively in the emerging markets while retaining its business in China. Lenovo now obtains about twenty percent of its revenues from emerging markets outside China. Lenovo Strategy emphasizes global innovation, global products and branding, global human resources, and creation of a corporate culture conducive to global success.

Lenovo unveiled many product including a Windows-based smartphone, a half-tablet, a half-notebook, a smart TV, and a thin and lightweight ultrabook PC at the annual Consumer Electronics Show in Las Vegas (USA). Such product depth and diversification is aimed at reaping every possible product segments in each country it operates at.

In developing its products, Lenovo emphasizes modular architecture- suppliers manufacture interchangeable components and modules, which are then snapped into PC cases rolling down assembly lines. Lenovo is the most popular brand in rural China where the firm established a complex distribution network extending to small cities and towns. At the same time, Lenovo purchased IBM's PC business, acquired the IBM brand name and the ThinkPad product brand. It leveraged the IBM name to build brand awareness on a global scale.

### **Answer 1(b)**

Understanding the cultural environment is one of the critical components of international business environment for any firm's survival and success. Beliefs and Values, treated as National Culture, are generally seen as formed by factors such as history language, religion geographic location, government and education. Firms are required to understand beliefs and values of prospective customers and clients in the countries where they do business.

### **Key Characteristics of Lenovo Culture are:**

- Even being a Chinese Firm, its official language is English which helps their employee remain connected.
- Socialisation of young managers helps them integrate into the Lenovo Organizational culture. This helps them get acquainted with firm's culture and goals.
- Broadly, tactically understand rules for appropriate action by managers at all levels in global operations.
- Socialization helps in exchange of ideas and knowledge exchange thus resulting in creation and assimilation of new knowledge and capabilities.
- Exchange of knowledge globally.
- Connectedness builds trust and cooperation

- Global mind-set and cosmopolitan values
- Global Spirit

### **Company's Organisational Culture and Organisational Goals**

- Connectedness, trust and cooperation facilitates the integration and assimilation of new knowledge and capabilities by Lenovo.
- Lenovo's process of socialization of young managers makes them well acquainted with the firm's culture and goals.
- Managers, wherever they operate, feel a strong connection to the firm.
- Fostering global spirit among executives due to team meetings among global executives from Beijing, Hong Kong, Singapore, Paris and North Carolina
- Lenovo managers are facilitated in global knowledge and capabilities.

### **Answer 1(c)**

Strategies for global business differ from those for domestic business because of difference in the nature of competitive forces. A firm's decision to adopt strategies for global business depends on two factors:

- Extent of cost pressures to denote the demand on a firm to minimise its per unit costs.
- Extent of pressures for local responsiveness to denote to make a firm to tailor its strategies to respond to national level differences in terms of variables like customer preferences and tastes, government policies and business practices.

There are four types of strategies for global business :

#### *(i) Global Strategy*

Where markets are converging and people's needs and desires have increasingly homogenized meaning, a firm can offer same and standardized products in such markets. In such scenarios, firms offering standardized products have competitive advantage in the form of lower costs resulting from economies of scale in product development, production and marketing. Lenovo has presence in 160 countries. In developing its products, Lenovo emphasizes modular architecture. Interfaces are standardized to facilitate production of PCs that are simultaneously differentiated but use standardized parts and components thus creating economies in scale, scope and systems.

Lenovo concentrates manufacturing at sites in China, Argentina, Mexico and Poland. Production in these low-cost countries generate cost efficiencies and economies of scale.

#### *(ii) International Strategy*

It involves creating an international division and exporting the products through that division to those countries where the products are needed. A company is really focused on the domestic market and just exporting what is demanded

abroad. Lenovo protects its core business especially the Chinese market and is increasing its market share in emerging markets and advanced economies thus leveraging 'protect and attack' strategy in its business operations.

(iii) *Multi-domestic Strategy*

Companies try to achieve a high level of responsiveness by making their products to the requirements of the countries they operate in. In Lenovo, R & D facilities have distinct talent capabilities. Products are standardized world-wide, but elements are customized to respond to local language needs.

(iv) *Transnational Strategy*

It involves integration of low costs and high local responsiveness and it requires innovative ways. Lenovo acquired IBM's PC business which enabled it to tap world-class technological know-how. Lenovo's marketing responds to local conditions. Prices are adapted to fit the buying power of low-income consumers. Through standardisation of interfaces to facilitate production of PCs, costs of manufacturing computers and of designing new ones are minimized.

