

GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

DECEMBER 2020

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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PROFESSIONAL PROGRAMME EXAMINATION

DECEMBER 2020

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 2020-21, unless stated otherwise.*

3. *Working notes should form part of the answer.*

PART A

Question 1

- (a) Anirudh, resident individual, aged 57 years provides the following particulars of his income/ loss, payments made and of receipts for the financial year 2019-20:

Particulars	Amount (₹)
Gross Rent received for let out property	3,60,000
Interest paid on Housing Loan taken for construction of the let out property	4,80,000
Loss suffered in cotton trading business	4,30,000
Unexplained cash credits in books	15,00,000
Cash gifts received from friends	2,72,000

Take that the Return of Income is to be filed by Anirudh in time as per section 139(1) of the Act and the fair rent of the let out property is also same of actual rent received of ₹3,60,000.

You are required to compute the total income and the amount of total tax, if any, payable by Anirudh for Asst. Year 2020-21. Indicate also the items of loss which can be carried forward to subsequent years, if any. (5 marks)

- (b) Examine and explain by giving reasons in brief as to the correctness or otherwise of each of the following statements in the context of provisions contained under the Income Tax Act, 1961 :
- Every person who during the previous year was a partner of a firm or a legal representative of any deceased partner shall not be liable jointly and severally to pay the amount of tax, penalty or other sum payable by the firm.
 - The application before the authority for seeking Advance Ruling is to be filed in triplicate and be accompanied by a fee of ₹10,000
 - Specified domestic transactions in case of an assessee means any business transacted between the assessee and other person as referred to in section 80-IA(10) of the I.T. Act subject to that the aggregate value of such transactions in the previous year exceeds ₹20 crores.

- (iv) Impermissible avoidance arrangement results directly or indirectly in the misuse, or abuse of provisions of I.T. Act and be subject to applicability of GAAR.
- (v) Tax Avoidance cannot be considered at par as Tax Evasion since it is usually done by taking advantage of loop-hole without any infringement of taxation laws so that least taxes are attracted. (5 marks)
- (c) General Anti Avoidance Rule (GARR) are applicable when an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement. Explain briefly in the light of provisions of the Income Tax Act, 1961 the meaning and the purpose behind the impermissible avoidance arrangements. (5 marks)

Answer 1(a)**Computation of Total Income & Tax Liability of Mr. Anirudh [Assessment Year 2020-21]**

<i>Particulars</i>	<i>Amount (Rs)</i>	
Income from House Property		
Gross Rent Received (GAV)	3,60,000	
Less : Standard Deduction at 30% [Section 24(a)]	(1,08,000)	
	2,52,000	
Less : Interest paid on Housing Loan [Section 24(b)]	(4,80,000)	
Loss from House Property	(2,28,000)	
Maximum loss allowed to be set off against Income from other sources	(2,00,000)	
Balance loss to be carried forward	(28,000)	
Balance Income		Nil
Profits and Gains of Business or Profession		
Loss from cotton trading business	(4,30,000)	
Set off against income from other sources	72,000	
Balance loss to be carried forward	(3,58,000)	Nil
Income from Other Sources		
Cash gifts received from friends	2,72,000	
Less : Set off losses from House Property	(200000)	
Less : Set off losses from cotton trade business	(72,000)	
Balance Income chargeable to tax		Nil
Unexplained Cash Credits as per section 68		15,00,000
Total Income		15,00,000

Total Income

Tax Payable on Income of Cash Credits [Rs. 15,00,000 @ 60%]	9,00,000
Add : Surcharge @ 25%	2,25,000
Total Tax and surcharge	11,25,00
Add : Cess at 4%	45,000
Total Tax Liability	11,70,000

Answer 1(b)

- (i) **Incorrect** : As per section 188A of the Income tax Act, 1961, Every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of this Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.
- (ii) **Incorrect** : As per section 245Q of the Income tax Act, 1961, the application before the authority for seeking Advance Ruling shall be made in Quadruplicate and to be accompanied by a fee of Rs.10000 or such fee as may be prescribed in this behalf, whichever is higher.
- (iii) **Correct** : As per section 92BA of the Income tax Act, 1961, "specified domestic transaction" in case of an assessee means any business transactions between the assessee and other person as referred to in section 80-IA(10) of the Income Tax Act, 1961 and where the aggregate of such transactions entered into by the assessee in the previous year exceeds Rs. 20 crore.
- (iv) **Correct** : As per section 96 of the Income tax Act, 1961, any arrangement which directly or indirectly resulted in the misuse or abuse of the provisions of the Act is an impermissible avoidance arrangement where GAAR provision shall apply.
- (v) **Correct** : Tax avoidance cannot be same as Tax Evasion. Azadi Bachao Andolan, (2003), 263 ITR 706 (SC) Supreme court held that citizen is free to carry on his business within the four corners of the law and that mere tax planning, without any motive to evade taxes through colourable devices is not frowned upon.

Answer 1(c)

As per section 95 of the Income tax Act, 1961, An arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement in relation to determination of tax arising there from.

As per section 96 of the Income tax Act, 1961, An impermissible avoidance arrangement means an arrangement, the main purpose of which is to obtain a tax benefit, and it;

- a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length.

- b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act.
- c) lacks commercial substance or is deemed to lack commercial substance under section 97 in whole or in part; or
- d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona-fide purposes.

(Attempt all parts of either Q.No.2 or Q. No. 2A)

Question 2

- (a) *Janak Poly Fibres Ltd. is an Indian company having registered office in Mumbai and John Stuart LLP is a non-resident Singapore base company. There have been a series of international transactions between both these companies since last so many years.*

Janak Poly Fibres Ltd. has entered into an Advance Pricing Agreement (APA) on 10th January, 2020 to determine the ALP for the transactions entered with John Stuart LLP by stating that P.Y. 2019-20 is the first of the consecutive previous years. The rate adopted under the Advance Pricing Agreement is Rs. 13,500 per MT.

The assessments for the assessment years 2012-13 to 2017-18 of Janak Poly Fibres Ltd. have been completed on various dates and in these years, the ALP determined and taken for the A.Y. 2012-13 to 2015-16 was ₹13,000 per MT and of ₹ 14,000 per MT for A.Y. 2016-17 and 2017-18. The quantity involved was 2 lakhs MT in each of these years respectively.

Assessments for the subsequent assessment years for 2018-19 and 2019-20 are pending and yet to be completed. The assessee had adopted the value of ₹ 13,200 per MT in both the assessment years 2018-19 and 2019-20.

In the backdrop of the above and taking note of the aforesaid information, you are required to answer the following; considering the transfer pricing provisions and the provisions contained under the Income Tax Act, 1961 :

- (i) *Can the Assessing Officer apply the roll back provisions for the A.Y. 2012-13 to A.Y. 2015-16 as the same will be beneficial to the department ?*
 - (ii) *In the given situation and the set of facts, state the year for which the APA cannot be applied.*
 - (iii) *What will happen to the assessments which have already been completed and are pending because of entering into APA ? (5 marks)*
- (b) (i) *Explain the manner and the means by which taxes to be levied on the income of a non-resident assessee can be recovered under the Income Tax Act, 1961. (3 marks)*
- (ii) *Examine the correctness of the following statements and provide answer with reference to the provisions contained under the Income-tax Act, 1961:*
- (1) *Anil, during the financial year 2019-20, paid interest to SBI on the loan*

taken by him for the higher education of his son from USA. His son was employed in a firm in USA during the year after completion of education. Anil is to be not allowed to get deduction under section 80E of the Income Tax Act, 1961.

(2) Subscription to notified bonds of NABARD would qualify for deduction under section 80C of the Income Tax Act, 1961. (2 marks)

(c) Anand provides the following details/particulars of his income earned from various activities during the financial year 1-04-2019 to 31-03-2020 :

- (i) Shares of XYZ Ltd an Indian company sold in the month of August, 2019 outside India in UK to a Non-resident individual which resulted into short term capital gain of ₹75,000.
- (ii) Interest received on the bonds from Government of India ₹28,500.
- (iii) Rental income of ₹9,00,000 received from the property located in Dubai which was deposited in the bank account maintained in Dubai. Out of this; an amount of ₹4,50,000 was remitted in a bank account in India during the year ended on 31-03-2020 and remaining amount was spent for the education of son doing MBA in U.K.
- (iv) Income of ₹1,80,000 earned from textile business in Sri Lanka which is being controlled from Mumbai.

Compute the total income of Anand for the A. Y. 2020-21 by taking his residential status as a (i) resident, and (ii) non-resident. (5 marks)

OR (Alternate question to Q. No. 2)

Question 2A

- (i) The residential status of Thomas for the previous year 2019-20 is of a resident but not ordinarily resident (R&NOR). He has following income during the year and asks you to explain by giving brief reasons as per provisions of the Income Tax Act, 1961 whether the same be taxable in the assessment year 2020-21 :
 - (a) Agricultural income of ₹35,000 from the land used for cultivating the crop of grapes located in Nasik, Maharashtra, India.
 - (b) Dividend of ₹55,000 from an Indian Mutual Fund company on the MF Units as specified under section 10(23D) of Act.
 - (c) Income received and accrued outside India from a business of cosmetics of ₹1,25,000 which is being controlled from India.
 - (d) Gifts received from brother of ₹21,000 and gifts of ₹51,000 received from persons who are not a relative on the occasion of his marriage.
 - (e) Past untaxed profits of earlier years of ₹2,50,000 lying in bank account maintained in Singapore and being remitted during the previous year 2019-20 to India. (5 marks)
- (ii) Can a resident make an application for seeking advance ruling from the Authority for Advance Ruling (AAR) ? Enumerate all those situations in which the ruling can be obtained by a resident from the Authority. (5 marks)

- (iii) *Lankawin Pty Inc of UK (LI) incorporated in London is a specified foreign company and is a non-resident in India. It received order for data processing services from Srikrishna Datamatics Ltd (SDL) an Indian company (holding 30% shares in Lankawin Pty Inc of UK) during the previous year 1-4-2019 to 31-3-2020. SDL has exercised a valid option for application of Safe Harbour Rules. (Assume that the operating margin required to be shown under the Safe Harbour Rules for the given gross receipts is 18% under Rule 10TD).*

Particulars/details and information in respect of transactions between both the companies relating to the P. Y. 2019-20 are as under :

<i>Particulars/Information</i>	<i>(₹ in Cores)</i>
<i>Value of international transactions entered into between both</i>	<i>110</i>
<i>Operating Expenses</i>	<i>93</i>
<i>Operating Margin</i>	<i>17</i>

In this back drop, you are required to examine and answer in the context of provisions contained under the Income Tax Act, 1961 the following issues :

- (a) *Whether the two companies are the Associate Enterprises and the transaction between them is an eligible international transaction ?*
- (b) *Whether SDL is an eligible assessee for the transaction with LI ?*
- (c) *Whether the results shown by SDL be acceptable to department or will SDL be required to make primary adjustment? (5 marks)*

Answer 2(a)

- (i) Roll back provisions in relation to Advance Pricing Agreement (APA) can be applied only for any previous year, falling within the period not exceeding four previous years, preceding the first of the five consecutive previous years stated in the APA. The first of the five consecutive previous years specified in the APA is the P.Y. 2019-20 relevant for A.Y. 2020-21. Therefore, P.Y. 2015-16 to 2018-19 relevant for A.Y. 2016-17 to 2019-20 are the years for which roll back provisions under the APA can be applied. As a consequence, the Assessing Officer cannot apply the roll back provisions for the AY 2012-13 to A.Y. 2015-16.
- (ii) **Assumption : The solution has been made based on the assumption that Janak Poly Fibers Ltd. (Indian Company) was making sales to John Stuart LLP (Non-Resident) Singapore base company.**

Rollback provisions cannot be applied where the same would result in reduction of Income. In the given situation, when the APA is applied for the A.Y. 2016-17 and 2017-18, the ALP per MT will be lower by Rs. 500 per MT (as taken in these years at Rs. 14000 per MT whereas under APA is 13,500 per MT) which when be applied on 2 lakh MT, the income would be lower by Rs 10 crores.

Hence rollback cannot be applied for AY 2016-17 and AY 2017-18. However, for all other years being AY 2018-19 and AY 2019-20 it has to be mandatorily applied.

Alternative 2(a)(ii) (OR)

Assumption : The solution has been made based on the assumption that Janak Poly Fibers Ltd. (Indian Company) was Purchasing from John Stuart LLP (Non-Resident) Singapore base company.

Rollback provisions cannot be applied where the same would result in reduction of Income. In the given situation, when the APA is applied for the A.Y. 2016-17 and 2017-18, the ALP per MT will be lower by Rs. 500 per MT (as taken in these years at Rs. 14000 per MT whereas under APA is 13,500 per MT) which when be applied on 2 lakh MT, the income would be higher by Rs 10 crores.

Hence rollback is to be applied for AY 2016-17 and AY 2017-18. However, for all other years being AY 2018-19 and AY 2019-20 it cannot be applied.

- (iii) Completed Assessments : The AO will reassess or re-compute the income adopting the ALP as per the APA entered into whenever for which year the same is applicable.

Pending Assessments: The pending assessments for the AY 2018-19 and AY 2019-20 will be completed in the light of the ALP as per the APA entered into between the assessee and Johan Stuart LLP.

Answer 2(b)(i)

As per section 173 of the Income tax Act, 1961, Taxes levied on the income of the non-resident may be recovered in the following manner:

- (i) *Deduction of tax at source under Chapter XVII-B* : The amount of tax should be deducted at the prescribed rates out of the payments by the person who makes the payment to a non-resident.
- (ii) *From his Agent or Assets* : All assets in India belonging to the non-resident principal can be proceeded against for the recovery of tax, on the basis of the assessment made against his statutory agent.
- (iii) Where any property of the non-resident principal is vested in the representative assesses or is under the control or management of the representative assessee, the same may be proceeded against, whether the demand is raised against the representative assessee or against the beneficiary direct. If there is no property in India of the non-resident at the time of making an assessment, the Assessing Officer may wait till any property of the non-resident comes into India.
- (iv) The special provisions relating to certain incomes of non-residents under chapter XII A example Section 115C, 115D, 115E, 115F, 115G, 115H, & 115-I under the Income tax Act, 1961.

Answer 2(b)(ii)

- (1) **The statement is Incorrect** : The deduction under section 80E of the Income Tax Act, 1961, is available to an individual in respect of interest on loan taken for his higher education or for the higher education of his relative being the spouse and children of the individual. Therefore, Anil will get the deduction under section 80E of the Income Tax Act, 1961 assuming the school, board or

university is recognised by the Central Government or State Government or local authority or by any other authority authorised by the Central Government or State Government or local authority . It is immaterial that his son is already employed in a firm for claiming deduction under section 80E of the Income Tax Act, 1961.

ALTERNATIVE 2(b)(ii)(1) (OR)

The statement is Correct: The deduction under section 80E of the Income Tax Act, 1961, is available to an individual in respect of interest on loan taken for his higher education or for the higher education of his relative being the spouse and children of the individual. For the purpose of this provision, "higher education" means any course of study pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorised by the Central Government or State Government or local authority to do so. In this case, the higher education has been completed from USA, which may not fall within the scope of Section 80E. Therefore, Anil will not get the deduction under section 80E of the Income Tax Act, 1961.

- (2) **The statement is Correct** : As per section 80C(2) of the Income tax Act, 1961, subscription to such bonds issued by NABARD (as the Central Government may notify in the Official Gazette) would qualify for deduction under section 80C of the Income tax Act, 1961.

Answer 2(c)

Computation of Total Income of Mr. Anand for AY 2020-21

S. No.	Particular	Resident	Non-Resident NR
(i)	Short term capital gain on sale of shares of an Indian Company (<i>income deemed to accrue or arise in India</i>)	75,000	75,000
(ii)	Interest received on Bonds from Government of India (<i>Income deemed to accrue or arise in India</i>)	28,500	28,500
(iii)	Rental income from house property situated outside India (<i>Income accrued or arise outside India</i>)	9,00,000	-
(iv)	Income from business in Sri Lanka which is being controlled from India (<i>Income accrued or arise outside India from a business controlled from India</i>)	1,80,000	-
Total Income		11,83,500	1,03,500

Note : Assumption: Resident is considered as Resident and Ordinarily Resident

'ROR'. However if considered Resident as RNOR the answer shall be 75,000 + 28,500 + NIL + 1,80,000 = 2,83,500.

Answer 2A(i)

The treatment to be given to the various Income derived/earned by **Mr. Thomas, resident but not ordinarily resident (RNOR)** during the previous year relevant to Assessment Year 2020-21 as per provisions of the Income Tax Act, 1961 shall be as under:

- a) Agricultural income of Rs. 35,000 derived from the land used for cultivating the crop of grapes situated in Nasik, Maharashtra, India is exempt from tax u/s 10(1) since covered under the definition of Agriculture Income u/s 2(1A) of the Income tax act, 1961.
- b) Income received by way of dividend of Rs. 55,000 in respect of Units of a Mutual Fund specified u/s 10(23D) is exempt from tax u/s 10(35) of the Income tax Act, 1961.
- c) Any income accrued or received from a business controlled or a profession set up in India is taxable as income for RNOR u/s 5 of the Income tax Act, 1961 and therefore income of Rs. 1,25,000 of the cosmetics business shall be subject to tax.
- d) All gifts from the relatives specified in section 56(2) and those received at the time of marriage from any person are not taxable. Therefore, total amount of gifts of Rs. 72,000 [21000+51000] received on the occasion of the marriage from the brother and friends are exempt from tax.
- e) Any profits of earlier years whether taxed or not when remitted to India are not taxable in the year of receipt. Therefore, past untaxed profits of Rs. 2,50,000 lying in bank account maintained in Singapore and remitted during the previous year to India is not taxable.

Answer 2A(ii)

As per section 245N(b)(A) of the Income Tax Act, 1961, Any person who is resident can make an application to the Authority for Advance Ruling (AAR) to seek ruling in respect of his tax liability in the situation specified therein.

The specified situation are as below:

- i) In relation to the tax liability of a non-resident arising out of a transaction undertaken or proposed to be undertaken by him with such non-resident.
- ii) In relation to his tax liability arising out of a transaction which has been undertaken or is proposed to be undertaken by him and shall include the determination of any question of law or of fact specified in the application.
- iii) In respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and shall include the determination or decision by the AAR on a question of law or of fact relating to such computation of total income specified in the application.
- iv) In relation to whether an arrangement proposed to be undertaken by him is an

impermissible avoidance arrangement under Chapter X-A of the Act and may be subjected to General Anti Avoidance Rules or not.

Answer 2A(iii)

- (a) Lankawin Pty Inc of UK (LI) is a specified foreign company in relation to Srikrishna Datamatics Ltd (SDL) of India and the condition of SDL holding shares carrying not less than 26% of the voting power in Lankawin Pty Inc also stands satisfied. Hence, LI and SDL are deemed to be Associated Enterprises as per section 92A(2) of the Income tax Act, 1961.

Providing of data processing services by SDL, an Indian Company to LI, a foreign company between the associated enterprises is an international transaction. Consequently, the provisions of transfer pricing are applicable on such transaction. Data processing services with the use of information technology falls within the definition of “information technology enabled services”, and is hence, an eligible international transaction.

- (b) Since SDL is providing data processing services to a non-resident associated enterprise and has exercised a valid option for Safe Harbour Rules, it is an eligible assessee.
- (c) SDL (as given in the problem), should have declared an operating profit margin of not less than 18% in relation to operating expenses so to be covered within the scope of Safe Harbour Rules in accordance with the circumstance mentioned in Rule 10TD.

In this case, the operating margin declared is 18.28% $[(17/93) \times 100]$ which is more in accordance with the circumstance mentioned in Rule 10TD.

Consequently, the department shall accept the transfer price declared by SDL in respect of such international transaction. Therefore, SDL need not to make any primary adjustment.

PART B

Question 3

- (a) *Hare Rama and Hare Krishna Pvt. Ltd engaged in the business of plastic goods provides the following particulars relating to the goods sold by it to Kamdhenu Enterprises during the month of January, 2020 :*

<i>Particulars</i>	<i>Amount (₹)</i>
<i>List price of the goods sold (exclusive of the taxes and discounts)</i>	<i>2,50,000</i>
<i>Tax levied by Municipal Authority on the sale of such goods</i>	<i>7,500</i>
<i>CGST and SGST chargeable on the goods</i>	<i>49,280</i>
<i>Packing charges (not included in price above)</i>	<i>5,000</i>

Hare Rama and Hare Krishna Pvt. Ltd received ₹7,500 as a subsidy from a NGO on the sale of such goods. The list price of ₹2,50,000 of the goods so given is after considering and deducting the amount of such subsidy. Hare Rama and Hare Krishna Pvt. Ltd offers 2% discount on the list price of the goods which is recorded in the invoice of the supplies.

Determine and work out the value of taxable supply as per provisions of GST law made by Hare Rama and Hare Krishna Pvt. Ltd. during the month of January, 2020 to Kamdhenu Enterprises. (5 marks)

(b) Examine and state by giving brief reasons as to the taxability/exemption or otherwise of each of the following independent services as per provisions/notifications issued under the CGST Act, 2017 :

(i) FSSAI services to Food Business Operators

(ii) News Agency Services

(iii) Organizing business exhibition outside India

(iv) Slaughtering of animals

(v) Information under RTI Act, 2005. (5 marks)

(c) Geetanzali Overseas Pvt. Ltd. was erroneously refunded on 16.06.2019 a sum of ₹30,000 in excess of the actual due amount of the duty drawback. A demand notice for recovery of the excess amount so paid was issued by the department on 24-08-2019. Geetanzali Overseas Pvt. Ltd. after receipt of the demand notice from the department returned the erroneous excess refund amount of ₹30,000 of the duty drawback to the department on 16-10-2019.

In this backdrop, you are required to explain in brief the provision contained under the Customs Act, 1962 and also to work out and calculate the amount of interest, if any chargeable from Geetanzali Overseas Pvt. Ltd. on the excess erroneous refund of drawback so made to them. (5 marks)

(d) LMN & Co, a partnership firm registered under GST law has its registered office located in Kochi, Kerala. The firm is engaged in the business of providing services to foreign customers for sourcing various products/goods from/in India. The vendor in India is always identified, product quality is being checked, price is mapped and thereafter the details are shared with the foreign customers.

The foreign customers place the order directly with the vendors in India so identified and details of which were being shared by LMN & Co, with the customers. LMN & Co. is having a policy to charge cost plus 12% mark up for the services so rendered and during the month of March, 2020 it has collected Euro 25,000 from customers in Sweden for such services.

You are required in the backdrop of above information, to explain in brief the applicable provisions of the GST Law and to answer thereunder about the nature of services provided by LMN & Co, place of service (POS) and whether the amount charged for services can be treated as export of service. (5 marks)

- (e) ANC & Co, a partnership firm having showroom in Chennai is a registered supplier under the regular scheme as per GST Laws. Total value of supplies made by them in the year ended on 31st March, 2019 was ₹36 lakhs. Details of transactions entered into by them during the period 01-04-2019 to 30-09-2019 being extracted from the books are given as under:

Particulars of Transactions	Amount (₹)
Intra-State supplies of product "Hot"	25,00,000
Intra-State supplies of product "Cold" (GST payable by the recipient under reverse charge)	4,00,000
Export of product "Hot"	11,00,000
Common inputs used in for all the above three supplies	25,00,000

Amounts given above are excluding the amount of GST wherever applicable. Rate of GST on all the supplies/export and on the inputs be taken at 12%.

Determine the amount of net GST liability of ANC & Co for the half year period ended on 30-09-2019. (5 marks)

Answer 3(a)

Hare Rama and Hare Krishna Pvt. Ltd.

Computation of Value of taxable supply for the month of January, 2020

Particulars	Amount (Rs.)	Amount (Rs.)
List price of the goods (exclusive of taxes and discounts)		2,50,000
Add: Tax levied by Municipal Authority on the sale of such goods [includible in the value as per Section 15(2)(a) of CGST Act, 2017]	7,500	
CGST and SGST chargeable on the goods (not includible as per section 15(2)(a) (Working Notes - 1)	---	
Packing charges [includible in the value as per Section 15(2)(c) of CGST Act, 2017]	5,000	
Subsidy received from a non-Government body (Working Notes -2)	7,500	20,000
Total		2,70,000

Less : Discount @ 2% on Rs. 2,50,000 5,000

[Since discount is known at the time of supply, it is deductible from the value of supply in terms of Section 15(3)(a) of CGST Act, 2017]

Value of Taxable Supply 2,65,000

Working Notes :

1. Section 15(2)(a) of the CGST Act, 2017 provides for exclusion of CGST, IGST, SGST, UTGST and Compensation Cess from the value of taxable supply.
2. Subsidy received from a non-government body is added back to determine the value of supply (Section 15(2)(e) of CGST Act, 2017).

Answer 3(b)

- (i) Services by way of licensing, registration and analysis or testing of food samples supplied by the Food Safety and Standards Authority of India (FSSAI) to Food Business Operators are exempt.

[Entry 47A of Notification No. 12/2017-CT (Rate)]

- (ii) Services by way of collecting or providing news by an Independent journalist, Press Trust of India or United News of India are exempt.

[Entry 49 of Notification No. 12/2017-CT (Rate)]

- (iii) Services by an organizer to any person in respect of organizing business exhibition outside India are exempt.

[Entry 52 of Notification No. 12/2017-CT (Rate)]

- (iv) Services by way of Slaughtering of animals are exempt.

[Entry 56 of Notification No. 12/2017-CT (Rate)]

- (v) Services by way of providing information under the Right to Information Act, 2005 are exempt.

[Entry 65A of Notification No. 12/2017-CT (Rate)]

Answer 3(c)

According to section 75A(2) of the Customs Act, 1962, where any drawback has been paid to the claimant erroneously or it becomes otherwise recoverable under the Customs Act, 1962 or the rules made there under, the claimant shall, within a period of two months from the date of demand pay in addition to the said amount of drawback, interest at the rate fixed under Section 28AA of the Customs Act, 1962 i.e. @ 15% p.a.

The amount of interest shall be calculated for the period beginning from the date of payment of such drawback to the claimant till the date of recovery of such drawback from the claimant.

Geetanzali Overseas Pvt. Ltd. had though refunded the amount on 16.10.2019, after issuance of demand notice to refund such excess amount on 24.08.2019 but the interest shall be charged from the date of payment being 16.06.2019 to the actual date of refund being 16.10.2019 and not from the date of issuance of demand notice on 24.08.2019.

Computation of interest chargeable on amount of Rs. 30,000

<i>Particulars</i>	<i>Amount (Rs.)</i>
Duty drawback erroneously refunded	30,000
Due date of payment of erroneous drawback	16.06.2019
Date of issuance of demand notice	24.08.2019
Date of repayment by the assessee	16.10.2019
No. of days of delay between 16.06.2019 to 16.10.2019 being (14 + 31+31+30+16 =122)	122 days
Rate of interest	15%
Quantum of Interest (30,000 x 122 / 365 x 15%)	1504

Answer 3(d)

LMN & Co. in the given case providing services of arranging/facilitating/ sourcing the supply of goods between the foreign customer and the Indian vendors which can be classified as intermediary services as per section 2(13) of the IGST Act, 2017.

Section 2(13) of the IGST Act, 2017 defines "intermediary" to mean a broker, an agent or any other person, by whatever name called, who arranges or facilitates the supply of goods or services or both, or securities, between two or more persons, but does not include a person who supplies such goods or services or both or securities on his own account.

The Place of Supply (POS) is to be determined as per section 13 of the IGST Act, 2017 where the location of the supplier of services or the location of the recipient of service is located outside India. Since, in the given case, the recipients of the supply are located outside India, in Sweden, the provisions of supply of intermediary services will be determined in terms of section 13 of the IGST Act, 2017.

The Place of Supply in case of intermediary services as per section 13(8)(b) of the IGST Act, 2017 is the location of the supplier i.e., the location of LMN & Co. which is in Kochi, Kerala in India.

As per section 2(6) of the IGST Act, 2017, export of services means inter alia, the supply of any service when the place of supply is outside India.

Since, in the given case, Place of Supply (POS) as per section 13(8)(b) of IGST Act, 2017 is in Kochi, Kerala in India, the transaction **does not tantamount to export of service** by LMN & Co.

Answer 3(e)

**Computation of GST Liability of ANC & Co.
for the period 01-04-2019 to 30-09-2019**

<i>Particulars</i>	<i>Amount (Rs.)</i>
GST on outward supply (Note – 1)	4,32,000
Total GST liability	4,32,000
Less : ITC as being available (Note – 2)	2,70,000
Balance GST liability	1,62,000

Note 1: Computation of GST on outward supply

<i>Particulars</i>	<i>Value (Rs.)</i>	<i>GST @ 12%</i>
Intra-State supplies of product “Hot”	25,00,000	3,00,000
Add : Intra-State supplies of product “Cold” (GST payable by the recipient under reverse charge)	4,00,000	Nil
Add : Export of product “Hot” [assuming the export is made on payment of IGST]”	11,00,000	1,32,000
Total	40,00,000	4,32,000

Note 2: Computation of ITC

<i>Particulars</i>	<i>Amount (Rs.)</i>
GST on inward supply (25,00,000 x 12%)	3,00,000
Total ITC as per Electronic Credit Ledger	3,00,000
Less : Credit for common inputs relating to the supply of 'cold' where RCM is applied [Exempt turnover : 4,00,000; total turnover Rs. 40,00,000 being 3,00,000 x 4/40]	30,000
ITC available (Assumed that all necessary conditions are complied with)	2,70,000

Alternate Answer 3(e)**Computation of GST Liability of ANC & Co.
for the period 01-04-2019 to 30-09-2019**

<i>Particulars</i>	<i>Amount (Rs.)</i>
GST on o outward supply (Note – 1)	3,00,000
Total GST liability	3,00,000
<i>Less</i> : ITC as being available (Note – 2)	2,70,000
Balance GST liability	30,000

Note 1: Computation of GST on outward supply

<i>Particulars</i>	<i>Value (Rs.)</i>	<i>GST @ 12%</i>
Intra-State supplies of product “Hot”	25,00,000	3,00,000
<i>Add</i> : Intra-State supplies of product “Cold” (GST payable by the recipient under reverse charge)	4,00,000	Nil
<i>Add</i> : Export of product “Hot” [Zero Rated]	11,00,000	Nil
Total	40,00,000	3,00,000

Note 2: Computation of ITC

<i>Particulars</i>	<i>Amount (Rs.)</i>
GST on inward supply (25,00,000 x 12%)	3,00,000
Total ITC as per Electronic Credit Ledger	3,00,000
<i>Less</i> : Credit for common inputs relating to the supply of ‘cold’ where RCM is applied [Exempt turnover : 4,00,000; total turnover Rs. 40,00,000 being 3,00,000 x 4/40]	30,000
ITC available (Assumed that all necessary conditions are complied with)	2,70,000

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

(a) Explain and state in brief the provisions of CGST Act, 2017 relating to all those

situations when the authority can confiscate the goods or the conveyance for levy of penalty. (5 marks)

- (b) (i) State in brief as per provisions of the CGST Act, 2017, a composition dealer/supplier how should raise GST bill/invoice for the supply of goods. Explain also what should be prominently stated on such invoice. Specify and state the rates of tax applicable to a dealer opting for composition scheme.

(3 marks)

- (ii) State the circumstances and the manner in which a summary assessment order passed by the proper officer under the CGST Act, 2017 can be ordered to be withdrawn. (2 marks)

- (c) PQR Ltd., registered in the State of Karnataka, manufacturers of heavy duty machinery supplied on 10th March, 2020 Milling Machinery to JKS Ltd. for their Rice Mill set up at Chennai. Tax invoice was raised by the supplier immediately after supply on 10-03-2020. The details/particulars relating to the rice mill machinery so supplied by PQR Ltd. are as under :

Particulars	Amount (₹)
Basic price of the Machinery	50,00,000
Installation of the Machine, costs are to be met by the buyer	1,20,000
Extended warranty taken by the buyer for the machinery from the suppliers	1,00,000
Cash discount as per invoice, but to be allowed only where payment is made in 15 days of supply	2% of the basic price

JKS Ltd. made the payment of the machinery on 04-04-2020 and hence was denied for cash discount by PQR Ltd. All values/amounts given above are exclusive of the amount of GST. Applicable rates under GST are to be taken as SGST 9%, CGST 9% and IGST 18%.

Compute the transaction value and the amount of GST liability. Adduce suitable working notes for the treatment of each item given while working out the amount of transaction value of the machinery. (5 marks)

OR (Alternate question to Q. No. 4)

Question 4A

- (i) Modern Art & Printers Pvt. Ltd., was incorporated on 12th January, 2020, having main object of the business of supply of books, pamphlets, brochures, envelopes, annual reports, leaflets, cartons, boxes etc. These would be printed with design, logo, name, address or other contents supplied by the recipient of such goods/materials as per their orders and requirements.

