

SUGGESTED ANSWERS

PROFESSIONAL PROGRAMME

ADVANCED TAX LAWS AND PRACTICE (PP-ATLP/2013)



**THE INSTITUTE OF
Company Secretaries of India**

IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

ICSI House, 22, Institutional Area, Lodi Road, New Delhi 110 003

Phones : 41504444, 45341000; Fax : 011-24626727

E-mail : info@icsi.edu; Website : www.icsi.edu

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PROFESSIONAL PROGRAMME
ADVANCED TAX LAWS AND PRACTICE
TEST PAPER 1/2013

Time allowed : 3 hours

Max. marks : 100

NOTE : *All Questions are compulsory. All references to Sections mentioned in Part-A of the Question Paper relate to the Income-Tax Act, 1961 and the relevant Assessment year 2014-15, unless stated otherwise.*

Part A

DIRECT TAXATION – LAW AND PRACTICE

Question No. 1

Answer the following Questions :

- (a) *How will the income be determined in case of outsourcing of business processes by Non-resident/ Foreign companies to B.P.O. units in India under Section 9 of the Income-tax Act, 1961?*
- (b) *Explain briefly about the residential status of HUF and company ?*

(5 marks each)

Answer to Question No. 1(a)

Income in case of outsourcing of business processes by a Non-resident/ foreign companies to B.P.O. units in India under section 9 of the Income-tax Act, 1961 comes under the head 'Income deemed to accrue or arise in India' and is taxable in case of resident and ordinarily resident, resident but not ordinarily resident and non-resident.

Answer to Question No. 1(b)

Residential status of HUF

The residential status of HUF depends upon the control and management of the affairs of the HUF.

A HUF is said to be resident in India within the meaning of section 6(2) in any previous year, if during that year the control and management of its affairs is situated wholly or partly in India. If the control and management of its affairs is situated wholly outside India during the relevant previous year, it is considered non-resident.

A HUF can be “not ordinarily resident”

If Karta of a resident HUF satisfies both the following additional conditions (as applicable in case of individual). Then resident HUF will be ROR, otherwise it will be RNOR:

- (1) Karta of Resident HUF should be resident in atleast 2 previous years out of 10 previous year immediately preceding relevant previous year.

- (2) Stay of Karta during 7 previous years immediately preceding relevant previous year should be 730 days or more.

Question No. 2

Answer the following:

- (a) *What are the "Tax exemption" available with respect to foreign income under Income-Tax Act, 1961.*
- (b) *Discuss the scope of the provisions the Central Government may make under Section 90A(1) of the Income Tax Act, 1961 in respect of an agreement between specified associations. (5 marks each)*

Answer to Question No. 2(a)

Special tax incentives provided to FII's in respect of income from securities and capital gains

1. Income other than income by way of dividends referred to in section 115-O received in respect of securities (other than units referred to in section 115AB): such income would be taxable @ 20 percent;

The following points should be noted:

- (a) The amount of income-tax calculated on the income by way of interest referred to in section 194LD shall be at the rate of 5 per cent.
- (b) Deduction under sections 28 to 44C or clause (i) or clause (iii) of section 57 or under Chapter VI-A shall not be allowed in respect of income referred above.

2. Income by way of short-term or long-term capital gains arising from the transfer of such securities would be taxable @ thirty percent and ten percent respectively.

However, such short term capital gains referred to in Section 111A (i.e. on which securities transaction tax has been paid) shall be taxable @ fifteen percent.

First and second provisos to section 48 shall not apply for the computation of capital gains arising out of the transfer of securities referred above.

Other exemptions include:

- (a) Exemptions for new industrial undertakings in FTZ's;
- (b) Deductions in case of royalties and fees for technical services earned by foreign nationals in India.

Special tax concessions is made available EEC investors under section 10(23BBB) of the Income Tax Act 1961.

There are other incentives for tax holidays specially relating to investments made in new industrial undertakings in under-developed areas. Moreover tax holiday facilities available for power generating sector and investment in building infrastructures.

There is also provision for deduction for capital expenditure for scientific research under section 35 of the Act.

To encourage venture capital financing, section 10(23FB) of the act provides an income tax exemption for all dividends and long term capital gains of a venture capital fund or a venture capital company from investments made by way of equity shares in venture capital undertakings. To obtain this exemption, venture capital fund or company must obtain approval from the prescribed authority and satisfy the prescribed conditions.

Answer to Question No. 2(b)

The Central Government is empowered by section 90A to enter into an agreement with any specified association in the specified territory outside India and the Central Government has been authorized to make such provisions as may be necessary for adopting and implementing such agreement. The provisions may be made:

- (a) For granting relief in respect of
 - (i) income on which tax have been paid both under Income Tax Act, 1961 and Income-Tax Act prevailed in that specified territory; or
 - (ii) income-tax chargeable under Income Tax Act, 1961 and under the corresponding law in force in that specified territory to promote mutual economic relations, trade and investment.
- (b) For the avoidance of double taxation of income under Income Tax Act, 1961 and under the corresponding law in force in that specified territory.
- (c) For exchange of information for the prevention of evasion or avoidance of income-tax chargeable under Income Tax Act, 1961 or under the corresponding law in force in that specified territory, or investigation of cases of such evasion or avoidance.
- (d) For recovery of income-tax under Income Tax Act, 1961 and under the corresponding law in force in that specified territory.

Where the Central Government has entered into an agreement with the specified association of any specified territory outside India for granting relief of tax, avoidance of double taxation, then, the provisions of Income Tax Act, 1961 shall apply to the assessee to whom such agreement applies, to the extent they are more beneficial to him.

Question No. 3

Sigma Ltd., a foreign company, enters into an agreement with Kalton Ltd., an Indian company. The agreement related to a matter included in the Industrial Policy of the current year and is in accordance with the policy. During the year 2012-13, a royalty of ₹60,00,000 is paid by Kalton Ltd. to Sigma Ltd., Sigma Ltd., has spend ₹15,00,000 on expenses covered under Section 28 to 44.

Compute the tax payable by Sigma Ltd. under the following situations:

- (a) *Kalton Ltd. pays the Income-tax payable by Sigma Ltd., as per the terms of agreement entered into before 1.6.2002.*
 - (b) *The agreement does not provides that Kalton Ltd., will bear the tax but it is mutually agreed by the parties that royalty of ₹60,00,000 will be paid net of taxes.*
- (10 marks)*

Answer to Question No. 3

- (a) As per section 10(6A), if as per the terms of the agreement, which is entered into before 1.6.2002 tax on royalty is payable by the Government or Indian concern, the tax so paid will not be included in the total income of the foreign company as such, it will be an exempt income in the hands of the foreign company. Therefore, in the instant case, the total royalty income will not be grossed up and income from royalty will be ₹60,00,000. No deduction is allowed in respect of any expenditure u/s 28 and 44C.

	₹
Therefore the total income of Sigma Ltd. is	60,00,000
Tax payable @ 25.75 % (including education cess + SHEC)	15,45,000
Less: tax paid by Kalton Ltd.	15,45,000
Net tax payable	nil

- (b) Since section 10(6A) is not applicable as the terms of agreement do not provide for payment of tax by Kalton Ltd., the total income will be computed as under:

Net income	₹60,00,000	
	Net income x 100/100-TDS	
Gross Income	₹60,00,000 x 100/74.25 =	80,80,808
Tax payable by Sigma Ltd. @ 25.75% on ₹80,80,808		20,80,808
Less: tax borne to be by Kalton Ltd.		20,80,808
Balance tax payable		nil

Part B**INDIRECT TAXATION — LAW AND PRACTICE****Question No. 4**

- (a) *Suraj Car Co., is manufacturing cars and discharging duty liability thereon by including cost of mandatory one year warranty in the transaction value of cars. An option was given to customers to obtain extended warranty for a further period of two years against payment of separate charges. This extended warranty was introduced by assessee and administered through dealer's for which dealers were allowed commission. Such extended warranty charges were not included in assessable value.*

The department contended that the same were includible in assessable value of manufactured cars. Discuss, in the light of decided case law, if any, whether contention of the department is tenable in law. (5 marks)

- (b) *Explain the validity of the following statements with reference to Chapter IX of the Customs Act, 1962 containing the provisions relating to warehousing:*
- (i) *Owner of any warehoused goods cannot carry on any manufacturing process or other operations in relation to warehoused goods.*

- (ii) *he importer must execute a bond equal to the amount of duty assessed with necessary surety or security.*
- (iii) *Warehoused goods may be transferred from one warehouse to another warehouse.* (2 marks each)
- (c) *Briefly discuss whether the following powers vest with the Commissioner (Appeals) under the Central Excise Act, 1944/Customs Act, 1962 :*
- (i) *Remanding the case back to the adjudicating authority; and*
- (ii) *Condoning the delay in filing appeal before him.* (2 marks each)

Answer to Question No. 4(a)

The facts of the case are similar to that in *CC Ex. v. Ford India Pvt. Ltd. (2010) 255 ELT A14 (SC)*. In this case, it was held that only the first sale transaction is relevant for the purpose of valuation of manufactured goods. The extended warranty was optional; it was not a condition of sale. The sale of car and sale of extended warranty are two different businesses, which had no direct or proximate connection.