**Answer 1(d)**

As firms expand to international markets, structural and environmental complexities and uncertainties require top management to focus on the impact of international business environment on the firm's operations.

Companies operating in international markets function in a highly competitive environment and require strategies that differentiate their products and enhance their perceived value while reducing production costs. Companies need to offer their products at competitive prices and at the same time tailor them to local needs. The International business environment is multi-dimensional encompassing political risks, cultural differences, exchange risks, legal and taxation issues.

**Pressures at Lenovo**

- PC industry had reached maturity level especially in the advanced economies. Computers have become commodities and profit margins are becoming thin.
- Being a global industry, firms compete with each other. PC firms, like Lenovo, were under pressure to ensure company survival and success.
- Lenovo was under pressure to integrate Chinese business methods with an international workforce of 27000 employees.
- Lenovo was also under pressure to blend the distinction existing between national and organizational culture of IBM.

**Advantages**

- Lenovo acquired PC business of IBM. The deal instantly established Lenovo as the number three PC maker worldwide.
- Lenovo formed a merger with NEC, the largest PC vendor in Japan, to have a better access of the huge Japanese PC market.

- Acquisition of IBM's PC business allowed Lenovo to tap world class technological know-how.
- Products were standardised worldwide but elements such as keyboards and software are standardised and customised to respond to local language needs.
- Socialisation of employees facilitated connectedness, trust building, cooperation and integration and assimilation of new knowledge and capabilities.

### Answer 1(e)

#### Actions and Decisions by Lenovo

- Organisational learning to optimise firm's value-chain activities continuously.
- Mergers/acquisitions to acquire market knowledge and other assets from partner firms and to expand into markets world-wide.
- Following a protect-and-attack strategy - protecting its core business in China as well as growing its market share in emerging markets and advanced economics.
- Emphasis on Global innovation-unveiling many products in Las Vegas and being on the leading edge of green technology.
- Emphasis on modular architecture by minimizing cost of manufacturing computers designing new ones and standardizing products world-wide.
- Global branding "For Those Who Do".
- Creating a global training programme and providing accelerated development opportunities for employment.
- Institutionalization of processes aimed at socializing young managers in to the company's Organisational culture.
- Concentration on production in Low-cost countries to generate cost effectiveness and economies of scale.
- Vision to maintain a sharp focus on customers and to provide them with the most innovative products worldwide.

### Question 2

(a) *Global opportunities are not without risks. Discuss.*

*How can these risks be minimised ?*

*(3+2=5 marks)*

(b) *Govind Fast Foods is doing good business and has garnered acceptability among its clients. It is contemplating to open fast-food chain along Delhi-Jaipur highway and enter into a franchise with Subway, a fast-food franchise in the USA.*

*Advise the company about the pros and cons of entering into the franchise with the USA fast-food chain Subway.*

*(5 marks)*

(c) *It is said that India has put in place liberal policies in foreign direct investment.*

*Yet, there are sectors where foreign direct investment is not allowed to the companies both under the automatic route as well as under the Government route.*

*What are the sectors where foreign direct investment is not allowed and why ?  
(2+3=5 marks)*

- (d) *Radha Exports has been toying with the idea of expanding its business in foreign countries. It is apprehensive of risks associated with its goods to be exported in overseas markets.*

*You, as Company Secretary, have been asked to prepare a note as to how the company should manage these risks. (5 marks)*

- (e) *Advocates of worldwide free trade are generally opposed to trading blocs, which they argue encourage regional trade as opposed to global free trade. Discuss. (5 marks)*

- (f) *You are a Company Secretary of Cube Ltd. which is planning into joint venture with Puma Ltd. based in London, for marketing and selling a new product launched by your company.*

*Advise your Board of Directors about the importance of specific inclusion of the following matters in the definitive joint venture agreement :*

(i) *Restrictive Covenants*

(ii) *Alternative dispute resolution (ADR) mechanism. (5 marks)*

### **Answer 2(a)**

Globalisation refers to the increasing integration of economies around the world, particularly through the movement of goods, services, and capital across borders.