Modern Art & Printers Pvt. Ltd. is desirous of knowing in the context of the provisions under the CGST Act, 2017 whether these would constitute supply of goods and/or supply of services falling under heading 9989 of the scheme of classification of services annexed to Notification No. 11/2017-CT(R) issued under CGST Act, 2017 and/or falling under Chapter-48 or 49 of the First Schedule to the Customers Tariff Act, 1975. You are required to give suitable advice in

the context of provisions contained under the Act, to Modern Art & Printers Pvt Ltd. (5 marks)

- (ii) (a) *Madhu Sudan, a resident individual of Jaipur, Rajasthan and not registered under GST law, has engaged Events and Events Pvt Ltd, event managers, having their registered office as per GST law at Mumbai, Maharashtra, to organise the wedding function of his daughter in a palace located in Ahmedabad, Gujarat. Determine the place of service (POS) for this event by giving in brief the provisions of CGST Act, 2017. Will your answer be different, if the function is to take place at Colombo, Sri Lanka. (3 marks)*
- (b) *Sanzari Electronics of Delhi has supplied a laptop (worth ₹59,000) along with a laptop bag (worth ₹1,000) in total for ₹60,000 (excluding GST) to Pankaj in Jaipur. Determine the GST liability on the sale made by Sanzari Electronics by taking the following applicable rates under GST :*

Item	SGST	CGST	IGST	
Laptop	9%	9%	18%	
Laptop bag	6%	6%	12%	(2 marks)

- (iii) *Capital Forex Private Limited, registered in Delhi, is engaged in the business as an authorized money changer and has opted to charge for the service so provided as per Rule 32(2)(b) of the CGST Rules, 2017.*

It has undertaken the following transactions of purchase and sale of foreign currency on 11-03-2020 :

- (i) *USD 1,400 purchased from Nagesh at the rate of ₹70 per USD. RBI reference rate on the day of transaction was ₹70.20 per USD.*
- (ii) *USD 2,500 sold to Mohan at the rate of ₹69.50 per USD. RBI reference rate for the day of transaction was not available.*

Explain in brief Rule 32(2)(b) of the CGST Rules, 2017 applicable as to valuation of supply in case of money changer service and also compute the value of taxable supply for both the above transactions. (5 marks)

Answer 4(a)

The authority under section 130 of CGST Act, 2017 can confiscate the goods or the conveyances for levy of penalty, if any person:

- i) supplies or receives any goods in contravention of any of the provisions of this Act or the rules made there under with intent to evade payment of tax; or
- ii) does not account for any goods on which he is liable to pay tax under this Act; or
- iii) supplies any goods liable to tax under this Act without having applied for registration; or
- iv) contravenes any of the provisions of this Act or the rules made there under with intent to evade payment of tax; or
- v) uses any conveyance as a means of transport for carriage of goods in contravention of the provisions of this Act or the rules made there under unless the owner of the conveyance proves that it was so used without the knowledge

or connivance of the owner himself, his agent, any, and the person in charge of the conveyance.

In such circumstances, all such goods or conveyances shall be liable to confiscation and the person shall be liable to penalty under section 122 of the CGST Act, 2017.

Answer 4(b)(i)

A composition supplier/dealer cannot issue a tax invoice as per provision of CGST Act, 2017 because a composition dealer cannot charge tax from their customers or from the persons to whom supplies have been made. Composition dealer is required to pay tax from his own and therefore, cannot issue a tax invoice but has to issue a Bill of Supply.

The dealer is required to mention "**Composition taxable person, not eligible to collect tax on supplies**" at the top of the Bill of Supply.

Rates applicable under Composition levy Scheme

<i>Type of business/service</i>	<i>SGST</i>	<i>CGST</i>
Manufacturers and traders (goods)	0.5%	0.5%
Restaurants not serving alcohol	2.5%	2.5%
Other service providers	3%	3%

Answer 4(b)(ii)

Section 64(2) of the CGST Act, 2017

A taxable person against whom a summary assessment order has been passed can apply for its withdrawal to the jurisdictional Additional/Joint Commissioner within thirty days of the date of receipt of the order.

If the said officer finds that the order is erroneous, he can withdraw it and direct the proper officer to carry out determination of tax liability in terms of sections 73 or 74 of CGST Act, 2017. Additional/Joint Commissioner can follow a similar course of action on his own motion, if he finds the summary assessment to be erroneous.

Answer 4(c)

Computation of Transaction value in case of supply of Milling Machinery by PQR Ltd.

<i>Particulars</i>	<i>Amount (Rs.)</i>
Basic price of the machinery	50,00,000
Add : Extended warranty charges (Working Note – 2)	1,00,000
Installation costs (Working Note – 3)	1,20,000
	52,20,000
Less: Cash discount at 2% of price (Working Note – 4)	(1,00,000)
Transaction value of the Machine supplied	51,20,000
IGST at 18% on Rs. 51,20,000	9,21,600

Working Notes:

1. As per Section 10(1)(d) of the IGST Act, 2017, the place of supply of the machine is the place of installation of the machinery, which is Chennai, in Tamil Nadu. The location of the PQR Ltd. is in Karnataka. Thus, it will be an Inter-State supply and hence IGST is payable.
2. Extended warranty charges are includible since transaction value includes all items, except those which are specifically excluded.
3. Installation of machine is ancillary to the principal supply of machine, thus it is a case of composite supply in terms of Section 2(30) CGST Act, 2017 and therefore the value of installation is liable to be added in the value of machine and charged to tax accordingly.
4. "Cash discount offered at the time of original supply in the invoice is to be deducted" as the supplier is right in assuming that the payment shall be made by the recipient within 15 days. However, once the recipient fails to make payment within 15 days, the supplier is required to issue a debit note towards the value of discount along with GST.

Answer 4A(i)

Supply of books, pamphlets, brochures, envelopes, annual reports, leaflets, cartons, boxes, etc. which are being printed with logo, design, name, address or other contents supplied by the recipient of such printed goods, are in the nature of composite supplies and the issue relating to whether such supplies constitute supply of goods or services under GST is to be determined on the basis of what constitutes the principal supply in such goods.

Principal supply has been defined in section 2(90) of the CGST Act, 2017 as supply of goods or services which constitutes the predominant element of a composite supply and to which any other supply forming part of that composite supply is ancillary.

The issue in hand had been clarified by the Government vide Circular No. 11/11/2017-GST dated 20.10.2017.

In the case of printing of books, pamphlets, brochures, annual reports, and the like, where only content is supplied to the publisher by the person who owns the usage rights to the intangible inputs while the physical inputs including paper used for printing belongs to the printer. Supply of printing (of which the content supplied by the recipient of supply) is the principal supply and therefore such supplies would constitute supply of service falling under heading 9989 of the scheme of classification of services under GST.

In case of supply of printed envelopes, letter cards, printed boxes, tissues, napkins, wall paper etc. printed with design, logo etc. supplied by the recipient of goods made using physical inputs including paper belonging to the printer, fall under Chapter 48 or 49 of the Customs Tariff Act, 1975. The predominant supply is that of goods and the supply of printing and the contents for printing (though supplied by the recipient of supply) is ancillary to the principal supply of goods.

Therefore such supplies would constitute supply of goods falling under respective headings of Chapter 48 or 49 of the Customs Tariff Act, 1975.

Modern Art & Printers Pvt. Ltd. is therefore advised to act accordingly by taking the

supply of printing of various products as a supply under GST and to tax the same on the basis of Composite Supply.

Answer 4A(ii)(a)

As per section 12(7)(a)(ii) of IGST Act, 2017, when service by way of organization of an event is provided to an unregistered person, the Place of Supply (POS) is the location where the event is actually being held and if the event is held outside India, than the place of supply is the location of recipient of the services.

- i) Since, in the given case, the service recipient Madhu Sudan is an unregistered person and event is being held in Ahmedabad, India, therefore Place of Supply (POS) is the location where the event is actually held i.e., Ahmedabad, Gujarat.
- ii) However, if the wedding is to take place outside India in Colombo, Sri Lanka, the place of supply will be Jaipur, Rajasthan i.e. the location of the recipient of services.

Answer 4A(ii)(b)

Supply of laptop bag is ancillary to the supply of laptop and are naturally bundled. Both such supplies qualify to be a Composite Supply with supply of laptop as a principal supply. Thus, in terms of Section 8(a) of the CGST Act, 2017, the tax rate as applicable to laptop shall remain applicable to laptop bag as well.

Being an interstate supply, tax under IGST @ 18% will be charged for this supply being the rate of principal supply of laptop. Thus the tax under IGST payable be 18% of Rs 60,000 = Rs. 10,800.

Answer 4A(iii)

Determination of value under CGST Rules, 2017

Capital Forex Pvt. Ltd. doing the business as Authorized Money Changers require to value for the services so provided under any of sub-rule (a) or (b) of Rule 32(2) of the CGST Rules, 2017. Capital Forex Pvt. Ltd. as given in the question has opted to value the services as per Rule 32(2)(b), which is explained hereunder:-

<i>S. No.</i>	<i>Currency Exchanged</i>	<i>Value of Supply</i>
1.	Up-to Rs. 1,00,000	1% of the gross amount of currency exchanged <i>OR</i> amount of Rs. 250 whichever is higher
2.	Exceeding Rs. 1,00,000 and up-to Rs. 10,00,000	Rs. 1000 + 0.50% of the (gross amount of currency exchanged above Rs. 1,00,000)
3.	Exceeding Rs.10,00,000	Rs. 5,500 + 0.1% of the (gross amount of currency exchanged above Rs. 10,00,000) <i>OR</i> the amount of Rs. 60,000 whichever is lower

Thus, the value of supply in the given cases would be computed as under:

- i) Gross amount of currency exchanged = Rs. 70 x 1,400 = Rs. 98,000.

Gross amount of currency exchanged is less than Rs. 1,00,000, value of supply is 1% of the gross amount of currency exchanged i.e. 1% of Rs. 98,000 or Rs. 250, whichever is higher = **Rs.980**

- ii) Gross amount of currency exchanged = Rs. 69.50 x 2,500 = Rs. 1,73,750. Since the gross amount of currency exchanged exceeds Rs. 1,00,000 but is less than Rs. 10,00,000, value of supply is Rs. 1,000 + 0.50% of (Rs. 1,73,750 - Rs. 1,00,000) = **Rs. 1,369**

Question 5

- (a) Kamdhuda Enterprises, a partnership firm applied for registration under the GST law and obtained the same on 10th January, 2020. Partners of the firm to keep the rates confidential for the goods sold want to show in the GST invoices to be raised consolidated amount which is inclusive of the amount of the GST for the concerned product sold. Advise the firm, whether this will be in accordance with the CGST Act, 2017 and can they do so. (3 marks)

- (b) Chitra of Udaipur, a registered person under GST law in the state of Rajasthan as per regular scheme, furnishes the following particulars of the Intra-State supplies/transactions (exclusive of GST) entered into during the month of January, 2020 :

Sl. No.	Particulars of Item	Amount (₹)
1.	Sale of Plastic Jewellery	6,20,000
2.	Sale of Electronic Tab (like I-pad)	4,20,000
3.	Sale of Dried Dates	5,40,000
4.	Sale of Chemical Fertilizers	5,80,000

Ascertain the GST liability of Chitra for the month of January, 2020 by taking the applicable rate as SGST 6% and CGST 6%. (3 marks)

- (c) Ashoka Enterprises, registered under GST law in the State of Rajasthan paying taxes as contained in section 9 of CGST Act, 2017. They asked their tax manager to pay taxes on quarterly basis. However, the tax manager advised to pay taxes on monthly basis. You are consulted to examine the rival contention and the validity of the view of tax manager of paying taxes on monthly basis and also to state how such taxes and the tax for the month of March are to be paid. (3 marks)

- (d) SAM Ltd. has two manufacturing units located in Maharashtra. One unit located in Nashik is engaged in manufacturing of fabrics and another unit located in Nagpur is engaged in manufacturing of grey cloth. They do not want to have separate registrations for both the units under the GST law. Explain as per provisions of CGST Act, 2017 whether separate registrations are to be taken for the two units when both are located in the same state. (3 marks)

- (e) CBZ Ltd. manufacturer of garments during the month of March, 2020 had exported the following brands/products to the customer in Germany :

Product	FOB value of goods Exported Amount (₹)	Market Price of goods exported Amount (₹)	Rate of Duty Drawback
A	4,30,000	3,50,000	30% of FOB
B	6,00,000	7,00,000	3.50% of FOB
C	3,00,000	3,50,000	1.50% of FOB

You are required to work out the amount of duty drawback as admissible as per section 75 of the Customs Act, 1962 in each of the aforesaid cases of exported goods keeping in consideration the following information:

- (i) Imported value of Product-B is ₹8,00,000
(ii) Product-C is manufactured out of duty free inputs. (3 marks)

Answer 5(a)

Rule 46 of the CGST Rules, inter alia, postulates that tax invoice to be issued by the registered person shall contain the following particulars:

- Taxable value of supply of goods or services or both;
- Rate of tax (Central tax, State tax, Integrated tax, Union territory tax or cess)
- Amount of tax charged in respect of taxable goods or services (Central tax, State tax, Integrated tax, Union territory tax or cess)

Therefore, the supplier is *bound to mention* the above listed details separately in the tax invoice to be issued for the product sold.

The proposed action of showing consolidated amounts in the tax invoices as contended by the partners of Kamdhuda Enterprises is incorrect and is not tenable in law under the CGST Act, 2017.

Answer 5(b)

Computation of GST Liability of Chitra

Sl. No.	Particulars of Items	Amount (Rs.)
1	Sale of Plastic Jewellery (Note)*	6,20,000
2	Sale of Electronic Tabs	4,20,000
3	Sale of Dried dates	5,40,000
4	Sale of Chemical Fertilizers	5,80,000
Total value of taxable Supplies		21,60,000
	SGST at 6%	1,29,600
	CGST at 6%	1,29,600

*Note – Plastic Jewellery are charged @ (6%+6%) since the question has assumed tax rate @ (6%+6%) for all taxable supplies.

First Alternate Answer 5(b)**COMPUTATION OF GST LIABILITY OF CHITRA**

<i>Sl. No.</i>	<i>Particulars of Items</i>	<i>Amount (Rs.)</i>
1	Sale of Plastic Jewellery (Note)*	Nil
2	Sale of Electronic Tabs	4,20,000
3	Sale of Dried dates	5,40,000
4	Sale of Chemical Fertilizers	5,80,000
Total value of taxable Supplies		15,40,000
	SGST at 6%	92,400
	CGST at 6%	92,400

**Note – If Plastic Jewellery is assumed as Plastic Bangles then rate of tax is Nil as Plastic Bangles are exempted under GST, Act, 2017.*

Second Alternate Answer 5(b)**COMPUTATION OF GST LIABILITY OF CHITRA**

<i>Sl. No.</i>	<i>Particulars of Items</i>	<i>Amount (Rs.)</i>
1	Sale of Plastic Jewellery (Note)*	6,20,000
2	Sale of Electronic Tabs	4,20,000
3	Sale of Dried dates	5,40,000
4	Sale of Chemical Fertilizers	5,80,000
Total value of taxable Supplies		21,60,000
	SGST (Sale of Plastic Jewellery charged @3% and Other sales charged @ 6%)	1,11,000
	CGST (Sale of Plastic Jewellery charged @3% and Other sales charged @ 6%)	1,11,000

**Note – If Plastic Jewellery is assumed as Imitation Jewellery then the rate of tax is (3%+3%), as Imitation Jewellery is chargeable at 3% tax under HSN 7117 of Schedule III to Notification No. 1/2017-Central Tax (Rate) dated 28.6.2017 as amended.*

Answer 5(c)

The advice given by tax manager is valid in law. Payment of taxes by the normal tax payer is to be done on monthly basis by the 20th of the succeeding month as specified

in section 9 of the CGST Act, 2017. Composition tax payers only required to pay tax on quarterly basis.

Payment of taxes can be made either by Debit of :

- a) Electric Cash Ledger; or
- b) Electronic Credit Ledger.

Payment of taxes for the month of March shall be paid by the 20th of April.

Answer 5(d)

As per section 25(2) of CGST Act, 2017 as amended w.e.f. 1.2.2019, a person seeking registration for GST shall be granted single registration in each state. Where a person has multiple business places in a state, all such business places shall be included in the single registration with such business place given the status of a principal business place.

However, proviso to Section 25(2) provides that a person having multiple business places may be granted separate registration for each business place in a State or Union territory subject to the conditions as may be prescribed.

In the present case, both the units of SAM Ltd. are located in Nashik and Nagpur in the State of Maharashtra. In case SAM Ltd. wish to have separate registration for each such business place, it can be granted by the authorities. Hence both the units can take separate registration for its units located in Nashik and Nagpur.

Answer 5(e)

- (i) As per Rule 9 of the Customs and Central Excise Duties Drawback Rules, 2017, the drawback amount or rate determined under rule 3 of the said rules shall not exceed one third of the market price of the export product. In the present case, duty drawback amount @ 30% of Rs. 4,30,000 = Rs. 1,29,000. However, duty drawback is to be restricted to 1/3 of the market price of the goods exported being 1/3 of Rs. 3,50,000 = **Rs. 1,16,667**.
- (ii) As per 1st proviso to Section 75 of the Customs Act, no drawback shall be allowed in case the export value of goods is less than the value of imported goods used in the manufacture or processing of export goods.

In the present case, assuming that Product B underwent manufacturing operation in India, as the export value i.e. FOB value of the goods Rs. 6,00,000 is less than the value of imported materials of Rs. 8,00,000 used therein, no drawback should be granted.

Alternatively, if Product - B is imported and the same product is exported without any manufacturing operation carried out on the same, no duty drawback is admissible under section 75 of the Customs Act, 1962 as the said provision envisage carrying out manufacturing or processing of imported inputs.

- (iii) As per Rule 3 of the Customs and Central Excise Duties Drawback Rules, 2017, no duty drawback shall be allowed, if the said goods are produced or manufactured, using imported materials or excisable materials in respect of

which duties have not been paid. In case of Product C, since it is manufactured out of duty free inputs, no duty drawback is allowed on export of Product C.

Question 6

- (a) Determine by giving brief reasons the requirement and date of issue of tax invoice under CGST Act in each of the following independent cases :
- Ritu Manufacturers Pvt. Ltd. of Delhi supplies goods to Prakhar Electronics, Gurugram, Haryana. The goods were removed from its factory in Delhi on 23rd September, 2019.
 - Katyani Security Services Ltd. has provided security services to Royal Jewellers for their Jewellery in the exhibition (JAS-2019) organized at Jaipur on 5th October, 2019.
 - Sultan Industries Ltd. of Delhi entered into a contract with Prakash Entrepreneurs of Delhi for supply of spare parts of a machine to them on 27th November, 2019. The spare parts were required to be delivered on 30th November, 2019. Sultan Industries Ltd. removed the finished spare parts from its factory on 29th November, 2019. (2×3=6 marks)
- (b) Specify all those conditions which are to be satisfied for imposing countervailing duty on the subsidized articles as specified in section 9 of the Customs Tariff Act, 1962. (4 marks)
- (c) HJK Ltd. a manufacturer of Cotton Grey Fabrics having its registered office located in Coimbatore, Tamil Nadu in the month of January, 2020 had imported a fabric making machinery from a supplier of Italy. HJK Ltd. entered into a contract agreement with RS Logistics Pvt. Ltd. a licensed customs broker having its office located in Bengaluru, Karnataka, to carry out and meet all the necessary legal formalities for getting the said machine cleared from the customs station of Kandla Port and thereafter to deliver the same to them in Coimbatore.

HJK Ltd. also authorised RS Logistics Pvt. Ltd. in this context under the agreement to incur on their behalf, the various expenses in relation to clearance of the imported machine, payment of duties and charges which shall stand to be reimbursable to them on actuals.

RS Logistics Pvt. Ltd. after clearance of machine raised an invoice in February, 2020 on HJK Ltd. as under :

Particulars	Amount (₹)
Agency charges	6,40,000
Unloading of machine at Kandla port, Gujarat	50,000
Prepared and submitted Bill of Entry and customs duty paid	5,00,000
Dock dues paid	50,000
Travelling expenses	40,000
Telephone and other expenses	12,000

You, in this backdrop, are required by taking that the conditions specified in rule 33 of the CGST Rules, 2017 stand satisfied :

- (a) to state the applicable provision of Rule -33 of the CGST Rules, 2017 and the nature of service provided by RS Logistics Pvt. Ltd.*
- (b) to compute the value of taxable supply.*
- (c) to state your answer when RS Logistics Pvt. Ltd. had charged an amount of ₹13,00,000 as a lump sum consideration for getting the imported machine cleared from the customs station and bringing the same to the warehouse of HJK Ltd. in Coimbatore. (5 marks)*

Answer 6(a)

- (i) As per section 31(1) of the CGST Act, 2017 a registered person supplying taxable goods required to issue the invoice before or at the time of removal of goods for supply to the recipient, where the supply involves movement of goods.
Ritu Manufacturers in this case, where movement of goods is between Delhi and Gurugram is required to issue a tax invoice on or before removal of the goods from factory i.e. on or before 23rd September, 2019.
- (ii) As per section 31(2) of CGST Act, 2017 a registered person supplying taxable services shall before or after the provision of service but within a prescribed period of 30 days issue a tax invoice.
Katyani Security Services Ltd needs to issue a tax invoice within days of supply of security services, i.e. on or before 4th November, 2019.
- (iii) As per provisions of section 31, invoice shall be issued before or at the time of removal of goods for supply to the recipient, where the supply involves movement of goods.
Accordingly, the tax invoice must be issued by Sultan Industries Ltd. Delhi on or before 29th November, 2019.

Answer 6(b)

As per Sec 9(1) of the Customs Tariff Act, 1975, the countervailing duty on subsidized articles is imposed, if the following conditions are satisfied:

- (a) Any country or territory, directly or indirectly, pays or bestows subsidy upon the manufacture or production or exportation of any article. Such subsidy includes subsidy on transportation of such article.
- (b) Such articles are imported into India.
- (c) The importation may/may not directly be from manufacture/ production.
- (d) The article, may be in the same condition as when exported from the country of manufacture or production or may be changed in condition by manufacture, production or otherwise.

As per Sec 9(3) of the Customs Tariff Act, 1975, the countervailing duty shall not be levied unless it is determined that –

- (a) the subsidy relates to export performance;

- (b) the subsidy relates to the use of domestic goods over imported goods in the export article; or
- (c) the subsidy has been conferred on a limited number of persons engaged in the manufacture, production or export of articles.

Answer 6(c)

Pure Agent under rule 33 of the CGST Rules, 2017 means as person who:

- a) enters into a contractual agreement with the recipient of supply to act as his pure agent to incur expenditure or costs in the course of supply;
- b) neither intends to hold nor holds any title to the goods or services both so procured or supplied as pure agent of the recipient of supply;
- c) does not use for his own interest such goods or services so procured; and
- d) receives only the actual amount incurred to procure such goods or services in addition to the amount received for supply he provides on his own account.

Service provided by RS Logistics Pvt. Ltd. to HJK Ltd. of Coimbatore is in the nature of a "Pure Agent" for the clearance of machine from the Custom station for the reason that the conditions specified in Rules 33 of the CGST Rules, 2017 stand fulfilled.

Therefore, the expenses incurred as pure agent shall be excluded from the value of supply.

Hence, value of taxable supply made by RS Logistics shall not include the amount incurred and reimbursed relating to Unloading of machine at port, Customs duty and Dock charges as detailed below:

<i>Particulars</i>	<i>Amount</i>
Agency charges	6,40,000
Travelling expenses	40,000
Telephone and other expenses	12,000
Value of taxable supply	6,92,000

Yes, answer would be different, if lump sum amount of Rs. 13,00,000 is being charged and paid because the nature of service will not be of a pure agent and in this case the value of taxable supply shall be Rs. 13,00,000 and GST shall be charged on Rs. 13,00,000 and not on Rs. 6,92,000.

DRAFTING, APPEARANCES AND PLEADINGS

Time allowed : 3 hours

Maximum marks : 100

NOTE : *Answer ALL Questions.*

Question 1

Attempt the following :

- (a) Discuss in brief the pre-requisites for an arbitration agreement.*
- (b) Write short note on compounding of offences under SEBI Act, 1992.*
- (c) Write short note on "Deed Escrow".*
- (d) What is the role of conveyance for the transfer of title in the property ?*
(5 marks each)

Answer 1(a)

The 'arbitration agreement' under the Arbitration and Conciliation Act, 1996 means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of defined relationship whether contractual or not. It may be in the form of an arbitration clause in a contract or in the form of a separate agreement. It has to be in writing. It is in writing if it is contained in a document signed by the parties, or in an exchange of letters, telex telegrams or other means of telecommunication "including communication through electronic means" which provide a record of the agreement, or in an exchange of statements of claim and defence in which the existence of agreement is alleged by one party and not denied by the other.

The important ingredient of the arbitration agreement is the consent in writing to submit dispute to arbitration. Consent in writing implies the application of mind to the reference of dispute to arbitration in accordance with Arbitration and Conciliation law and the binding nature of the award made there under.

An arbitration agreement stands on the same footing as any other agreement. It is binding upon the parties unless it is intended with fraud, undue influence etc., in which case it can be avoided like any other agreement. An arbitration rests on mutual voluntary agreement of the parties to submit their differences to selected persons whose determination is to be accepted as a substitute for the judgement of a court.

Every arbitration agreement must have the following pre- requisites:

- (i) a dispute between parties to an agreement, requiring a settlement.
- (ii) its submission for a settlement to a third person. And
- (iii) a decision by such third person according to his own judgement based on the facts and circumstances of the dispute, which is binding on both the parties.

Section 7 of the Arbitration and Conciliation Act, 1996 defines 'Arbitration Agreement'.

- i. An arbitration agreement must comply with the requirements of a valid contract.
- ii. An arbitration agreement must be in respect of a dispute that is arbitrable.

Answer 1(b)

According to Section 24 A of the SEBI Act, 1992 permits compounding of offences by the court where prosecution proceedings are pending. Compounding is essentially a settlement process by which an accused pays compounding charges in lieu of undergoing prosecution. Section 24 A reads as under:

“Notwithstanding anything contained in the Code of Criminal Procedure Code, 1973 any offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal (SAP) or a court before which such proceedings are pending.”

Compounding Offence can cover appropriate prosecution cases filed by SEBI before the criminal courts. Prosecution means filing of criminal complaints before various criminal courts by SEBI for violation of provisions of securities laws which may lead to imprisonment and / or fine. Compounding of offence can take place at any stage after filing criminal complaints by SEBI.

Settlement of proceedings through compounding can be sought by any person who is notified that a proceeding may be instituted against him/her, or any party to a proceeding already instituted, may, at any time, propose in writing for settlement.

Important Indicative Factors considered for the purpose of compounding of offences under the SEBI Act, 1992 are as follows —

- (i) Whether violation is intentional
- (ii) Party's conduct
- (iii) Gravity of Charge
- (iv) History of non-compliance
- (v) Good track record of the violator
- (vi) Whether there were circumstances beyond the control of the party
- (vii) Nature of violation i.e. technical / minor etc.
- (viii) Consideration of the amount of investors' harm or party's gain
- (ix) Processes which have been introduced since the violation to minimize future violations;
- (x) Compliance schedule proposed by the violator
- (xi) Economic benefits accruing to a party from delayed or avoided compliance.
- (xii) Conditions where necessary to deter future non-compliance by the same or another party.
- (xiii) Satisfaction of claim of investors regarding payment of money due to them or delivery of securities to them
- (xiv) Compliance of the civil enforcement action by the accused
- (xv) Party has undergone any other regulatory enforcement action for the same violation;
- (xvi) Any other factors necessary in the facts & circumstances of the case.

Where compounding is proposed by a party, such application may be made to the court and a copy can be addressed to the “Division of Prosecution, Enforcement Department” at SEBI’s Mumbai address. So far as process of compounding of offences is concerned, any party who wishes to compound an offence shall file an appropriate application before the court where complaint is pending with a copy addressed to the Prosecution Division, Enforcement Department of SEBI’s Mumbai office which will forward the application to be placed before the High Powered Committee.

Answer 1(c)

A deed signed by one party will be delivered to another as an “escrow” for it is not a perfect deed. “Escrow” means a simple writing not to become the deed of expressed to be bound thereby, until some conditions should have been performed.

A grantor may effectively deliver a deed in the future by an escrow. An escrow is a deed given to third party, called an “escrow agent”, to hold and then deliver to the grantee when specified conditions are met.

The parties may close a real estate sale by using an escrow agent. The grantor can give the deed to the escrow agent with instructions to deliver the deed to the grantee when the grantee delivers the purchase price to the escrow agent.

Likewise, the grantee can deliver payment to the escrow agent with instructions to give it to the grantor when the grantor gives the deed to the agent and the rest of the contract conditions are fulfilled, such as getting an acceptable title insurance policy.

The escrow agent also may manage the closing in other ways, like allocating expenses and recording documents.

When a deed is delivered by escrow, it conveys title when the escrow conditions are met. The parties may give the written instructions to the escrow agent detailing the conditions, or they may simply instruct the escrow agent to close the escrow when the conditions of the parties’ purchase agreement are met.

Answer 1(d)

Conveyancing is an art of drafting of deeds and documents whereby land or interest in land i.e. immovable property is transferred by one person to another.

Mitra’s Legal and Commercial Dictionary defines “Conveyance” as the action of conveyancing, a means or way of conveyancing, an instrument by which title to property is transferred, a means of transport, vehicle.

According to Clause 10 of Section 2 of the Indian Stamp Act, 1899, “Conveyance includes a conveyance on sale and every instrument by which property, whether movable or immovable, is transferred inter vivos and which is not otherwise specifically provided by Schedule I of the Act.” The term ‘Conveyance’ as such refers to the act of transferring property from one party to another.

Whereas, Section 5 of Transfer of Property Act, 1882 makes use of the word “Conveyance” in the wider sense. Section 5 of Transfer of Property Act, 1882 defines “transfer of property” as an act which a living person conveys property, in present or in future, to one or more other living persons, or to himself, and one or more other living persons and “to transfer of property” is to perform such act.

Thus, conveyance is an act of conveyancing or transferring any property whether movable or immovable from one person to another permitted by customs, conventions and law within the legal structure of the country. Hence, conveyance is an act of by which movable or immovable property is transferred by way of sale, lease, gift, exchange, will or bequeathment.

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

Question 2

Explain the following :

(a) *A sub-lease is an absolute assignment.*

(b) *Consideration Clause.*

(c) *Indenture.*

(d) *Caveat petition.*

(4 marks each)

Or (Alternate Question to Q. No. 2)

Question 2A

Attempt the following :

(i) *Draft a Petition for grant of probate of a Will.*

(ii) *Write a short note on Deed Poll.*

(iii) *Draft an application for setting aside ex-parte decree.*

(iv) *“Goodwill of a business is an intangible asset.” Explain.*

(4 marks each)

Answer 2(a)

A sub-lease is a demise by a lessee for lessor term than he himself has. Every lessee, however short his term may be, make a sub-lease unless he is refrained by the contract of the tenancy from subletting. If the demise is for the whole term or for a period beyond the term, it amounts to assignment. If the lessee divests himself he becomes a stranger to the demised property and he has no right to have possession delivered up to him. It is true that a covenant against subletting will restrain the assignment, but a mere covenant against subletting does not prohibit underletting a part of the premises. As long as the lessee remains in possession he may permit another person to use the demised premises without committing a breach of covenant, namely not to assign, underlet or part with the possession of the demised premises.

The Privy Council pointed out in *Hunsrai v. Bejoylal Seal*, (1930) 57 Cal 1176, that in India a sub-lease is not an absolute assignment and it was further held in *Akshoy Kumar v. Akman Molla*, (1915) 19 CWN 1197, that there is no privity of estate as between the lessor and the sub-lessee, who does not step into the shoes of the lessee. A sub-lease is not prejudiced by the surrender of the head lease (Section 115 of Transfer of Property Act) but the position is different in the case of forfeiture which annuls all sub-leases except in case of fraud as between the lessor and lessee. A sub-lessee is entitled to relief against forfeiture under Section 114 of the Transfer of Property Act, 1882, which is

applicable only in the case of non-payment of rent. No relief is open to the sub-lease in case of transfer of breach of covenant in restraint of transfer.

Answer 2(b)

A Consideration Clause specifies the value given in return for a bargain. Consideration is very important in a document and must be expressed. In the absence of mention of consideration the evidentiary value of document is reduced that the document may not be adequately stamped and would attract penalty under the Indian Stamp Act, 1899.