The definition of transaction value in section 4 of the Central Excise Act, 1944 makes it clear that only payments made by the buyers of the goods are includible in transaction value. In this case, optional extended warranty charges are paid by final customers and not by dealers.

Hence, contention of the Department is not tenable in law and Suraj Car Company is not required to include these charges in the assessable value of cars.

Answer to Question No. 4(b)(i)

False

Section 65 of the Customs Act, 1962 provides that owner of any warehoused goods may carry on any manufacturing process or other operations in relation to warehoused goods with the sanction of Assistant or Deputy Commissioner of Customs and subject to prescribed conditions on payment of prescribed fees.

Answer to Question No. 4(b)(ii)

False

As per Section 59, the importer must execute a bond for twice the amount of duty assessed with necessary surety or security/bank guarantee.

Answer to Question No. 4(b)(iii)

True

According to Section 67 of the Customs Act, 1962, the owner of any warehoused goods may remove the warehoused goods from one warehouse to another, with the permission of proper officer and subject to such conditions as may be prescribed.

Answer to Question No. 4(c)(i)

No, Commissioner (Appeals) does not have power to remand the case back to the adjudicating authority for fresh adjudication — *MIL India Ltd., v. CC Ex/(2007) 210 ELT 188 (SC)* and CBEC F. No.275/34/2006-CX.8A, dated 18.2.2010. Earlier, the power to remand was vested with him but later on it was removed to avoid delay in adjudication process.

Answer to Question No. 4(c)(ii)

Yes, Commissioner (Appeals) can condone the delay in filing the appeal before him for a further period of 30 days—Section 35 of the Central Excise Act and Section 128 of the Customs Act. But he has no power to condone delay beyond 30 days under any circumstances.

Question No. 5

- (a) Determine the taxable turnover, input tax credit and net VAT payable by a works contractor from the details given below on the assumption that the contractor maintains sufficient records to quantify the labour charges. Assume output VAT at 12.5%:

	₹(lakhs)
(i) Total contract price (excluding VAT)	100
(ii) Labour charges paid for execution of the contract	35
(iii) Cost of consumables used not involving transfer of property in goods	5
(iv) Material purchased and used for the contract taxable at 12.5% VAT (VAT included)	45

The contractor also purchased a plant for use in the contract for ₹10.4 lakhs. In the VAT invoice relating to the same VAT, was charged at 4% separately and the said amount of ₹10.4 lakhs is inclusive of VAT. Assume 100% input credit on capital goods.

Make suitable assumption wherever required and show the working notes.

(5 marks)

- (b) Write a note on the concept of Service Tax. (5 marks)
- (c) What are the provisions relating to filling of return under the Service Tax Law ? (5 marks)
- (d) What do you mean by Reverse charge mechanism. Give examples where such mechanism is applicable. (10 marks)

Answer to Question No. 5(a)

'Transfer of property in goods' involved in execution of works contract is liable to VAT as 'deemed sale' of goods. However, the service element comprising of labour charges and consumable and profit attributable thereto is not liable to VAT. Hence, the

taxable value of the works contract and VAT liability thereon shall be computed in the following manner:

	₹
Total contract price (excluding VAT)	1,00,00,000
Less : Labour charges paid for execution of the contract	(35,00,000)
Cost of consumables used not involving transfer of property in goods	(5,00,000)
Taxable value of the 'works contract'	<u>60,00,000</u>
VAT payable thereon @ 12.5%	7,50,000
Less : Input VAT credit on material (45 lakhs x 12.5% /112.5%)	5,00,000
Input VAT credit on capital goods (10.4 lakhs x 4% /104%)	40,000
Net tax payable	<u>2,10,000</u>

Assumption : It must be noted that in *State of Jharkhand v. Voltas Ltd.* [2007] 7 STR 106 (SC) it was held that 'profit earned by the contractor to the extent it is relatable to supply of labour and services' cannot be included in the value of 'works contract' for the charge of VAT. This finds statutory recognition in Rule 2A of the Service Tax (Determination of Value) Rules, 2006 where it was specified that value for the purpose of service tax shall be the contract price less value of goods transferred in works contract, i.e. part of deemed sale.

Explanation (b)(vii) provides for 'value of services'. Hence, profit attributable to service element is also to be excluded.

Alternative solution : If the aforesaid assumption is not taken, then the profit attributable to the works contract shall be excluded from the value of works contract and VAT liability shall be computed accordingly. The relevant computations are shown below:

	<i>Service element</i>	<i>Sale element</i>
Cost of materials purchased and used for the contract (net of VAT)		40,00,000
Cost of plant purchased and used for the contract(net of VAT, assuming 100% depreciation on account of fully used for contract)		10,00,000
Labour charges paid for execution of the contract	35,00,000	
Cost of consumables used not involving transfer of property in goods	5,00,000	
A. Cost of Element	<u>40,00,000</u>	<u>50,00,000</u>

Total profit on the contract [contract price ₹100 lakhs - total cost ₹90 lakhs (40 lakhs 50 lakhs) = ₹10 lakhs. This profit of ₹10 lakhs is apportioned in the ratio of respective costs.]

	<i>Service element</i>	<i>Sale element</i>
B. Profit attributable to the two elements:		
1. Service element [10 lakhs x 40 lakhs/90 lakhs]		
2. Sale elements [10 lakhs x 50 lakhs / 90 lakhs]	4,44,444	5,55,556
Total value (A+B)	44,44,444	55,55,556
VAT payable thereon @ 12.5%		6,94,444
Less : Input VAT credit on materials (45 lakhs x 12.5%/112.5%)		5,00,000
VAT credit on capital goods (10.4 lakhs x 4% /104%)		40,000
Net VAT payable		1,54,444

Answer to Question No. 5(b)

Concept of Service Tax

Indirect taxes are basically taxes on domestic consumption. Earlier, these taxes were being imposed on goods when manufactured, imported, exported, or sold, in the name of Excise duty, Customs duties, VAT and CST respectively.

But of late, it has been found that there is heavy burden of tax on goods whereas service sector is being left over untaxed even though there is consistent growth of this sector. In fact, service sector's share in GDP is more than 60%. Given the potential of this sector, and also to balance the incidence of indirect taxes evenly on goods and services, Govt. introduced tax on services also in 1994 through

The Finance Act, 1994 and was made applicable all over India except Jammu and Kashmir.

Since there was no specific Entry for service tax, it was introduced under the residuary Entry No. 97 of Union List under VII Schedule to Constitution of India.

Levy of service tax began with three services on a selective basis and the list expanded to over 125 taxable services. In 2012, comprehensive system of taxation was introduced with a negative list and mega exemption scheme. With the advent of this new scheme,

- (i) All services including declared services except those in negative list became chargeable.
- (ii) 'service' has been defined
- (iii) New charging Section 66B replaced the earlier Section 66. Section 66B provides that there shall be levied a tax (hereinafter referred to as the service tax) at the rate of 12% on the value of all services plus education cess at the rate of 2% and SHEC at the rate of 1%, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed.

- (iv) Place of Provision of Services Rules, (POPSR) 2012 have been notified to determine the location to ascertain whether service has been provided in taxable territory or not.
- (v) Service tax was also made payable on accrual basis by enacting Point of Taxation Rules, (POTR), 2011

With all these developments, service tax collections have increased enormously and will soon match the other central (Indirect) taxes in revenue generation.

Answer to Question No. 5(c)

Filing of returns is governed by Section 70 of The Finance Act, 1994 read with Service Tax Rules, 1994

- According to Rule 7 of the Service Tax Rules, 1994, return under Service Tax is required to be filed by every assessee on half yearly basis in Form ST-3 or Form ST-3A, as the case may be, along with a copy of the Form TR-6/GAR-7, in triplicate for the months covered in the half-yearly return.
- Every assessee shall submit the half yearly return by the 25th of the month following the particular half-year. In case of input service distributor service tax returns are due to be filed by 31st October and 30th April respectively.
- Every assessee is required to file return electronically with effect from 1st October, 2011, Vide Notification No. 43/2011 dt. 25th August 2011, every Assessee shall submit a half yearly return electronically. Assesseees can file service tax return online at registering at <https://www.aces.gov.in>.
- Even a NIL return has to be filed if the assessee has not rendered any taxable service during a particular half year.
- Return of service has to be filed within prescribed period. If not filed, penalty is leviable under section 77(2). Alternatively according 7C, a late fee has to be paid along with the filing of the return of service tax if the same is filed late.
- Minimum late fee is Rs. 500 and with a maximum of Rs. 20,000. This late fee, however, can be waived partly or fully in case of nil returns supported by a sufficient cause.

Answer to Question No. 5(d)

As per Section 68, every person providing taxable services i.e. provider of output service is liable to pay service tax. But in special cases service receiver is liable to pay service tax. This is known as **reverse charge**. Reverse charge mechanism is resorted to, by Govt. for two main purposes viz;

- (i) convenience in tax collection; and
- (ii) prevention of leakages in tax collection/ tax evasion.