The following are the important risks:

- *Political and Regulatory Risks* : Political instability in various countries coupled with not so smooth transfer of power results in new Political regimes. Different types of regulations for doing business in host countries poses several potential business risks for any firm.
- *Cultural and Managerial Risks* : Products/services have to be tailored to suit customers' preferences and choices, attitudes towards certain products and services, traditions, values and beliefs. There is a need for suitable change in management practices, more particularly relating to human resource aspects.
- *Exchange risk* : Every country has its own currency system as the currency of one country is not in circulation in the other country. Therefore, one currency is exchanged with another currency at some rate. The exchange rate keeps on fluctuating causing risk of loss to firms engaged in international business
- *Credit risk* : It is the risk of loss due to a debtor's non-payment of a loan or other line of credit (either the principal or interest (coupon) or both). It is difficult to ascertain the credit-worthiness of a foreign buyer. When a foreign buyer goes bankrupt, the domestic exporter faces great loss.

- *Transport risk* : Due to long distance between countries, goods are dispatched either by ship or cargo flights. Sea and air transport poses several kinds of transit and transport risks such as collision of vessel, piracy, jetsam, flotsam of vessel resulting in derelicts and wreckage of cargo.
- *Market risk* : Competition in international business is severe and market conditions keep on changing frequently. It may not be possible for a firm to compete in international markets.

### **Minimisation of Risks**

- The International Monetary Fund works to help economies manage or reduce these risks, through economic analysis and policy advice and through technical assistance in areas such as macroeconomic policy, financial sector sustainability, and the exchange-rate system.
- Economies, would need to embrace policy changes to build strong economies and a stronger world financial system
- Strategic vision to become more competitive, diversification to gain advantages of internationalization.
- Internationally engaged firm can manage their credit risks by taking a Credit Risks Policy from Export Credit Guarantee Corporation of India.
- Similarly, transport and transit risks of loss or damage to cargo can be managed by taking a cargo insurance or transport insurance. There are 24 General Insurance Companies in India offering insurance coverage for transport risks.
- Exchange rate fluctuation risk can be managed by taking forward cover or by Option. Commercial banks in India offer such exchange rate coverage instruments to hedge exchange rate risks.
- Indian embassies, now offers help in coping up political crises and act to promote India's business interest by taking active interest with political establishment of counter parties. Indian firms should establish strong contacts with Indian embassies abroad.

### **Answer 2(b)**

Franchising refers to the methods of practicing and using another person's business philosophy. The franchisor grants the independent operator the right to distribute its products, techniques, and trademarks for a percentage of gross monthly sales and a royalty fee.

Govind fast foods will have the advantage of starting up a new business quickly based on a proven trademark and formula of doing business of Subway. It may be able to take businesses to a level which it would not have been possible without the expert guidance from Subway. Govind fast foods may also receive significant training from Subway.

Govind fast foods is also required to take note of constraints. There is no guarantee of improved financial performance. Moreover, there is loss of control as it would have to follow the use of a system, trademarks, assistance, training and marketing of Subway.

Further, franchise agreements are unilateral contracts or contracts of adhesion wherein generally the contract terms are advantages for the franchiser when there is a conflict in the relationship.

**Answer 2(c)**

FDI is prohibited under the Government Route as well as the Automatic Route in the following sectors:

- Atomic Energy
- Lottery Business
- Gambling and Betting
- Business of Chit Fund
- Nidhi Company
- Agricultural (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors) and Plantations activities (other than Tea Plantations).
- Housing and Real Estate business (except development of townships, construction of residential/ commercial premises, roads or bridges to the extent specified in Notification of RBI.
- Trading in Transferable Development Rights (TDRs).
- Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

Rationale behind prohibition in the above mentioned sectors are:

- Protection of National and Strategic Interests;
- Safeguarding of territorial integrity and sovereignty of the country;
- Curbing of interference in national politics;
- To check creation of monopolies or oligopolistic structures;
- Protection against displacement of domestic producers;
- To safeguard national economic autonomy and control; and
- To minimize balance of payments problems due to servicing of foreign debt capital.

**Answer 2(d)**

Like any business transaction, risk is also associated with good to be exported in an overseas market. The various types of export risks involved in an international trade are Credit Risk, Poor Quality Risk, Transportation Risks, Logistics Risk, Legal Risks, Political Risk, Unforeseen Risks and Exchange Rate Risks.

**Methods and instruments to manage risks**

- *Forfaiting*

It is a form of supplier credit, which means that the supplier offers credit terms to the buyer and then sells the debt to a bank without recourse. This allows the seller to reduce his exchange rate risk and to eliminate most non-payment risks.

- *Hedging*

Exporters and importers can manage foreign exchange risk by hedging through forward and future contracts.