Consideration is required for each party benefiting from, and bound by a contract. In most agreements, the consideration is the bargain or exchange:- an exchange of service for salary and benefits, an exchange of property for instalments payments, or transfer of property rights for cash. In some cases, especially where a party gives up some right or interest, the consideration is expressly stated as an acknowledgement of the receipt of value.

Thus, enforcing any legal contract requires it to have an element of consideration included in it and thereby consideration clause in these documents has its own significance.

Answer 2(c)

Indentures are those deeds in which there are two or more parties. It refers to a legal and binding agreement, contract, or document between two or more parties. The term 'indenture' comes from the Medieval English — "It is a legal contract written in duplicate on the same sheet, with the copies separated by cutting along a jagged line so that the teeth of the two parts could later be refitted to confirm authenticity. Each party to the deed would then retain a part. When the agreement was made before a court of law a tripartite indenture was made, with the third piece kept at the court. The term is used for any kind of deed executed by more than one party, in contrast to a deed poll which is made by one individual. In the case of bonds, the indenture shows the pledge, promises, representations and covenants of the issuing party.

Answer 2(d)

"Caveat" is a Latin term which means, "let a person beware" originated in the mid of 16th Century. In law, it may be understood as a notice, especially in probate, that certain actions may not be taken without informing the person who gave the notice. It may simply be understood as a warning. In the Civil Procedure code of 1908, it was inserted under Section 148 A by the recommendations of the Law Commission of India's 54th Report and was inserted by the CPC (Amendment) Act 104 of 1976.

Thus, Caveat Petition as such is a precautionary measure by a person who holds a strong fear that a case against him is going to be filed in the court of law.

Before the National Company Law Tribunal

(Caveat No. _____ of 2020)

Memorandum of Caveat must contain the following particulars :

1. Set out the Court where the Caveat Petition is to be filed.

2. Set out details of the order against which appeal or application or petition is expected.
3. Address for the service on the caveator. And Address for service on the counsel for the caveator.
4. Specify the authority who passed the order with reference number & date (enclose copy of order appealed against).
5. Set out the details of expected Appellant(s) / Petitioner(s) / Applicant(s) / with Address.
6. Prayer — It should be in terms that let no orders be passed in the appeal expected to be filed or in any petition or application or interlocutory application that may be preferred by the expected Appellant / Petitioner / Applicant without service of notice on the caveator.

The caveator undertakes to accept service of appeal or petition or application and appear before this Tribunal on the date and time at which the appeal / petition / application is moves by expected appellatant / petitioner / applicant.

Dated at _____ Day _____ of (Month)

Counsel for Caveator

Caveator

Verification

The caveator above named state and verify that the contents of this caveat lodged are true and correct.

Verified at New Delhi on this day of2020

Caveator

Answer 2A(i)

Petition for grant of probate of a Will

(Under section 276 of the Indian Succession Act 1925)

In the Court of the District Judge/District Delegate at..... Act 39 of 1925
Case (Or. Misc. Judicial Case) No.of 20.....

A.B. son of C.D. (State here description and address)

..... Petitioner.

In the matter of grant of a probate of the Will of E.F., deceased, under section. 276 of the Indian Succession Act, 1925. The above-named petitioner states as follows:

1. That E.F., since deceased ofP.S. Dist.....died at his residence at.....on.....(date of death) and the writing annexed, in sealed cover, is his last Will, duly executed by the deceased on.....

2. That the petitioner was named as the executor in the said will.
3. That the amount of assets which is likely to come to the petitioner's hand is estimated at Rs.....as described in Schedule 'A' below (when necessary – and the amount of debts are shown in Schedule 'B' below).
4. That the said deceased left behind the following relations, besides the petitioner:
 - (i) G..... Son of (State residence) Brother
 - (ii) H..... widow of of the deceased. (State residence) Widow
 - (iii) M.....Daughter of (State residence) Daughter
5. That at the time of his death the deceased had his fixed abode at..... (or the deceased had his immovable properties at village – P.S. – Dist.-) within the jurisdiction of this court.
6. That to the best of the petitioner's belief no application has been made to any other court for a probate of the said Will (see section 279 of the Indian Succession Act, 1925).
7. That the petitioner has paid off Estate Duty on the estate of E.F. – deceased.

The petitioner, therefore, prays that the court may be pleased to grant to the petitioner probate of the said Will of the deceased.

Verification

I, (A.B.), the petitioner in the above petition, declare that statements made in paras 1 to 7 hereinabove are true to my knowledge and belief and I sign this verification this theday of 20..... at the Bar Library, (place) (see section 280 of the Indian Succession Act, 1925).

Sign A.B.

I, Sri.....one of the witnesses to the last Will of E.F. deceased, declare that I was present and saw the said testator affixing his signature in the said Will. (See section 281 of the Indian Succession Act, 1925).

Sign A.B.

Schedule 'A'

(State here assets likely to come to the hand of the executor).

Schedule 'B'

(State here liabilities, debts, if any – where necessary).

Answer 2A(ii)

A deed between two or more parties where as many copies are made as there are parties, so that each may be in possession of a copy. This arrangement is known as deed pool. In other words A deed poll is a legal document binding only to a single person or several persons acting jointly to express an active intention.

A deed made and executed by a single party e.g. power of attorney, is called a deed poll, because in olden times, it was polled or cut level at the top. It had a polled or clean cut edge. It is generally used for the purpose of granting powers of attorney and for exercising powers of appointment or setting out an arbitrator's award. It is drawn in first person usually.

Answer 2A(iii)

**APPLICATION FOR SETTING ASIDE EXPARTE DECREE
BEFORE THE HON'BLE COURT OF**

Suit No. / 2020

AB S/o.....

R/o.....

Plaintiff

Versus

CD S/o.....

R/o.....

Defendant

The Defendant/Applicant respectfully states as follows:

1. That the applicant was one of the defendants in the above case and an ex parte decree has been passed against him on January 21, 2020.
2. That he was prevented by the reasons disclosed in the annexed affidavit, which he claims were sufficient, from appearing when the suit was called on for hearing.

The applicant prays that ex parte decree passed against him on January 21, 2020 be set aside.

(Signature of the Applicant)

AB

Place:

Date:

Advocate for the Applicant

Affidavit in support of the above application

1. I make oath and say that I had to join a marriage ceremony of my sister's son on January 22, 2020, at Jabalpur, and therefore I left my village on January 18, 2020 and returned from it on January 30, 2020.
2. I make oath and say that, on January 16, 2020, I had given my papers to Sri Chaman Lal, Advocate, and had instructed him to file the Vakalatnama and written statement on my behalf on January 21, 2020, the date fixed for issues.

3. I am informed by Sri Chaman Lal, Advocate, and I verily believe it to be true, that, on January 21, 2020, when the case was called on, Sri Chaman Lal was engaged in a Sessions case, before the Additional Judge at Kanpur.
4. I am informed by Sri Chaman Lal, and, verily believe it to be true, that when Sri Chaman Lal came to the court a few minutes later, he found the case had been decreed exparte.

(Signature)

Applicant

Answer 2A(iv)

Goodwill is an intangible asset. It is easy to describe but difficult to define. It represents the value to a business attaching to all the factors, internal and external, which enable it to earn a differential return of profit on the capital employed; that is, a better return than that which arises in other comparable businesses, having regard to the nature, size, location and risk inherent in such a business, and which is capable of being enjoyed by a successor.

Goodwill has been variously defined by different commercial pundits. Some definitions are: "The goodwill of a business is the advantage, whatever it may be, which a person gets by continuing to carry on, and being entitled to represent to the outside world that he is carrying on a business, which has been carried on for some time previously."

Wharton's Law lexicon defines goodwill as the advantage or benefit which is required by a business, beyond mere value of the capital stock, funds or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers.

Supreme Court of India in *Khushall Khengar Shah v. Khorshedbanu*, AIR 1970 SC 1147, had opined goodwill of a business as an intangible asset being the whole advantage of the reputation and connections formed with the customers together with the circumstances which make the connections durable. It is that component of the total value of the undertaking which is attributable to the ability of the concern to earn profits over a course of years because of its reputation, location and other features.

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

Question 3

Attempt the following :

- (a) *Discuss the Signature and Attestation Clause.*
- (b) *Write down the mode of transfer of Actionable Claim.*
- (c) *Write down the distinction between Conveyance and Contract.*
- (d) *Write down the conditions under which you will suggest a company to bring a suit for Specific Performance.* (4 marks each)

Or (Alternate Question to Q. No. 3)

Question 3A

- (i) *What is the difference between a 'Firm' and 'One Person Company'.*

(ii) *Distinguish between Sale and Hire Purchase.*

(iii) *How Patents are assigned ? Explain.*

(iv) *Distinguish between Partnership and LLP.*

(4 marks each)

Answer 3(a)

After attestation clause, signatures of the executants of the documents and their witnesses attesting their signatures follow. If the executant is not competent enough to contract or is juristic person, deed must be signed by the person competent to contract on its behalf. For example, if the deed is executed by the company or cooperative society then the person authorised in this behalf by and under the articles of association or rules and regulations or by resolution as the case may be should sign the document and seal of the company/society should be so affixed, thereto by mentioning the same.

In India, the Deed of Transfer is not required to be signed by the transferee even though the transferee is mentioned as party in the document. All conditions and covenants are binding upon him without his executing the conveyance, if he consents to it by entering into the lease granted under the conveyance. However, in case the deed contains any special covenant by the transferee or any reservation is made by the transferee then it is always proper to have the deed signed by the transferee also.

Attestation is necessary in the case of some transfers, for example, mortgage, gift, sale, and revocation of Will. In other cases, though it is not necessary, it is always safe to have the signatures of the executant attested. Attestation should be done by at least two witnesses who should have seen the executant signing the deed or should have received from the executant personal acknowledgement to his signatures. It is not necessary that both the witnesses should have been present at the same time. There is no particular form of attestation but it should appear clearly that witnesses intended to sign is attesting the witnesses. General practice followed in India is that the deed is signed at the end of the document on the right side and attesting witnesses may sign on the left side. If both the parties sign in the same line then the transferor may sign on the right and the transferee on the left and witnesses may sign below the signatures.

Answer 3(b)

Section 130 of the Transfer of Property Act, 1882 lays down the mode of transfer of actionable claim:

1. The transfer of an actionable claim whether with or without consideration shall be effected only by the execution of an instrument in writing signed by the transferor or his duly authorised agent, and shall be complete and effectual upon the execution of such instrument, and thereupon all the rights and remedies of the transferor whether by way of damages or otherwise, shall vest in the transferee, whether such notice of the transfer as is hereinafter provided be given or not;

Provided that every dealing with the debt or other actionable claim by the debtor or other person from or against whom the transferor would, but for such instrument of transfer as aforesaid, have been entitled to recover or enforce such debt or other actionable claim, shall (save where the debtor or other person is a party to the transfer or has received notice thereof as hereinafter provided) be valid as against such transfer.

2. The transferee of an actionable claim may, upon the execution of such instrument of transfer as aforesaid, sue or institute proceedings for the same in his own name without obtaining the transferor's consent to such suit or proceedings, and without making him a party thereto.

Every notice of transfer of an actionable claim must be in writing signed by the transferor or his agent duly authorised in this behalf, or in case the transferor refuses to sign, by the transferee or his agent, and must state the name and address of the transferee. (Transfer of Property Act, 1882, Section 131).

Answer 3(c)

The distinction between conveyance and contract is quite clear. Contract remains to be performed and its specific performance may be sought but conveyance passes on the title to property to another person. Conveyance does not create any right of any action but at the same time it alters the ownership of existing right. There may be cases where the transaction may pertain both contract as well as conveyance. For example, lease, whereby obligation is created while possession of the property is transferred by lessor to lessee. More so, contracts are governed by provisions of the Indian Contract Act, 1872 whereas the cases of transfer of immovable property are governed by the Transfer of Property Act, 1882 in India. A mere contract to mortgage or sale would not amount to actual transfer of interest in the property but the deed of mortgage or sale would operate as conveyance of such interest. In other words, once the document transferring immovable property has been completed and registered as required by law, the transaction becomes conveyance. Any such transaction would be governed under the provisions of the Transfer of Property Act, 1882.

Answer 3(d)

Specific performance is an order of a court which requires a party to perform a specific act, usually what is stated in a contract. It is an alternative to awarding damages, and is classed as an equitable remedy commonly used in the form of injunctive relief concerning confidential information or real property. While specific performance can be in the form of any type of forced action, it is usually used to complete a previously established transaction, thus being the most effective remedy in protecting the expectation interest of the innocent party to a contract.

Orders of specific performance are granted when damages are not an adequate remedy, and in some specific cases such as sale of land. Such orders are discretionary, as with all equitable remedies, so the availability of this remedy will depend on whether it is appropriate in the circumstances of the case.

The Supreme Court in *Babulal v. Hazari Lal Kishori Lal & others*, AIR 1982 SC 818; 1982 SCC (1) 525 has held that no special form of decree in a suit for specific performance is supplied by the Civil Procedure Code, 1908. Chapter 11 of the Specific Relief Act, 1963 deals with the various circumstances under which a contract may be enforced specifically and where it cannot be allowed. When a contract is to be specifically enforced, it means simply this that when the parties do not agree to perform the contract mutually, the intervention of the Court is required and the Court will do all such things as the parties would have been bound to do had this been done without the intervention of the Court.

By the decree for specific performance, the court sets out what it finds to be the real contract between the parties and declares that such a contract exists and it is for the executing court to do the rest. It may be noticed further that a decree in a suit for specific performance has been considered to be somewhat in the nature of preliminary decree which cannot set out in the fullest detail the different steps which are required to be taken to implement the main portion of the order directing specific performance of the contract. The executing court is in such a case vested with authority to issue necessary directions.

The concerned company is suggested accordingly.

Answer 3A(i)

A Firm/Partnership : A firm or Partnership is an association of two or more like minded persons formed with a common objective to establish a lawful business house of their choice with the idea of earning profits. Therefore, all partners of firm mutually agree to share all profits and losses of the business amongst them according to their predetermined shares/proportions fixed by them in the partnership agreement. Partnership is defined in Section 4 of the Indian Partnership Act, 1932 as a relation between persons who have agreed to share profits of business carried on by all or any one of them acting for all. Persons who have entered into partnership with one another are called individually partners and collectively a firm, and the name under which their business is carried on is called the firm name. In partnership, the property of the firm is the property of the individuals comprising it. Creditors of a partnership firm are creditors of individual partners and a decree against the firm can be executed against the partners jointly and severally. Partners are the agents of the firm. A partner's liability is always unlimited.

Limited Liability Partnership (LLP)

As per Section 2 of the Limited Liability Partnership Act, 2008 limited liability partnership means a partnership formed and registered under the LLP Act.

LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership. LLP can continue its existence irrespective of changes in partners. It is capable of entering into contracts and holding property in its own name. LLP is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP.

Further, no partner is liable on account of the independent or un- authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decision or misconduct. Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners or between the partners and the LLP as the case may be.

One Person Company

As per section 2(62) of the companies act, 2013 One Person Company means a company which has only one person as a member.

Features of a One Person Company

Here are some general features of a one-person company:

- a. *Private company* : Section 3(1)(c) of the Companies Act says that a single person can form a company for any lawful purpose. It further describes OPCs as private companies.

- b. *Single-member* : OPCs can have only one member or shareholder, unlike other private companies.
- c. *Nominee* : A unique feature of OPCs that separates it from other kinds of companies is that the sole member of the company has to mention a nominee while registering the company.
- d. *No perpetual succession* : Since there is only one member in an OPC, his death will result in the nominee choosing or rejecting to become its sole member. This does not happen in other companies as they follow the concept of perpetual succession.
- e. *Minimum one director* : OPCs need to have minimum one person (the member) as director. They can have a maximum of 15 directors.
- f. *No minimum paid-up share capital* : Companies Act, 2013 has not prescribed any amount as minimum paid-up capital for OPCs.
- g. *Special privileges* : OPCs enjoy several privileges and exemptions under the Companies Act that other kinds of companies do not possess.

Answer 3A(ii)

“Sale”, is a contract by which property in goods passes from the seller to the buyer for a price.

A “hire purchase agreement” is basically a contract of hire, but in addition, it gives the hirer an option to purchase the goods at the end of the hiring period. Consequently, until the final payment, the hirer is merely a bailee of goods and ownership remains vested in the bailor. Under such a contract, the owner of goods delivers the goods to person who agrees to pay certain stipulated periodical payments as hire charges. Though the possession is with the hirer, the ownership of the goods remains with the original owner.

The essence of hire purchase agreement is that there is no agreement to buy, but only an option is given to the hirer to buy by paying all the instalments or put an end to the hiring and return the goods to the owner, at any time before the exercise of the option.

Since the hirer does not become owner of the goods until he has exercised his option to buy, he cannot pass any title even to an innocent and bona fide purchaser. The transaction of hire-purchase protects the owner of the goods against the insolvency of the buyer, for if the buyer becomes insolvent or fails to pay the instalments, he can take back the goods as owner. And if the hirer declines to take delivery of the goods, the remedy of the owner will be damages for non-hiring and not for rent for the period agreed.

It is important to note the difference between a hire purchase agreement and mere payment of the price by instalments because, the latter is a sale, only the payment of price is to be made by instalments.

The distinction between the two is very important because, in a hire-purchase agreement the risk of loss or deterioration of the goods hired lies with the owner and the hirer will be absolved of any responsibility therefor, if he has taken reasonable care to

protect the same as a bailee. But it is otherwise in the case of a sale where the price is to be paid in instalments.

Answer 3A(iii)

Patent is a right, granted by the Government under the Patents Act, 1970 to the grantee, of exclusive privileges of making or selling a new invention or process protected under the patent. The Act confers upon the patentee the right to safeguard his property in the patent and sue the person who infringes upon his patent right.

After a complete specification in pursuance of an application for a patent has been accepted and on the request of the applicant, the Controller shall cause the patent to be sealed with the seal of the Patent Office under Section 43 of the Patents Act, 1970. Section 48 of the Act, confers upon the Patentee where the subject matter of the patent is a product, the exclusive right to prevent third parties who do not have his consent from the act of making, using, offering for sale, selling or importing for those purposes that product in India. Where the subject matter of the patent is a process, the patentee is given exclusive right to prevent third parties who do not have his consent from the act of using that process and from the act of using, offering for sale, selling or importing for those purposes the product obtained directly by that process in India provided that the product obtained is not a product in respect of which no patent shall be granted under this Act.

Section 68 of the Act makes provision with regard to the assignment of patents. The Section lays down:

An assignment of a patent or of a share in a patent, a mortgage, licence or the creation of any other interest in a patent shall not be valid unless the same were in writing and the agreement between the parties concerned is reduced to the form of a document embodying all the terms and conditions governing their rights and obligations and duly executed.

Section 69 of the Act dealing with registration of assignments prescribes:

Where any person becomes entitled by assignment, transmission or operation of law to a patent or to a share in a patent or becomes entitled as a mortgagee, licensee or otherwise to any other interest in a patent, he shall apply in writing in the prescribed manner to the Controller for the registration of his title or, as the case may be, of notice of his interest in the register.

Section 70 of the Act makes provision with regard to the power of registered grantee or proprietor to deal with patent. The Section lays down:

Subject to the provisions contained in this Act relating to co-ownership of patents and subject also to any rights vested in any other person of which notice is entered in the register, the person or persons registered as grantee or proprietor of a patent shall have power to assign, grant licences under, or otherwise deal with, the patent and to give effectual receipts for any consideration for any such assignment, licence or dealing:

Provided that any equities in respect of the patent may be enforced in like manner as in respect of any other movable property.

Answer 3A(iv)

Partnership is an association of two or more like minded persons formed with a common objective to establish a lawful business house of their choice with the idea of earning profits. Therefore, all partners of firm mutually agree to share all profits and losses of the business amongst them according to their predetermined shares/proportions fixed by them in the partnership agreement. Partnership is defined in Section 4 of the Indian Partnership Act, 1932 as a relation between persons who have agreed to share profits of business carried on by all or any one of them acting for all.

Persons who have entered into partnership with one another are called individually partners and collectively a firm, and the name under which their business is carried on is called the firm name. In partnership, the property of the firm is the property of the individuals comprising it. Creditors of a partnership firm are creditors of individual partners and a decree against the firm can be executed against the partners jointly and severally. Partners are the agents of the firm. A partner's liability is always unlimited.

Limited Liability Partnership (LLP) — As per Section 2(n) of the Limited Liability Partnership Act, 2008 limited liability partnership means a partnership formed and registered under the LLP Act. LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership. LLP can continue its existence irrespective of changes in partners. It is capable of entering into contracts and holding property in its own name. LLP is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP. Further, no partner is liable on account of the independent or un-authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decision or misconduct. Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners or between the partners and the LLP as the case maybe.

Question 4

- (a) *Write down the essentials of Memorandum of Association required for the incorporation of a company.*
- (b) *Draft an application to sue as an indigent person with assumed facts.*
(8 marks each)

Answer 4(a)

Based on the provisions of Section 4 of the Companies Act, 2013, the main drafting requirements of contents of a Memorandum are summarized below:

1. Name of the company

As per Section 4(1) (a) of the Companies Act, 2013, in the case of a public limited company the name of the company should last with the word "Limited", or in the case of a private limited company, the name of the company should last with the words "Private Limited. In case of Companies Registered under Section 8 of the Companies Act, 2013 these provisions does not apply.

As per Section 4(2) of the Companies Act, 2013, the name stated in the memorandum shall not—

- (a) be identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law. or

- (b) be such that its use by the company –
 - (i) will constitute an offence under any law for the time being in force, or
 - (ii) is undesirable in the opinion of the Central Government.

2. Registered Office of the Company

As per Section 4(1) (b) the memorandum of the company should mention the State in which the registered office of the company is to be situated.

3. Objects of the Company

The memorandum of the company should state the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

The objectives of the company may be categorized as

- (i) the main objects to be pursued by the company on its incorporation.
- (ii) subjects incidental and ancillary to the attainment of the main objects, and
- (iii) Other objects not included in (i) and (ii) above.

An act beyond the objects mentioned in the memorandum is ultra vires and void and cannot be ratified even by all members of the company. There is no restriction on objects except it should be legal and lawful. While drafting the objects, care should be taken to see that:

- (i) The objects are stated in a precise and clear manner so that there is no ambiguity in their interpresentation.
- (ii) Each object is stated independently.
- (iii) There is no inconsistency or contradiction between the objects.
- (iv) The same objects are not repeated in other clauses of objects in different words and phraseology.
- (v) No object is illegal, immoral or against public policy.
- (vi) Objects are properly arranged and divided and set in short sentences.

Prior approval of the competent authority is obtained wherever necessary for carrying out any objective.

4. The Liability of Members

This clause of memorandum should state the liability of members of the company, whether limited or unlimited, and also state, –

- (i) In the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them and
- (ii) In the case of a company limited by guarantee, the amount up to which each member undertakes to contribute –

- (A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be. and
- (B) To the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves.

5. Capital Clause

This clause of memorandum of association of company should include in the case of a company having a share capital, –

- (i) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share. and
- (ii) The number of shares each subscriber to the memorandum intends to take, indicated opposite his name.

Answer 4(b)

Application to sue as an indigent-person

In the Court of the Sub-Judge/Civil Judge at.....

Misc. Judicial Case No. /20.....

Title Suit No. /20..... (New)

A.B. Plaintiff.

Versus

C.D. Defendant.

Suit for title and Khash possession Valued at Rs.....

The above-named plaintiff states as follows:

(Here insert the pleadings)

Then add:

The plaintiff petitioner is an indigent person. He is not possessed of sufficient means to enable him to pay the said court-fees of Rs..... prescribed by law for the plaint of the above suit.

(Or, where no such fee is prescribed – The plaintiff petitioner is an indigent person. He is not entitled to property worth Rs. 1,000 other than the subject-matter of this suit).

The Plaintiff has not entered into any agreement with anybody in respect of the subject-matter of the suit. He has not transferred any of his property within two months next before presentation of this application, either fraudulently or in order to be able to apply for permission to sue as an indigent person.

The properties owned and possessed by the Plaintiff, with estimated value thereof, are specified below.

List of properties with value thereof.

(a) Rs.....

(b) Rs.....

(In words) Rs.

It is, therefore, prayed that the plaintiff petitioner may be permitted to sue as an indigent person.

Signature of the Plaintiff

Question 5

Draft the following :

(a) *A specimen Deed of Sale by a Certified Guardian (Appointed by the Court) of a Hindu Minor. Assume facts.*

(b) *A Deed of Assignment of Business Debt. Assume facts. (8 marks each)*

Answer 5(a)

THE DEED OF SALE is made on this..... day of..... BETWEEN AB of, etc. (vendedor) of one part and CD of, etc. (purchaser) of the other part.

WHEREAS by an order made by the District Judge of..... in Case No..... of under Act VIII of 1890 (cause title) the said AB was appointed certificated guardian of XY who was then and is still now a minor.

AND WHEREAS by an order dated..... the..... day of..... made by the District Judge of..... in Misc. Judicial Case No. ... of..... the said AB was authorised to sell the lands, hereditament and tenement belonging solely and exclusively to the said minor on terms there under contained which property is fully mentioned and described in the Schedule hereto.

AND WHEREAS the said order is still in full force and virtue.

AND WHEREAS in pursuance of the said order the said AB as such certificated guardian has contracted with the said CD for absolute sale of the said property at and for the sum of Rs.....

NOW THE INDENTURE WITNESSETH that for the consideration as aforesaid and in exercise of the powers, authorities and liberties conferred upon and vested under and by virtue of the hereinbefore recited order dated..... and all other powers and authorities enabling him in that behalf the said AB do hereby grant, convey, sell, transfer, assign and assure as certificated guardian of the said minor the said property and every part whereof unto and to the use of the said CD, To Have and To Hold the same absolutely and for ever.

AND THIS INDENTURE FURTHER WITNESSETH that the said AB do hereby covenant with the said CD that the said AB has not here to before done, executed, performed or knowingly suffered to the contrary any act, deed or thing whereby or by reason or means

whereof the said property or any part thereof may in any way be encumbered or prejudiced in title or estate or the said AB may be hindered or prevented from granting, transferring, conveying, selling, assigning or assuring the same in the manner hereinbefore indicated.

The Schedule above referred to

IN WITNESS WHEREOF, etc.

Signed, sealed and delivered
.....AB

.....CD

Answer 5(b)

THIS DEED OF ASSIGNMENT made this..... day of..... between..... son of..... resident of..... (hereinafter called "the Assignor") of the one part, and....., son of....., resident of....., (hereinafter called "the Assignee") of the other part.

WHEREAS the assignor has, for some time been carrying on the business of....., in the course whereof the several persons whose names, addresses and occupations are mentioned in the Schedule appended hereto, have become lawfully debtors to him and so for the several sums of money set opposite to their respective names;

AND WHEREAS the assignor has contracted with the assignee for the absolute sale to him of the said business debts at..... and for the sum of Rs..... (Rupees.....).

NOW THIS DEED WITNESSES that in consideration of the sum of Rs..... (Rupees.....) now paid to the assignor by the assignee (the receipt whereof the assignor hereby acknowledges), the said assignor, as beneficial owner, does hereby transfer, sell and assign unto and to the use of the said assignee, all the several said debts, and sums of money specified in the said Schedule which are now due and owing to the assignor to have and to receive them for his absolute use and benefit with absolute power, authority and liberty to enforce payment thereof by suit or otherwise and that the assignor does hereby covenant with the assignee that all the several debts are lawfully due to him and the parties by whom they are payable are alive, and further that he has not entered into any arrangement with any of them and that the assignor shall at all times hereafter do, execute and perform all such and other acts, deeds, things, or writings as may be reasonably required for realization of the said debts, and further and better and more effectively transferring and/or assuring them or any of them in favour of the assignee.

Schedule above referred to

IN WITNESS WHEREOF the assignor and the assignee do hereto affix their signatures on the day, month and the year above mentioned at..... (place).

Witness:

(Assignor)

Witness: (Assignee)

Question 6

- (a) *Enumerate the Appellate Authorities under the Competition Act, 2002.*
- (b) *Draft a 'Deed of Agreement' for admission of a new partner into firm. Assume facts. (8 marks each)*

Answer 6(a)**As per section 53A(1) of the Competition Act, 2002**

The National Company Law Appellate Tribunal constituted under section 410 of the companies Act, 2013 shall, on and from the commencement of Part XIV of Chapter VI of the Finance Act, 2017, be the Appellate Tribunal for the purpose of this Act and the said appellate Tribunal shall –

- (a) to hear and dispose of appeals against any direction issued or decision made or order passed by the Commission under sub-sections (2) and (6) of section 26, section 27, section 28, section 31, section 32, section 33, section 38, section 39, section 43, section 43A, section 44, section 45 or section 46 of the Act;
- (b) to adjudicate on claim for compensation that may arise from the findings of the Commission or the orders of the Appellate Tribunal in an appeal against any finding of the Commission or under section 42A or under sub-section(2) of section 53Q of this Act, and pass orders for the recovery of compensation under section 53N of the Act.

As per Section 53B of the Competition Act, 2002–

- (1) The Central Government or the State Government or a local authority or enterprise or any person, aggrieved by any direction, decision or order referred to in clause (a) of Section 53A may prefer an appeal to the Appellate Tribunal.
- (2) Every appeal under sub-section (1) shall be filed within a period of sixty days from the date on which a copy of the direction or decision or order made by the Commission is received by the Central Government or the State Government or a local authority or enterprise or any person referred to in that sub-section and it shall be in such form and be accompanied by such fee as may be prescribed.

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of sixty days if it is satisfied that there was sufficient cause for not filing it within that period.

Answer 6(b)

THIS DEED OF AGREEMENT is made the day of 2020 BETWEEN AB son of aged R/o and CD son of aged R/o partners in the firm CD & Co. of the one part, AND EF son of aged years resident of of the other part.

WHEREAS the said AB and CD are partners in the firm CD & Co. situated in..... and are bound as such under a deed partnership executed by them on

the..... day of..... 2020 hereinafter referred to as the "partnership deed".

AND WHEREAS the said EF is desirous of being admitted as a member in the aforesaid firm of CD and Co. and invest a sum of Rs..... AND the said AB and CD are willing to admit him as an additional partner.

NOW THEREFORE THE DEED WITNESSES that in pursuance of the said agreement and in consideration of the said EF bringing in and contributing the sum of Rupees..... (Rs.....) only as additional capital of the above partnership firm, it is mutually agreed as follows:

1. The parties hereto shall, as from the date hereof be and continue partners for the unexpired residue of the terms mentioned in para..... of the partnership deed subject in all respects to the conditions, stipulations, and provisions of the aforesaid partnership deed, so far as applicable, and except as varied by this deed of agreement.
2. The capital mentioned in the partnership deed shall hereafter be changed to the sum of Rupees..... only and the partners shall hereafter have the undernoted shares in the capital.
 AB shall have Rs..... in the said capital;
 CD shall have Rs..... in the said capital; and
 EF shall have Rs..... in the said capital.
3. The profits and losses of the partnership shall continue to be borne by the partners hereto in proportion to their above named respective shares.

IN WITNESS WHEREOF the said AB, CD and EF have hereto at..... signed the day and the year first above mentioned.

WITNESSES:

- | | |
|----|-----------|
| 1. | Sd/- A.B. |
| 2. | Sd/- C.D. |
| 3. | Sd/- E.F. |

BANKING LAW AND PRACTICE

(Elective Paper 9.1)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer **ALL** Questions.

Question 1

Case Study:

COMPLIANCE IN BANKS

A quick view of banking and finance sector would show that the sector has recorded substantial growth in the business, the number of products has exploded, the number of delivery points (Branch, ATM, Internet, Mobile, Business Correspondent/Business Facilitator) have increased manifold, the geographical and client outreach has multiplied and above all the number of risks have gone up as well. As a consequence, risks have increased. Technology has come to play an important role in all these including making compliance happen. This has resulted in spiralling up of compliance costs in recent years. But one should not be worried about the cost of compliance. A perusal of the RBI/SEBI/IRDA websites would also show that a number of banks and institutions have been levied regulatory penalties in recent years. This is the cost of non-compliance which is on the increase. Unlike the past where non-compliance was not much noticed, today, it may lead to stiff monetary fines, legal and regulatory sanctions. The media is more active today in reporting such events which could lead to a loss of reputation and may be loss of business as well. In the past regulators were perceived being soft on non-compliance. The significant increase in the size of the penalties announced by the regulators around the world in the recent years clearly shows that they shifting their stance and are getting tough as non-compliance could have serious implications for stability of financial sector as a whole. It is for this reason that the compliance function is very important.