Under reverse charge mechanism, service receiver is directly liable to pay service tax. Thus, it partakes of the features of direct tax. Hence, the service receiver has to register himself and comply with the procedures of maintaining records, filing or returns

etc. But at the same time, he cannot assume the status of a service provider simply because he is discharging the liability of service tax:

- (i) he cannot include the value of these services for the purpose of claiming exemption limit of 10 lakh rupees as a small service provider and he has to pay service tax separately on these services;
- (ii) he cannot utilise cenvat credit to discharge the liability under reverse charge.

Note : For the above two purposes, his status remains to be that of a service receiver only.

Reverse Charge Mechanism Under the New Tax Regime : Under the earlier selected system of taxation, only a few categories of persons were identified for reverse charge scheme. With the expansion of gamut of services,

- (i) the list has been expanded and
- (ii) certain services have been made payable on shared basis. for example, if works contract service is provided by a non body corporate to a body corporate, 50% service tax is payable each by service provider and service receiver.

List of services covered under Reverse charge mechanism along with the share of service provider and share of service recipient on which they are required to pay service tax:

<i>Sl.No.</i>	<i>Description of a Service</i>	<i>Percentage of service tax payable by the person providing service</i>	<i>Percentage of service tax payable by the person receiving the service</i>
1	Services provided or agreed to be provided by an insurance agent to any person carrying on insurance business	Nil	100%
2	Services provided or agreed to be provided by a goods transport agency in respect of transportation of goods by road	Nil	100%
3	Services provided or agreed to be provided by way of sponsorship	Nil	100%
4	Services provided or agreed to be provided by an arbitral tribunal	Nil	100%
5	Services provided or agreed to be provided by individual advocate	Nil	100%
6	Services provided or agreed to be provided by way of support service by Government or local authority	Nil	100%

<i>Sl.No.</i>	<i>Description of a Service</i>	<i>Percentage of service tax payable by the person providing service</i>	<i>Percentage of service tax payable by the person receiving the service</i>
7	(a) In respect of services provided or agreed to be provided by way of renting or hiring any motor vehicle designed to carry passenger on abated value.	Nil	100%
	(b) In respect of services provided or agreed to be provided by way of renting or hiring any motor vehicle designed to carry passenger on non abated value.	60%	40 %
8.	Services provided or agreed to be provided by way of supply of manpower for any purpose	25%	75 %
9.	Services provided or agreed to be provided by way of works contract	50%	50%
10.	Any taxable services provided or agreed to be provided by any person who is located in a non-taxable territory and received by any person located in the taxable territory (Import of services)	Nil	100%

Question No. 6

(a) *What is Transaction Value ? What are the conditions that are to be fulfilled for accepting transaction value as the assessable value ? How will the value of imported goods to be determined when the transaction value is rejected ?*

(5 marks)

(b) *XYZ Ltd., imported a machine at a FOB value of ₹17,00,000. This sum includes ₹2,00,000 attributable to post-importation activities to be carried out by the seller. XYZ Ltd., had supplied raw material worth ₹5,00,000 to the seller for the manufacture of the said machine. The goods were imported by vessel and actual cost of transport is ₹80,000. The importer has also paid demurrage charges ₹5,000 and lighterage and barge charges ₹15,000, in addition to said ₹80,000. The importer also paid ₹25,000 for transportation of goods from port of entry to Inland Container Depot. The actual cost of insurance is ₹50,000. Compute assessable value.*

(5 marks)

Answer to Question No. 6(a)

As per rule 2(g) : "**transaction value**" means the value referred to in sub-section (1) of section 14 of the Customs Act, 1962.

As per section 14 of the Customs Act, 1962, the value of imported and export goods shall be the Transaction Value that is the price actually paid or payable;

- when sold for export to India for delivery at the time and place of importation in case of imports; and
- when sold for export from India the price for delivery at the time and place of exportation, in case of exports, where the buyer and seller are not related and price is the sole consideration for the sale subject to such other conditions as “may be specified in the rules” made in this behalf.

The transaction value shall include in addition to the price paid or payable on imported goods any amount paid or payable for costs and services including:

- commissions and brokerage,
- engineering,
- design work,
- royalties and license fees,
- costs of transportation to the place of importation,
- insurance,
- loading, unloading and handling charges.

The transaction value of the imported goods, as determined under rule 3(1) shall be acceptable as the value of such goods only if the following conditions are fulfilled [Rule 3(2)]-

There are no restrictions as to the disposition or use of the goods by the buyer other than restrictions which –

- (i) are imposed or required by law or by the public authorities in India; or
- (ii) limit the geographical area in which the goods may be resold; or
- (iii) do not substantially affect the value of the goods;

According to Rule 12, where the proper officer has reasons to doubt the truth or accuracy of the value declared and declared value does not represent the transaction value then the declared value can be rejected, and the value shall be determined by proceeding sequentially in accordance with rules 4 to 9.

Answer to Question No. 6(b)

Computation of Assessable Value

	₹
FOB value	17,00,000
<i>Add:</i> Adjustment under Rule 10(1) for raw material supplied by XYZ Ltd.	5,00,000
<i>Less:</i> Amount attributable to post- importation activities	<u>(2,00,000)</u>
Transaction Value	20,00,000
<i>Add:</i> Actual cost of transportation (80,000+5,000+15,000)	1,00,000
<i>Add:</i> Actual cost of Insurance	<u>50,000</u>
CIF value	21,50,000
<i>Add:</i> Landing charges @ 1%	<u>21,500</u>
Assessable value	<u>21,71,500</u>

Note:

1. Post- importation charges cannot be a part of the value of imported goods as they are incurred in India after import. Hence not considered.
2. Demurrage charges were assumed to be ship demurrage charges payable to shipping company and hence added to the freight charges as per Rule 10(2).
3. Lighterage and barging charges form part of cost of transport as per Explanation to Rule 10(2) and are, therefore, part of freight charges, includible in assessable value.
4. Cost of transportation from port of entry to Inland Container Depot does not form part of cost of transport as per Rule 10(2).

Question No. 7

- (a) Explain the obligation cast on person-in-charge on arrival of vessels or aircrafts in India under Section 29 of the Customs Act, 1962. (5 marks)
- (b) Certain goods were imported in February 2010. "Into bond" bill of entry was presented on 14th February 2010 and goods were cleared from the port for warehousing. Assessable value was \$ 5,00,000. Customs officer issued the order under section 60 permitting the deposit of the goods in warehouse on 21st February 2010 for 3 months. Goods were not cleared even after warehousing period was over, i.e., 21st May 2010 and extension was also not obtained. Customs officer issued notice under Section 72 demanding duty and other charges. Goods were cleared by importer on 28th June 2010. What is the amount of duty payable while removing the goods?

Compute on the basis of following information (assume that no additional duty of customs or special additional duty of customs is payable) :

	14.2.2010	21.5.2010	28.6.2010
Rate of Exchange per US \$	₹48.20	₹48.40	₹38
Basic customs duty	35%	30%	25%

(5 marks)

Answer to Question No. 7(a)

Obligations of person-in-charge on arrival of vessels or aircrafts in India (Section 29 of the Customs Act, 1962)

The person-in-charge of a vessel or an aircraft entering India from any place outside India shall not cause or permit the vessel or aircraft to call or land at any place other than a customs port or a customs airport -

- (a) for the first time after arrival in India; or
- (b) at any time while it is carrying passengers or cargo brought in that vessel or aircraft as the case may be, unless permitted by the Board.

However, any vessel or aircraft which is compelled by accident, stress of weather or

other unavoidable cause to call or land at a place other than a customs port or customs airport but the person-in-charge of any such vessel or aircraft –

- (a) shall immediately report the arrival of the vessel or the landing of the aircraft to the nearest customs officer or the officer-in-charge of a police station and shall on demand produce to him the log book belonging to the vessel or the aircraft;
- (b) shall not without the consent of any such officer permit any goods carried in the vessel or the aircraft to be unloaded from, or any of the crew or passengers to depart from the vicinity of, the vessel or the aircraft; and
- (c) shall comply with any directions given by any such officer with respect to any such goods, and no passenger or member of the crew shall, without the consent of any such officer, leave the immediate vicinity of the vessel or the aircraft.

The departure of any crew or passengers shall not be prohibited from the vicinity of, or the removal of goods from, the vessel or aircraft where the departure or removal is necessary for reasons of health, safety or the preservation of life or property.

Answer to Question No. 7(b)

Computation of customs duty payable by the importer (in ₹)

Assessable value US \$ 5,00,000 x ₹48.20 (note 1)	2,41,00,000
Basic customs duty @ 30% (note 2)	72,30,000
Add : education cess @ 2%:	1,44,600
Add : SHEC @ 1%	72,300
Customs duty - Total	74,46,900

Notes:

1. As per section 14, the assessable value is to be computed as per the exchange rate in force on the date on which into-bond bill of entry for warehousing is filed u/s 46 of the Act. Therefore, the rate of exchange in force as on 14th February i.e. ₹48.20 per US \$ has been taken.
2. As per decision of the Supreme Court in *Kesoram Rayon v. CC [1996] 86 ELT 464 (SC)* when the warehousing period expires without extension thereof, the date on which warehousing period comes to an end will be the date of deemed removal and the rate of duty prevalent on that date shall be applicable for determining customs duty. Therefore, the date of expiry of warehousing period i.e. 21st May will be the date of deemed removal and rate of duty prevalent on that date i.e. 30% (plus 3% EC & SHEC) shall be the rate of customs duty chargeable on such goods.