- *Export credit insurance*

Export credit insurance (ECI) protects an exporter of products and services against the risk of non-payment by a foreign buyer.

- *Export credit guarantee*

Export credit guarantees are instruments to safeguard export-financing banks from losses that may occur from providing funds to exporters.

- *EXIM Bank*

It issues guarantees (advance payment guarantee, performance guarantee, guarantee for release of retention money, guarantee for rising borrowings overseas) for project export contract.

**Answer 2(e)**

A trading bloc is a group of countries within a geographical region that protect themselves from imports from non-members. A trade bloc is basically a free-trade zone, or near-free-trade zone, formed by one or more tax, tariff, and trade agreements between two or more countries.

The various advocates of global free trade argue that regional trade is encouraged by trading blocs and is opposed to international trade and business. They are of view that trading blocs are likely to be disadvantageous to world trade and reduce the beneficial effects of specialization and the exploitation of comparative advantage among countries. Moreover, inefficient producers within the bloc may be protected from more efficient ones outside the bloc.

On the other hand, the protagonists of regional trading blocs perceive the following points:

- At the regional level, there is a wider application of the comparative advantage within the bloc.
- Easier access to each other's markets means that trade between members is likely to increase.
- Producers can benefit from the application of scale economies, which will lead to lower costs and lower prices for consumers.

- Firms inside the bloc are protected from cheaper imports from outside, such as the protection of the EU shoe industry from cheap imports from China and Vietnam.

Thus, in conclusion one can say their regional blocs are not in conflict with international trade. Both can coexist. There is no threat to international trade from EU, SAARC, NAFTA, ASEAN etc.

### **Answer 2(f)**

(i) *Restrictive covenants*

A Restrictive Covenant is a specific type of covenant in which someone agrees to be restricted by a contract. The most common type of restrictive covenant is one in which a former employee is restricted from working in his or her field for a specific time and within a specific area after leaving employment. Cube Ltd. would be advised to enter into restrictive covenants in the complex area of parallel or relates businesses. It should also seek non-disparagement, confidentiality and nonsolicitation of employee covenants. Whether an IJV is dissolved or ends by one party purchasing the interest of another, non-competition provisions may well be appropriate.

(ii) *Alternative Dispute Resolution*

Only Cube Ltd. and Puma Ltd. themselves can achieve a solution their will not only resolve the dispute and facilitate a useful future relationship. Mediation, conciliation and arbitration are the important ADR mechanism. Arbitration is the more important and prominent of the private settlement mechanisms for international commercial relations. Arbitration is consensual, a private procedure and leads to a final and binding determination of the rights and obligations of the parties. Cube Ltd. would be advised to include an arbitration clause in the joint venture agreements.

### **Question 3**

*Arrow logistics deals with providing logistics services for heavy machinery. It is grappling with the problem of storage and handling.*

*What should the company do to ensure efficient handling and movement of heavy machinery from origin to the destination ? (5 marks)*

### **Answer 3**

Containerisation is the technique or practice of stowing freight in reusable containers of uniform size and shape for transportation. The freight may sometimes be oddly shaped and in different quantities. But when stowed and shipped in containers, it can be handled as a single piece thus making it a lot easier to transport which in turn reduces the time and costs involved. Containerisation involves the unitizing of cargo through the use of standard metal containers. A cargo container is a large container for freight. Cargo containers can be loaded onto container ships, planes, railroad cars, and trucks.

The goods shipped most likely will fall under one of three categories:

- Refrigerated cargo

- Dry cargo
- Dangerous and hazardous cargo

Depending upon the product/cargo, cargo containers come in different sizes, types and stages. By construction, heavy machinery container could be:

- Open door container (a container with a fitted removable roof, or a tarpaulin roof, so the container can be loaded or unloaded from the top used for heavy machinery.
- Platform or bolster for barrels and drums.

#### Question 4

*Speciality Agro Products Ltd. requires clarity about the special provisions about agricultural subsidies so that the company is not subject to countervailing measures.*

*As Company Secretary of the said company, advise the management :*

- The rationale behind the grant of subsidy to farming industry.*
- When is the subsidy considered to be unfair. (3+2=5 marks)*

#### Answer 4

- The Rationale behind the grant of subsidy to farming industry*

The term subsidy means money granted by the State or a Public Body to keep the prices of commodities under control. Subsidy may take the form of direct or indirect government grants on production or exportation of goods including any special subsidy on transportation of any product. The subsidy is usually given to remove some type of burden and is often considered to be in the interest of the public.