Another reason why the compliance function is important is the increase in the risks faced by the banks. Banks have to manage risk. In their anxiety to manage risks, banks are known to have taken up hedge products which have proved harmful bringing the banking system to a halt. The regulator is however worried about the need to maintain financial stability. There is the issue of depositor protection. There is the worry that the banking sector may unwittingly use for terrorist funding and money laundering activities. All of these have resulted in regulations in the form of Capital Adequacy norms, IRAC norms, AML/KYC norms, disclosure norms, Customer Service Code etc. Banks will have to know for themselves as also tell the regulators that these norms are being adhered to. It is the compliance function which monitors these aspects and gives a feedback both to the regulator and the Board. In this regard, the Compliance Function has to ensure strict observance on the following:

- (a) That the bank has full knowledge of all relevant provisions contained in various legislations such as Banking Regulation Act and rules framed for the purpose in respect of Reserve Bank of India Act, Foreign Exchange Management Act, and*

Prevention of Money Laundering Act and that these norms have been factored in developing internal rules for doing the business of banking.

- (b) Ensure observance of regulatory guidelines issued from time to time by RBI.*
- (c) Ensure adherence to standards and codes, fair practices code prescribed by BCSBI, IBA, FEDAI and FIMMDA etc.*
- (d) Ensure adherence to listing related guidelines issued by SEBI.*
- (e) Ensure observance to bank's internal policies.*

The above mentioned legislation and guidelines are concerned not only with business matters but also focus on observing appropriate standards of market conduct, managing conflicts of interest, treating customers fairly, and ensuring the correctness of customer advice. These have implications for the structuring of banking products and/or selling and rendering financial counselling to the customer. Compliance is not strictly what is stated in the Acts and Guidelines. Compliance has to go beyond what is the legal minimum applicable to the bank and walk the extra mile towards achieving better minimum applicable to the bank and walk the extra mile towards achieving better standards of integrity and ethical conduct. Thus Governance has an important role in compliance. It is the management that has to set the standards of compliance by showing a willingness to comply and internalize compliance in the day to day business. The Compliance Department at the Head Office of the Bank should play the central role in the area of identifying the level of compliance risk in each business line, products and processes and issue instruction to operational functionaries/formulate proposals for mitigation of such risk. It should periodically circulate the instances of compliance failures among staff along with preventive instructions.

An Annual Report on compliance failure/breaches should be compiled and placed before the Board/ACB/Board Committee and circulated to all the functional heads. Non-compliance with any regulatory guidelines and administrative actions initiated against the bank and or corrective steps taken to avoid recurrence of the lapses should be disclosed in the annual report of the banks.

The code of conduct for employees should envisage working towards earning the trust of the society by dealing with customers in a fair manner and conducting business operations consistent with rules and regulations. Due weightage could be given to record of compliance during performance appraisal of staff at various levels. Staff accountability should be examined for all compliance failure.

In this backdrop, you are required to give answers in the context of prevailing banking practices and various RBI compliances to the following :

- (a) Explain the difference between Early Warning Signals (EWS) and Red Flagged Accounts (RFA). (10 marks)*
- (b) (i) What is meant by Central Fraud Registry (CFR) ?*
- (ii) M/s Super Great & Company, a partnership firm is maintaining a satisfactory Current Account for the last five years with PQR bank branch. An accountant of M/s Super Great & Company, who is the regular visitor to the branch,*

presents two cheques of ₹25,000/- each signed by a partner. The branch as a matter of routine paid the cheques. The firm, on reconciliation of their accounts, informs the branch that the accountant was removed a month back and the cheques which were paid by the bank were not signed by the partners. As such the firm demands that the debit entries be removed from the account. Give your decision on the case with reasons. (5+5 marks)

(c) Explain briefly :

(i) The rationale behind the reporting the Frauds to Reserve Bank of India.

(ii) Reserve Bank of India guidelines of Reporting Bank Fraud to Police/CBI. (5+5 marks)

(d) Explain the risk which arises out of the external factors like non-compliance of regulatory and legal framework in banks. Describe the different approaches as per BASEL II framework for estimating capital charge for this risk. (10 marks)

(e) Explain the following terms relating to compliance in banks :

(i) Reputational Risk

(ii) Compliance Audit. (5+5 marks)

Answer 1(a)

A Red Flagged Account (RFA) is one where a suspicion of fraudulent activity is thrown up by the presence of one or more Early Warning Signals (EWS). These signals in a loan account should immediately put the bank on alert regarding a weakness or wrong doing which may ultimately turn out to be fraudulent. A bank cannot afford to ignore such EWS but must instead use them as a trigger to launch a detailed investigation into a RFA.

Banks may choose to adopt or adapt the relevant signals from this list and also include other alerts/ signals based on their experience, client profile and business models. The EWS so compiled by a bank would form the basis for classifying an account as a RFA.

The threshold for EWS and RFA is an exposure of Rs.500 million or more at the level of a bank irrespective of the lending arrangement (whether solo banking, multiple banking or consortium). All accounts beyond Rs.500 million classified as RFA or 'Frauds' must also be reported on the Central Repository of Information on Large Credits (CRILC) data platform together with the dates on which the accounts were classified as such.

The RBI has set up the CRILC to collect, store, and disseminate credit data to lenders. Hence, banks will have to furnish credit information to CRILC on all their borrowers having aggregate fund- based and non-fund based exposure of Rs. 5 million and above. Similarly, banks will be required to report among others, the SMA status of the borrowers to CRILC.

The modalities for monitoring of loan frauds below Rs.500 million threshold is left to the discretion of banks. However, banks shall continue to report all identified accounts to Central fraud Monitoring Cell (CFMC), RBI as per the existing cut-offs.

The tracking of EWS in loan accounts should not be seen as an additional task but must be integrated with the credit monitoring process in the bank so that it becomes a continuous activity and also acts as a trigger for any possible credit impairment in the loan accounts, given the interplay between credit risks and fraud risks. In respect of large accounts it is necessary that banks undertake a detailed study of the Annual Report as a whole and not merely of the financial statements, noting particularly the Board Report and the Managements' Discussion and Analysis Statement as also the details of related party transactions in the notes to accounts. The officer responsible for the operations in the account, by whatever designation called, should be sensitized to observe and report any manifestation of the EWS promptly to the Fraud Monitoring Group (FMG) or any other group constituted by the bank for the purpose immediately. To ensure that the exercise remains meaningful, such officers may be held responsible for non-reporting or delays in reporting.

The FMG or any such designated committee shall classify the account as RFA and the details of RFA accounts shall be put up to the CMD/CEO every month.

A report on the RFA accounts shall be put up to the Special Committee of the Board for monitoring and follow-up of Frauds (SCBF) providing, inter alia, a synopsis of the remedial action taken together with their current status.

Answer 1(b)(i)

A Central Fraud Registry (CFR) based on the Fraud Monitoring Returns, filed by the banks and the select Financial Institutions, including the updates thereof, has been made available, for which banks have been given access through user-ids and password. CFR is a web-based and searchable database. The practice of issuing paper based Caution Advice (CA) has since been discontinued. However CAs on frauds including attempted frauds having systemic implication will be issued as and when required. Banks are advised to make full use of the CAs/CFR for timely identification, control, reporting and mitigation of fraud risk. Banks are also advised to put in place proper systems and procedure to ensure that the information available in CA/CFR is made use as a part of the credit risk governance and fraud risk management.

This searchable database helps Banks to detect early the instances of fraud by borrowers and also in carrying out due diligence during the credit sanction process.

Answer 1(b)(ii)

The bank is liable as the payment has been made on the basis of forged signature of the drawer. Forgery being a nullity, the bank has no valid mandate to debit the customer with the amount. As per Section 10 of the Negotiable Instruments Act, 1881 the payment made in case of forged signature of the drawer, the paying banking will not get the valid discharge as the same will not be considered as payment in due course. Therefore, bank has no mandate to debit the accounts of M/s Super Great & Company and bank will have to reverse the entry.

Answer 1(c)(i)

Reserve Bank of India (RBI) directions are issued with a view to providing a framework to banks enabling them to detect that fraudsters are brought to book early, examining staff accountability and do effective fraud risk management. These directions also aim

to enable faster dissemination of information by the RBI to banks on the details of frauds, unscrupulous borrowers and related parties, based on banks' reporting so that necessary safeguards/preventive measures by way of appropriate procedures and internal checks may be introduced and caution exercised while dealing with such parties by banks.

The objective of the framework is to direct the focus of banks on the aspects relating to prevention, early detection, prompt reporting to the RBI and the investigative agencies and timely initiation of the staff accountability proceedings while ensuring that the normal conduct of business of the banks and their risk taking ability is not adversely impacted and no new and onerous responsibilities are placed on the banks. In order to achieve this objective, the framework has stipulated time lines with the action incumbent on a bank. The early detection of Fraud and the necessary corrective action are important to reduce the quantum of loss which the continuance of the Fraud may entail.

Answer 1(c)(ii)

In dealing with cases of fraud / embezzlement, banks should not merely be actuated by the necessity of recovering expeditiously the amount involved, but should also be motivated by public interest and the need for ensuring that the guilty persons do not go unpunished. Therefore, as a general rule, the following cases should invariably be referred to the State Police or to the CBI as detailed below:

<i>Category of Bank</i>	<i>Amount involved in the fraud</i>	<i>Agency to whom complaint should be lodged</i>	<i>Remarks</i>
Private Sector/ Foreign Banks	Rs.10000 and above	State Police	If committed by staff
	Rs. 0.1 million and above	State Police	If committed by outsiders on their own and/or with the connivance of bank staff/officers.
	Rs. 10 million and above	In addition to State Police, SFIO, Ministry of Corporate Affairs, Government of India, Second Floor, Paryavaran Bhavan, CGO Complex, Lodhi Road, New Delhi-110 003.	Details of the fraud are to be reported to SFIO in FMR Format.

Public Sector Banks	Below Rs. 30 millions		
	1. Rs. 10,000/- and above but below Rs.0.1 million	State Police	If committed by staff*
	2. Rs.0.1 million and above but below Rs. 30 million	To Offences Wing of the state concerned	To be lodged by the Regional Head of the bank concerned.
	Rs. 30 million and above and up to Rs. 250 million	CBI	To be lodged with Anti Corruption Branch of CBI (where staff involvement is prima facie evident) Economic Offences Wing of CBI (where staff involvement is prima Facie Not Evident)
	More than Rs. 250 million and up to Rs. 500 million	CBI	To be lodged with Banking Security and Fraud Cell (BSFC) of CBI (irrespective of the involvement of a public servant).
	More than Rs. 500 million	CBI	To be lodged with the Joint Director (Policy) CBI, HQ New Delhi.

** Note: All fraud cases of value below 10,000/- involving bank officials, should be referred to the Regional Head of the bank, who would scrutinize each case and direct the bank branch concerned on whether it should be reported to the local police station for further legal action.*

Answer 1(d)

Operational Risk : The risks which arise out of the failure in internal systems and procedures, internal control system and/or human and system errors, and other internal/ external factors like non- compliance of regulatory and legal frame work, frauds, misappropriation etc. One or more of these mentioned risks are collectively called as the Operational Risk. Thus Operational Risk covers the non- compliance of regulatory and legal frame work in banks.

Operational risks can arise due to:

1. Non-compliance with laid-down procedures and authorizations for dealing, settlement and custody.

2. Fraudulent practices involving deals and settlements.
3. Legal risks due to inadequate definitions and coverage of covenants and responsibilities of the bank and counterparty in contracts and agreements.
4. Information Technology, which drives the markets, should be given importance in managing the risks, especially the operational risks. The quality of software, hardware and the up gradation of IT support system are very crucial for ensuring quick and correct transfer of financial transactions and funds across the international markets.
5. Human Resource Management needs to be given proper attention to reduce the impact of operational risks through human errors and systems failure. Good and effective training would help to have better results and lesser operational risks.
6. Non compliance of legal and/or regulatory frame work, due to inadequate definitions and coverage of covenants and responsibilities of the bank and counterparty in contracts.
7. Frauds, insufficient internal control systems.
8. Money laundering: International bank's main concern is to manage the money laundering activities. In view of the fast changing and increasing usage of technology, funds can be transferred from one end to the other part of the world quickly.

The BASEL II framework offers the following three approaches for estimating capital charge for operational risk:

1. *The Basic Indicator Approach (BIA)* : This approach sets a charge for operational risk as a fixed percentage ("alpha factor") of a single indicator, such as the banks gross annual revenue.
2. *The Standardized Approach (SA)* : This approach requires that the banks separate it's operations into eight standard business lines, such as trade finance, corporate banking and others. The capital charge for each business line is calculated by multiplying gross income of that business line by a factor ("beta") assigned to that business line.
3. *Advanced Measurement Approach (AMA)* : Under this approach, the Regulatory Capital requirement will equal the risk measure generated by the banks' internal operational risk measurement system.

Answer 1(e)(i)

Reputational Risk : Reputational risk is a threat or danger to the good name or standing of a business or entity. Reputational risk can occur in the following ways:

- Directly, as the result of the actions of the company itself.
- Indirectly, due to the actions of an employee or employees.
- Tangentially, through other peripheral parties, such as joint Venture partners or suppliers.

In addition to having good governance practices and transparency, companies need

to be socially responsible and environmentally conscious to avoid or minimize reputational risk.

Reputational risk is a hidden danger that can pose a threat to the survival of the biggest and best-run companies. It can often wipe out millions or billions of Rupees in market capitalization or potential revenues and can occasionally result in a change at the uppermost levels of management.

The biggest problem with reputational risk is that it can literally erupt out of nowhere. Reputational risk can also arise from the actions of errant employees, such as egregious fraud or massive trading losses disclosed by some of the world's biggest financial institutions. In an increasingly globalized environment, reputational risk can arise even in a peripheral region far away from home base.

In some instances, reputational risk can be mitigated through prompt damage control measures, which is essential in this age of instant communication and social media networks. In other instances, this risk can be more insidious and last for years. For example, gas and oil companies have been increasingly targeted by activists because of the perceived damage to the environment caused by their extraction activities.

Answer 1(e)(ii)

Compliance Audit

A Compliance Audit is the types of audit services that their performance is mainly focusing on whether the entity complying with local law, regulation, and related rule. A compliance audit also reviews whether entity complying with internal rule, regulation, policies, decisions, and procedures.

An entity required to comply with the local law and regulations or they will face with penalties or fine. Some fine is only for certain monetary amount and some fine require to close operation.

Types of Compliance Audit/Review : In general, the compliance auditor performs its audit against certain requirement as follows:

1. *Local Law and Regulation :* The entity need to make sure that they are operating in compliance with the law, and related law. To ensure this business might need to set up proper business procedure and processes or sometime, they might need the legal consultant to have their decision advised.
2. *Business Related regulation and framework :* Besides reviewing against local law and regulation, compliance auditor might need also to review the compliance with related regulation and framework. For example, if the corporation is listed on the stock exchange outside the country that they are operating. Then they need to make sure that the entity complies with the requirement of that stock exchange requirement.
3. *Entity's policy, procedure, and Processes :* Compliance auditor also performs its audit again entity's internal policy, procedure, and processes. Those internal policy and procedure are very important to the entity for sustainable growth.

Question 2

(a) From the financial statements given below for AB Ltd., calculate the following ratios and give your comments as a loan processing officer of the bank :

- (i) Current Ratio
- (ii) Acid Test Ratio
- (iii) Stock Turnover Ratio
- (iv) Debt Equity Ratio
- (v) Interest Coverage Ratio

Income statement of AB Ltd. for the year ending 31st March 2019 :

	₹ in lakh	₹ in lakh
Sales		
Cost of Goods Sold :		500
Stock, 1st April 2018	40	
Add : Purchase	245	
Direct Expenses	25	
	<u>310</u>	
Less : Stock 31st March 2019	<u>60</u>	250
Gross Profit		250
Operating Expenses	110	
Interest Expenses	20	130
Net profit before tax		120
Provision for Income tax		60
Net Profit		60

Balance Sheet of AB Ltd. as at 31st March 2019

Liabilities	₹ in lakh	Assets	₹ in lakh
Equity Share Capital	150	Fixed Assets	400
Reserves and Surplus	300	Stock	60
10% Debentures	200	Debtors	230
Creditors	180	Cash at Bank	155
Bills Payables	70	Bills Receivable	43
		Prepaid Expenses	12
Total	900	Total	900

(20 marks)

- (b) On 31st March, 2019, North Indian Bank Ltd. finds its non-performing advances classified as follows :

	₹ in '000
Sub-standard Assets (Secured)	46400
Doubtful Assets : Upto one year (Secured)	12830
Doubtful Assets : one year to three (Secured)	7820
Doubtful Assets : Above three years (Secured)	3290
Loss Assets	5175

Calculate the following as on 31st March, 2019 :

- (i) The amount of provision to be made against the advances.
 (ii) Provision Coverage Ratio (PCR). (5+5 marks)

Question 2(a)

(i) **Current Ratio** = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

Current Assets = Stock + Debtors + Cash at Bank + Bills Receivable + Prepaid Expenses

= Rs. (60+230+155+43+12) lakh = Rs. 500 lakh

Current liabilities = Creditors + Bills Payable

= Rs. (180+70) lakh = Rs. 250 lakh

Current Ratio = $\frac{\text{Rs. 500 Lakh}}{\text{Rs. 250 Lakh}} = 2:1$

Comments : Current Ratio 2:1 is satisfactory, it shows good liquidity position.

(ii) **Acid Test Ratio** = $\frac{\text{Quick Asset}}{\text{Current Liabilities}}$

Quick Assets = Debtors + Cash at Bank + Bills Receivables

= Rs. (230 + 155 + 43) lakh = Rs. 428 lakh

Current liabilities = Rs. 250 lakh

Acid Test Ratio = $\frac{\text{Rs. 428 Lakh}}{\text{Rs. 250 Lakh}} = 1.71:1$

Comments : Quick Ratio 1.77:1 is satisfactory, it shows good liquidity position.

$$(iii) \text{ Stock Turnover Ratio} = \frac{\text{Cost of Goods sold}}{\text{Average Stock}}$$

$$\text{Average Stock} = \frac{\text{Opening Stock} + \text{Closing Stock}}{2}$$

$$= (\text{Rs. 40 lakh} + \text{Rs. 60 lakh})/2$$

$$= \text{Rs. 50 lakh}$$

Stock Turnover Ratio = Rs. 250 lakh/Rs. 50 lakh = **5 times**.

Comments : Stock Turnover Ratio 5 times is satisfactory.

$$(iv) \text{ Debt Equity Ratio} = \frac{\text{Long Term Debt}}{\text{Shareholders' fund}}$$

$$\text{Long term debt} = \text{Rs 200 lakh Equity}$$

$$= \text{Equity Share Capital} + \text{Reserves and Surplus}$$

$$= \text{Rs. 150 lakh} + \text{Rs. 300 lakh} = \text{Rs. 450 lakh}$$

Debt Equity Ratio = Rs. 200 lakh/Rs. 450 lakh = **0.44:1**

Comments : Debit Equity Ratio 0.44:1 is satisfactory, shows good solvency position.

$$(v) \text{ Interest Coverage Ratio} = \frac{\text{Profit before tax and Dividend and Interest}}{\text{Interest}}$$

$$\text{Profit before Tax and Interest} = \text{Rs. 120 lakh} + \text{Rs. 20 lakh} = \text{Rs. 140 lakh}$$

$$= \text{Rs. 140 lakh} / \text{Rs. 20 lakh} = \textbf{7 times}$$

Comments : Interest Coverage ratio 7 times is satisfactory.

Answer 2(b)(i)

Calculation of the amount of provisions to be made against the advances:

	Amount (Rs. in 000)	% Required as provision	Provision (Rs. in 000)
Sub Standard Assets (Secured)	46400	15	6960.00
Doubtful Assets: Upto One year (Secured)	12830	25	3207.50
Doubtful Assets: One year to three years (Secured)	7820	40	3128.00
Doubtful Assets: Above three years (Secured)	3290	100	3290.00
Loss Assets	5175	100	5175.00
Total Provision Required	75515		21760.50

Answer 2(b)(ii)**Calculation of Provision Coverage Ratio (PCR)**

$$\text{Provision Coverage Ratio} = \frac{\text{Provision made for Non Performing Assets (NPA)}}{\text{Non Performing Assets}}$$

Provision made for NPA = Rs. 21760500

Non Performing Assets (NPA)= Sub Standard + Doubtful + Loss Assets

$$= \text{Rs. } 46400000 + \text{Rs. } 12830000 + \text{Rs. } 7820000 + \text{Rs. } 3290000 + \text{Rs. } 5175000$$

$$= \text{Rs. } 75515000$$

$$\text{Provision Coverage Ratio} = \frac{21760500 \times 100}{75515000} = 28.82\%$$

Question 3

Explain in brief the following :

- (a) *Reverse Mortgage (RM) is specially designed by the banks for certain category of the customers.*
- (b) *Marginal Cost of Funds Based Lending Rate (MCLR).* (3+2 marks)

Answer 3(a)**Reverse Mortgage (RM)**

The RM is formulated for the old age care of home owners, who have inadequate income to support themselves. Under RM, the Bank makes payments to the borrower / borrowers (in case of living spouse), against mortgage of his / their residential house property.

Payment may be made either by way of :

- (i) periodic installments; or
- (ii) lump sum payments.

The borrower is not expected to service the loan during his lifetime. The cause of loan recovery occurs on the demise of the last surviving borrower or on his/her leaving the house property permanently/happening of any event which triggers foreclosure.

Reverse mortgage is a novel and socially preferred alternative to selling and moving out of the house in order to generate a fixed income stream. Currently, there is lack of awareness about this product in India. However education and counseling can help the elderly to understand its benefits over traditional loans and also the emotional, social and physiological advantages that reverse mortgage offers. Development of a strong financial and regulatory framework is also needed to make this concept successful in serving the needs of the senior citizens in India.

Answer 3(b)**Marginal Cost of funds Based Lending Rate (MCLR)**

The MCLR methodology for fixing interest rates for advances was introduced by the Reserve Bank of India with effect from April 1, 2016. This new methodology replaced the base rate system introduced in July 2010.

The marginal cost of funds-based lending rate (MCLR) refers to the minimum interest rate of a bank below which it cannot lend, except in some cases allowed by the RBI. It is an internal benchmark or reference rate for the bank. MCLR actually describes the method by which the minimum interest rate.

MCLR actually describes the method by which the minimum interest rate for loans is determined by a bank - on the basis of marginal cost or the additional or incremental cost of arranging one more rupee to the prospective borrower.

Question 4

Give your decision on the following cases with reasons:

- (a) *Mr. Agassi is a trustee for M/s Nadal with a substantive balance in a Bank. The Branch Manager of the Bank asks Mr. Agassi to repay the overdraft granted to him in his personal account. He gives a cheque for the amount from his Trust Account to him. What should the Branch Manager do?*
- (b) *Mr. Pyarelal a Saving Bank Account holder of a branch had given a mandate to the branch to credit proceeds of Dividend/Interest warrants as and when received from companies. These instructions were being carried out regularly by the branch. Mr. Pyarelal suddenly passed away last month and after his death the branch received a dividend warrant for ₹2,000 for credit to his account. What should the Branch Manager do? (3+2 marks)*

Answer 4(a)

Bankers are expected to exercise a closer watch on the conduct of the Trust Account than those in which there is no element of trust. Any transaction, appearing must put the Banker on enquiry. A typical case is the issue in question where a customer draws a cheque on the trust account and deposits it into his own account with the object of reducing or extinguishing his personal overdraft. In the absence of an explanation to the complete satisfaction of the banker, such a transaction should not be allowed.

Answer 4(b)

Like all the mandates, the mandate for the payment of Dividend warrants to the branch also ceases to be operative after the death of Mr. Pyarelal. However, it is a common practice among bankers to continue to receive such instruments even after the death of a customer. The amount credited to the account of the deceased or to a new account (to be operated by the executor / administrator) belongs to the estate of the deceased customer which is paid to the legal heirs or operated by the executor / administrator so appointed by the court.

Question 5

Briefly Differentiate between :

(a) Data Warehouse and Data Mining

(b) Business Continuity Plan (BCP) and Disaster Recovery Management Plan (DRMP). (2+3 marks)

Answer 5(a)**Data Warehouse and Data Mining**

Collection of data to fulfill the information needs of middle and top management, which would enable them to improve in decision making, planning, controlling, and forecasting. Data warehousing is therefore a "Continuous Process" than a project. It is not a product. Data warehouse is the central component for carrying out data warehousing process. Therefore, data warehouse is the key component but it is not and end in itself.

Data warehouse allows to build the "Data Mountain". Data mining allows us to shift this mountain down to the essential information that is useful for business decisions. Technology makes available a flood of information at one's finger tips. The problem is to keep your head above the flood of information and at the same time not losing touch with what is happening in your area of interest.

Data Mining (DM) is the process of identifying valid, novel, potentially useful and ultimately understandable patterns in data. DM is emerging as a powerful decision support tool that frequently uncovers patterns that predict future behavior.

Answer 5(b)**Business Continuity Plan (BCP) and Disaster Recovery Management Plan (DRMP)**

Business Continuity Plan relates to resuming maintaining and recovering business activity in the event of disruptions, disasters and calamities. The plan should accomplish three objectives:

- a) Manage an immediate crisis.
- b) Initiate action to continue business activities in the short term.
- c) Establish the organizational procedure to manage medium and long term recovery.

Disaster Recovery Management Plan : DRMP deals with the emergency action which the branch will take to deal with a situation of disaster. In a fully computerized bank branch, DRMP has acquired high importance. It covers three steps of action when a disaster strikes, Viz.,

- a) Confronting the disaster by an Emergency Plan;
- b) Procurement of required materials through a Back Up Plan; and
- c) To restore the office to normalcy for speeding up commencement of normal business transactions.

When a disaster strikes, the three teams will go into action. All information is made

available in the Plan, i.e., persons who would be involved in confronting the disaster, their duties and areas of responsibilities. Information like telephone / cell number, address of hardware/ software personnel, electrician, etc. are also kept handy to facilitate contact in an emergency. Rigorous training is provided to the team, including mock drills or simulated attacks to test DRMP drawn up by bank branches.

Question 6

Write short notes on the following :

(a) *Capital Conservation Buffer*

(b) *Countercyclical Buffer*

(c) *Net Stable Fund Ratio (NSFR).*

(1+2+2 marks)

Answer 6(a)

Capital Conservation Buffer : Key feature of Basel III is that banks will be required to hold a capital conservation buffer of 2.5% of Risk Weighted Assets (RWAs) in the form of Common Equity to withstand future periods of stress bringing the total Common Equity requirement of 7% of RWAs and total capital to RWAs to 10.5%. The aim of asking to build conservation buffer is to ensure that banks maintain a cushion of capital that can be used to absorb losses during periods of financial and economic stress.

Answer 6(b)

Countercyclical Buffer : This is also one of the key elements of Basel III. The countercyclical buffer has been introduced with the objective to increase capital requirements in good times and use the same in difficult times. The buffer will slow banking activity when it overheats and will encourage lending when times are tough i.e., in difficult times. The buffer will range from 0% to 2.5% of total Risk Weighted Assets (RWA) of the banks, consisting of common equity or other fully loss-absorbing capital. Banks are required to have an additional cushion of capital with which to absorb potential losses, enhancing their resilience and contributing to a stable financial system. It is part of Basel III regulatory capital framework. In essence it is a mechanism to build up additional capital during periods of excessive credit growth when risks of system-wide stress are observed to be growing markedly.

Answer 6(c)

Net Stable Fund Ratio (NSFR): "Stable funding" is defined as the portion of those types and amounts of equity and liability financing expected to be reliable sources of funds over a one-year time horizon under conditions of extended stress.

NSFR = Available amount of stable funding x 100% required amount of stable funding.

Available Stable Funding (ASF) is defined as the total amount of a bank's:

(a) Capital;

(b) Preferred Stock with maturity of equal to or greater than one year;

(c) Liabilities with effective maturities of one year or greater;

- (d) That portion of non-maturity deposits and / or term deposits with maturities of less than one year that would be expected to stay with the institution for an extended period in an idiosyncratic stress event; and
- (e) The portion of wholesale funding with maturities of less than a year that is expected to stay with the institution for an extended period in an idiosyncratic stress event.

CAPITAL, COMMODITY AND MONEY MARKET
(Elective Paper 9.2)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer **ALL** Questions.

Question 1

- (a) XYZ & Associates a leading CS firm in Delhi, specialized in providing professional services, ranging from legal services & management consultancy services. Mr. A, a prominent businessman and lawyer by profession, approached XYZ & Associates requesting the incorporation of 4 private limited companies with ₹ 1,00,000 issued share capital for each company (i.e. total of ₹4,00,000) with the principal activities to invest, on the behalf of prominent investors, in the real estate property of Delhi NCR.

XYZ & Associates performed full Know Your Client (KYC) verification of Mr. A, by obtaining all the required identification and economic profile data and also performed a full background check for the said individual as to identify any Politically Exposed Person, sanctions and adverse media positive matches. All the performed procedures did not identify anything suspicious or negative which would prevent the acceptance of Mr. A as client.

XYZ & Associates got incorporated all the 4 companies, with Mr. A as the sole Beneficial Shareholder (BO) and immediately funds were deposited in the bank accounts of each of the 4 companies for ₹10,00,00,000 (i.e. total of ₹ 40,00,00,000). Each of the funds was shown as loans payable, for 1% interest, to a common investor Mr. P from Ghaziabad. The funds were then immediately invested in commercial property in Noida.

During a Regulatory monitoring inspection from Directorate of Enforcement, it is identified that Mr. P (the sole investor) is a Politically Exposed Person and has a criminal history and sentences by courts for embezzlement, money laundering, and being involved in a criminal organization. XYZ & Associates is reported in the Disciplinary Committee of ICSI for not performing adequate KYC procedures and also the specific BO (Mr. A) and the sole investor (Mr. P) are reported by ICSI to Directorate of Enforcement. In the light of the above answer the following:

- (i) What are the red flags were needed to be identified which might indicate money laundering activity in this case ? What are the risks and the potential threats that the XYZ & Associates may be faced with in this situation ? What steps may the CS firm undertake to mitigate its risks and possible exposure ? (10 marks)
- (ii) What KYC/Due Diligence work the CS firm could have carried out and when? (10 marks)

(iii) *What are the functions of Directorate of Enforcement under Prevention of Money Laundering Act, 2002 ?* (10 marks)

(b) *Following information and figures are noticed from the Annual Accounts for the year ended 31st March, 2019 of MNP Limited, a listed company :*

- (i) *Authorized Shares Capital ₹10 crore comprising of one crore Equity shares of ₹10 each.*
- (ii) *Paid-up Share Capital of ₹4.5 crore comprising of 40,00,000 Equity shares of ₹10 each fully paid-up and 10,00,000 Equity shares of ₹10 each called and paid-up to ₹5 each. The total paid-up capital is paid up in cash.*
- (iii) *Securities Premium Account ? 10 crore.*
- (iv) *2,50,000 fully convertible debentures of ? 100 each. These debentures are due for conversion on 30th June, 2019 in full into fully paid Equity shares of ₹10 each in the ratio of two equity shares for one debenture.*
- (v) *General Reserve ₹15 crore.*
- (vi) *Fixed asset revaluation reserves ₹2.5 crore.*

It was further ascertained that the partly paid shares were made fully paid by 30th June, 2019. The directors of MNP Limited propose to issue bonus shares in the ratio of 1 : 1.

In the light of above answer the following :

- (1) *Explain the procedure of issue of bonus shares by listed companies as per the SEBI (ICDR) Regulations 2009.* (10 marks)
- (2) *Advise the directors on the matter with reference to the guidelines issued by SEBI on bonus issue. What will be your advice, if the company has defaulted in the matter of payment of interest on fixed deposits ?* (10 marks)

Answer 1(a)(i)

The red flags which indicate money laundering in the given case are as under:

- (a) No economic substance in the business setting of the four companies of having only one sole investor (Mr.P) for all four companies and the only return sought, for a total of ₹ 40,00,00,000 investment, to be 1%.
- (b) Beneficial owner (Mr. A) is a prominent lawyer and the principal activities sought for the four companies as to invest in real estate, do not tie directly to his primary profession of being lawyer.
- (c) Beneficial owner only invested ₹ 4,00,000 in total to all four companies and the sole investor invested ₹ 40,00,00,000 in total to all four companies, so a question arises on who the real Beneficial owner is in all four companies.

Risks and threats a CS firm may face in this situation:

- (a) XYZ & Associate has been reported to the Disciplinary Committee, on the grounds of aiding money laundering due to the insufficient performance of KYC for this

specific client, and with the risk of severe disciplinary measures to be decided against the firm.

- (b) XYZ & Associates has been reported to Directorate of Enforcement, and will be part of an investigation and the possibility of criminal proceedings against them, on the grounds of aiding money laundering due to the insufficient performance of KYC for this specific client.