Provisions of Section 15(1)(b) are applicable only to those cases where the goods are removed from warehouse by due date. For default cases under Section 72, actual date of submission of Bill of Entry is not relevant. Official due date of removal is relevant.

Question No. 8

(a) Explain whether assembly amounts to manufacture? (5 marks)

(b) Compute assessable value for Central Excise purposes of Product A whose details are given below. Out of 1,000 units manufactured, 800 units of product A have been cleared to a sister unit for further production of excisable goods on assessee's behalf; the balance 200 units are lying in stock—

Direct Material consumed (inclusive of excise duty @ 8.24%)	2,16,480
Direct Labour & Director Expenses	1,80,000
Works Overheads (inclusive of Quality Control costs of ₹25,000 and Research & Development Costs of ₹75,000)	1,60,000
Administrative Overheads (60% related to production)	1,50,000
Packing Cost of primary as well as secondary packing	40,000
Net value of non-excisable inputs received free of cost from sister unit for manufacture of A	80,000
Value of moulds, dies, etc. received free of cost from sister unit for manufacture of A (25% of the value relates to current production)	2,00,000
Interest and financial charges	86,000
Abnormal losses (not included above)	14,000
VRS compensation to labour/employees (not included above)	1,00,000
Selling and Distribution Costs (including advertisement)	36,000
Reliable value of Scrap/Wastage	10,000
	(5 marks)

Answer to Question No. 8(a)**Assembling**

- Whether assembling amounts to manufacture: Assembling activity may or may not amount to manufacture. It depends on the nature of assembling activity and the resultant product.
- If a new or different article emerges as a result of assembling activity, then it is manufacture. Eg. Assembling of various parts into a computer.
- If different parts are put together but no new article emerges and the use of parts is same even after assembly, then there is no manufacture. Eg. Assembly of tools to make it a tool kit. In this case there is only a change in name but use of tools is same.
- Certain assembling activity may be a deemed manufacture as per Tariff Act.

Answer to Question No. 8(b)

Transfer of goods to a sister unit is a related person transaction governed by Rule 9 of Valuation Rules, 2000. Since the goods are being used for self consumption and not for sale, 110% of cost of production as given in Rule 8 shall be taken as value for assessment.

Calculation of cost of production in terms of Rule 8 of Valuation Rules, 2000

<i>Elements of cost as per CAS-4</i>	<i>₹</i>
Direct material consumed (net of excise duty, assuming that CENVAT credit of inputs has been availed) [2,16,480 x 100/108.24]	2,00,000
Direct Labour & Direct expenses	1,80,000
Works Overheads (Depreciation; Quality Control costs and Research & Development costs also form part of 'cost')	1,60,000
Administrative overheads (only those relating to production form part of 'cost')	90,000
Packing cost of primary as well as secondary packing (it forms part of cost)	40,000
Inputs received free of cost from sister unit(they also form part of 'cost' for the purpose of Rule 8 as per CAS-4; as their value is 'cost' of product A)	80,000
Amortised cost of moulds, dies, etc. received free of cost from sister unit will form part of 'cost' (since 25% related to current year production, hence, 25% of the total value of moulds and dies, etc. is includible in the 'cost')	50,000
Interest and financial charges (do not form part of cost)	nil
Abnormal losses (do not form part of cost)	nil
VRS compensation to labour/ employees(they shall also not form part of 'cost', as it is non-recurring cost arising due to unusual or unexpected occurrence of events)	nil
Selling and distribution costs (do not form part of cost)	nil
Realisable value of scrap/wastage (deductible from cost)	(10,000)
Cost of production of 1,000 units (as per CAS-4)	<u>7,90,000</u>
Cost per unit	790
Add : 10% notional profit margin as per Rule 8	79
Assessable value under Rule 8 (110% of cost of production per unit)	869
Assessable value of 800 units cleared to sister unit	6,95,200

Note : Since the value of secondary packing was not segregable, entire cost of packing was treated as part of Prime Cost.

TEST PAPER 2/2013

Time allowed : 3 hours

Max. marks : 100

NOTE : All Questions are compulsory. All references to Sections mentioned in Part-A of the Question Paper relate to the Income-Tax Act, 1961 and the relevant Assessment year 2014-15, unless stated otherwise.

Part A

DIRECT TAXATION – LAW AND PRACTICE

Question No. 1

Answer the following Questions :

- (a) What do you mean by Arm's Length Price? What are the methods of calculating it ?
- (b) A Foreign Company has entered into an agreement with an Indian Company on 1.6.2003 under which industrial equipment belonging to the firm has been leased to the latter on an annual lump sum payment of \$ 50,000. How will the lease rent be taxed in the hands of the foreign company in the Assessment Year 2014-15?
- (c) Give the difference between 'Tax Planning' and 'Tax Management'.

(5 marks each)

Answer to Question No. 1(a)

Arm's Length Price

Arm's Length price means fair price of goods transferred or services rendered. It is the price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.

In other word, it is the price that would have prevailed if the enterprise were at arm's length from each other i.e. where the enterprises involved were not controlled, influenced by or associated with another enterprise. It is the price that would have existed between enterprises, not associated or related with each other.

Methods of calculating arm's length price

As per section 92C(1), the arm's length price in relation to an international transaction shall be determined by any of the following methods:

(A) Comparable Uncontrolled Price Method (CUP)

Comparable Uncontrolled Price ("CUP") method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.

An uncontrolled price is the price agreed between the unrelated parties for the transfer of goods or services. If this uncontrolled price is comparable with the price charged

for transfer of goods or services between the Associated Enterprises, then that price is Comparable Uncontrolled Price (CUP). This is the most direct method for determination of Arm' Length price.

(B) *Resale Price Method (RPM)*

Rule 10B (1) (b) of Income Tax Rules, 1962 prescribes Resale Price method by which,

1. The price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise is identified;
2. Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;
3. The price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
4. The price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;
5. The adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

(C) *Cost Plus Method (CPM)*

Rule 10B (1) (c) of Income tax Rules, 1962 prescribes Cost Plus Method, by which,

- (i) The direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;
- (ii) The amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;
- (iii) The normal gross profit mark-up so determined is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;
- (iv) The costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii);

- (v) The sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise.

Under the Cost Plus Method, an arm's-length price equals the controlled party's cost of producing the tangible property plus an appropriate gross profit mark-up, defined as the ratio of gross profit to cost of goods sold (excluding operating expenses) for a comparable uncontrolled transaction.

(D) *Profit Split Method (PSM)*

Rule 10B (1) (d) of Income tax Rules, 1962 prescribes Profit Split Method, which may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which:

- (i) The combined net profit of the associated enterprises arising from the international transaction, in which they are engaged, is determined;
- (ii) The relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;
- (iii) The combined net profit is then split amongst the enterprises in proportion to their relative contributions, as computed above;
- (iv) The profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction.

(E) *Transactional Net Margin Method (TNMM)*

Rule 10B (1) (e) of Income Tax Rules, 1962 prescribes, Transactional net margin method, by which,

- (i) The net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
- (ii) The net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- (iii) The net profit margin referred to in (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;
- (iv) The net profit margin realized by the enterprise and referred to in (i) is established to be the same as the net profit margin referred to in (iii);

- (v) The net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

Answer to Question No. 1(b)

Under section 9(1)(vi) of the Income Tax Act, 1961, the expression "royalty" would include any lump sum consideration for the use of or the right to use any industrial, commercial or scientific equipment but not including the amount referred to in section 44BB. Under section 115A, any income by way of royalty or fees for technical services (FTS) other than income referred to in section 44DA, received from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or the Indian concern (the agreement is approved by the Central Government or where it relates to the matter included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy) will be taxable @ 25%. This will be subject to the provisions of the Double Taxation Avoidance Agreement between India and the country in which the foreign company is assessed.

Answer to Question No. 1(c)

Difference between 'Tax Planning' and 'Tax Management'

Tax planning can be defined as an arrangement of one's financial and business affairs by taking legitimately in full benefit of all deductions, exemptions, allowances and rebates so that tax liability reduces to minimum. Tax planning should not be done with intent to defraud the revenue and colourable devices cannot be part of tax planning. It is fully within the framework of law and it makes use of the beneficial provisions in law.

Tax Management involves the compliance of law regularly and timely as well as the arrangement of the affairs of the business in such manner that it reduces the tax liability. Functions under tax management includes filing of return, payment of tax on time, appear before the Appellate authority etc. Tax management emphasizes on compliance of legal formalities for minimization of taxes while tax planning emphasis on minimization of tax burden.

Question No. 2

Rohit files the return of income disclosing an income of Rs.4,50,000. The full tax payable on the declared income is covered by tax deducted at source, advance tax and tax on self assessment. The Assessing Officer, through oversight, does not pass any order thereon and the assessment becomes barred by limitation. The assessee claims that since no assessment has been made, on him, the entire tax paid by him is refundable. Discuss the correctness or otherwise of the claim.