If a domestic industry, like farming, is struggling to survive in a highly competitive international industry with low prices, a government may give cash subsidies to farms so that they can sell at the low market price but still achieve financial gain. Article 13 of the Agreement on Subsidies and Countervailing measures (SCM Agreement) provides for special rules regarding subsidies for agricultural products. Domestic supports which are in full conformity with the Agriculture Agreement are not actionable multilaterally, although they also may be subject to countervailing duties. Finally, domestic supports within the "green box" of the Agriculture Agreement are not actionable multilaterally nor are they subject to countervailing measures.

- When subsidy is considered to be unfair*

Subsidy is a benefit provided to a particular class of persons when they meet a certain specified criteria. The subsidy would become unfair, when by virtue of the benefit so provided, it creates an unfair advantage to such class of persons, providing better than needed competitive advantage and diluting the level playing field in internationally competitive price sensitive market. In terms, if subsidy causes business injury to traders of other countries, they can challenge it at WTO and impose Countervailing duty so as to provide level field to their traders.

**Question 5**

*Summarise the foreign trade policy initiatives of the Government of India to boost exports. (5 marks)*

**Answer 5**

The long-term policy objective for the Govt. of India is to double India's share in global trade by 2020. The foreign trade policy prohibits export or import by any person without an IEC number unless specifically exempted. There are two schemes for exports of Merchandise and Services respectively, such as Merchandise Exports from India Scheme (MEIS) and Service Exports from India Scheme (SEIS) to provide rewards to exporters to offset infrastructural inefficiencies & associated cost involved and provide exporter a level playing field.

Units undertaking to export their entire produce may be set up under the EOU scheme, and other schemes. Duty exemption schemes consist of Advance Authorization Scheme and Duty Free Import Authorization Scheme. Under the Merchandize Export from India Scheme, duty credit scrips are issued to eligible exporters thus enhancing their exports prospects in overseas markets. Similarly, under Services Export from India Scheme, services exporters are eligible for duty credit scrip. The SEZ Act, 2005 envisages key role for State Govt. in export promotion and creation of related infrastructure. The Free Trade and Warehousing Zones is a special category of SEZ and is governed by the provisions of the SEZ Act and the rules. The Organisational structure for the promotion of exports includes a number of councils and organisations set up during the post-independence period.

The Department of Commerce, Govt. of India, is the most important organ concerned with the regulation, development and promotion of India's international trade.

**Question 6**

*Intellectual property protection should contribute to technical innovation and the transfer of technology. It must also ensure penalties for infringement to deter violations.*

*How does the Agreement on Trade Related Aspects of Intellectual Property Rights narrow the gaps in the way these rights are protected around the world ?*

*(5 marks)*

**Answer 6**

The WTO's TRIPS Agreement is an attempt to narrow the gaps in the way these rights are protected around the world, and to bring them under common international rules. It establishes minimum levels of protection that each government has to give to the intellectual property of fellow WTO members. In doing so, it strikes a balance between the long term benefits and possible short term costs to society. Society benefits in the long term when intellectual property protection encourages creation and invention, especially when the period of protection expires and the creations and inventions enter the public domain. Governments are allowed to reduce any short term costs through various exceptions, for example to tackle public health problems. And, when there are trade disputes over intellectual property rights, the WTO's dispute settlement system is now available.

The agreement covers five broad issues:

- how basic principles of the trading system and other international intellectual property agreements should be applied
- how to give adequate protection to intellectual property rights
- how countries should enforce those rights adequately in their own territories
- how to settle disputes on intellectual property between members of the WTO
- special transitional arrangements during the period when the new system is being introduced.

The TRIPS Agreement has an additional important principle i.e. intellectual property protection should contribute to technical innovation and the transfer of technology. Both producers and users should benefit, and economic and social welfare should be enhanced, the agreement says. The agreement also says governments have to ensure that intellectual property rights can be enforced under their laws, and that the penalties for infringement are tough enough to deter further violations. The procedures must be fair and equitable, and not unnecessarily complicated or costly.

The areas covered by the TRIPS Agreement are as under:

- Copyright and related rights
- Trademarks, including service marks
- Geographical indications
- Industrial designs
- Patents
- Layout designs (topographies) of integrated circuits
- Undisclosed information, including trade secrets.

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