Steps to be taken by CS firm to mitigate its risks and possible exposure:

- (a) XYZ & Associates should revisit its KYC procedure.
- (b) XYZ & Associate should fully and openly cooperate, both with ICPAC and Directorate of Enforcement accordingly, for the investigation currently in place for Mr.A and Mr.P

Answer 1(a)(ii)

KYC / Due Diligence work to be performed by CS Firm-

The CS firm should have recognized and implement appropriate KYC procedures as to mitigate the risk that corrupt Politically Exposed Persons (PEPs) are firstly concerned about hiding their identity and secondly about hiding their assets. The real risky PEPs are the suits, the middlemen, the associates who stand in the shadows and are almost always the ones involved in the account openings. These people are the PEPs you really need to look out for. In fact, the political figure is arguably the last person you need to watch out for. As such, an effective PEP risk mitigation solution should not merely provide a long list of office holders' names and positions but in order to identify risk critically and methodically, it must also provide the identities of all those 'exposed persons' that surround the PEP.

The CS firm should have assessed the economic substance of the transactions and the reasoning of why the identified Beneficial owner (Mr.A) has only invested a total of ₹4,00,000 and the Sole Investor (Mr.P) has invested a total of ₹ 40,00,00,000 (with only 1% return), as such critically assessing on who the real Beneficial owner is.

A full KYC procedure should have been performed, not only on the Beneficial owner but also on the Sole Investor. Source of funds and source of wealth, for the Sole Investor (Mr.P), should have been identified and thoroughly examined in terms of legitimacy of the source.

CS firm should have established monitoring procedures on the following:

- i) ensure clients due diligence information is up to date as existing clients sometimes become PEPs after they enter a business relationship;
- ii) ensure internal procedures include employee ongoing training programmes, addressing effective ways of determining whether clients are PEPs;
- iii) use of the internet and media as sources of information for the determination, monitoring and verification of information in relation to PEPs;
- iv) use of available commercial databases, but do not fall into the trap of wrongly assuming that a name is (not) in such a database then the client is (not) a PEP;

- v) use of countries' published list of domestic PEPs;
- vi) use in-house developed databases as a tool to assist in the determination of who is a PEP;
- vii) use countries' asset disclosure systems applying to those individuals who hold prominent public functions;
- viii) use of self-declarations by a client of their PEP status, while noting that such procedure would shift the financial organisation's obligation to their client, which is not an acceptable practice; and
- ix) use general information publicised by competent authorities (e.g. the level of corruption in the country, the level of income for certain types of positions).

Answer 1(a)(iii)

1. Investigate contraventions of the provisions of Foreign Exchange Management Act, 1999 (FEMA). Contraventions of FEMA are dealt with by way of adjudication by designated authorities of Enforcement Directorate (ED) and penalties upto three times the sum involved can be imposed.
2. Investigate offence of money laundering under the provisions of Prevention of Money Laundering Act, 2002 (PMLA) and to take actions of attachment and confiscation of property if the same is determined to be proceeds of crime derived from a Scheduled Offence under PMLA, and to prosecute the persons involved in the offence of money laundering. There are 156 offences under 28 statutes which are Scheduled Offences under PMLA.
3. Adjudicate Show Cause Notices issued under the repealed Foreign Exchange Regulation Act, 1973 (FERA) upto 31.5.2002 for the alleged contraventions of the Act which may result in imposition of penalties. Pursue prosecutions launched under FERA in the concerned courts.
4. Sponsor cases of preventive detention under Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 (COFEPOSA) in regard to contraventions in FEMA.
5. Render cooperation to foreign countries in matters relating to money laundering and restitution of assets under the provisions of PMLA and to seek cooperation in such matters.

Answer 1(b)(1)

Procedure for issue of bonus shares by listed company as per SEBI (ICDR) Regulations 2009

The procedure for issue of bonus shares by a listed company is enumerated below:

1. Ensure that if conversion of FCDs / PCDs is pending, similar benefit has been extended to the holders of each FCDs / PCDs, through reservation of shares in proportion of such convertible part of FCDs / PCDs. The shares so reserved may be issued at the time of conversion (s) of such debentures on the same terms on which the bonus issue was made.

2. Ensure that bonus issue has been made out of free reserves built out of the genuine profits or securities premium collected in cash only.
3. Ensure that reserves created by revaluation of fixed assets are not capitalized.
4. Ensure that the company has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it or in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.
5. Ensure that the bonus issue is not made in lieu of dividend.
6. There should be a provision in the Articles of Association of the company permitting issue of bonus shares; if not, steps should be taken to alter the articles suitably.
7. The share capital as increased by the proposed bonus issue should be well within the authorized capital of the company; if not, necessary steps have to be taken to increase the authorized capital.
8. Finalize the proposal and fix the date for the Board Meeting for considering the proposal and for authorizing the taking up of incidental and attendant matters.
9. If there are any partly paid-up shares, ensure that these are made fully paid-up before the bonus issue is recommended by the Board of directors.
10. The date of the Board Meeting at which the proposal for bonus issue is proposed to be considered should be notified to the stock exchange (s) where the company's shares are listed.
11. Hold the Board Meeting and get the proposal approved by the Board.
12. The resolution to be passed at the General Meeting should also be approved by the Board in its meeting. The intention of the Board regarding the rate of dividend to be declared in the year after the bonus issue should be indicated in the resolution for bonus issue to be passed by members in general meeting.
13. Immediately after the Board meeting intimate the stock exchange (s) regarding the outcome of the Meeting.
14. Ensure that the company has announced bonus issue after the approval of Board of Directors and did not require shareholders' approval for capitalization of profits or reserves for making bonus issue as per the Article of Association, had implemented bonus issue within fifteen days from the date of approval of the issue by the board of directors of the company and must not have the option of changing the decision. However, where the company was required to seek shareholders' approval for capitalization of profits or reserves for making bonus issue as per the Article of Association, the bonus issue has implemented within two months from the date of the meeting of the Board of Directors where in the decision to announce bonus was taken subject to shareholders' approval.
15. Arrangements for convening the general meeting should then be made keeping in view the requirements of the Companies Act, with regard to length of notice, explanatory statement etc. Also three copies of the notice should be sent to the stock exchange (s) concerned.

16. Hold the general meeting and get the resolution for issue of bonus shares passed by the members. A copy of the proceedings of the meeting is to be forwarded to the concerned stock exchange (s).
17. In consultation with the Regional Stock Exchange fix the date for closure of register of members or record date and get the same approved by the Board of directors. Issue a general notice under Section 91 of the Companies Act, 2013 in respect of the fixation of the record date in two newspapers one in English language and other in the language of the region in which the Registered Office of the company is situated.
18. Give 7 days' notice to the stock exchange (s) concerned before the date of book closure / record date.
19. After record date process the transfers received and prepare a list of members entitled to bonus shares on the basis of the register of members as updated. This list of allottees is to be approved by the Board or any Committee thereof. The list usually serves as allotment list and on this basis the allotment is to be made to the eligible members.
20. File return of allotment with the Registrar of Companies within 30 days of allotment (Section 39 of the Companies Act, 2013). Also intimate stock exchange (s) concerned regarding the allotments made.
21. Ensure that the allotment is made within fifteen days of the date on which the Board of directors approved the bonus issue.
22. Submit an application to the stock exchange (s) concerned for listing the bonus shares allotted

Answer 1(b)(2)

In the above stated problem, MNP Ltd, authorized capital is INR 10 Crores and proposes to issue bonus shares in the ratio of 1:1, which means the authorized capital after bonus issue is to be increased by passing a special resolution. In the said problem, MNP Ltd has-

Fully paid up share capital	₹4.0 Crore	40,00,000 shares of ₹10 each
Partly paid-up capital (to be made fully paid-up before bonus issue)	₹1.0 Crore	10,00,000 shares of ₹10 each, ₹5 paid-up
2,50,000 convertible debentures of ₹100 each convertible into fully paid up shares of ₹10 each in the ratio of 2 equity shares for every 1 debenture	₹0.50 Crore	5,00,000 shares of ₹10 each.
Total capital after conversion	₹5.50 Crore	5,50,000 shares of ₹10 each

In all the company will be having 40,00,000 + 10,00,000 + 5,00,000 shares of ₹10 each amounting to ₹5.5 Crore paid-up capital. If the company propose to issue bonus shares in the ratio of 1:1, then post-issue capital will be ₹11 Crore (5.5 Crore + 5.5 Crore), bringing the authorized capital to ₹11 Crore.

Bonus shares only against reserves, etc. if capitalized in cash (Regulations 94)

- 1) The bonus issue shall be made out of free reserves built out of the genuine profits or securities premium collected in cash only and reserves created by revaluation of fixed assets shall not be capitalized for the purpose of issuing bonus shares.
- 2) Without prejudice to the provisions of sub-regulation (1), the bonus share shall not be issued in lieu of dividend.

Applying the above regulations, MNP Ltd, currently has ₹24.50 Crore (general reserve of ₹14.50 Crores and INR 10 Crores as securities premium amount) which can be utilized for the purpose of bonus issue amounting to ₹5.5 Crores.

Completion of bonus issue (Regulation 95)

- 1) An issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders' approval for capitalization of profits or reserves for making the bonus issue, shall implement the bonus issue within fifteen days from the date of approval of the issue by its Board of directors. Provided that where the issuer is required to seek the shareholders' approval for capitalization of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its Board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.
- 2) Once the decision to make a bonus issue is announced, the issue cannot be withdrawn.

As per regulation 92 of SEBI (ICDR) Regulations 2009, if company defaulted in payment of interest on fixed deposit it cannot issue bonus shares.

Question 2

- (a) *M/s Bholu Guru Pvt. Ltd. is a small-size unlisted company, presently experiencing liquidity problems. The directors, keen on overcoming the difficulty by improving collections, etc., are exploring two alternatives.*
 - (i) *Approximately 70% of annual sales are on credit basis. Normal credit period is 60 days, but many customers exceed this limit, and year end debtors are a true indicator. A scheme of 1.5% discount for payment in 10 days is proposed to be offered. The Company expects that at least half of credit customers would avail of this discount, and bad debts will also fall by 50%. Assume 365 days a year.*
 - (ii) *Engage a debt factoring company. The factor will extend finance up to 90% of debts arising from credit sales; charge a fee of 2% on total annual credit sales. The factor will also levy finance charges of 11%. With this arrangement*

administration costs are expected to come down by ₹ 70,000. Bank overdraft rate for company is 10%

Additional financial information is as follows :

Forecast for next year	₹ in '000
Sales	4850
Cost of Sales	2862
Bad Debts	48
PAT	325
Stock	455
Trade Debtors	846
Trade Creditors	550
Bank Overdraft	565
Equity Holders Fund	1575
Directors Loans	450

Evaluate each of the two alternatives, and select the best alternative for the company. (10 marks)

(b) The following is the information of Company Kingkong Limited listed on Bombay Stock Exchange (BSE) :

- (i) The paid up equity share capital of the company is ₹10,00,00,000 comprising of 1,00,00,000 equity shares of ₹10 each.
- (ii) The promoters of the company viz. Mr. Narayanan members, relatives, associate companies are holding 55,00,000 equity shares, representing 55% of the total paid up capital of the company as on 31st March, 2013.
- (iii) The promoters intend to acquire further 5% (500000 shares) of total share capital of the company under regulation 3(2) of the SEBI (Substantial Acquisition of Shares and Takeover) Regulation 2011 (hereinafter referred as "Takeover Regulations") in the financial year 2015-16.
- (iv) Further, they are desirous of increasing their holding by further 5% shares (500000 shares) in each financial year 2016-17, 2017-18 and 2018-19 in terms of the regulations without making any public announcement, by way of purchase from open market in normal segment of the Stock Exchange.
- (v) The said acquisitions shall also not be through bulk/block deal/negotiated deal or Preferential allotment.

In light of the above information explain the following :

- (1) Can the promoters of the company acquire additional 5% (500000 shares) during the financial year 2015-16 as per regulation 3(2) of the Takeover Regulation ?

(2) Can the promoters further acquire 5% additional shares as per regulation 3(2) of the Takeover Regulations in each Financial Year 2016-17, 2017-18 and 2018-19 till reaching the level 75% of the share capital of the company? (10 marks)

(c) What do you understand by the term American Depository Receipts (ADRs)? Explain its types and mechanism with the help of an example. (10 marks)

Answer 2(a)

Alternate I – Early Payment Discount

Particulars	(₹ in 000s)
Annual Sales	4850.00
Credit Sales	3395.00
Year end Debtors	846.00
Year end debtors represent $(846 \times 365 / 3395)$	91 days
50% of debtors value	1698.00
Credit Period of each debtors	10 days
Discount to be allowed at 1.5% of 1698	25.47
Annual Collection from such debtors $(1698 - 25.47)$	1672.53
Reduction in Credit Period (91 days – 10 days)	81 days
Reduction in Overdraft $(1672 / 365) * 81$	371
Reduction in Overdraft interest at 10% (A)	37.10
Add reduction in bad debts (50% of 48) (B)	24.00
Total Benefit $(37.10 + 24.00)$ (A+B) (x)	61.10
Cost by way of 1.5% (of INR 1698) discount on debtors value at 50% of INR 3395 (y)	25.47
Net benefit $(x - y)$ (i.e. $61.10 - 25.47$)	35.63

Alternate II - Factoring

Particulars	(₹ in 000s)	(₹ in 000s)
Annual Sales		4850.00
Credit Sales (70%)		3395.00
Year-end debtors		846.00
90% of year end debtors, taken as indicator	761.40	
Saving at Overdraft Interest of 10%	76.14	

Saving in Administration costs	70.00	146.14
Service Charges 2% of 3395	(67.90)	
Interest Costs (11% on 761.40)	(83.75)	(151.65)
Net Cost (146.14 – 151.65)		(5.51)

Conclusion : Of the two alternatives, the first alternative, i.e. to offer a cash discount seems to be the ideal choice, as it maximizes the value of the entity to equity holder.

Answer 2(b)

The Regulation 3(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 provides for exemption from making a public announcement subject to the following conditions:

- (i) The shareholding of the Acquirer is between 25% of the total shares or voting rights of the company and the “maximum permissible non-public shareholding limit”.
- (ii) Pursuant to the acquisition, to the shareholding of the Acquirer should not breach the maximum public shareholding limit.
- (iii) For calculating the acquisition limit of 5% of shares or voting rights, as specified under Regulation 3(2) of the Takeover Regulations, only gross acquisition shall be taken into account. Any intermittent fall in shareholding owing to disposal of shares by the acquirer or dilution of shareholding on account of fresh issue of share capital shall be ignored.
- (iv) In case the acquisition has taken place by way of issue of new shares of the target company or where the target company has issued shares during a financial year, the difference between the pre-allotment and post-allotment voting rights shall be taken into account for calculating the acquisition limit under Regulation 3(2) of the Takeover Regulations.

Further, the Promoters of the company are currently holding 55% shares in the company, which is within the eligible limit as stated at point no. (i) above. Moreover, the promoters want to increase their shareholding by 5% in each of the financial year 2013-14, 2014-15, 2015-2016 and 2016-17. The precise query of the applicant is whether promoters of the company are allowed to acquire 5% of shares only once, or acquire 5% shares is available for every financial year.

The language “any financial year” mentioned in Regulation 3(2) of the Takeover Regulations should be read as “every financial year”. Therefore, the promoters of the company are eligible to acquire upto 5% of shares of the company every financial year without attracting the obligation to make a public announcement as provide under Regulation 3(2) of Takeover Regulations, subject to the fulfilment of other conditions mentioned therein.

Answer 2(c)

An American Depository Receipt (ADR) is a negotiable security representing ownership on some underlying shares of a non-US company, which can be traded on US

stock exchanges. ADRs are denominated in US dollars and function on the lines of the shares of a US company in terms of trading and dividend payment.

Types of ADRs: ADRs can be classified into two broad categories:

1. *Un-sponsored ADRs* : In such ADRs, the company has got no agreement with the custodian or depository bank for the issuance of ADRs. These are traded on the Over-The-Counter (OTC) market and are issued according to the market demand forces. Un-sponsored ADRs can be issued by a number of depository banks. Each depository services only the ADRs issued by it.
2. *Sponsored ADRs* : These are the ADRs which are sponsored by the company itself. In this case, the foreign company itself want to issue ADRs and it does so by designating a depository bank that will issue ADRs in the foreign market on its behalf. It is of the following types:
 - (a) *Level 1 Sponsored ADRs* : These are lowest level of sponsored ADRs. These are traded only on the OTC market. The company is supposed to adhere to minimal US Securities and Exchange Commission (SEC) requirements and is not required to publish reports in accordance to US GAAP Standards.
 - (b) *Level 2 Sponsored ADRs* : In level 2 ADRs, the ADRs are listed on a recognized US stock exchange and can be traded thereafter. The stock exchanges in which these ADRs can be traded are New York Stock Exchange (NYSE), NASDAQ, and the American Stock Exchange (AMEX).

In such ADRs, the company is supposed to adhere to higher level of SEC Regulations and is also required to publish annual reports in accordance with US GAAP or IFRS (International Financial Reporting Standards).
 - (c) *Level 3 Sponsored ADRs* : These are the highest level of sponsored ADRs. As such, it requires adherence to stringent rules and regulations similar to US companies. In this type of ADRs, the company rather than letting its shares from the home market to be deposited in for the ADR program, actually issues fresh shares in the form ADRs to raise capital from the US market.

The mechanism of the working of an ADR

The following example would give a clear understanding of the mechanism of the working of an ADR and the parties involved.

1. Suppose there is a broker, say Mrs. X. She buys the shares of a company, say Reliance Industries Limited (RIL) from the BSE Ltd.
2. She then goes to his custodian bank, say ICICI, to hold the shares for the issuance of ADRs.
3. She then goes to another bank, called the Depository bank, say JP Morgan and asks them to issue ADRs on the basis of shares in the custody of ICICI.

In case of sponsored ADRs, the company (RIL in this case) can itself have a designated depository for issuance of ADRs, bypassing the custodian.
4. JP Morgan then confirms the shares held by ICICI and issues ADRs to Mr. X.

5. An ADR issued can represent a fraction of a share (say 1 ADR = $\frac{1}{2}$ a share of RIL), 1 single share or multiple shares (say 10 shares of RIL make 1 ADR).
6. These ADRs then can be traded on the US stock exchanges in a way similar to the trading stocks of US companies

Question 3

After doing a course in online trading, Bharat started an online portal for stock trading under the name "Bharat Trading". He met his school friend Bhavesh after a long time in a bank where Bhavesh had come to open a Demat account. Bharat urged Bhavesh to invest in the forthcoming IPOs of blue chip companies whereas Bhavesh was inclined to buy existing securities of the other companies to build his investment portfolio.

In the context of the above case :

- (a) Identify the two different types of capital market being referred to in the above paragraph.
- (b) State any four differences between the two different types of capital market.
(5 marks)

Answer 3

- (a) **Types of Capital Market** : The two different types of capital market being referred to are as under:
 - (i) *Primary Market* : "Bharat urged Bhavesh to investment in the forthcoming IPOs of blue chip companies".
 - (ii) *Secondary Market* : "Bhavesh was inclined to buy existing securities of the other companies to build his investment portfolio".

Answer 3(b)

Any four differences between the two different types of capital market i.e. primary and secondary markets are as under:

S.No.	Basis	Primary Market	Secondary Market
1	Meaning	It is the market for new issue of securities	It is the market for old securities
2	Aspects	Only buying of securities takes place	Both buying and selling of securities takes place
3	Parties involved	It involved dealing between the company and investors	It involves dealing between the two investors
4	Price	Prices of the securities are determined by the company	Prices of the securities are determined by the forces of the demand and supply

Question 4

(a) *What are Treasury Bills ? Explain its various types as issued by RBI.*

(3 marks)

(b) *A Co-operative Bank wishes to buy 91 days Treasury bill on 22nd October, 2018 maturing on 6th December, 2018. The rate quoted by seller is ₹ 99.1589 per ? 100 face value.*

Calculate its Yield to Maturity (YTM). Assume : 365 days a year. (2 marks)

Answer 4(a)

Treasury Bills: Treasury Bills are money market instruments issued by the Reserve Bank of India (RBI) to finance the short term requirements of the Government of India. These are discontinued securities and thus are issued at a discount to face value. The return to the investor is the difference between the maturity value and issue price. In the short term category of investment instruments, the treasury bill carry the lowest risk. RBI issues these at a prefixed date and of a fixed amount.

There are four types of treasury bills:

1. *14 day Treasury Bill:* The maturity is in 14 days. Its auction is on every Friday of every week. The notified amount for this auction is ₹100 Crore.
2. *91 day Treasury Bill:* The maturity is in 91 days. Its auction is on every Friday of every week. The notified amount for this auction is ₹100 Crore.
3. *182 day Treasury Bill :* The maturity is in 182 days. Its auction is on every alternate Wednesday (which is not a reporting week). The notified amount for this auction is ₹100 Crore.
4. *364 day Treasury Bill:* The maturity period is 364 days. Its auction is on every alternate Wednesday (which is not a reporting week). The notified amount for this auction is ₹500 Crore.

Answer 4(b)

The YTM (Yield to Maturity) can be calculated as under:

$$Y = \frac{(100 - P) \times 365 \times 100}{P \times D}$$

Wherein

Y = Discounted yield

P = Price

D = Days to maturity

The days to maturity of Treasury bills are 45 (October – 10 days, November – 30 days and December- 5 days)

$$\text{Yield to Maturity (YTM)} = \frac{(100 - 99.1589) \times 365 \times 100}{(99.1589 \times 45)} = 6.88\%$$

Question 5

- (a) *What is daily 'Mark to Market' settlement?* (3 marks)
- (b) *A trader enters into a short futures contract to sell April Silver for ₹48,000 per kilogram on the MCX. The size of each contract is 5 kilogram. The initial margin is ₹5,000 and the maintenance margin is ₹20,000. Compute the futures price above which there will be a margin call?* (2 marks)

Answer 5(a)

Daily mark to market settlement is done till the date of the contract expiry. This is done to take care of daily price fluctuations for all trades. All the open positions of the members are marked to market to market at the end of the day and the profit / loss is determined as below:

1. On the day of entering into contract, it is the difference between the entry value and daily settlement price for that day.
2. On the intervening days, when the member holds an open position, it is the difference between the daily settlement price for that day and the previous day's settlement price.
3. On the expiry date if the member has an open position, it is the difference between the final settlement price and the previous day's settlement price.

Answer 5(b)

There will be a margin call when the difference between the initial margin and the maintenance margin i.e. ₹25,000 - ₹20,000 = ₹5,000 is the loss from that account.

So a change of ₹5,000 / 5 = ₹1,000 per kilogram of future will make a margin call.

When the price of silver futures goes above ₹49,000 trader would be asked to deposit the margin amount

Question 6

What aspects SEBI shall take into account before granting a certificate of registration to a broker under SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992 for admission on any Stock Exchange. (5 marks)

Answer 6

SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992 now known as SEBI (Stock Brokers) Regulations, 1992 contains Regulations 3 to 10 which deal with registration of stock brokers. An application by a stock broker for grant of a certificate of registration shall be made to SEBI through stock exchanges, of which he is admitted as a member.

SEBI shall take into account the following aspects before granting a certificate:

1. Whether the stock broker is eligible to be admitted as a member of a stock exchange.
2. Whether he has the necessary infrastructure like adequate office space, equipment and manpower to effectively discharge his activities.

3. Whether he has any past experience in the business of buying, selling or dealing in securities.
4. Whether he was subjected to disciplinary proceedings under the rules, regulations and bye-laws of a stock exchange with respect to his business as a stock broker involving either himself or any of his partners, directors or employees; and
5. Whether he is a fit and proper person.

INSURANCE LAW AND PRACTICE (Elective Paper 9.3)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer **ALL** Questions.

Question 1

Answer the following questions as per the given situation :

- (a) Rampant malpractices are bleeding public sector insurance companies and they need to restructure their activities so as to bring about change in the sector. Claims ratio is as high as 150 percent and there are too many malpractices in the health sector.

The structural inefficiencies are hampering the development of the sector. Insurers need to develop a framework for collecting statistics and databases, develop comprehensive products which are transparent and user-friendly. Health insurance should be made mandatory for all jobs and employees should be encouraged to go in for CGHS schemes as well as policies provided by insurance companies.

The health care sector is estimated at ₹ 80,000 crore and is expected to grow by ₹10,000 crore every year. Expenditure on health insurance is expected to touch six percent of household income up from the current two percent. Government spending accounts for less than 25 percent of expenditure on health while in developed countries the figure is in the range of 40 to 60 percent. Although the insurable population is placed at two million the potential market is placed at 315 million people. Insurance companies are keen to resolve the stalemate as they do not make money from health insurance. Another key area where business is impacted is in the area of mergers and acquisitions.

A survey on health insurance was carried out and nearly 37 percent of respondents opined that corruption could impact the valuation of a company thereby denying shareholders of a fair price. Moreover, this could also make it difficult for them to find a suitable business partner, thereby seriously impacting the growth prospects of the business.

What are the ethical aspects of claims management particularly in the case of health insurance ?

What are the procedures followed by the insurance companies in close proximate claims cases ? (5 marks each)

- (b) Barun Ojha, as a bachelor, took a life policy "Poorna Suraksha" from ABC Life and named his father Tarun as his nominee. During the tenure of the policy, he married Sujata Jha, but he did not change the nomination in his policy. Subsequently, Barun died of a heart attack when the policy was still in force. His wife Sujata lodged a claim with the insurance company; simultaneously Barun's

father Tarun also filed a claim as the official nominee of the deceased. Insurance company found the claim under the policy justified but does not want a confrontation with the two parties staking the claim, as they do not want to take any risk of being questioned for the wrong payment from their behalf if they make payment to any one of them. They wanted that both the parties should amicably settle the issue off the court or get it settled through a legal process before it can make any payment to any one of them.

What do you mean by Nomination ? In which case the provisions of Section 39 of Insurance Act, 1938 do not apply. Do you think that the stand taken by the insurer is correct in the circumstances of the above case ?

(10 marks)

- (c) *On 21-02-2014 a sale deed was executed between Srivastava and Kulwant and Srivastava sold his house to Kulwant and the ownership was transferred by registration in the name of Kulwant. Just before selling the property Srivastava had taken a fire insurance cover for his house taken with insurer XYZ Ltd. and the period of insurance was 18-8-2013 to 17-8-2014. Kulwant and Srivastava came to mutual understanding and according to that 75% of the sale money was paid by the former to the latter at the time of execution of the sale deed and the balance was to be given within one year, which was agreed by means of a promissory note executed by Kulwant in favour of Srivastava.*

On execution of the sale deed, Kulwant obtained a fire insurance cover for the house in his name from his insurer ABC General Insurance Co. A fire accident took place on 13-5-2014 in which the whole house was destroyed by fire.

When Kulwant filed a claim for the loss of the house with his insurer ABC General Insurance Co. and after insurance surveyor investigated the whole case, the insurer agreed to pay the loss to the extent of 75% of the value of the house only saying that as on the date of loss Kulwant has not paid 25% of the value of the house to Srivastava, so the claim cannot be paid to that extent and that the same has to be recovered by Srivastava under his policy.

Define the principle of Insurable Interest and also explain how the same ensure legality to an Insurance contract. Discuss the eligibility of claim recovery under both the policies in the above case. (10 marks)

- (d) *Savita got her Honda City car insured under Motor Comprehensive policy from ABC General Insurance Co. for the period from 1-6-2017 to 31-5-2018 for a value of ₹3.75 lakh. On 15-10-2017 she sold the car to Gautam. The car met with an accident on 10-12-2017 and was extensively damaged. A pedestrian was also injured in the accident. The repair to the car had cost Gautam ₹1,39,500 and he filed the claim with the insurance company. The pedestrian also claimed damages for the injury.*

(i) *Discuss the admissibility of the claims.*

(ii) *What are the legal aspects of third-party motor insurance ? Are there any exemptions to the concept of compulsory third party insurance ? Discuss.*

(5 marks each)

- (e) *Ram Kumar was highly successful sales manager in XYZ Life Insurance Co. An expert salesman, he was often approached by his agents for help in finalizing high sum assured policies. During one of his high profile get-togethers, one of the film stars showed a keen interest in taking an insurance policy. The film star was looking for a high sum assured covers i.e. ₹50 crore. Ram Kumar was keenly interested because he had not dealt with such a big value policy so far.*

After coordinating with one of his agents. Ram Kumar played a key role in finalizing the deal. All his energies were now focused on getting this proposal passed by the underwriting department. All special medical reports required were quickly secured and filed with that department. Ram Kumar also recommended the company to issue the policy.

The underwriting department was headed by Anshuman, who was more concerned for quality than quantity of business. Anshuman thought it was his duty as the underwriter to have strict control over new business flowing into the organization. Ram Kumar and his people, on the contrary, believed that new business was important for the growth of the company and therefore the underwriters should not be allowed to affect the flow of new business by being rigid.

When the proposal came back from Head Office after scrutiny, Ram Kumar found that the proposal for a cover of ₹50 crore had been modified to ₹50 crore on a short term plan basis.

State :

- (i) ***Whether an insurer should follow strict underwriting procedure and whether the points of view between the marketing and the underwriting departments should not be identical.***
- (ii) ***The consequences that could be faced by an under-writer by adopting flexible and easy underwriting control.*** (5 marks each)

Answer 1(a)

Ethical aspect of claims management : Claims operation involves considerable sums of money. It is not uncommon to find that some of the individual claimants are tempted, either knowingly or unknowingly, to make company's funds due to the activities of such persons is not justifiable as far as other honest claimants are concerned who are satisfied with what is due to them in terms and conditions of the policy. Therefore, it is the responsibility of the insurance companies, as trustees of the policyholders' money, to ensure as far as possible, that moral hazard is eliminated or at least minimized.

Since loss is personal, the individual is likely to react in a subjective manner and tends to exaggerate his claim. This can be tackled without much difficulty. But, a more difficult problem is corporate clients trying to take advantage of insurance. Some of them are said to treat their insurance division as a profit centre. Therefore, it is necessary to successfully assess the moral hazard at the time of underwriting itself. When this is subsequently found, it is essential that insurance companies share this information with one another and deal with such clients in a suitable manner.

In the case of Health Insurance, most of the case settlement is done by TPA. A TPA

is basically a middle man who facilitates the settlement of a health insurance claim. A TPA is appointed by the insurer. TPAs help you (the insured) process your health insurance claim using various hospital bills and documents. However, they are not responsible for claims rejection or acceptance. So as per the case a survey on health Insurance was carried out and nearly 37% respondent said that corruption is leading to high valuation of a company.

Close Proximity claims : Generally, a feeling arises that whenever a claim occurs immediately after the assumption of risk, that there is something wrong with the claim. It need not necessarily be a false claim if it occurs immediately after a policy is issued instead of occurring after a gap of 5/10 days and is deemed a pure chance event.

However, in the present scenario, there should be a standard procedure as described below to conduct an investigation and clear the doubt. Unfortunately, the insurer is in such a vulnerable position that if he settles such a claim, it may become a matter of vigilance. If he delays, he is open for criticism in the consumer forums and it may turn out to be a grievance as far as the insured is concerned.

When a claim arises within 5 days from the date of inception of the cover, the following procedure should be adopted as a matter of routine. The operational office has to appoint an investigator immediately who has to comply with the following guidelines:

- He has to visit the accident spot immediately and collect the details of persons/ vehicles involved.
- Contact police/transport authorities for obtaining the material evidence as to the nature, cause, exact date and time of the accident.
- To collect prefix and suffix cover notes issued, if any.
- To obtain the copy of the proposal submitted, and also to confirm as to whether the subject matter was inspected before the inception of the cover and if so by whom.
- To get confirmation as to whether any message has been given to operating offices by the development officers/agent immediately after the assumption of the cover.

Answer 1(b)

Nomination of Life Insurance Policies is a process whereby if the Life Insured dies within the policy tenure, the Insurer would pay out the proceeds of that policy to the Nominee. The process of selecting that candidate or Nominee is called Nomination. The policy holder has to select a nominee to the life insurance policy at the time of purchase. It works similar to a nominee whom a bank account holder should appoint to receive the money in the bank account in case of the account holder's death.

The provisions of Section 39 of Insurance Act, 1938 are not applicable to any life insurance policy to which Section 6 of Married Women's Property Act, 1874 applies or has at any time applied except where before or after Insurance Laws (Amendment) 2014, a nomination is made in favour of spouse or children or spouse and children whether or not on the face of the Policy it is mentioned that it is made under Section 39 of Insurance Act, 1938. Where nomination is intended to be made to spouse or children or spouse

and children under Section 6 of Married Women's Property Act, 1874, it should be specifically mentioned on the Policy. In such a case only, the provisions of Section 39 of Insurance Act, 1938 will not apply.

The stand taken by the insurer is not correct.

The policyholder is entitled to authorize an individual to receive policy monies. The insurance company is duty bound to make the payment to the nominee as mentioned in the policy. There is no need for any apprehension on the part of the insurer that its action of making payment to the nominee would be questioned.