(10 marks)

Answer to Question No. 2

This problem is based on a case decided by the Gujarat High Court in *ITO v. Saurashtra Cement & Chemical Industries Ltd. (1992) 194 ITR 659* in which the court held that liability to pay income tax chargeable under section 4(1) of the Act does not depend upon the assessment being made by the Income tax officer but depends on the enactment by any Central Act prescribing rate or rates for any assessment year. Thus, as soon as the rates are prescribed by the appropriate legislation, the liability to pay tax

arises on the total income which is to be computed by the assessee in accordance with the provisions of the Act, if it exceeded the maximum amount not chargeable to tax.

On filing the returns under section 139, the provisions of self assessment contained in section 140A come into operation and it becomes obligatory on the part of the assessee to discharge his liability which has arisen to pay the tax together with the interest that may be payable for late furnishing of returns. The tax payable on the basis of the returns filed by the assessee is treated as "assessed tax". It is not at all made dependent on any regular assessment being made though, in the event of regular assessment, the amount paid under sub-section (1) of section 140A is deemed to have been paid towards the regular assessment. Therefore by no stretch of imagination, can the tax paid and collected under section 140A be described as a mere ad hoc or interim payment which can be said to fail in the absence of a regular assessment. The procedure of assessment by the Income Tax Officer is essentially to check the computation of total income done by the assessee and to find out whether the computation made is correct or not. Where the return has been accepted by the Income tax Officer who may not assess the total income, it cannot be said that the liability to pay the tax under the Act on the basis of the admitted total income as reflected from the return would vanish.

In view of the aforesaid case, the claim of the assessee is not valid.

Question No. 3

Explain the powers of the authority for advance rulings in regard to rejection of an application and modification of an order. (5 marks)

Answer to Question No. 3

The powers of the authority for advance rulings in regard to *rejection of an application*:

Section 254R(2) of the Income-Tax Act provides that the Authority may, after examining the application and the records called for, either 'allow' or 'reject' the application. The word 'allow' has been used synonymously with 'admit'. In other words, after examining the records, the Authority either admits or rejects the application. In case Authority has admitted the application, it is empowered to collect or receive additional material and it will examine all the material thus available to it at the time of hearing and pronouncing a ruling on the application. In case the application has been rejected, an opportunity of being heard must be given to the assessee.

Authority for Advance Ruling (AAR) not to allow an application for Advance Ruling where the question raised in the application:

- (a) is already pending as on the date of application before any income tax authority or Appellate tribunal (except in case of public sector company);
- (b) is already pending as on the date of application before any court; or
- (c) involves determination of Fair Market Value of any property; or
- (d) relates to a transaction or issue, which is designed prima facie for avoidance of income tax (except in case of public sector company)

Issue to be pending in assessee's own case : Application will be rejected by AAR when the question raised in the application is pending in his own case before any income

tax authority. An issue raised by any other person similar to the issue raised by the applicant in his application cannot disqualify the applicant's application.

Allowance/Rejection Order to CIT and Applicant : The authority shall pass the ruling in writing within six months of the receipt of application and the copy of the order thereof, shall be sent to the commissioner and assessee.

Powers of the authority for advance rulings in regard to modification of an order:

Where the authority finds suo motu or on a representation made to it by the applicant or the Commissioner or otherwise, *but before the ruling pronounced by the Authority has been given effect to by the Assessing Officer*, that there is a change in law or facts on the basis of which the ruling was pronounced, it may order modification of such ruling in such respects as it considers appropriate, after allowing the applicant and the Commissioner a reasonable opportunity of being heard.

Part B

INDIRECT TAXATION — LAW AND PRACTICE

Question No. 4

- (a) *Slow & Fast Co., a manufacturer of footwear, used to purchase various raw materials like fabrics, rubber, chemicals, solvent, etc. which were mixed together. The thin layer of such mixture was sandwiched between two sheets of textile fabric through a calendaring machine. The resultant product 'Double Textured Rubberized Fabric' (DTRF) was cut and stitched as per requirement and was used as show-uppers. At times, DTRF was sent to job-workers for stitching purposes. After completing the entire process, the vulcanization of footwear was done and then, it would be available for sale as footwear.*

Some of the DTRF was used in the manufacture of canvas shoes, which were exempt from duty. The department contended that the intermediate product DTRF was a distinct product with specific properties and was used in considerable quantities for making rain-coats, handbags, etc., in the outside market. Since the DTRF was excisable good and it was used in the manufacture of exempted final product being canvas shoes, therefore, DTRF was liable to excise duty. However, the department did not have sufficient evidence to prove its marketability.

Examine whether contention of the department is correct by referring to case law, if any, in the light of explanation added to Section 2(d) of the Central Excise Act, 1944 w.e.f. 10th May, 2013 ? (5 marks)

- (b) *Facility Ltd., made an unauthorized import of goods, which were later on confiscated. Goods were not redeemed by paying fine under section 125 of the Customs Act, 1962. The assessee contended that once the imported goods were confiscated and the option to release them was not exercised, no duty was payable it placed reliance on section 23 of the said Act which provides that if the owner of imported goods relinquishes his title to the goods, he shall not be liable to pay the duty thereon. Discuss briefly whether the assessee is bound to pay customs duty with reference to decided case law, if any.* (5 marks)

- (c) Explain the interpretation of phrase 'a mistake apparent from record' as mentioned in section 35C(2) of the Central Excise Act, 1944. (5 marks)

Answer to Question No. 4(a)

The facts of the given case are similar to *Bata India Ltd. v. CCE (2010) 252 ELT 492(SC)*. The Apex Court observed that mere theoretical possibility of the product being sold is not sufficient but there should be commercial capability of being sold.

The Supreme Court further ruled that the burden to show that the product is capable of being bought or sold is entirely on the revenue, which has failed to prove marketability. Therefore, 'Double Textured Rubberized Fabric (DTRF)' was not liable to excise duty.

The above judgement is in conformity with the explanation to Section 2(d) of Central Excise Act, 1944 inserted by the Finance Act, 2008 according to which capability of being bought and sold for a consideration constitutes deemed marketability.

Hence, the contention of the department is not correct and Solid Shoes Co. is not required to pay duty on DTRF.

Answer to Question No. 4(b)

Yes, the assessee is bound to pay customs duty, even if the goods are confiscated and not redeemed by paying fine.

The facts of the case are similar to *Poona Health Services v. C.Cus. 2009 (242) E.L.T. 335 (Bom.)*. The High Court elucidated the distinction between section 23 and section 125. Under section 23, the person who imports the goods, surrenders his title in the goods. By surrendering title in the goods, the person importing the goods or the owner of the goods ceases to have a right to claim the goods. On the other hand, the order of confiscation is passed in respect of the person who has claimed to import or export the goods. It implies that he claims title or right in the property. The fine under section 125 is payable by the person who seeks redemption of the goods. If the goods are not redeemed, then they vest in the State. The person however, who had imported the goods, does not cease to have liability for payment of duty because he continues to be the person who had imported the goods and claims title of the goods. The two sections therefore, operate in two different situations and are mutually exclusive. Therefore, section 23 cannot be considered for the purpose of interpreting section 111.

Section 111 confers the power to confiscate and applies only when the goods are improperly imported and or the other provisions are satisfied. The fine payable to get possession of the goods under section 125 is distinct and different from the duty of goods which are to be imported or exported.

Hence, in case the imported goods are confiscated, and goods are not redeemed by paying fine, the importer is bound to pay the customs duty.

Note : Section 111 provides for confiscation of improperly imported goods.

Answer to Question No. 4(c)

Tribunal has no powers to review its orders. However, it may pass order for rectifying "a mistake apparent from the records", within six months of passing an order under section 35C(2) of Central Excise Act, 1944.

In *Asst Commr, IT, Rajkot v. Saurashtra Kutch Stock Exchange Ltd. 2008 (230) ELT 385 (SC)* Supreme Court, while interpreting the phrase “any mistake apparent from record” stated that a patent, manifest and self-evident error which does not require elaborate discussion of evidence or argument to establish it, can be said to be an error apparent on the face of the record and can be corrected while exercising certiorari jurisdiction. An error apparent on the face of the record means an error which strikes on mere looking and does not need long drawn-out process of reasoning on points where there may conceivably be two opinions. Such error should not require any extraneous matter to show its incorrectness.

The Apex Court further clarified that an error cannot be said to be apparent on the face of the record if one has to travel beyond the records to see whether the judgment is correct or not. An error which has to be established by a long drawn process of reasoning on points where there may conceivably be two opinions can hardly be said to be an error apparent on the face of the record.