Further simply because the nominee receives the policy monies the interest of anyone who has the legal right to receive the money does not get affected as the mere nomination does not have the effect of conferring on the nominee any beneficial interest in the amount payable under the life insurance policy on the death of the assured. The nomination only indicates the hand which is authorized to receive the amount, on the payment of which the insurer gets a valid discharge of its liability under the policy. The amount, however, can be claimed by the heirs of the assured in accordance with the law of succession governing them. The nominee only receives the claim amount as a trustee.

Answer 1(c)

A person is said to possess an insurable interest in a property if he has a legal relationship with the said property by which he would stand to lose financially if the property is lost or destroyed. The principle of insurable interest adds legal validity to an insurance contract without which such contracts would be wagering or gambling in nature according to the Indian Contract Act 1872. Presence of insurable interest prevents fraudulent practices. In the absence of insurable interest, an unconcerned person can purchase policies on someone else's property and inflict loss on it deliberately to get the proceeds of the insurance settlement. Insurable interest provides the right to secure insurance and claim compensation to the insured based on the principle of indemnity. For example, people have insurable interests in their own homes and vehicles, but not in their neighbors' homes and vehicles, and almost certainly not those of strangers.

An insurance contract must meet four conditions in order to be legally valid: it must be for a legal purpose; the parties must have a legal capacity to contract; there must be evidence of a meeting of minds between the insurer and the insured; and there must be a payment or consideration.

As long as the sale deed has been affected by Srivastava in favour of Kulwant evidencing the sale of the house by the former to the latter and the ownership transferred in his name, the insurable interest is said to exist with Kulwant. The insurer of the policy taken by Kulwant is liable to pay for the loss in full subject to the admissibility of the claim under the policy and subject to other conditions of the policy. Non-payment of 25% of the value of the house by Kulwant to Srivastava will not affect the former's claim under the policy with his insurer. Payment of the said 25% balance by Kulwant to Srivastava is guaranteed by means of a separate promissory note, which will not in any way interfere with the settlement of the claim of Kulwant under his insurance policy. Payment arrangement between the parties is of no concern of the insurer. As long as the house has been registered in the name of the new purchaser by virtue of the sale deed, there will be no liability under the policy taken by Srivastava and no benefit under the said

policy can also accrue to the new purchaser as transfer of a fire insurance is not automatic unless the insurer is intimated of the transfer and request made transferring the insurance in the name of the purchaser and acceptance of change and confirmation of cover in favour of the new owner is confirmed by the insurer.

Answer 1(d)(i)

In this case, the insured Savita sold the vehicle to Gautam and it is presumed that the insurance is not got transferred to the purchaser. The insurance can be transferred to the new purchaser on specific request to the insurer. As this is not done, the insurance company is not liable for the claim. Thus the own damage claim of ₹1,39,500 is not admissible. However, if the insurance has been duly transferred to the purchaser then the claim of ₹1,39,500 as per the rules would be admissible and can be paid to Gautam.

However, as regards the legal liability of third party i.e. the pedestrian who was injured, the insurers will be liable for the legal liability to the pedestrian as per the order of the court as the third party insurance is deemed to be transferred to the purchaser.

Answer 1(d)(ii)

The legal aspects of third-party motor insurance are now codified under the Motor Vehicles Act, 1988. The provisions are the pivot around which the entire insurance aspect of motor transport hinges. All the sections of the Act are inter-related and have to be examined thoroughly. Section 146 of Motor Vehicles Act prescribes the necessity for insurance against third party risks – no person can use a motor vehicle in a public place unless there is in force in relation to that motor vehicle, by that person or another, a policy of insurance. A vehicle carrying or meant to carry hazardous or dangerous goods should have a policy under the Public Liability Insurance Act, 1991 also.

Section 146 seeks to protect the members of the public travelling in vehicles or using the roads (public places) from the financial liability caused by risk attendant upon the use of the motor vehicle. The third-party (TP) car cover serves to protect the insured from claims arising from a third party, when the insured person's vehicle is at fault. This cover will pay for any fiscal liability that arises out of the accident. As per the rules, no vehicle can run on the road without TP insurance. Based on the capacity of the car or two-wheeler, the third-part premium rate is fixed and notified by Irdai at the start of a financial year. Elsewhere, an Own Damage (OD) or a Comprehensive Policy cover covers loss or damage to the vehicle insured in addition to all the covers provided by a third-party policy.

For new buyers, there will be three options to choose from - Buy a long-term package, a bundled package, or stick to a standalone TP cover. Here is a closer look at each of these options:

Option1. Long-Term Package Cover : (TP=3 Years Plus OD=3 Years)

Such a cover will offer both motor third-party insurance and own damage insurance for three years or five years, as the case may be.

Option2. Bundled Cover : (TP=3 Years Plus OD=1 Years)

Such a cover will offer a three-year or five-year term (as applicable) for the third-party component and a one-year term for Own Damage.

Option3. Standalone Third-Party Only cover : (TP=3 Years without OD)

This option always existed for anyone buying motor insurance. The only change is that now one has to purchase TP for 3 or 5 years, as the case may be.

Exemptions : The provisions relating to compulsory for third party insurance do not apply to any vehicle owned by the Central Govt. or State Govt. and used for Govt. purposes unconnected to any commercial enterprises. The Govt. has been given the power to grant an exemption to any vehicle owned by

- a. The Central Govt. or the State Govt. if the vehicle is used for Govt. purposes unconnected with any commercial activity;
- b. Any local authority
- c. Any state transport undertaking.

Answer 1(e)(i)

Sales and Marketing function is termed as 'production or 'sales' in the insurance business. It aims at securing a large number of proposals to the company. Insurance comes into existence only when a policy is sold. The agents and the sales force are inclined towards getting more business so that they can earn better incentives and can progress in their careers. Mr Ram in this case was only playing a role of marketing team to bring business for the company. In order to procure business they may promise more but are subject to underwriting procedures and their decision in underwriting is not final. Underwriting is the primary function of an insurer. In a broad sense, underwriting is concerned with the complete transaction of insurance. It means assessing risk i.e. it deals with acceptance or rejection of risk. Underwriting may be defined as a process of selecting and classifying risk and determining the terms and conditions on which the risk is accepted in order to meet company objectives. . Anshuman was heading the underwriter department and on behalf of the company he had to assess the risk attached with this policy. So after submitting the report of underwriter the company issues the policy. Thus the underwriting department is looking more at the quality of business rather than the quantity of business.

Answer 1(e)(ii)

Underwriters are the risk managers of the organization. They help the organization to keep actual experience within the mortality assumption used in calculating the premium rates, which helps the company to offer insurance cover at competitive terms, maintain equity between policyholders, and offer cover to as wide a group of lives as possible. If the underwriter adopt flexible and easy control then the insurance company have to bear a huge loss due to the fraudulent and irresponsible behaviour in the company. All the risk attached with the individual policy will be assessed by the underwriter, so we say that their role is very crucial in running the insurance companies.

Question 2

Sudhakar Gupta has taken a life insurance policy on his life on 7-2-2018 for ₹ 1 lakh. But to get the benefit of lesser age premium the date of commencement of the policy is given as 7-4-2017. His yearly premium is ₹ 10,305 and the second yearly premium was due on 7-4-2018.

Sudhakar Gupta and Sachin Agarwal were partners in a business. Sachin Agarwal has also insured his life for a premium of ₹2,486 per annum. They issued a joint cheque towards combined premium on 7-5-2018. The insurer issued a stamped receipt on 25-5-2018 and sent the cheque for collection.

The cheque for the premium amount was dishonoured and the cheque was sent back by the bank on 8-6-2018. The intimation of the dishonoured cheque was sent by the company on 21-7-2018 which was posted by it on 30-7-2018. It was posted to Sudhakar Gupta's residence and was received at his residence on 1-8-2018. The intimation required that Sudhakar Gupta is to pay the premium with interest by 16-8-2018. But the insurers were not aware that in an uneventful incident of an accident on 28-7-2018, Sudhakar Gupta had already expired. Anita Gupta, the wife of Sudhakar Gupta claimed the insurance and also the accident cover. She said that the insurer was deficient in the services and did not intimate about the dishonour of the cheque in time. To support her statement, she quoted the insurer's circular that stated that the intimation of the dishonoured cheques should be intimated immediately by the concerned staff by contacting the policyholder, which is not done in this particular case.

Required : State whether Anita Gupta will get the insured money from the company, i.e. is her claim maintainable ?

(i) Discuss with reference to :

- (a) Deficiency of service*
- (b) Payment of premium and grace period*
- (c) Revival of discontinued policies*
- (d) Forfeiture.*

(4×5=20 marks)

(ii) Explain in brief the impact of lapsation of life insurance policies to the insurers. (10 marks)

Answer 2(i)(a)

It may be true that the insurance company did not intimate the cheque dishonour in time, say within 2 or 3 days of cheque return. In fact that the cheque was not honoured is not informed in time by the bank also. Date of the cheque was 7.5.2018, it was returned by the bank on 8.6.2018 almost after one month.

The delay was further added by the insurance company as it posted the intimation of cheque dishonour on 30.7.2018 only after 50 + days. This inspires the internal circular. But this deficiency is just an administrative lapse and not sufficient to warrant to pay the claim.

Answer 2(i)(b)

As per terms of a Life insurance policy and also the regulations specified by the IRDA for protection of policyholders, a grace period of one month (30 days) will be allowed for payment of yearly, half-yearly or quarterly premiums and 15 days for monthly premiums. If death occurs within this period and before the payment of the premium then due, the policy will be still valid and the sum assured will be paid after the deduction of the said

premium. In this case, the premium was due on 7.4.2018. The cheque was paid on 7.5.2018 after the lapse of the grace period. The company sent it for collection on 25.5.2018 and it was returned on 8.6.2018 which means that for 60 days as against the grace period of 30 days the premium was not paid. Both Sudhakar Gupta and Sachin Agarwal must definitely be aware that there were insufficient funds in the Bank. The policy lapsed as the premium was not paid in the grace period.

Answer 2(i)(c)

Revival of a lapsed policy is a privilege or concession granted to the policyholder by the insurance company. The insurance company reserves the right to accept or decline the revival of a discontinued policy. There are also certain limitations while reviving a policy they are:

- Revival should be during the lifetime of the assured and not after his death.
- Within a period of 3 years from the due date of the first unpaid premium
- Before the date of maturity
- The conditions relating to the payment of the premium due on the lapsed policies should be complied with.

In this case, the lapsed policy was not revived during the lifetime of Sudhakar Gupta the life assured. It could not be revived after his death. In any case, it is the right of the insurance company to revive the policy even if Sudhakar Gupta had paid the premium before he died after the grace period. However, the policy of Sachin Agrawal can be revived by the Insurance company as per the terms and condition of insurance contract.

Answer 2(i)(d)

In certain cases and under certain circumstances, the insurance company can forfeit the money paid by the insured. Non-payment of premiums is one such circumstance. When the forfeiture clause has invoked, the claims under the policy shall cease and the money paid shall belong to the insurance company. In this case, this clause could very much be invoked by the insurance company.

Answer 2(ii)

Lapsation of life insurance policies is a curse for the insurer and a serious disease within an insurance company - which, if not cured, could even lead to the whole company's bankruptcy. Lapsation impacts on customer retention, product performance, pricing factors, public image and workforce planning, and is ultimately detrimental to the insurer's business.

Customer retention

Lapses may be the source of customer dissatisfaction. Satisfied customers generally want to continue to do business with the company.

Product performance

Product performance and the solvency of any organization within a competitive market are entirely dependent on the persistence of the business.

Pricing factors

Insurance pricing depends on estimations as to the net rate of investment yield, management expenses and mortality selection. The impact of lapsation on these factors is mentioned below:

Investment yield

The insurer may lose planned investment cash flows; this may result in forced investment sales (at a loss) in order to meet surrender demands.

Management expenses

Insurance companies tend to make a profit out of premium received after three years of policy have completed. This is due to the fact that the first year of a policy is very expensive for the insurance company, compared with the premium taken in the first year.

Mortality or morbidity adverse selection

In general, insured's that have adverse health or other insurability problems tend not to lapse, causing the insurer to experience a greater proportion of claims than expected if the lapse rate is high.

Detrimental effect on public image

The insurance company suffers the loss of public image through adverse publicity. This is namely because a lapsed policyholder will seldom speak well of the insurance company with which they were insured. The policyholder's ego is hurt.

Workforce planning

Policy lapsation even hampers insurance companies' ability to do proper workforce planning, as they cannot accurately evaluate the number of administrative staff needed to process proposals and undertake any further processing or policy servicing. Lapsation is, therefore, an anti-employee phenomenon.

Detrimental to the insurer's business

Apart from the direct losses, the unproductive efforts involved in the administration of lapsed policies will mean the company may need to forego opportunities to generate genuine business. The organisational goals and objectives stand defeated, leading (in extreme cases) to the insurance company failing.

Question 3

Raghuvir, a farm owner holds 50 acres of land at Badli Village in Haryana. His main cultivation was mustard seeds for which he uses a separate irrigation facility. He uses to buy fertilizer from a nearby fertilizer factory adjacent to his land. The waste products from the fertilizer factory flow to a nearby lake through a cement pipe and the pipe runs through the agricultural land of Raghuvir. The waste products were the various chemicals used by the fertilizer company during the manufacturing process and are poisonous. One fine day, Raghuvir found out that the cement pipe has developed a crack and the waste products are accumulating in his land which is resulting in a poor yield from his land in that year.

After analyzing the liability insurance concepts, determine whether the farm owner is justified in claiming compensation for the loss of income due to the cultivation of mustard seeds. (5 marks)

Answer 3

The fertilizer factory can be held liable for the loss of income due to crop failure. The factory operators could have reasonably foreseen that the waste product was likely to accumulate in the farm owner's land if there is a breakage of the pipe. Also, the accumulation of waste products as a result of the breakage of the pipe resulted in land becoming not useful for cultivation purposes. The factory is clearly identified as responsible for the loss and thus Raghuvir is justified in claiming compensation for loss from the factory.

Question 4

The Term, whole life, endowment, annuity policies or the combination of policies are available in the market. The best policy is the one that best meets your financial needs. You have to select the policy according to your needs.

Suggest suitable life insurance policies for the given situations :

- (a) *You are at the age of 25. You just joined an organization. You are recently married. Now you cannot spend more on life insurance.*
- (b) *You are the only earning member in your family. You purchased a flat by taking a loan from housing finance. As long as you are there you can pay EMIs regularly. You want to retain the house for your family members even in your absence.*
- (c) *You are at the beginning of career; you want to combine both insurance and saving. But the combination of this saving and insurance is costly. Right now you cannot invest much, having dependents and you want to invest later after settling in the career.*
- (d) *You want to leave an estate to your family after you. But you cannot pay the premiums after retirement. You are undisciplined in your saving habits and you are not financially savvy.*
- (e) *You want to set up a saving stream, beyond term plans. (1×5=5 marks)*

Answer 4(a)

For these situations, the suggested best policy is Term Insurance Policy. These plans offer life insurance cover for the specific number of years, at least cost. The premium of Term Insurance is comparatively low at the age of 25. Since the entire premium goes towards the cost of insurance, there is only risk cover and no saving element is involved.

Answer 4(b)

The best policy for this situation is the Mortgage Redemption Insurance policy. These plans offer life insurance cover for the specific number of years like till the loan is cleared (or on death, an outstanding loan is covered) at the least cost.

Answer 4(c)

The best policy for this situation is the Convertible Term insurance policy. This plan

offers life insurance cover for the specific number of years, and at the same time it also facilitates to convert this policy into endowment policy (when your income increases) which includes saving element.

Answer 4(d)

The best policy for this situation is Limited Payment Whole Life insurance policy. In this plan, the policy remains in full force for the whole of life, but premiums are payable for a limited number of years only, after which the policy becomes paid up for its full face amount. The premium - paying period may be expressed as a set number of years or to a specified age.

Answer 4(e)

The best plan for this situation is Endowment plans or money - back plans. These policies promise not only the policy face amount on the death of the insured during a fixed term of years but also the full face amount at the end of the term if the insured survives the term.

Question 5

Subhash is running a business of footwear and insured all his factory machinery on a market value basis with three different insurers as per details below :

<i>Insurer</i>	<i>Policy taken</i>	<i>Sum Insured ₹ in Lakh</i>
<i>A</i>	<i>Standard Fire and Special Perils Policy</i>	<i>31.25</i>
<i>B</i>	<i>Standard Fire and Special Perils Policy excluding flood cover</i>	<i>18.75</i>
<i>C</i>	<i>Standard Fire and Special Perils Policy Excluding Riot and Strike cover</i>	<i>12.50</i>

Recently there was a heavy shower which resulted in heavy flood in the area, ₹10 lakh worth of the machinery was damaged. How do insurers share this loss ?

(5 marks)

Answer 5

The policy issued by the insurer B does not cover the flood peril. Hence the same will not contribute to the loss. On the date of loss, the market value of the insured asset is ₹ 62.50 lakh. As against this, the aggregate of the sum insured under the policies issued by insurers A and C is only ₹ 43.75 lakh. The balance ₹ 18.75 lakh are deemed to be self-insured by Subhash. Accordingly, all the will share the loss of 10 lakh as under:

Insurer A pays: $31.25/62.50 \times 10 = ₹ 5.0$ lacs

Insurer C pays: $12.5/62.50 \times 10 = ₹ 2.0$ lacs

Subhash bears: $18.75/62.50 \times 10 = ₹ 3.0$ lacs

Question 6

Hyderabad Air Show Tragic :

“Two pilots and a civilian were killed after a naval aircraft crashed on a nearby residential building near Begumpet airport during an air show in Hyderabad on Wednesday morning” city police said. “Seven others were also injured in the mishap”, the police added. “The pilots were identified as Commander and Lt. Commander”, a navy spokesman said in New Delhi. “Lt. Commander belongs to Delhi”, he added.

Identify and discuss, how risks involved in the above event can be managed by insurance and who should be taking insurance. (5 marks)

Answer 6

The risks involved include:

- Liability against loss of life of the pilots
- Liability against loss of life/disability of the third party
- Loss of property/damage to aircraft
- Liability against loss of property of the third party

Aviation Insurance can very well come to the rescue in such cases. The firm which owns the air craft has the primary responsibility to take insurance. The organizers of the event are also liable to arrange for compensation to the affected parties.

The most common coverage's of aviation insurance are:

- a. Aircraft liability insurance
- b. Hull coverage
- c. Personal accident

The premium rate for each aircraft is driven by international reinsurance markets, mainly @ UK, based on the world trend in claims experience during the preceding years.

Aircraft Liability Insurance

The liability in case of aviation insurance is divided into two categories:

- (i) Passenger liability
- (ii) Death and injury to third parties

There are some policies that cover both these categories as well as property damage with a single limit to cover all three of them (like floating policies in fidelity guarantee).

Admitted liability

Here specific amounts are allocated beforehand to the various kinds of injuries like the loss of a limb, eye or life. The policy is written on a 'per seat' basis. In case of an accident, the insurer offers the payment along with the release of liability against the insured. The injured party is required to sign the release against the insured if he wants payment from the insurer.

Medical Payments

The aircraft liability insurance also provides coverage of medical payments for injuries sustained while travelling in or entering or alighting from the aircraft. This policy coverage is available only if the policy includes passenger bodily injury liability.

Hull coverage

Hull refers to the body and machinery of the aircraft. Some policies provide open perils coverage both on ground and in flight whereas others restrict the open perils coverage to ground only.

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

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer **ALL** Questions.

Question 1

Read the case law carefully and answer the questions at the end in detail :

Glivec is the beta-crystalline form of imatinib mesylate manufactured by a Swiss drug company XXX. The drug is administered to cancer patients suffering from chronic myeloid leukemia. It does not cure the disease but controls cellular action, thereby making cancer manageable to some extent for many patients. While this drug is a great advance in the treatment of cancer, patients are obliged to take it for the rest of their lives. XXX developed Glivec in the 1990s and received Food and Drug Administration (US) approval for marketing in the United States in May 2001. The drug is produced by XXX in Beta form, while it is generically produced in Alpha form in India.

XXX filed a mailbox application for a patent in India in July 1998, and was granted “Exclusive Marketing Rights” (EMR) in 2003. EMR meant that XXX could prevent Indian pharmaceutical companies from producing and selling generic versions of the drug for 5 years or until the decision on the application for a patent.

The Beta form has, according to XXX, many advantages over the Alpha form, including more beneficial flow properties, improved thermodynamic stability (better storage of drug), lower hygroscopicity (longer shelf life) and, most notably, a 30% increase in bioavailability (absorption into blood stream). It further claimed that the aforesaid properties make the invented product “new” (and superior !) as it “stores better and is easier to process”.

Reckoning and availing of its rights under EMR dispensation, XXX filed an infringement suit against six generic competitors who were producing Glivec in the Indian market : A, B, C, D, E and F. The said producers, along with cancer patient advocacy groups and legal rights organizations, filed pre-grant opposition to the patent for Glivec. XXX, holding EMR rights priced Glivec at about 10 times the price that generic producers were selling at. Consumers suffered the high price at which XXX was selling and in many cases had to forego the drug on the account of affordability.

XXX’s application for patent was taken out of the mailbox for consideration after amendments were made to the Patents Act. But before it was taken up for consideration, the patent application had attracted the said pre-grant oppositions in terms of section 25(1) of the Act.

The Assistant Controller of Patents and Designs at the Chennai patent office heard all the parties and rejected the application for grant of patent to the subject product

by separate, though similar, orders passed on the opposition petitions. The Assistant Controller held that the invention claimed by XXX was anticipated by prior publication, the invention claimed was obvious to a person skilled in the art and further that the patentability of the alleged invention was disallowed by Section 3(d) of the Act. In particular, he was not convinced that the patent application presented a new substance because Glivec was simply the salt of a known substance. He observed that although the new Beta drug could be more effectively absorbed into the bloodstream, this bioavailability was not an improvement in efficacy as required by Section 3(d).

At that time, the Appellate authority under the Act had yet to become functional. The applicant XXX therefore, challenged the orders passed by the Assistant Controller in Writ petitions filed directly before the Madras High Court. After the formation of the Intellectual Property Appellate Board (IPAB), the writ petitions challenging the orders of the Assistant Controller were transferred from the High Court to IPAB.

The applicant's appeals against the orders passed by the Assistant Controller were finally heard and dismissed by the IPAB by a long and detailed judgment. The IPAB reversed the findings of the Assistant Controller on the issues of anticipation and obviousness. It held that the applicant's invention satisfied the tests of novelty and non-obviousness. The IPAB, however, held that the patentability of the subject product was hit by section 3(d) of the Act. Referring to section 3(d) the IPAB observed:

"Since India is having a requirement of higher standard of inventive step by introducing the amended section 3(d) of the Act, what is patentable in other countries will not be patentable in India. As we see, the object of amended section 3(d) of the Act is nothing but a requirement of higher standard of inventive step in the law particularly for the drug/pharmaceutical substances."

The IPAB also noted the following observations of the Madras High Court : "We have borne in mind the object which the amending Act wanted to achieve namely, to prevent ever-greening; to provide easy access to the citizens of the country to life saving drugs and to discharge their constitutional obligation of providing good health care to its citizens."

In the light of the High Court's observation, the IPAB also referred to the pricing of the drug Glivec by the applicant, while it enjoyed EMR over it, and held that the patentability of the subject product would also be barred by section 3(b) of the Act. In this regard, the IPAB observed that when the applicant was holding the right as EMR, it used to charge ₹1,20,000/- per month for a required dose of the drug from a cancer patient, which was too unaffordable to the poor cancer patients in India. Furthermore, the grant of product patent on the application may create a havoc on the lives of poor people and their families affected with cancer for which this drug is effective. This will have disastrous effect on the society as well. Considering all the circumstances placed before the IPAB, it observed that the applicant's alleged invention was not worthy of a reward of any product patent on the basis of its impugned application for not only for not satisfying the requirement of section 3(d) of the Act, but also for its possible disastrous consequences on such grant as stated above, and also for attracting the provisions of section 3(b) of the Act which prohibits grant of patent on inventions, exploitation of which could create public

disorder among other things. IPAB upheld the decision of the Assistant Controller on section 3(d) of the Act to the extent that product patent cannot be made available to the Applicant.

Against the order of the IPAB, XXX directly moved the Supreme Court through a petition under Article 136 of the Constitution. XXX engaged senior counsels to argue their case in the Supreme Court.

*Counsels appearing for XXX strenuously argued that section 3(d) was not meant to be an exception to Clauses (j) and (ja) of section 2(1) of the Act. They insisted that section 3(d) had no application to the case of the subject product. The subject product, having satisfied the tests of invention as provided in Clauses (j) and (ja) of section 2(1), could not be denied patent for allegedly failing to satisfy the tests under section 3(d). XXX's counsels submitted that section 3(d) was a provision put in *ex abundanti cautela non nocer* (abundant caution does no harm) to remove all doubts and also that it was a provision *ex majore cautela* (out of abundant caution). The counsels submitted that the primary purpose of section 3(d), as was evidenced from the legislative history, was to prevent "evergreening" and yet to encourage incremental inventions. "Evergreening" is a term used to label practices that have developed in certain jurisdictions wherein a trifling change is made to an existing product, and claimed as a new invention. The coverage/protection afforded by the alleged new invention is then used to extend the patentee's exclusive rights over the product, preventing competition. It was further argued that, by definition, a trifling change, or in the words of the section "a mere discovery of a new form of a known substance", could never ordinarily meet the threshold of novelty and inventive step under clauses (j) and (ja) of section 2(1). An invention cannot be characterized by the word "mere". The word "invention" is distinct from the word "discovery". The counsels therefore, submitted that section 3(d) operated only as *ex majore cautela*, ensuring that mere discoveries could never, by an effort at interpretation of clauses (j) and (ja) of section 2(1), be considered inventions.*

Questions :

- (a) *If you have to judge this case, what would be your Judgment ?* (10 marks)
- (b) *What "efficacy" means under the Patent Act ?* (10 marks)
- (c) *Section 2(1)(j) defines invention. What is its scope ?* (10 marks)
- (d) *What are the requirements of 'invention' and 'patentability' ?* (10 marks)
- (e) *What is 'enhanced efficacy' ?* (10 marks)

Answer 1(a)

According to Section 3(d) of the Patents Act, 1970 the mere discovery of a new form of a known substance which does not result in the enhancement of the known efficacy of that substance or the mere discovery of any new property or new use for a known substance or of the mere use of a known process, machine or apparatus unless such known process results in a new product or employs at least one new reactant is not an invention.

"Explanation:- Salts, esters, ethers, polymorphs, metabolites, pure form, particle size, isomers, mixtures of isomers, complexes, combinations and other derivatives of

known substance shall be considered to be the same substance, unless they differ significantly in properties with regard to efficacy”.

The issue of efficacy in the instant case on an analysis shows that in whatever way therapeutic efficacy may be interpreted, this much is absolutely clear that the physico-chemical properties of beta crystalline form of Imatinib Mesylate, namely:

- (i) more beneficial flow properties,
- (ii) better thermodynamic stability, and
- (iii) lower hygroscopicity, may be otherwise beneficial but these properties cannot even be taken into account for the purpose of the test of section 3(d) of the Act, since these properties have nothing to do with therapeutic efficacy.

Furthermore, in whichever way section 3(d) of Indian Patent Act may be viewed, whether as setting up the standards of “patentability” or as an extension of the definition of ‘invention’, the subject product, that is, the beta crystalline form of Imatinib Mesylate, fails the test of section 3(d) of the Act.

It needs to be kept in mind that each of the different forms mentioned in the application for a patent must have some properties inherent to that form. These forms, unless they differ significantly in property with regard to efficacy, are expressly excluded from the definition of “invention”. Hence, the mere change of form with properties inherent to that form would not qualify as “enhancement of efficacy” of a known substance. In other words, the explanation is meant to indicate what is not to be considered as therapeutic efficacy. The test of enhanced therapeutic efficacy must be applied strictly.

In the case of *Novartis AG v. Union of India & Ors.* (AIR 2013 SC 1312, 1313), the Supreme Court held that the primary purpose of section 3(d), as is evidenced from the legislative history, is to prevent “evergreening” and yet to encourage incremental inventions. “Evergreening” is a term used to label practices that have developed in certain jurisdictions wherein a trifling change is made to an existing product, and claimed as a new invention. The coverage/protection afforded by the alleged new invention is then used to extend the patentee’s exclusive rights over the product, preventing competition. By definition, a trifling change, or in the words of the section “a mere discovery of a new form of a known substance”, can never ordinarily meet the threshold of novelty and inventive step under clauses (j) and (ja) of section 2(1). An invention cannot be characterized by the word “mere”. The word “invention” is distinct from the word “discovery”.

In view of the above, XXX cannot be granted the patent sought by it.

Answer 1(b)

The word “efficacy” is used both in the text added to the substantive provision as also in the explanation added to the provision, section 3(d) of the Patents Act, 1970 .

Efficacy means “the ability to produce a desired or intended result”. Hence, the test of efficacy in the context of section 3(d) would be different, depending upon the result the product under consideration is desired or intended to produce. In other words, the test of efficacy would depend upon the function, utility or the purpose of the product under consideration. Therefore, in the case of a medicine that claims to cure a disease, the test of efficacy can only be “therapeutic efficacy”.

With regard to the genesis of section 3(d), and more particularly the circumstances in which section 3(d) was amended to make it even more constrictive than before, there is no doubt that the therapeutic efficacy of a medicine must be judged strictly and narrowly. The test of enhanced efficacy in case of chemical substances, especially medicine, should receive a narrow and strict interpretation and should be based not only on external factors but on sufficient internal evidence that leads to the same view. The text added to section 3(d) by lays down the condition of enhancement of the known efficacy'. Further, the explanation requires the derivative to differ significantly in properties with regard to efficacy'. What is evident, therefore, is that not all advantageous or beneficial properties are relevant, but only such properties that directly relate to efficacy, which in case of medicine, as seen above, is its therapeutic efficacy.

In the case of *Novartis AG vs. Union of India*, W.P. No. 24760/06) Supreme Court observed that "Due to the advanced technology in all fields of science, it is possible to show by giving necessary comparative details based on such science that the discovery of a new form of a known substance had resulted in the enhancement of the known efficacy of the original substance and the derivatives so derived will not be the same substance, since the properties of the derivatives differ significantly with regard to efficacy."

It was further held by the Apex Court – "in the case of medicines, efficacy means "therapeutic efficacy" and physico-chemical properties of substances do not meet the requirement of "therapeutic efficacy". It was also held that patent applicants must prove the increase in therapeutic efficacy and just increased bioavailability alone may not necessarily lead to an enhancement of therapeutic efficacy, and in any given case enhanced efficacy must be specifically claimed and established by research data.

Answer 1(c)

According to Section 2(1) (j) of the Patents Act, 1970, invention means a new product or process involving an inventive step and capable of industrial application.

Further as per Section 2(1)(ja) of the Act "Inventive step" means a feature of an invention that involves technical advance as compared to the existing knowledge or having economic significance or both and that makes the invention not obvious to a person skilled in the art.

Section 2(1)(ac) of the Act provides that "capable of industrial application", in relation to an invention, means that the invention is capable of being made or used in an industry.

In Invention, claims define the contours of rights, if and when a patent is granted for an invention. Claims shall define clearly the scope of the invention with conciseness, precision and accuracy, so that others may know the exact boundary into which they should not trespass. Each claim is evaluated on its own merit and, therefore, if one of the claims is objected, it does not mean that the rest of the claims are invalid. It is therefore important to make claims on all aspects of the invention to ensure that the applicant gets the widest possible protection.

Having many claims, where each claim has a different scope, allows the applicant to have a legal title to different aspects of the invention. A good drafting may begin with broad claims and develops towards claims that are narrower in scope. Terms of the

claim which confuse the scope of the invention, or claim that are not specific (e.g. any novel matter) should be avoided.

However, in case of chemicals and especially pharmaceuticals, if the product for which patent protection is claimed is a new form of a known substance with known efficacy, then the subject product must pass, in addition to clauses (i) and (ja) of section 2(1), the test of enhanced efficacy as provided in section 3(d) read with its explanation.

In *Bishwanath Prasad Radhe Shyam v. Hindustan Metal Industries (PTC (suppl) (1) 731 (SC))*, Supreme Court held that the object of patent law is to encourage scientific research, new technology and industrial progress. The price of the grant of monopoly is the disclosure of the invention at the Patent Office, which after the expiry of the fixed period of monopoly, passes into the public domain. The fundamental principle of patent law is that a patent is granted only for an invention which must have novelty and utility. It is essential for the validity of a patent that it must be the inventor's own discovery as opposed to mere verification of what was, already known before the date of the patent.

Answer 1(d)

A subject matter in order to get a patent under the Patents Act, 1970 has to pass the test of invention and patentability, both being distinct concepts.

In order for a subject matter to pass the test of invention it must satisfy the following conditions as laid down under Section 2(1) (j) and Section 2(1)(a) of the Act

- i. It must be “new”;
- ii. It must be “capable of being made or used in an industry
- iii. It must have inventive step
 - a. entails technical advance over existing knowledge;
 - b. has an economic significance and
 - c. makes the invention not obvious to a person skilled in the art.

As per Section 2(1)(l) of the Patents Act, 1970 “New invention” means any invention or technology which has not been anticipated by publication in any document or used in the country or elsewhere in the world before the date of filing of patent application with complete specification, i.e. the subject matter has not fallen in public domain or that it does not form part of the state of the art.

Once a product or a process has passed the test of invention, it also has to pass the test of patentability. A subject matter passes the test of patentability, if it has not been specifically excluded from patentability under the Act. Section 3 and Section 4 of the Act list down subject matters, which are not patentable.

The basic criteria for patentability of an invention in India are as follows:

- *Absolute novelty* – the invention should be new and not disclosed to the public anywhere in the world in any form or through any medium.
- *Inventive step/non-obviousness* – the invention should not be obvious to a person skilled in the art in the relevant area of technology and should involve an inventive

feature which is distinctive in nature from the previous inventions made in the same field.

- *Industrial application* – the new product or process should be capable of being made or used in an industry and it should have economic significance.

Answer 1(e)

In relation to "enhanced efficacy", the parameters for proving enhanced therapeutic efficacy, especially in case of medicines should receive a narrow and a strict interpretation. To support this interpretation, the following needs to be reckoned:

- (i) the explanation to section 3 (d) of the Patents Act, 1970 which requires derivatives to "differ significantly in properties with regard to efficacy", so that not all advantageous and beneficial parameters would amount to enhancement of efficacy; and
- (ii) the main text of section 3(d) which states "enhancement of known efficacy"

The new form of a known substance has to have significant advantageous and beneficial properties over known substance in order to pass the bar of enhanced therapeutic efficacy under section 3 (d).

However, just because the word efficacy has to be given a strict interpretation under section 3 (d) that does not in any way mean that it bars all incremental inventions of chemical and pharmaceutical substances. Essentially section 3 (d) provides a bar that incremental inventions of chemical and pharmaceutical substances need to pass in order to be patentable.

'enhanced efficacy' involves not only an external patentability test of non-obviousness/ inventive step, but also another external patentability test of utility, i.e. enhanced utility over the prior art. Thus, Section 3(d) is a confusing mix-up where a patent-eligibility provision involves two patentability tests (of non-obviousness and utility). Normally, the patent-eligibility examination should precede and the patentability examination should follow. But in the case of Section 3(d), the patentability examination is conducted right at the beginning and under the garb of a patent-eligibility examination.

Section 3(d) of the Patents Act, 1970 may be construed as a refinement of patentability criteria to cater for "evergreening" – a specific problem inherent in pharmaceutical innovations. More specifically, the "enhanced efficacy" criterion can be seen as refinement of "nonobviousness" principles, i.e. most forms of existing pharmaceutical substances are deemed obvious, unless they demonstrate increased "efficacy." At some level, section 3(d) could also be said to embody a utility test, i.e. unless the new form has significantly enhanced utility over and above what existed before in the art, it is not patentable. Efficacy need not be quantified in terms of numerical value to determine whether the product is efficacious because it is not possible to have a standard numerical value for efficacy for all products including pharmaceutical *products*.

Question 2

Read the case below carefully and answer the questions at the end in detail :

PPP, a small scale industry company, is engaged in manufacturing of low cost

backhoe loaders, called 'Bull Smart', light construction equipment. It informed the Competition Commission of India (CCI) alleging that QQQ, a competitor company, inter alia, was contravening the provisions of section 4 of the Indian Competition Act, 2002.

QQQ is stated to be India's largest manufacturer of construction equipments and has been engaged in manufacturing of 21 different construction and earthmoving machines under 7 product types such as Backhoe Loaders, Loading Shovels, Tracked Excavators, Compactors, Telehandlers, Skid Steer Loaders and Pick and Carry Cranes in India. QQQ's market share was 75%. The large sized QQQ has been operating independently of competitive forces in the relevant market.

As per the information furnished by PPP, the product 'Bull Smart' was exhibited at an 'Exhibition' in Bangalore, one of India's premier earthmoving machinery exhibitions and the product was due to be launched in November, 2011 in the said Exhibition. It was stated by PPP that 'Bull Smart' became a sensation and received overwhelming appreciation from existing and potential customers and peers from across the industry and attracted heavy crowds on the very first day of the Exhibition because it was an indigenously developed 60 HP hydrodynamic transmission based backhoe loader.

PPP alleged that during the formal launch of 'Bull Smart' at the Exhibition, it was served with an ex parte interim injunction order granted by the Hon'ble High Court of Delhi on an application by QQQ alleging that PPP had infringed the design registrations/ copyright of QQQ in developing the backhoe loader 'Bull Smart'. The said order restrained PPP and its dealers 'from making, selling, offering for sale, dispatch, advertising, directly or indirectly dealing in/launching backhoe loaders in any manner'.

It was the case of PPP that QQQ obtained the ex-parte ad interim injunction order based on misrepresentation of images/design registration number/documents and bogus numbers, suppression of its pre-existing UK patent, misrepresentation by comparing the wrong angle of the images in the application and reliance upon fraudulent design registrations which were pre-existing in the public domain

It was further averred that QQQ, armed with the ex parte order of the Hon'ble Delhi High Court, forced PPP to remove the backhoe loader 'Bull Smart' from the Exhibition in front of a huge crowd of dealers, existing and potential customers, end-customers, financing company officials, bankers, suppliers, foreign delegates and peers in the industry and media.

Furthermore, PPP stated that pursuant to the said order, teams consisting of local commissioners appointed by the Hon'ble Delhi High Court along with the officials of QQQ and their advocates visited PPP's manufacturing plant and stopped the operations and production of the backhoe loader 'Bull Smart'. In the process, all the documents, moulds and components were seized and sealed. The said ex parte order of the Hon'ble Delhi High Court prohibited even the dealers from displaying any sales, promotional material or the product itself at the dealer(s) showroom and, as a result, the dealerships were closed across India on the day of the formal launch and even before the formal sale of 'Bull Smart' could commence.

On 29 Nov, 2011, PPP moved the High Court for vacation of the ex-parte interim

stay order and submitted all the evidence required to show that there was no similarity in the design of backhoe loader 'Bull Smart' developed by it and the designs registered by QQQ. Further, stated PPP, that in its application for vacating the ex-parte ad interim order, it had submitted evidence to show that QQQ misrepresented the images and the design registration numbers/documents and misled the Hon'ble Delhi High Court to secure an ad interim ex-parte injunction order in its favour. PPP adduced evidence before the Controller of Designs to show that the design registrations obtained by QQQ were fraudulently obtained.

After hearing the parties, a consent order was passed by the Hon'ble High Court on 12 Dec, 2011.

".....that parties have arrived at a workable interim arrangement by which it is agreed that : (i) the interim order shall stand suspended, till further orders; and (ii) the defendants will permit the engineers of the plaintiff to inspect the product in question at a time, date and place to be mutually agreed upon between the parties within ten days.'

PPP informed the CCI that after nearly 10 months, QQQ, much to its surprise, voluntarily withdrew its application for ex-parte interim injunction and the Hon'ble Delhi High Court dismissed the case as withdrawn and vacated its ex-parte interim order and that all this had caused huge irreparable damages to PPP. It was prayed by PPP before the CCI that QQQ should be directed to cease and desist from misusing or abusing judicial process to exclude competitors, including PPP, and all other anticompetitive activity and that CCI should penalize QQQ for its anti-competitive practices in contravention of the provisions of the Act.

Questions:

- (a) What are the requirements for the registration of a design? (10 marks)
- (b) What nature of work cannot be protected as design under Design Act? (10 marks)
- (c) As per your judicious understanding, what orders should be passed in the instant case? (10 marks)

Answer 2(a)

A design is capable of being registered under the Design Act, 2000, only if it is new or original. It shall be considered to be new when it has not been disclosed to the public, anywhere in India or in any other country, by publication or by use or in any other way, prior to the filing date or priority date. Also if it is significantly distinguishable from known designs or combination of known designs. Original in relation to a design, means

- (a) Originating from the author of design, and
- (b) Includes the cases, which though old in themselves yet are new in their application.

According to Section 5 of the Act, the Controller may, on the application of any person claiming to be the proprietor of any new or original design not previously published in any country and which is not contrary to public order or morality, register the design

and Controller shall grant a certificate of registration to the proprietor of the design when registered under Section 9 of the Act.

Answer 2(b)

According to the Designs Act, 2000 'Design' means only the features of shape, configuration, pattern or ornament or composition of lines or colour or combination thereof applied to any article whether two dimensional or three dimensional or in both forms, by any industrial process or means, whether manual, mechanical or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye, but does not include any mode or principle or construction or anything which is in substance a mere mechanical device, and does not include any trade mark, as define in clause (v) of sub-section of Section 2 of the Trade and Merchandise Marks Act, 1958, property mark or artistic works as defined under Section 2(c) of the Copyright Act, 1957.

Design is a specific Intellectual Property Right and therefore it does not include:

- (i) any trademark, as defined in Section 2(zb) of the Trademarks Act, 1999, or
- (ii) any property mark, as defined in Section 479 of the Indian Penal Code, 1860, or
- (iii) any artistic work, as defined in Section 2(c) of the Copyright Act, 1957.

The expression 'Artistic Work 'in (iii) above means

- (i) a painting, sculpture, drawing (including a diagram, map, chart or plan), an engraving or a photograph, whether or not any such work possesses artistic quality.
- (ii) any work of architecture i.e. any building or structure having an artistic character or design or any mode for such building or structure.
- (iii) any work of artistic craftsmanship.

The following work cannot be registered as a design:

- Books, jackets, calendars, certificates, forms-and other documents, dressmaking patterns, greeting cards, leaflets, maps and plan cards, postcards, stamps, medals.
- Labels, tokens, cards, cartoons.
- Any principle or mode of construction of an article.
- Mere mechanical contrivance.
- *Buildings and structures.*
- *Parts of articles not manufactured and sold separately.*
- *Variations commonly used in the trade.*
- *Mere workshop alterations of components of an assembly.*
- *Mere change in size of article.*
- *Flags, emblems or signs of any country.*
- *Layout designs of integrated circuits.*

Answer 2(c)

From the information furnished, relevant market in this case is the market for manufacturing and sale of backhoe loaders in India'. Reckoning the size and market share of QQQ and the fact that it operates independently of competitive forces in the relevant market. It would conclude that it was a dominant enterprise in the relevant market. (Section 4 of Competition Act, 2002)

The entire case of abuse as laid and made by PPP was predicated upon the alleged bad faith litigation filed by QQQ before the Hon'ble High Court of Delhi. It was argued by PPP that the bad faith litigation initiated by QQQ against it alleging infringement of its design rights was totally false and that the said legal proceedings before the Hon'ble High Court of Delhi were only initiated to harass it and prevent the launch of 'Bull Smart', which in effect would have competed with backhoe loaders of QQQ in the relevant market. Furthermore, PPP alleged that the injunction was obtained on the basis that Bull had infringed the registered designs and copyrights of QQQ while manufacturing 'Bull Smart, which designs and copyrights themselves were obtained fraudulently.

The predation through abuse of judicial processes presents an increasing threat to competition, particularly due to its relatively low anti-trust visibility. QQQ by abusing its dominant position in the relevant market sought to stifle competition in the relevant market by denying market access and foreclosing entry of 'Bull Smart' in contravention of the provisions of section 4 of the Competition Act, 2002.

This case demonstrates that denial of market access and abuse of judicial process stifle Competition and that holding of Intellectual Property Right for design does not provide immunity to the holder from action under the Competition Act for violating section 4 thereof.

Question 3

Discuss the need for registration of work under the Copyright Act, 1957. (5 marks)

Answer 3

Under the Copyright Act, 1957 the term "work" includes an artistic work comprising of a painting, a sculpture, a drawing (including a diagram, a map, a chart or plan), an engraving, a photograph, a work of architecture or artistic craftsmanship, dramatic work, literary work (including computer programmes, tables, compilations and computer databases), musical work (including music as well as graphical notations), sound recording and cinematographic film.

Registration of a creative, original work is not required for copyright protection. Under Copyright Act following the Berne International Convention on Artistic, dramatic work, there is no need for registration of a work. Copyright protection is available to a work once it comes into existence. Non registration of work under Copyright Act doesn't deprive it of copyright protection and economic and moral rights. In fact in case of copyright infringement the passing off remedies are available to the author or owner of the work. Indian Copyright Act provides the procedure and rules with regards to the registration of copyright work.

Registration of work creates the records of the origination of rights of the stakeholder

in the work. In case of violation of copyright in a registered copyright work, the concept of infringement is applicable.

Question 4

What are the exclusive rights under Copyright Act, 1957 in case of computer programme as subject matter of copyright protection ? (5 marks)

Answer 4

According Section 2(ffc) of the Copyright Act, 1957, "computer programme" means a set of instructions expressed in words, codes, schemes or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result;

Further, Section 2(o) of the Copyright Act, 1957 states that "literary work" includes computer programmes, tables and compilations including computer databases.

In view of the above, all economic and moral rights available for the literary work under the copyright are applicable for computer programme also.

The exclusive copyrights in respect of a work of a computer programme include:

- (i) doing any of the acts specified in respect of a literary, dramatic or musical work and
- (ii) selling or giving on commercial rental or offer for sale or for commercial rental, any copy of the computer programme.

The Copyright Act, 1957 protects the author's economic and moral rights in the copyrighted work as stated in section 14 and 57 respectively, including the rights in computer software/programmes.

Question 5

Differentiate between substantive and non-substantive examination of designs under Design Act. (5 marks)

Answer 5

The substantive and non-substantive examinations are important for registration of a design. The classification of substantive and non-substantive are made on the basis of nature of examination.

In non-substantive examination of the design application, the focus is more on the procedural part or documentation of related matter, like whether prescribed format followed, prescribe fee paid, proper name address of stakeholder mentioned, declaration of proprietorship, power of authority (if applicable).

However, in case of substantive examination of designs, it is done to determine the fundamental issues like whether a design under consideration is (a) capable of fulfilling the criteria of design under the Designs Act 2000, (b) New or original, (c) Prejudicial to public order or morality, (d) Prejudicial to the security of India.

Question 6

Differentiate between the concept of "authorship" and "ownership" in a copyright work under the Copyright Act. (5 marks)

Answer 6

According to Section 17 of the Copyright Act, 1957, the author of a work shall be the first owner of the copyright therein.

Author is the person who creates the original work. In the absence of any agreement, generally author becomes the owner of the copyright work. Therefore all economic right as well as moral rights vest in him from the moment he creates the copyright work. However, in certain circumstances, the ownership issue depends on other factors. Such circumstances are covered under the copyright Act are as follow:-

- a) In the case of a government work, government shall, in the absence of any agreement to the contrary, be the first owner of the copyright therein.
- b) In the case of a work made or first published by or under the direction or control of any public undertaking, such public undertaking shall, in the absence of any agreement to the contrary, be the first owner of the copyright therein.
- c) In the case of a literary, dramatic or artistic work made by the author in the course of his employment by the proprietor of a newspaper, magazine or similar periodical under a contract of service or apprenticeship, for the purpose of publication in a newspaper, magazine or similar periodical, the said proprietor shall, in the absence of any agreement to the contrary, be the first owner of the copyright in the work in so far as the copyright relates to the publication of the work in any newspaper, magazine or similar periodical, or to the reproduction of the work for the purpose of its being so published, but in all other respects the author shall be the first owner of the copyright in the work.
- d) In the case of a work made in the course of the author's employment under a contract of service or apprenticeship, the employer shall, in the absence of any agreement to the contrary, be the first owner of the copyright therein.
- e) In the case of a photograph taken, or a painting or portrait drawn, or an engraving or a cinematograph film made, for valuable consideration at the instance of any person, such person shall, in the absence of any agreement to the contrary, be the first owner of the copyright therein.

INTERNATIONAL BUSINESS – LAWS AND PRACTICES (Elective Paper 9.5)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer **ALL** Questions.

Question 1

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

When the General Agreement on Tariffs and Trade (GATT) was first signed, the textile and apparel industries were too controversial to be included within its scope. Employment in these industries was still high in Europe and the United States, and developed countries feared significant unemployment if protective measures were not continued against new producers from developing economies. As a result, textile trade was negotiated bilaterally and governed for 20 years by the rules of a separate international agreement, the Multifibre Arrangement (MFA), which allowed for the emergence of an international quota system regulating world trade in textiles and clothing.

Despite these protectionist measures, employment in these industries continued to decline in the developed world as manufacturers closed facilities or relocated production in lower-cost countries. And textile and apparel quotas were not immune from politics. After the terrorist attacks of September 11, 2001, on New York and Washington, DC, Pakistan was recruited to the US. war on terror. The country was extended US\$143 million in new textile quotas by the United States, and the European Union increased Pakistan's quota by 15 percent.

The MFA was later replaced by the WTO Agreement on Textiles and Clothing, which set out a transitional process for the ultimate removal of these quotas by January 1, 2005. Tariffs would remain. These were generally higher in developing countries, ranging from 5 to 30 percent in Malaysia (depending on the category), 13 to 35 percent in Mexico, and up to 44 percent in Turkey. Among developed countries, tariffs were highest in Australia, Canada, and the United States, where they ranged between 0 and 15 percent.

The end of quotas was expected to create big winners and losers. For example, sources at the WTO estimated that India's share of US. clothing imports would rise from 4 percent before to 15 percent after the lifting of quotas, and China's share of imports would rise from 16 percent before to 50 percent after the lifting of quotas. China was also expected to see a large increase in its position in the European Union. Estimates put that share at 29 percent of total imports the first year quotas were lifted, threatening currently strong regional producers such as Turkey. In fact, many expected China to attain a 50 percent share of world market within only a few years.

China's textile and apparel industries had several advantages over those in other

developing countries. Chinese labor was often cheaper and usually more productive, which was a particular advantage in the labor-intensive apparel industry. Huge factories attained substantial economies of scale, and China provided a good transportation infrastructure with especially quick turnaround times for ships in Chinese ports. Locally produced inputs such as cotton also helped keep cost low. Productive Chinese textile mills provided cheap cloth to Chinese garment manufacturers. In addition, opponents accused China of unfairly gaining advantage by pegging its currency too low and not allowing it to revalue based on market demand. China was also notorious for massive software pirating, including software used in the textile and apparel industries, resulting in savings from the avoidance of paying royalties on the intellectual property of others. Critics argued that many Chinese manufacturers were government owned and thereby received unfair subsidization.

However, others were less sure about the ability of China to attain and sustain its projected gains in market share. Besides the possibility that its currency could be revalued, the Chinese economy showed signs of overheating and the government might decide to tighten credit to textile mills. As many foreign clothing manufacturers moved production to China, prices for materials and labor could increase. Already, clothing factories in China's more developed coastal cities were experiencing difficulty in recruiting new labor. As China's rural incomes rose, fewer Chinese migrated to its cities. Many international producers—as well as global buyers—were considering the risk (both political and economic) of relying too heavily on a single source such as China. Also, the large increases in market share predicted for China were based on actual experience in Australia, where quotas had been removed several years earlier. But some analysts believed that supplier countries near to major markets could partially defend their positions if they focused on “replenishment” products-fashion-oriented products whose buyers (such as Wal-Mart) were sensitive to a supplier's ability to fill reorders very quickly and reliably.

Still, China presented a very real threat to the textile and apparel industries in most other countries. One report projected Mexico's share of the U.S. market to fall from 10 percent to only 3 percent, and the market share for the rest of the Americas to fall from 16 percent to 5 percent. U.S. manufacturers would suffer both directly and indirectly, as many U.S. firms supplied inputs to apparel manufactures in Latin American and the Caribbean. Also of concern was whether bilateral trade agreements between the United States and Latin American countries would allow Latin American clothing manufacturers to use Chinese textiles in clothing exports that received lower tariff rates from the United States. Even if the use of Chinese textiles were to be prohibited or penalized many believed that Chinese textiles could be smuggled easily into Mexico or Central America due to lax customs procedures. Therefore, enforcing such a rule would be difficult.

The lifting of textile and apparel quotas threatened the economies of developing countries more than it did those of the United States or Europe. Cambodia, for example, expected its economic growth rate to be halved by expected losses in its garment sector. A system originally designed to protect jobs in Europe and the United States had become the vehicle by which many countries in the developing world could receive guaranteed, if limited access to these developed markets. For example, if Wal-Mart sought to source a large amount of T-shirts, its preferred

supplier in China might not be able to deliver the full amount due to a U.S. quota on T-shirts from China. Wal-Mart could be forced to seek additional suppliers in other developing countries, even if the output from those manufacturers was more costly and of lower quality than that of the preferred Chinese supplier.

But guaranteed market access for less-efficient developing countries was now disappearing. In response, a coalition consisting of U.S. manufacturers and those from twenty-four developing countries convened a Summit on Fair Trade in Brussels and issued a communiqué warning the WTO that thirty million jobs were at risk in the developing world with the passing of the Multifibre Arrangement. Not everyone was sympathetic. The executive director of the U.S. Association of Importers of Textiles and Apparel, sent a letter to the trade representatives at Brussels scoffing, "There is no 'crisis' other than the one created by those who did not prepare or who are unwilling to compete without the crutch of protection."

One of the early promoters of the summit was Mauritius, a tiny island state located off the coast of East Africa. Its population was largely ethnic Indians, many bilingual in French and English. A stable, business-friendly government had offered tax incentives to export-oriented industries, and large amounts of foreign investment in clothing manufacture had poured into the country. The garment industry grew to employ one in five working Mauritians, producing products for such global brands as Calvin Klein and Gap. As a result, the median household income of the country had doubled in 10 years to US\$4,560, making it one of the highest-income countries in Africa. However, the entry of China into the world market had already resulted in the closing of garment factories on the island, and unemployment had risen from 3 percent to 10 percent.

Bangladesh, a mostly Muslim country of 140 million, was another case in point. Its garment industry employed half the country's industrial workforce and supplied 80 percent of its hard-currency earnings, Bangladesh was one of the poorest countries in Asia and had been designated the most corrupt country in the world by watchdog organization Transparency International. Political tension was pervasive, and Muslim fundamentalist parties were expanding their control in parliament. Some rural areas had become essentially ungovernable harbors of militant Islamic extremists who were opposed to the neighboring governments of India and Myanmar.

Bangladesh ranked low in basic infrastructure such as transportation and communications, and delays and strikes at its ports often forced garment exporters to employ expensive air-cargo space in order to meet order deadlines. While its garment workers earned less than half of what Chinese garment workers earned, its garment factories had never attained the economies of a scale found in China. Unlike China, its apparel industry had no homegrown source of cotton and remained dependent on imported fabrics. Nonetheless, under the MFA Bangladesh had become a major supplier of apparel to both the United States and Europe.

Now experts estimated that over half of the jobs in the Bangladesh apparel industry would disappear. In addition, fifteen million jobs in related industries would be lost as well. As in Mauritius, factory closings had already begun. The burden of this unemployment would fall on both men and women, as over half the workers in the industry were female. An earlier increase in female employment (attributed to the

garment industry) had resulted in improvements in women's lives, such as increased enrollments in primary education. Also, studies had linked a decline in domestic violence against women in developing countries with a woman's ability to earn cash outside the home.

As the end of textile and apparel quotas approached, both the EU and the United States prepared to apply temporary restrictions on certain Chinese imports that would threaten their own manufacturers. The ability to employ such temporary restrictions had been previously negotiated as part of the agreement for China to join the WTO. However, just two weeks before quotas were due to be lifted, China announced that it would impose export duties on its garment industry. The duties would be levied by item rather than by value and would amount to somewhere between 2.4 and 6 cents per piece. Some industry observers predicted that the duties would be painful to Chinese producers without being crippling. Others believed that the impact would be negligible. Nonetheless, Chinese officials insisted that the export tariffs represented a serious attempt to limit the Chinese threat to other developing countries, such as Cambodia and Bangladesh.

Questions :

- (a) What factors contribute to a country's success as an apparel exporter ?
(10 marks)
- (b) Which theory best explains a nation's success in this industry post MFA-the theory of comparative advantage or the theory of competitive advantage ? Explain.
(10 marks)
- (c) What actions would you suggest for textile and garment producers in Mexico and Turkey ?
(10 marks)
- (d) Why do you think the Chinese government has imposed export tariffs on its industry ?
(10 marks)
- (e) Is there hope for Mauritius and Bangladesh in the global economy ? What advice would you give these countries ?
(10 marks)

Answer 1(a)

Textile and apparel industries had several advantages. Cheaper labor often and usually more productive, which was a particular advantage in the labor-intensive apparel industry. Huge factories attained substantial economies of scale, and a good transportation infrastructure with especially quick turnaround times for ships in ports. Locally produced inputs such as cotton also helped keep cost low. Productive textile mills provided cheap cloth to garment manufacturers. In addition, advantage of currency too low and not allowing it to revalue based on market demand. Massive software pirating, including software used in the textile and apparel industries, resulting in savings from the avoidance of paying royalties on the intellectual property of others. Government owned and receiving subsidization.

Any country success as apparel exporter is dependent on variety of factors. The case given in the question indicates that China's success as apparel exporters has

been due to factors like lower wage rate and higher manpower productivity, higher compliance, use of modern manufacturing techniques including information technology, relationship with buyers, customer-centricity and capability for newer product development. Efficiency in garment manufacturing is a function of 4 Ms; manpower (trained staff at all levels), *machinery* (both core machines and software), *material* (availability at right time and quality) and *methods* (standard systems and processes). Compliance refers to meeting legal obligations for safeguarding the health, safety, and welfare of workers in an organisation. Buyers globally are focusing on sourcing from compliant garment factories with many like H&M, C&A, Zara, etc, insisting on traceability to ensure that the goods are ethically manufactured.

In this developing world, technology has become an essential part of running any business. It is crucial that garment manufacturers introduce timely technological advancements in order to ensure product quality and sustainable growth. Today, information technology has become an integral part of the apparel industry. With emerging garment manufacturing countries such as Bangladesh and Vietnam, India is facing a stiff competition to maintain its global standing. In such challenging situations, developing long-term partnerships with buyers is the best way to grow and sustain the business. Customer-centricity is no more just related to the services sector; rather, it is transforming most of the manufacturing businesses. Product development is the lifeline for adding new buyers as well as retaining the existing ones. With product strategy being a vital part of the overall business strategy, it is vital for garment manufacturers to adapt to global requirements.

The factors that contribute to a country's success as an apparel exporter are enumerated below:

- i. *Basic Infrastructure* : Basic Infrastructure such as transportation and communications plays crucial role in a Country's success as an apparel exporter. Bangladesh faced troubles as it ranked low in basic Infrastructure and it had to employ expensive air-cargo space to meet deadlines. Buyer's demand for higher value at lower price cannot be met unless Country has good basic infrastructure.
- ii. *Tax incentives* : Policy of the government which offers tax incentives to export oriented industries help countries. A stable, business-friendly government which offers tax incentives to export-oriented industries, help countries in gaining large amounts of foreign investment in clothing manufacture.
- iii. *Cheap Labor* : Cheap labor is a crucial factor in a country's success as an apparel exporter as apparel industry is a labor intensive industry. Cheap labor is the most important factor of production.
- iv. *Availability of Cotton* : Fabric is the backbone of apparel industry. The extensive growth of cotton provides a main advantage to its textile sector through uninterrupted supply of quality cotton, which is the main raw material required for textile industries. Bangladesh had to import fabrics which increased its production cost as it had no homegrown sources of cotton whereas China had locally produced cotton which helped it to keep its cost low.
- v. *Lower production cost* : Economies of scale are an important concept for any business in any industry and represent the cost-savings and competitive

advantages larger businesses have over smaller ones. This helps in lowering the cost.

- vi. *Upgrading in the Buyer-Driven Apparel Value Chain*: The apparel industry is the quintessential example of a buyer-driven production chain marked by power asymmetries between the producers and global buyers of final apparel products. The most valuable activities in the apparel value chain are not related to manufacturing per se, but are found in the design, branding, and marketing of the products. These activities are performed by lead firms, which are large global retailers and brand owners in the apparel industry.
- vii. *Export Promotion*: The government must focus on providing export promotion schemes to the exports so that they are able to transfer values and benefits to the end customers. Schemes like duty remission, exemption, tax rebates, institutional support, financial support, duty free procurement of machinery.

Answer 1(b)

International trade is that factors of production such as capital and labor are typically more mobile within a country than across countries. Thus international trade is mostly restricted to trade in goods and services, and only to a lesser extent to trade in capital, labor or other factors of production. Trade in goods and services can serve as a substitute for trade in factors of production. Instead of importing a factor of production, a country can import goods that make intensive use of that factor of production and thus embody it. An example is the import of labor-intensive goods by the United States from China. Instead of importing Chinese labor, the United States imports goods that were produced with Chinese labor.

The MFA was later replaced by the WTO Agreement on Textiles and Clothing, which set out a transitional process for the ultimate removal of these quotas by January 1, 2005. Tariffs would remain. These were generally higher in developing countries, ranging from 5 to 30 percent in Malaysia (depending on the category). 13 to 35 percent in Mexico, and up to 44 percent in Turkey. Among developed countries, Tariffs were highest in Australia, Canada, and the United States, where they ranged between 0 and 15 percent.

The end of quotas was expected to create big winners and losers. For example, sources at the WTO estimated that India's share of US clothing imports would rise from 4 percent before to 15 percent after the lifting of quotas and China's share of imports would rise from 16 percent before to 50 percent after the lifting of quotas. China was also expected to see a large increase in its position in the European Union. Estimates put that share at 29 percent of total imports the first year quotas were lifted, threatening currently strong regional producers such as Turkey. In fact, many expected China to attain a 50 percent share of world market within only a few years.

Eighteenth-century economist David Ricardo created the theory of comparative advantage. He argued that a country boosts its economic growth the most by focusing on the industry in which it has the most substantial comparative advantage. Comparative advantage due to lower costs (for example, labour, raw materials, capital, or infrastructure) or size still exists. Globalisation now allows organisations to match comparative advantages by outsourcing inputs such as raw materials, capital, and even generic

scientific knowledge from anywhere and to disperse selective activities overseas to take advantage of low costs of labour or capital. Failure to disperse activities to access comparative advantages will lead to a competitive disadvantage.

Competitive advantage is what a country, business, or individual does that provide a better value to consumers than its competitors. There are three strategies companies use to gain a competitive advantage. First, they could be the low-cost provider. Second, they could offer a better product or service. Third, they could focus on one type of customer.

Competitive advantage arises from a process of innovation and productivity growth, the strategy development, core product and process R&D, and a critical mass of an organisation's sophisticated production (or service provision). At the home base reside the essential skills and technology; it is the integration site for inputs and information sourced from global activities; and the most productive jobs are located there. Competitive advantage is what makes you better than anyone else due to a variety of factors like cost structure, branding, and the quality of product offerings, the distribution network, intellectual property, and customer service.

Successes of the countries in textile export after Multi-fibre Arrangement (MFA) are because of competitive advantages not because of comparative advantages.

Answer 1(c)

Mexico's share of the U.S. market to fall from 10 percent to only 3 percent, and the market share for the rest of the Americas to fall from 16 percent to 5 percent. U.S. manufacturers would suffer both directly and indirectly, as many U.S. firms supplied inputs to apparel manufacturers in Latin American and the Caribbean. Also of concern was whether bilateral trade agreements between the United States and Latin American countries would allow Latin American clothing manufacturers to use Chinese textiles in clothing exports that received lower tariff rates from the United States. Even if the use of Chinese textiles were to be prohibited or penalized many believed that Chinese textiles could be smuggled easily into Mexico or Central America due to lax customs procedures. Therefore, enforcing such a rule would be difficult. The Mexican government should rationalized their import duty on textile to check Chinese textile products.

The Mexican and Turkey textile and garment producer should improve their manufacturing competitiveness to compete against Chinese textile manufacturers.

Further Textile manufactures in Turkey and Mexico can also take the following actions:

1. Bilateral, trilateral or multilateral trade agreements with developed and developing countries. A trade agreement confers favored trading status between nations. By giving them access to each other's markets, it increases trade and economic growth. The terms of the agreement standardize business operations and level the playing field. Each agreement covers five areas.
 - First, it eliminates tariffs and other trade taxes. This gives companies within both countries a price advantage. It works best when each country specializes in different industries.
 - Second, Countries agree they won't dump products at a cheap cost. Their

companies do this to gain unfair market share. They drop prices below what it would sell for at home or even its cost to produce. They raise prices once they've destroyed competitors.