Re-examination of evidence by CESTAT on a debatable issue amounts to review. It is not a rectification of mistake apparent on record. [*RDC Concrete (I) P. Ltd., 2011 (S.C.)*]

Question No. 5

- (a) *What is VAT invoice ? What are the mandatory provisions to be complied with while issuing a VAT invoice by a registered dealer ?* (5 marks)
- (b) *What is the extent and scope of Service Tax Law ?* (5 marks)
- (c) *What are the provisions of Section 72 relating to Best Judgement Assessment under the Service Tax Law ?* (5 marks)
- (d) *Compute the amount of service tax in the following cases, assuming the applicable rate of service tax to be 12.36%*
 - (i) *A goods carriage carrying 5 consignments (all belonging to different persons) at fare of ₹300 each.*
 - (ii) *A goods carriage carrying 10 consignments (all belonging to different persons) at fare of ₹500 each.*
 - (iii) *A goods carriage carrying 5 consignments (booked by five different persons but addressed to the same consignee) at fare of ₹300 each.*
 - (iv) *A goods carriage carrying 5 consignments (booked by five different persons but addressed to the same consignee) at fare of ₹400 each. (10 marks)*

Answer to Question No. 5(a)

VAT invoice

The entire design of VAT with input tax credit is crucially based on documentation of tax invoice, cash memo or bill. Every registered dealer, other than a composition dealer, shall issue to the purchaser serially numbered tax invoice with the prescribed particulars. This tax invoice will be signed and dated by the dealer or his regular employee, showing the required particulars. Tax invoice must contain TIN of the buyer as well as seller. The dealer shall keep a counterfoil or duplicate of such tax invoice duly signed and dated. Failure to comply with the above will attract penalty. The purchaser will get input tax credit on the basis of the said tax invoice.

However, Tax invoice cannot be issued by a dealer:

- (i) under composition scheme.
- (ii) in case of interstate sales.
- (iii) Covered under threshold limit (Small Dealer)

Contents of VAT invoice

- (a) Name, address and VAT registration number of the seller.
- (b) Date of issue of the invoice
- (c) Mechanically printed serial No. Of the invoice
- (d) Quantity and description of goods sold
- (e) Unit price and the amount charged (excluding VAT)
- (f) Amount of VAT charged
- (g) Name, address and VAT registration No. of the purchaser
- (h) GR No. and the name of the transporter (if any)
- (i) Signature of authorised person

Answer to Question No. 5(b)

Extent and scope of Service Tax law

Service tax is an indirect tax levied on certain services provided by certain categories of persons including companies, association, firms, body of individuals etc. Service sector contributes about 64% to the GDP. Service sector is today occupying the centre stage of the Indian economy. The Parliament derives its authority from Entry 97 of List I of the Seventh Schedule to the Constitution for levying tax on services provided.

Service Tax is levied vide Finance Act, 1994 (the Act). The Finance Act, 1994 applies all over India except the state of Jammu & Kashmir.

With effect from 1st July 2012, a new charging Section 66B has been inserted by the Finance Act 2012. Section 66B provides that there shall be levied a tax (hereinafter referred to as the service tax) at the rate of twelve per cent on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed.

The taxation of services is completely overhauled from positive approach or selective services to negative list approach. Now, no classification of services is required for the purpose of taxability.

Service has been defined under Section 65B(44) of The Act. Additionally, a list of 9 activities has been specified as declared services under section 66E of the Act. This obviated the need for definition of individual services.

Moreover, only services rendered in taxable territory are taxable for which Place of

Provision of Service Rules, 2012 ('POPSR') are prescribed and with this Import of Services and Export of Services Rules has been rescinded. New section 66F was introduced for interpretation of services and treatment of bundled services.

Answer to Question No. 5(c)

Best judgement Assessment

Section 72 of Finance Act, 1994 (introduced by Finance Act, 2008 w.e.f. 10-5-2008) empowers the Central Excise Officer to make best judgment assessment.

Central excise officer can make best judgment assessment in the following two cases:-

If any person, liable to pay service tax,—

- (a) fails to furnish the return under section 70 or
- (b) having made a return, fails to assess the tax in accordance with the provisions of this Chapter or rules made there under.

Procedure to be followed :-

1. Central Excise Officer would require the assessee to produce such accounts, documents or other evidence as he may deem necessary.
2. After taking into account all the relevant material which is available or which he has gathered, he shall issue notice to the assessee quantifying the value of taxable service to the best of his judgment, its basis for determination and service tax payable thereon.
3. The assessee shall be given an opportunity of being heard.
4. The Central Excise Officer shall pass an order in writing determining the sum payable/ refundable to the assessee on the basis of such assessment.

Answer to Question No. 5(d)

- (i) Since the gross amount charged for all consignments does not exceed Rs. 1500, **the service is fully exempt.**
- (ii) While the gross amount charged exceeds ₹1500, it appears that the consignments are addressed to different consignee. Since the gross amount charged in respect of 'individual consignment' does not exceed ₹750, **the same shall be exempt from service tax.**
- (iii) Even if all the consignments are addressed to a single consignee, since the gross amount charged for all consignment does not exceed ₹1500, therefore, **the same shall be exempt from service tax.**
- (iv) Since all the consignments are addressed to same addressee, the same is an individual consignment. Since the gross amount charged is ₹2,000, there is no scope for any exemption available to small consignment. However, the abatement @ 75% shall be available.

Accordingly, the value of taxable service = $5 \times 400 \times 25\% = ₹500$;

And service tax thereon = $₹500 \times 12.36\% = ₹61.8/-$

Question No. 6

- (a) Enumerate the various dutiable factors that are to be added to the transaction value under Rule 10(1) of the Customs Import Valuation Rules, 2007. (5 marks)
- (b) From the following particulars, calculate assessable value and total customs duty payable:
- (i) Date of presentation of bill of entry: 20.6.2012 (Rate of BCD 25%; Exchange Rate : ₹43.60 and rate notified by CBEC ₹43.80.
 - (ii) Date of arrival of goods in India: 30.6.2012 (Rate of BCD 20%; Exchange Rate: ₹43.90 and rate notified by CBEC ₹44.00.
 - (iii) Rate of Additional Customs Duty: 14%.
 - (iv) CIF value 2,000 US Dollars; Air Freight 500 US Dollars, Insurance Cost 100 US Dollars (Landing Charges not ascertainable).
 - (v) Education Cess applicable 2% and SHEC is 1%. Assume there is no special CVD. (5 marks)

Answer to Question No. 6(a)**Adjustment specified in Rule 10(1) of the Customs Import Valuation Rules, 2007**

In determining the transaction value, there shall be added to the price actually paid or payable for the imported goods, —

- (a) The following to the extent they are incurred by the buyer but are not included in the price actually paid or payable for the imported goods, namely:-
- (i) commission and brokerage, except buying commissions;

Buying commission refers to fees paid by an importer to his agent for service of representing him abroad in purchase of goods being valued. Commission paid to canalising agent in India is not buying commission – *Hyderabad Industries Ltd. v. UOI (2009) 115 ELT 593 (SC)*.
 - (ii) the cost of containers imported along with the goods; however, if the importer undertakes the responsibility to return them within 6 months under a bond, the cost of containers will not be included.
 - (iii) the cost of packing whether for labour or materials.
- (b) The value, apportioned as appropriate, of the following goods and services where supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale for export of imported goods, to the extent not included in the price actually paid or payable, namely:-
- (i) materials, components, parts and similar items incorporated in the imported goods;
 - (ii) tools, dies, moulds and similar items used in the production of the Imported goods;

- (iii) materials consumed in the production of the imported goods;
- (iv) engineering, development, art work, design work, and plans and sketches undertaken elsewhere than in India and necessary for the production of the imported goods;
- (c) Royalties and licence fees related to the imported goods that the buyer is required to pay, directly or indirectly, as a condition of the sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable. These include payments related to royalties, trademarks, copyrights etc.
- (d) The value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues, directly or indirectly, to the seller;
- (e) All other payments actually made or to be made as a condition of sale of the imported goods, by the buyer to the seller, or by the buyer to a third party to satisfy an obligation of the seller to the extent that such payments are not included in the price actually paid or payable.

Note : Inspection charges are not includible in value of the imported goods if the contract does not specify for certification by an independent agency [*Bombay Dyeing & Mfrg. (S.C.)*]

Answer to Question No. 6(b)

Computation of assessable value and the total customs duty payable –

<i>Computation of FOB value</i>	<i>US \$</i>	<i>US \$</i>
CIF value		2,000
<i>Less</i> : Air freight	500	
Insurance charges	100	600
FOB Value		1,400
 Computation of Assessable Value -		
FOB value as calculated above		1,400
<i>Add</i> : Air freight restricted to 20% of FOB value in case of imports of goods by air	280	
Insurance charged (actual)	100	380
CIF value (for customs purposes)		1,780
<i>Add</i> : Landing charges @ 1% of CIF value		17.8
Assessable value		1,797.8
Assessable value in Indian Rupees (1,797.8 x 43.8)		78,743.64

Computation of Customs Duties

<i>Description</i>	<i>Value-Cumduties (₹)</i>	<i>Duties (₹)</i>
Assessable value	78,743.64	
Basic customs duty (20% of ₹78,43.64) (a)	15,748.73	15,748.73
	94,492.37	
Additional duty of customs 14% of ₹94,492.37 (b)	13,228.93	13,228.93
	107,721.30	28,977.66
Education cess @ 2% of ₹28,977.66	579.56	579.56
SHE Cess @ 1% of ₹28,977.66	289.78	289.78
Total	108,590.64	29,847.00

Total customs duty payable is ₹29, 847 (Rounded off to the nearest rupee u/ s. 154A)

Note:

1. Rate of exchange notified by CBEC on the date of submission of Bill of Entry has been taken.[vide proviso to Section 14 (1)].
2. Rate of duty as per section 15 (1) (a) shall be of the latter of the two events; date of the arrival of aircraft or date of submission of the bill of entry. Hence, rate on 30th June has been taken.