- Third, the government refrain from using unfair subsidies. Many countries subsidize strategic industries, such as energy and agriculture. This lowers the costs for those producers. It gives them an unfair advantage when exporting to another nation.
 - Fourth, the agreement standardizes regulations, labor standards, and environmental protections. Fewer regulations act like a subsidy. It gives the country's exporters a competitive advantage over its foreign competitors.
 - Fifth, they agree to not steal the other's innovative products. They adopt each other's copyright and intellectual property laws.
2. Linking Global Value Chains (GVCs) and focusing on trade facilitation and Improving diplomatic relations with developed countries :

A value chain is the full range of activities that firms engage in to bring a product to the market, from conception to final use. Such activities range from design, production, marketing, logistics and distribution to support to the final customer. They may be performed by the same firm or shared among several firms. As they have spread, value chains have become increasingly global. GVCs draw on some basic characteristics of today's global economy:

- The growing interconnectedness of economies. In GVCs economic activities are fragmented and dispersed across countries. Today, more than half of the world's manufacturing imports are intermediate goods (primary goods, parts and components, and semi-finished products), and more than 70% of the world's services imports are intermediate services, such as business services. Exports increasingly include value added imported from abroad.
- Specialisation of firms and countries in tasks and business functions. Today, most goods and a growing share of services are "made in the world", with different firms and countries specialising in the specific functions and tasks that collectively constitute a GVC. However, many policies are still based on the assumption that goods and services are produced in just one country.
- Networks of global buyers and suppliers. In GVCs firms control and coordinate activities in networks of buyers and suppliers, and multinational enterprises (MNEs) play a central role. Policy affects how these networks are formed and where their activities are located.
- New drivers of economic performance. In GVCs, trade and growth rely on the efficient sourcing of inputs abroad, as well as on access to final producers and consumers abroad. The fragmentation of production in GVCs is a means of increasing productivity and competitiveness. GVCs also affect the labour market, mainly by affecting demand for different skills groups.

Answer 1(d)

China charged export duty on its shipments of textiles and apparel after the global

market was liberalized. The move was done to defuse confrontation with the US Government, which was considering whether to limit Chinese clothing imports because of fears of China's textile industry will swamp producers in the United States and other countries, potentially throwing millions of people out of work.

China's action, published on government Websites, came less than three weeks before the end of a system that has restricted international trade in textiles and apparel for decades. Under that system, detailed quotas have limited the amount of clothing, towels, sheets and other textile items that each country can sell in the United States, Europe and Canada. The end of the quota system will allow countries to sell as much clothing as they can around the world and has prompted economists and industry experts to predict China's low-cost factories will dominate the trade. The Chinese government wanted to send a message to the world that it is respecting the rights of other countries to protect themselves from cheap imports.

As the end of textile and apparel quotas approached, both the EU and the United States prepared to apply temporary restrictions on certain Chinese imports that would threaten their own manufacturers. The ability to employ such temporary restrictions had been previously negotiated as part of the agreement for China to join the WTO. However, just two weeks before quotas were due to be lifted, China announced that it would impose export duties on its garment industry. The duties would be levied by item rather than by value and would amount to somewhere between 2.4 and 6 cents per piece. Some industry observers predicted that the duties would be painful to Chinese producers without being crippling. Others believed that the impact would be negligible. Nonetheless, Chinese officials insisted that the export tariffs represented a serious attempt to limit the Chinese threat to other developing countries, such as Cambodia and Bangladesh.

Answer 1(e)

Mauritius, a tiny island state located off the coast of East Africa, Its population was largely ethnic Indians, many bilingual in French and English. A stable, business-friendly government had offered tax incentives to export-oriented industries, and large amounts of foreign investment in clothing manufacture had poured into the country. The garment industry grew to employ one in five working Mauritians, producing products for such global brands as Calvin Klein and Gap. As a result, the median household income of the country had doubled in 10 years to US\$4,560, making it one of the highest-income countries in Africa. However, the entry of China into the World market had already resulted in the closing of garment factories on the island, and unemployment had risen from 3 percent to 10 percent.

Bangladesh, a mostly Muslim country of 140 million, was another case in point. Its garment industry employed half the country's industrial workforce and supplied 80 percent of its hard currency earnings, Bangladesh was one of the poorest countries in Asia and had been designated the most corrupt country in the world by watchdog organization Transparency International. Political tension was pervasive, and Muslim Fundamentalist parties were expanding their control in parliament. Some rural areas had become essentially ungovernable harbors of militant Islamic extremists who were opposed to the neighboring governments of India and Myanmar.

Bangladesh ranked low in basic infrastructure such as transportation and communications, and delays and strikes at its ports often forced garment exporters to

employ expensive air-cargo space in order to meet order deadlines. While its garment workers earned less than half of what Chinese garment workers earned, its garment factories had never attained the economies of a scale found in China. Unlike China, its apparel industry had no homegrown source of cotton and remained dependent on imported fabrics. Nonetheless, under the MEA Bangladesh had become a major supplier of apparel to both the United States and Europe.

Now experts estimated that over half of the jobs in the Bangladesh apparel industry would disappear. In addition, fifteen million jobs in related industries would be lost as well. As in Mauritius, factory closings had already begun. The burden of this unemployment would fall on both men and women, as over half the workers in the industry were female. An earlier increase in female employment (attributed to the garment industry) had resulted in improvements in women's lives, such as increased enrolments in primary education. Also, studies had linked a decline in domestic violence against women in developing countries with a woman's ability to earn cash outside the home.

EU and the United States prepared to apply temporary restrictions on certain Chinese imports that would threaten their own manufacturers. This will help Mauritius and Bangladesh textile industry to survive. In the meantime these two countries should remove the weaknesses exist in their textile industry.

Question 2

- (a) *What factors should international business managers consider in determining the economic and cultural risk with countries ?*
- (b) *Why government is promoting Special Economic Zone (SEZ) and why do you think SEZ is a better model to increase India's export in comparison to EPZ and FTZ ?*
- (c) *Why some countries accepted the globalization and why some countries rejected globalization or embraced it only tepidly ?*
- (d) *Analyze the taxation issues and ethical issues with multinational corporations.*
- (e) *Most of the time India's trade balance is negative. How you will explain the India's foreign trade using international trade theories ?*
- (f) *Explain the functioning of WTO with the help of WTO structure. (5 marks each)*

Answer 2(a)

The economic environment relates to all the factors that contribute to a country's attractiveness for foreign businesses. The economic environment can be very different from one nation to another. Countries are often divided into three main categories: the more developed or industrialized, the less developed or third world, and the newly industrializing or emerging economics. Within each category there are major variations, but overall the more developed countries are the rich countries, the less developed the poor ones, and the newly industrializing (those moving from poorer to richer). These distinctions are usually made on the basis of gross domestic product per capita (GDP/capita). Better education, infrastructure, technology, health care, and so on are also often associated with higher levels of economic development. Clearly the level of economic activity combined with education, infrastructure, and so on, as well as the degree of

government control of the economy, affect virtually all facets of doing business, and a firm needs to understand this environment if it is to operate successfully internationally. While analysing the economic environment, the organisation intending to enter a particular business sector may consider the following aspects:

- Economic system to enter the business sector
- Stage of economic growth and the pace of growth.
- Level of national and per capita income.
- Incidents of taxes, both direct and indirect.
- Infrastructure facilities available and the difficulties thereof.
- Availability of raw materials and components and the cost thereof.
- Sources of financial resources and their costs.
- Availability of manpower-managerial, technical and workers available and their salary and wage structures.

The cultural environment is one of the critical components of the International Business environment and one of the most difficult to understand. This is because the cultural environment is essentially unseen; it has been described as a shared, commonly held body of general beliefs and values that determine what is right for one group, according to Kluckhohn and Strodtbeck. National culture is described as the body of general beliefs and values that are shared by a nation. Beliefs and values are generally seen as formed by factors such as history, language, religion, geographic location, government, and education; thus firms begin a cultural analysis by seeking to understand these factors. Firms want to understand what beliefs and values they may find in countries where they do business, and a number of models of cultural values have been proposed by scholars.

The most well-known is that developed by Hofstede in 1980. This model proposes four dimensions of cultural values including individualism, uncertainty avoidance, power distance and masculinity.

- Individualism is the degree to which a nation values and encourages individual action and decision making.
- Uncertainty avoidance is the degree to which a nation is willing to accept and deal with uncertainly.
- Power distance is the degree to which a national accepts and sanctions differences in power.
- Masculinity is the degree to which a nation accepts traditional male values or traditional female values.

This model of cultural values has been used extensively because it provides data for a wide array of countries. Many academics and managers found this model helpful in exploring management approaches that would be appropriate in different cultures. For example, in a nation that is high on individualism one expects individual goals, individual

tasks, and individual reward systems to be effective, whereas the reverse would be the case in a nation that is low on individualism.

While analyzing social and cultural factors, the organisation may consider the following aspects:

- Approaches of the society towards business in general and in specific areas; Influence of social, cultural and religious factors on acceptability of the product; Life style of people and the products useful for them:
- Level of acceptance of, or resistance to change:
- Values attached to a particular product i.e. possessive value or functional value in the product;
- Demand of specific products for specific occasions:
- Propensity to consume and to save.

Answer 2(b)

India was one of the first in Asia to recognize the effectiveness of the **Export Processing Zone (EPZ)** model in promoting exports, with Asia's first EPZ set up in Kandla in 1965. With a view to overcome the shortcomings experienced on account of the multiplicity of controls and clearances, absence of world-class infrastructure, and an unstable fiscal regime and with a view to attract larger foreign investments in India, the **Special Economic Zones (SEZs)** Policy was announced in April 2000.

This policy intended to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with the minimum possible regulations. SEZs in India functioned from 01.11.2000 to 09.02.2006 under the provisions of the Foreign Trade Policy and fiscal incentives were made effective through the provisions of relevant statutes.

To instil confidence in investors and signal the Government's commitment to a stable SEZ policy regime and with a view to impart stability to the SEZ regime thereby generating greater economic activity and employment through the establishment of SEZs, a comprehensive draft SEZ Bill prepared after extensive discussions with the stakeholders. A number of meetings were held in various parts of the country both by the Minister for Commerce and Industry as well as senior officials for this purpose. The Special Economic Zones Act, 2005, was passed by Parliament in May, 2005 which received Presidential assent on the 23rd of June, 2005. The draft SEZ Rules were widely discussed and put on the website of the Department of Commerce offering suggestions/comments. Around 800 suggestions were received on the draft rules. After extensive consultations, the SEZ Act, 2005, supported by SEZ Rules, came into effect on 10th February, 2006, providing for drastic simplification of procedures and for single window clearance on matters relating to central as well as state governments.

The main objectives of the SEZ Act are:

- (a) generation of additional economic activity
- (b) promotion of exports of goods and services;

- (c) promotion of investment from domestic and foreign sources;
- (d) creation of employment opportunities:
- (e) development of infrastructure facilities:

It is expected that this will trigger a large flow of foreign and domestic investment in SEZs, in infrastructure and productive capacity, leading to generation of additional economic activity and creation of employment opportunities.

The SEZ Act 2005 envisages key role for the State Governments in Export Promotion and creation of related infrastructure. A Single Window SEZ approval mechanism has been provided through a 19 member inter-ministerial SEZ Board of Approval (BoA). The applications duly recommended by the respective State Governments/UT Administration are considered by this BoA periodically. All decisions of the Board of approvals are with consensus.

The SEZ Rules provide for different minimum land requirement for different class of SEZs. Every SEZ is divided into a processing area where alone the SEZ units would come up and the non-processing area where the supporting infrastructure is to be created.

The SEZ Rules provide for: -

- Simplified procedures for development, operation, and maintenance of the Special Economic Zones and for setting up units and conducting business in SEZs;
- Single window clearance for setting up of an SEZ;
- Single window clearance for setting up a unit in a Special Economic Zone;
- Single Window clearance on matters relating to Central as well as State Governments;
- Simplified compliance procedures and documentation with an emphasis on self-certification;

The incentives and facilities offered to the units in SEZs for attracting investments into the SEZs, including foreign investment include:

- Duty free import/domestic procurement of goods for development, operation and maintenance of SEZ units
- 100% Income Tax exemption on export income for SEZ units under Section 10AA of the Income Tax Act for first 5 years, 50% for next 5 years thereafter and 50% of the ploughed back export profit for next 5 years.
- Exemption from minimum alternate tax under section 115JB of the Income Tax Act.
- External commercial borrowing by SEZ units upto US \$ 500 million in a year without any maturity restriction through recognized banking channels.
- Exemption from Goods & Services Tax
- Exemption from Central Sales Tax for certain industries, not subsumed in GST Regime.

- Single window clearance for Central and State level approvals.
- Exemption from State sales tax and other levies as extended by the respective State Governments for certain industries, not subsumed in GST regime.

SEZ mode has inherent benefits over the EPZ and Free Trade Zone (FTZ) as SEZ is much larger in geographical size than EPZ and FTZ. The SEZ has a larger scope of business than EPZ and FTZ are mere trading centres are suitable for countries which are well connected logistically for trading for example, UAE, Singapore. SEZ is a time-tested model are found in all the countries but EPZ is found in developing or developed countries. Infrastructure of SEZ consists of manufacturing units, townships, roads, hospitals and schools and other services but EPZ is confined to manufacturing establishments. The benefits of SEZ are more towards the growth of domestic business catalysing the greater economic activity for exports where EPZ has the main objective of developing exports business. SEZ is open to all fields of businesses like manufacturing, trading and service but EPZ focuses more on manufacturing. Further; the tax benefits in SEZ are much more than in EPZ. There is very limited accountability of export performance in SEZ but it has great influence over the business carried out in EPZ as the penalties and duty recovery is imposed in case of shortfall. The consumption of raw material that is imported duty free has to be consumed over a period of 5 years in SEZ but the time period in EPZ is only one year. Laws concerning the certification of the import goods are much more relaxed in SEZ than in EPZ. Custom departments have less interference in the inspection of the premises in SEZ but EPZ requires routine customs inspection of cargo. FDI investment in manufacturing units does not require sanctions from the board as it is in EPZ.

Answer 2(c)

Globalization means increasing integration of economics around the world particularly through the movement of goods, services and capital across borders. The term also refers to movement of people (Labour) knowledge (technology) across international borders.

Some countries accepted the globalization because of its benefits which are mentioned below:

- (i) Increase in competitive strength of domestic industry
- (ii) Access to advanced technology
- (iii) Access to foreign investment
- (iv) Reduction in cost of production
- (v) Growth and expansion in participating countries
- (vi) Higher volume of trade
- (vii) Consumer welfare
- (viii) Benefits like help in professionalization of management, promotion of mutual cooperation, paving way for world peace.

As some countries have embraced globalisation, and experienced significant income

increases, other countries that have rejected globalisation, or embraced it only tepidly, have fallen behind. A similar phenomenon is at work within countries – some people have, inevitably, been bigger beneficiaries of globalisation than others.

Over the past two decades, income inequality has risen in most regions and countries. At the same time, per capita incomes have risen across virtually all regions for even the poorest segments of population, indicating that the poor are better off in an absolute sense during this phase of globalisation, although incomes for the relatively well-off have increased at a faster pace. Consumption data from groups of developing countries, reveal the striking inequality that exists between the richest and the poorest in populations across different regions. However, increased trade globalisation is not associated with a decline in inequality. The spread of technological advances and increased financial globalisation - and foreign direct investment in particular – have instead contributed more to the recent rise in inequality by raising the demand for skilled labor and increasing the returns to skills in both developed and developing countries.

The support for globalization is the lowest in the USA and even in certain other developed countries including Britain, France and Germany. People are generally wary of immigration that accompanies the opening up of the economy. These countries feel threatened as it could endanger their culture and environment. The dynamics of globalization process reveals that developed and developing countries participate in unequal footings. Developed countries along with their mighty MNCs exert a very strong force globally while developing country governments and civil society organization hold much less sway. Developed country governments often reserve and exercise the right to take unilateral and bilateral actions. Economic efficiency argument in support of globalization ignores real social consequences. Farmers in developing countries commit suicides as commodity prices crash, workers lose jobs as they are retrenched from factories because developing countries like India, Mexico, and Philippines do not have the advantage of economies of scale. Globalization is often accused of contributing to the rise in poverty in developing countries. Poorer countries (Africa, the Balkans, parts of Caribbean) share in world trade has fallen over the past 20 years. Income inequality has risen in most regions such as in developing Asia, emerging Europe, Latin America. Despite all claims of welfare in the globalized era, more than a billion people in the world still live on less than a dollar a day. On an average, developed countries impose tariffs on developing countries four times higher than those on developed ones. Rich countries incur cost three times more in trade restrictions than they give in development aid. Globalization pushes workers from the organized to the unorganized sector where they enjoy much less job security and sometimes lower wages as well.

Some Countries oppose Globalization because of the following reasons:

- *Unequal economic growth*: While globalization tends to increase economic growth for many countries, the growth isn't equal—richer countries often benefit more than developing countries.
- *Lack of local businesses*: The policies permitting globalization tend to advantage companies that have the resources and infrastructure to operate their supply chains or distribution in many different countries, which can hedge out small local businesses—for instance, a local New York hamburger joint may struggle to compete with the prices of a multinational burger-making corporation.

- *Increases potential global recessions* : When many nations' economic systems become interdependent, the likelihood of a global recession increases dramatically—because if one country's economy starts to struggle, this can set off a chain reaction that can affect many other countries simultaneously, causing a worldwide financial crisis.
- *Exploits cheaper labor markets* : Globalization allows businesses to increase jobs and economic opportunities in developing countries, where the cost of labor is often cheaper. However, overall economic growth in these countries may be slow or stagnant.
- *Causes job displacement* : Globalization doesn't result in an increased number of jobs; rather, it redistributes jobs by moving production from high-cost countries to lower-cost ones. This means that high-cost countries often lose jobs due to globalization, as production goes overseas.

Answer 2(d)

Taxation issues : A multinational corporation (MNC) in its true sense operates with different companies located in different countries under same management group. They transfer finished and semi-finished goods, raw materials, spares and services among the group companies. 40% of the international trade consists of transfers between related business companies. For MNCs there are the separate tax and tariffs rates, government regulations but they have to operate under political risk as compared to their domestic counterparts. Transfer pricing helps an MNC in tax planning, avoiding exchange controls and supporting credit status of affiliates. In many cases, there are charges against MNCs on the usage of transfer pricing system for dubious activities. Hence, it becomes a source of conflict between the MNC and the host government. However, the adverse effects of transfer pricing can be checked to a great extent by regulations. As per one school of thought there should not be any regulation for transfer pricing and no MNC will be compelled to adopt transfer pricing technique. The play of market force will decide optimal allocation of resources. However this concept is not quite prevalent and hence, it requires some regulation. Which may be direct or indirect. Direct Regulation includes the measures replacing directly one particular transfer price by another set of prices fixed by the host government. All the intra firm transactions are required to take place at the fixed place. In many developing countries, the government has fixed ceiling on the royalty payment, but that affects adversely to MNCs. In short, it can be said that, direct regulations is possible. Indirect regulation may be applied in different forms, which are as follows:

- Harmonization of tax and tariff between home and host country.
- Compensation for the loss of corporate tax revenues on account of transfer pricing
- Apportionment of the consolidated profit of the MNC among the relevant units on the basis of total assets, sales and labour and capital employed

Ethical issues : Scandals and bankruptcies in the United States at companies like Enron and World Com Inc. have focused attention on the abuse of the power entrusted to executives by shareholders, employees and customers and they underscore the need for reforms to bolster business ethics. Corruption is not inherent to any one society. Its reach is global. Fifteen percent of all companies in industrialized nations have to pay

bribes to win or retain business. Ethical issues in business have become more complicated because of the global and diversified nature of many large corporations. Managers must balance the ideal against the need to produce a reasonable profit for the company's shareholders with honesty in business practices, safety in the workplace, and larger environmental and social issues.

Answer 2(e)

Even if the balance of trade was not a specific source of concern, the commodity composition of trade was. Exports of manufactured goods were considered beneficial, and exports of raw materials were considered harmful; imports of raw materials were viewed as advantageous and imports of manufactured goods were viewed as damaging. This ranking of activities was based not only on employment grounds, where processing and adding value to raw materials was thought to generate better employment opportunities than just extraction or primary production of basic goods, but also for building up industries to strengthen the economy and the national defense.

Mercantilists advocated that government policy be directed to arrange the flow of commerce to conform these beliefs. They sought a highly interventionist agenda, using taxes on trade to manipulate the balance of trade or commodity composition of trade in favor of the home country. But even if the logic of mercantilism was correct, this strategy could never work if all nations tried to follow it simultaneously. This is due to the fact that not every country can have a balance of trade surplus, and not every country can export manufactured goods and import raw materials.

In each country Consumers have a preference for variety but there is a tradeoff between variety and cost, consumers want variety but since there are economies of scale - a firm's unit costs fall as it produces more - more variety means higher prices. Preferences for variety push in the direction of more variety, economies of scale push in the direction of less. So suppose that without trade country I produces varieties A, B, C and country II produces varieties X, Y, Z. In every other respect the countries are identical so there are no traditional comparative advantage reasons for trade.

Nevertheless, if trade is possible it is welfare enhancing. With trade, the scale of production can increase which reduces costs and prices. The number of world varieties will decrease even as the number of varieties available to each consumer increases. That is, with trade, production will concentrate in say A, B, X, Y so each consumer has increased choice even as world variety declines.

Answer 2(f)

Structure of the World Trade Organization : The WTO has 164 members, accounting for 98% of world trade. The WTO is headed by the Ministerial Conference, while the daily operations are carried out by three administrative bodies:

1. *General Council* : The General Council comprises the representatives of all member countries and acts as the representative of the Ministerial Conference when it comes to daily operations. Its job is to carry out the implementation and monitoring function of the WTO. The General Council is further divided into multiple councils and committees that focus on specific topics. Examples of such bodies include the Council on Goods, the Councils on Services, the Committee on Textiles under the Council on Goods, etc.

2. *Dispute Settlement Body*: The Dispute Settlement Body is a part of the General Council and is responsible for settling trade disputes between member states. There is also an Appellate Body, where member states can appeal any decisions made against them during a dispute settlement.
3. *Trade Policy Review Body*: The Trade Policy Review Body is also a part of the General Council and is responsible for ensuring the trade policies of member states are in line with the goals of the WTO. Member countries are required to inform the WTO about changes in their laws and trade policies. The body undertakes regular reviews of the policies to ensure they conform to the rules of the WTO. This is part of the monitoring function of the WTO, and it helps the WTO to adapt to the changing economic landscape.

Functions of WTO

- Administering WTO trade agreements;
- Forum for trade negotiations;
- Handling trade disputes;
- Monitoring trade policies;
- Technical assistance and training for developing economies;
- Cooperation with other international organizations.

Question 3

If a large fertilizer company seeking your advice for warehouse management then what type of warehouse would you suggest to the company and why you will advise the company to invest money on IT for warehouse management ? (5 marks)

Answer 3

Private warehouses : These warehouses are owned by private entities or individuals and are used exclusively for the goods owned, imported by or on behalf of the licensee. The warehouses are usually constructed at strategic locations to cater various manufacturing, business and service units. They are flexible enough to be customized in terms of storage and placement, according to the nature of the products.

Bonded warehouses : The concept of bonded warehouses was developed in order to facilitate the deferred payment of customs duty by entrepreneurs, exporters and importers, to enable them to carry out their operations with least investment. These warehouses are used to store imported goods under an undertaking or 'bond', which does not allow the release of goods until the Custom duties are paid. These are generally owned managed and controlled by both government and private parties and are established near ports. Government and private parties together manage bonded warehouses.

IT adoption has the following advantages that can help warehousing players increase their competitiveness:

- *Reduced labour costs*: Automated storage and order picking systems can reduce the need for labour and wheeled machinery in the warehouses. In automated

goods to person order-picking systems, the right goods are brought automatically to the right person at the right time. This eliminates the need to walk, increasing the productivity of slower-moving Stock Keeping Units ('SKUs') nearly 10 times from traditional zone-picking or pick-to-pallet approaches. Higher productivity automated systems also reduce the number of operators required for storage, picking, packing, etc.

- *Improved space efficiency* : By making maximum use of headroom and minimizing aisle widths, automated storage systems for pallets, tote-bins and cartons, we can reduce footprint requirements for stock storage and will it land and storage costs.
- *Improved ergonomics and safety* : Automated storage systems reduce the need for forklift trucks and eliminate the need to have pallet movements interleaved with other tasks such as order-picking. Automated goods to person palletizing stations provide for sliding rather than listing of cases. Also, ergonomic pick-from-tote stations for small and split-case items minimise bending and twisting, reducing injuries, complaints and lost lime.
- *Flexibility to different order profiles* : Automated order-picking systems are equally productive for small as well as large orders and the productivity is independent of the number of SKUs as against the manual systems, where more SKUs and smaller orders mean greater walking distances which reduce productivity.
- *Higher customer satisfaction* : Automated order-picking systems allow for greater flexibility with respect to how and when an order is assembled and the order to be picked up at any time, improving response times and increasing fulfillment consistency and quality. All this contributes to higher customer satisfaction.
- *Quick response and access to information* : Automation of warehouses through warehouse management systems helps eliminate paperwork and costly shipping errors by helping access the information quickly and efficiently.
- *Track and trace* : Warehouse management systems can track inventory throughout the warehouse and the movement of the product from one location to the next.
- *Standardised procedures* : Use of warehouse management systems ensures standardisation of processes and procedures such as set acceptance standards for product receipt, monitoring vendor performance, managing customer inventory, expediting orders more efficiently, etc.

Question 4

An Indian automobile company made joint venture with a European company for technology transfer to manufacture automobile in India and after running successfully for 15 years in India now both the company wants to terminate their joint venture. Explain how the company can terminate the joint venture. (5 marks)

Answer 4

Any number of events may lead to the termination of a Joint Venture (JV). Many termination events are anticipated and provided for in the joint venture agreement. For

example, a breach of the joint venture agreement may trigger termination or failure to meet research and development deadlines may lead to termination. A JV may terminate upon achieving its objectives. Alternatively, a JV may terminate upon failing to meet its objectives. The agreement could provide that one JVP buy the other out or sell its shares, or vice versa.

Excessive costs, failure to achieve projected income, or unforeseen capital requirements may make the continuation of a JV unattractive. In addition, a change in the JV's objectives or those of a shareholder may also lead to the early termination of the JV. Changes in objectives may result from a JVP's internal strategic redirection, competitive advances, or market changes beyond the control of the JV or its shareholders. Disagreement by JVPs on fundamental management issues may also lead to termination.

An obvious disadvantage of sharing capital obligations is the need to share profits generated from the actual operation of the JV. Issues can arise in this area because of the fact that parties will also be contributing intangible assets to the business, such as intellectual property rights and technical expertise. Technology and management sharing can potentially create significant problems among the parties. In particular, one party's mastery of the other's technology can lead to improvements on that technology beyond the intended services of the JV, a factor that tends to discourage companies from disclosing their technologies for fear of losing the competitive edge to their JVP.

However, JVs offer a structure where both partners contribute to the costs associated with the exploitation of the technology in proportion to their expected benefits. The motive of forming a joint venture is to gain from the venture by both the parties and terminate the venture when the desired objective is fulfilled.

Listed below are the ways a joint venture can be terminated or dissolved:

- According to the termination or dissolution provisions in the joint venture contract, most joint venture contracts will state a date upon which the venture is to end.
- Because it was ordered by a court decree.
- At the direction of one of the venturers. Moreover, provisions regarding at-will dissolution will likely be contained in the contract.
- The stated goals of the venture have not been met, or have already been completed.
- The aims of the venture have become impossible to fulfill and therefore the joint venture in jeopardy.
- There are one or more entities that disagree with the aims of the venture or have developed different business goals.
- The market conditions could have rendered the joint venture unprofitable, inappropriate, or irrelevant.
- Legal problems or other financial hardships have taken place.

Question 5

If the companies are making strategic alliances for market development, knowledge transfer and growth strategy for entering new market then why strategic alliance

failed due to lack of trust, clash of culture and lack of coordination between management teams.
(5 marks)

Answer 5

Some of the reasons for the failure of Strategic Alliance are as follows:

Lack of trust : Risk sharing is the primary bonding tool in a partnership. What will happen if one company is successful and the other experiences a failure? A sense of commitment must be generated throughout the partnership. In many alliance cases one company will point the failure finger at the partnering company. Shifting the blame does not solve the problem, but increases the tension between the partnering companies and often leads to alliance ruin. Building trust is the most important and yet most difficult aspect of a successful alliance. Only people can trust each other, not the company. Therefore, alliances need to be formed to enhance trust between individuals. The companies must form the three forms of trust, which include responsibility, equality and reliability. Many alliances have failed due to the lack of trust causing unsolved problems, lack of understanding and despondent relationships.

Clash of cultures : Cultural clash is probably one of the biggest problems that corporations in alliances face today. These cultural problems consist of language, egos, chauvinism, and different attitudes to business. Problems can be particularly acute between a publicly quoted American holding company, keenly focused on shareholders' value, and Japanese partners who have different priorities. It is important for the companies that are working together to be able to communicate and understand each other well or they are doomed before they even start. After the communication is worked out the firms face the problems with operations. Different cultures operate in different ways. For example, US companies tend to evaluate performance on the basis of profit, market share, and specific financial benefits While Japanese companies focus more on quality aspects, customer benefits and value addition.

Lack of coordination between management teams : Action taken by subordinates that are not congruent with top-level management can prove particularly disruptive, especially in instances where companies remain competitors in spite of their strategic alliance. If it were to happen that one company would go off on its own and do its own marketing and sell its own product while in alliance with another company it would for sure be grounds for the two to break up, and they would most likely end up in a legal battle which could take years to solve.

Lack of a Shared Vision : Inherent to a partnership is a shared goal or commitment that will benefit both parties. Making sure that partners start on the same page—and stay there—takes upfront and honest communication in the partnership's infancy and throughout. All too often there is a disconnect in expectations or understanding that will undercut the benefits to both parties and eventually undermine the alliance.

Poor Governance : Good governance promotes investor confidence, which is crucial to the ability of entities listed on stock exchanges to compete for capital. Good governance is essential to develop additional values to the stakeholders as it ensures transparency which ensures strong and balanced economic development. This also ensures that the interests of all shareholders are safeguarded. Poor Governance can dilute the strategic alliance.

Question 6

India is firmly committed to the principle of free and fair trade among nations which is the very foundation of the multilateral trade order established by WTO. Discuss. (5 marks)

Answer 6

India is firmly committed to the principle of free and fair trade among nations, which is the very foundation of the multilateral trade order established by WTO. While a giant step has been taken by India towards establishment of free trade regime with the phasing out of Quantitative Restrictions on imports, there is also a need to ensure fair trade. Depending upon the need, anti-dumping, anti-subsidy countervailing and safeguard measures have been invoked in the past.

All these measures are in the nature of trade remedies, which the domestic industry could take advantage of subject to the fulfillment of essential conditions and criteria as mandated under law. The government has already put in place the requisite legal and institutional mechanism for administering these measures. However, various concepts and legal and operational aspects involved in these schemes need to be understood in the proper sense and in the right perspective.

Under the existing WTO arrangement, and in terms of various provisions under the Customs Tariff Act of 1975 (as amended in 1995) and Rules framed there under, anti-dumping and allied measures constitute the legal framework, within which the domestic industry can seek necessary relief and protection against dumping of goods and articles by exporting companies and firms of any country from any part of the world. These measures have assumed a great deal of relevance in India in recent times in view of the scenario arising out of unfair trade practices adopted by some of the trading partners, especially in the post-QR phase.

The Anti-Dumping and allied measures are complex legal disciplines which are often not within the easy comprehension of the trade and industry who are the users of these measures. To obviate this difficulty faced by large sections of the domestic industry, there is a need to explain the basic concepts, legal provisions and procedural aspects in clear and easy language for their benefit. This will facilitate the domestic industry to avail of these remedial measures in the wake of alleged dumping and of injury caused by unfair trade practices.

However, it is always necessary to bear in mind that the anti-dumping action can never be an action based on presumption and vague complaints and only on very rare occasions suo-moto proceedings can be initiated. The requisite parameters of law have to be duly complied with and need to be fully supported and substantiated with facts and figures before any action could be initiated.

Sections 9, 9 A, 9 B and 9 C of the Customs Tariff Act, 1975 as amended in 1995 and the Customs Tariff (Identification, Assessment and Collection of Anti-dumping Duty on Dumped Articles and for Determination of Injury) Rules, 1995 framed there under form the legal basis for anti-dumping investigations and for the levy of anti-dumping duties. These laws are based on the Agreement on Anti-Dumping which is in pursuant of Article VI of GATT 1994.

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