Question No. 7

(a) Write a note on entry of goods on importation. (5 marks)

(b) A person makes an unauthorized import of 1000 pieces of ophthalmic rough blanks CIF priced at \$1 per piece by air from USA (Tariff Heading 70.1510). The consignment is liable to be confiscated. Import is adjudicated. AC gives to the party an option to pay fine in lieu of confiscation. It is proposed to impose fine equal to 50% of margin of profit. The market price is ₹100 per price of ophthalmic rough blank. The rates of duty are:

Basic customs duty	20%
Additional duty of customs under section 3(1)	NIL
Additional duty of customs under section 3(5)	NIL
Education cess and Secondary and Higher Education Cess	2% + 1%
Exchange Rate	\$1 = ₹45

Compute: (i) Amount of fine; (ii) Total payment to be made by party to clear the consignment.

What is the maximum amount of fine that can be imposed in this case ?

(5 marks)

Answer to Question No. 7(a)**Entry of Goods on Importation (Section 46)**

Under Section 46(1) of the Customs Act, an Importer of any goods, other than goods intended for transit or transshipment is required to file electronically a "Bill of Entry for home consumption" or "for warehousing".

Bill of Entry is required to be presented electronically; however, the commissioner of customs may, in cases where it is not feasible to make entry by presenting electronically allow an entry to be presented in any other manner.

If the Bill of Entry at the time of presentation is not reasonably complete in all material particulars, the proper officer may, pending the production of such information, permit him, previous to the entry thereof

- (a) to examine the goods in the presence of an officer of customs, or
- (b) to deposit the goods in a public warehouse appointed under section 57 without warehousing the same.

Bill of entry shall include all the goods mentioned in bill of lading or other receipt given by the carrier to the consigner. [Section 46(2)]

A bill of entry may be presented at any time after the delivery of the import manifest or import report. However, the Commissioner of Customs may in any special circumstances permit a bill of entry to be presented before the delivery of such report. [Section 46(3)]

Further, a bill of entry may be presented even before the delivery of such manifest if the vessel or the aircraft by which the goods have been shipped for importation into India is expected to arrive within thirty days from the date of such presentation.

The importer while presenting a bill of entry shall at the foot thereof make and subscribe to a declaration as to the truth of the contents of such bill of entry and shall, in support of such declaration, produce to the proper officer the invoice, if any, relating to the imported goods [Section 46(4)].

If the proper officer is satisfied that the interests of revenue are not prejudicially affected and that there was no fraudulent intention, he may permit substitution of a bill of entry for home consumption for a bill of entry for warehousing or vice versa. [Section 46(5)].

Answer to Question No. 7(b)

- (i) Amount of fine = 50% of profit.

Profit = market value - cost of imports where cost = assessable value + duties

- (ii) Total payment to be made by party to clear the consignment = fine + duty
- (iii) Maximum amount of fine that can be imposed = market value - duty

As the declared CIF value of goods is \$ 1 per piece and price for consignment of 1000 pieces will be \$ 1000 (CIF). Rate of exchange is \$ 1 = ₹ 45. Hence, CIF value is

₹45,000. Add landing charges @ 1%. Therefore, total Assessable Value in Rupees will be ₹45,450 [₹45,000 CIF plus 450 landing charges].

Basic duty @ 20% will be ₹9,090 (20% of ₹45,450). There is no CVD and SAD and education cess and SHEC is @ 3%. Therefore, total duty payable is ₹9,362.78 (9,090 + 272.7) [rounded off to ₹9,363]

Total cost to the importer is price plus duty, i.e. ₹45,450 plus ₹9,363. Thus cost to the importer is ₹54,813. The market value is ₹100 per piece, i.e. ₹1,00,000 for the consignment. Therefore, his margin of profit is ₹1,00,000 - ₹54,813 = ₹45,187.

(i) Fine equals to 50% of Margin of profit i.e. (50% of 45,187) = ₹22,593

(ii) Total amount payable will be:

Duty	₹9,363
Fine	₹22,593
Total	<u>₹31,956</u>

(iii) The maximum amount of fine that can be imposed is ₹90,637 (Market price ₹1,00,000 less amount of duty ₹9,363)

Question No. 8

(a) Write a note on dutiability of waste and scrap ? (5 marks)

(b) M/s Radha & Co. Ltd., a manufacturer of dutiable as well as exempted goods and also a provider of taxable as well as exempted services, furnishes the following information:

(Amount ₹ lakhs)

	Financial Year 2013-14	For month of April, 2013
(1) Value of exempted goods removed @ Rs.300 per unit	330	30
(2) Value of dutiable goods removed	605	55
(3) Value of exempted services provided	220	40
(4) Value of taxable services provided	275	25
(5) Credit of input services, commonly used for all goods and services, taken	—	₹1,60,680
(6) Credit of inputs, commonly used for all goods and services, taken (80,000 units x ₹25 per unit x 14.42%)	—	₹2,88,400

You are required to compute the provisional amount of proportionate credit reversible under Rule 6(3A) of the CENVAT Credit Rules, 2004 for the month.

Given that for every unit of exempted goods, three units of inputs are required. (5 marks)

Answer to Question No. 8(a)**Dutiability of Waste and Scrap**

Dutiability under excise is not dependent on the nature, name or description of goods. Levy arises when there is a manufacture of tariff goods which are marketable. Even scrap and waste can be dutiable if the above conditions are satisfied.

The Supreme Court in KHANDELWAL METAL & ENGG. WORKS held that scrap and waste can be dutiable if the conditions for levy are fulfilled.

Eg. Bagasse arising out of crushing of sugar cane is a waste product but it is dutiable because it arises out of process of manufacture and is in Tariff Act and also marketable.

Similarly, the scrap iron in the process of steel products becomes dutiable.

Answer to Question No. 8(b)

The amount of provisional credit reversible under Rule 6(3A) shall be as follows-

Particulars	₹
CENVAT credit attributable to inputs used in or in relation to manufacture of exempted goods = 10,000 x 3 = 30,000 units	
CENVAT credit attributable to exempted goods = 30,000 x 25 x 14.42%	1,08,150
CENVAT credit attributable to input used for provision of exempted services = value of exempted services during preceding financial year x (Cenvat credit taken on input- Cenvat credit attributable to inputs used in exempted goods) / (value of dutiable goods during preceding financial year + value of taxable and exempted services during preceding financial year)	
= 220 lakhs x $\frac{2,88,400 - 1,08,150}{(605 \text{ lakhs} + 220 \text{ lakhs} + 275 \text{ lakhs})}$	36,050
Cenvat credit attributable to input services used in or in relation to manufacture of exempted goods or provision of exempted services = value of exempted goods and services during the preceding financial year x Cenvat credit taken on input services/ total value of all goods and services(exempted or dutiable /taxable) during the preceding financial year	
= 550 lakhs x $\frac{1,60,680}{1430 \text{ lakhs}}$	61,800
Provisional Cenvat credit reversible under Rule 6(3A) for the month (₹1,08,150 + ₹36,050+ ₹61,800)	2,06,000

TEST PAPER 3/2013

Time allowed : 3 hours

Max. marks : 100

NOTE : All Questions are compulsory. All references to Sections mentioned in Part-A of the Question Paper relate to the Income-Tax Act, 1961 and the relevant Assessment year 2014-15, unless stated otherwise.

Part A

DIRECT TAXATION – LAW AND PRACTICE

Question No. 1

Answer the following Questions in brief :

(a) Taxation of LLP & Companies ?

(b) Maintenance of Documents under Transfer Pricing ? (5 marks each)

Answer to Question No. 1(a)

Taxation of LLP

As per Income Tax Act 1961, LLPs are treated like partnership firms for the purpose of computation of Income Tax. All the rules which are applicable to the partnership firm are also applicable to LLPs. As per Finance Act 2011, provisions relating to Alternate Minimum tax were brought in force.

LLP is taxable @ 30%

Surcharge- Nil

Education cess @ 2% & Secondary & Higher education cess (SHEC) @ 1%

Alternate Minimum Tax (AMT) (Section 115JC)

Where the regular income tax payable for a previous year by a person other than a company is less than the alternate minimum tax payable for such previous year then the adjusted total income shall be deemed to be the total income of that person for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% plus education cess @ 2% & SHEC @ 1%. Further the provisions of AMT under Chapter XII-BA shall not apply to an individual or HUF or an association of person or body of individuals (whether incorporated or not) or an artificial juridical person referred to in section 2(31)(vii) if the adjusted total income of such person does not exceed twenty lakh rupees.

Taxation of Companies

Domestic companies:

Tax rate on total income: 30%

Surcharge @ 5% is applicable if total income of the domestic company exceeds

₹ one crore but does not exceed Rs.ten crores. Surcharge @ 10% shall be levied if total income of domestic company exceeds Rs. ten crores.

Education cess @ 2% and SHEC @ 1% is levied on tax including surcharge.

Foreign companies:

Tax on total income: 40%

Surcharge @ 2% is applicable if total income of the domestic company exceeds Rs. one crore but does not exceed ₹ten crores. Surcharge @ 5% shall be levied if total income of domestic company exceeds ₹ten crores.

Education cess @ 2% and SHEC @ 1% is levied on tax including surcharge.

Minimum Alternate tax (MAT)

MAT provisions are provided in Section 115JB of the Act. As per Section 115JB, all companies having book profits under the Companies Act shall have to pay MAT at the rate of 18.5%. According to section 115JB, if the income tax payable by a company on its total income as computed under the Act in respect of any previous year relevant to the Assessment year commencing on or after 1st April, 2012 is less than 18.5% of such book profit then the tax payable for the relevant previous year shall be deemed to be 18.5% of such book profit. Surcharge and cess shall be levied separately on such amount.

Answer to Question No. 1(b)

The various types of information and documents to be maintained in respect of an international transaction, the associated enterprise and the transfer pricing method used are prescribed in Rule 10D of the Income Tax Rules, as under:

- (a) A description of the ownership structure of the enterprise and details of shares or other ownership interest held therein by other enterprises;
- (b) A profile of the multinational group of which the assessee enterprises i.e. taxpayer is a part and the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been made by the taxpayer and the ownership linkages among them;
- (c) A broad description of the business of the taxpayer and the industry in which it operates and the business of the associated enterprises;
- (d) The nature, terms and prices of international transaction entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
- (e) A description of the functions performed, risks assumed and assets employed or to be employed by the taxpayer and by the associated enterprise involved in the international transaction;
- (f) A record of the economic and market analysis, forecasts, budgets or any other financial estimates prepared by the taxpayer for its business as a whole or separately for each division or product which may have a bearing on the international transaction entered into by the taxpayer;

- (g) A record of uncontrolled transactions taken into account for analysing their comparability with the international transaction entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be relevant to the pricing of the international transactions;
- (h) A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;
- (i) A description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;
- (j) A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transaction;
- (k) The assumptions, policies and price negotiations if any which have critically affected the determination of the arm's length price;
- (l) Details of the adjustments, if any made to the transfer price to align it with arm's length price determined under these rules and consequent adjustment made to the total income for tax purposes;
- (m) Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Rule 10D also prescribes that the above information is to be supported by authentic documents which may include the following:

- (a) Official publications, reports, studies and data bases of the government of the country of residence of the associated enterprise or of any other country;
- (b) Reports of market research studies carried out and technical publications of institutions of national or international repute;
- (c) Publications relating to prices including stock exchange and commodity market quotations;
- (d) Published accounts and financial statements relating to the business of the associated enterprises;
- (e) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transaction similar to the international transactions;
- (f) Letters and other correspondence documenting terms negotiated between the taxpayer and associated enterprise;
- (g) Documents normally issued in connection with various transaction under the accounting practices followed.

Question No. 2

Answer the following Questions in brief:

- (a) Amount misappropriated by a director who is holding 21% shares of the company, can be treated as deemed dividend under Section 2(22)(e), if the company has accumulated profits. (5 marks)
- (b) As the tax manager of your company, your director approaches you with the information that the company has made a payment of ₹10,00,000 to a rival competitor to acquire premises at a different location to ward off competition in the area of its operations. You are required to comment upon their nature, viz., capital or revenue and discuss their allowability under Income tax Act, 1961. (5 marks)

Answer to Question No. 2(a)

The amount misappropriated by the director cannot be treated as deemed dividend in his hands since in such a case there is no lending or advancing by the company. It cannot be said that in such a case the company has paid anything and unless there is an actual payment by the company as a loan or advance to the assessee, it cannot be treated as dividend under section 2(22)(e). [*CIT v. G. Venkataraman* [1975] 101 ITR 673 (Mad.)]

Answer to Question No. 2(b)

Non-compete fees is neither considered as intangible asset for depreciation nor allowable as revenue expenditure. The above case is similar to the following case, wherein the taxpayer paid a non-compete fee for a restraint period of seven years and claimed the same as revenue expenditure. The AO considering it as capital expenditure of enduring value disallowed the same. The taxpayer's alternate claim for depreciation was rejected by the appellate authorities. The HC held that the amount was capital in nature as the arrangement was to endure for a substantial period. HC observed that the words 'similar business or commercial rights' have to necessarily result in an intangible right enforceable against the 'world at large' to qualify for depreciation. Since the non-compete rights acquired by the taxpayer was restrictive and purely personal in nature the same was not entitled to depreciation. [*Sharp Business Systems v. CIT* – [2012] 211 Taxman 576 (Del)(HC)]

Question No. 3

- (a) What is Deemed Dividend under Section 2(22)(e)? (5 marks)
- (b) Rakesh, a resident, is a musician; deriving income from concerts performed outside India of ₹50,000. Tax of ₹10,000 was deducted at source in the country where the concerts were given. India does not have any agreement with that country for avoidance of double taxation. Assuming that the Indian income of Ramesh is ₹2,00,000. What is the relief due to him under section 91 for the Assessment Year 2014-15 and assuming that Ramesh has deposited ₹16,000 in public fund account during the previous year 2013-14. (5 marks)

Answer to Question No. 3(a)**Deemed Dividend under Section 2(22)(e)**

Any payment by a company, not being a company in which the public are substantially

interested, of any sum by way of advance or loan to a shareholder beneficially holding not less than 10% of the voting power or to a concern in which such shareholder is a member or a partner and in which he has substantial interest at any time during the previous year or any payment by such a company on behalf or for the individual benefit of any such shareholder, to the extent to which company in either case possesses accumulated profit shall be treated as deemed dividend.

Answer to Question No. 3(b)

Relief under section 91 will be calculated as follows:

	₹
Indian income	2,00,000
Foreign income	50,000
Gross total income	<u>2,50,000</u>
Less : deduction u/s 80C (PPF contribution)	<u>(16,000)</u>
Total income	<u>2,34,000</u>
Tax on net income	3,400
Less : Rebate u/s 87A	<u>2,000</u>
Balance	1,400
Add : EC & SHEC @ 3%	<u>42</u>
	<u>1,442</u>
Average rate of tax in India [i.e. ₹1,442/₹2,34,000]	0.62%
Average rate of tax in foreign country [i.e. ₹10,000/₹50,000]	20%
Doubly taxed income [i.e. ₹50,000]	50,000
Rebate u/s 91 on ₹50,000 @ 0.62% (lower of average Indian and foreign tax rate)	310
Tax payable in India [₹1,442 - ₹ 310]	1,132
Tax rounded off	1,130

Part B

INDIRECT TAXATION — LAW AND PRACTICE

Question No. 4

(a) Compute the assessable value of excisable goods, for levy of duty of excise, given the following information –

	₹
Cum-Duty wholesale price including sales tax of ₹ 2,500	15,000
Normal secondary packing cost	1,000
Cost of special secondary packing	1,500
Cost of durable and returnable packing	1,500
Freight	1,250
Insurance on freight	200

Trade discount (normal practice)

1,500

Rate of Central Excise duty as per Central Excise

Tariff 10% Ad valorem

(5 marks)

(b) *What do you understand by 'Doctrine of Unjust Enrichment'*

(5 marks)

Answer to Question No. 4(a)

Computation of Assessable value

	₹	₹
Cum-duty price		15,000
<i>Less : deductions (see notes)</i>		
Sales tax	2,500	
Durable and returnable-packing	1,500	
Freight	1,250	
Insurance	200	
Trade-discount	<u>1,500</u>	6,950
		8,050
<i>Less : Central Excise Duty thereon @ 10.30% Ad-valorem</i>		
8,050 x 10.30/ 110.30		<u>752</u>
Assessable value		<u>7,298</u>

Notes:

1. The transaction value does not include Excise duty, sales tax and other taxes.
2. The Excise duty is to be charged on the net price, hence trade discount is allowed as deduction.
3. With regards to packing, all kind of packing except durable and returnable packing is included in the assessable value. The durable and returnable packing is not included as such packing is not sold and is durable in nature.
4. It is assumed that sale took place at factory and hence freight and insurance charges have been deducted from the price. (Rule 5 of Valuation Rules, 2000)

Answer to Question No. 4(b)

Doctrine of Unjust Enrichment

In case of refunds, there is a major controversy that a claim of refund can be entertained only if the duty has not already been passed to the buyers. The reason being that if the claim of refund is allowed when the duty has already been passed to others, it would tantamount to unintended profit to the assessee resulting into his unjust enrichment. Thus, no manufacturer would be entitled to the refund of excise duty, if he has already passed on the incidence of such duty to the buyer.

There is a presumption that the manufacturer has already passed on the incidence

to the buyer and hence the manufacturer has to prove to the contrary that he has not passed on the incidence to the buyer. In view of this, deciding a refund claim is a quasi-judicial function and the Assistant Commissioner has to issue a notice to the claimant and hear him before rejecting the claim in full or in part.

In MAFATLAL INDUSTRIES CASE, the nine member bench of the Supreme Court held that the doctrine of unjust enrichment is constitutionally valid and only in specified cases the amount is refundable.

Doctrine of unjust enrichment is applicable to captive consumption goods also [SOLAR PESTICIDES, S.C]

The statutory provisions to prevent unjust enrichment have been provided in Section 11B, 11D, 12A, 12B, 12C and 12D of the Central Excise Act. However, the following types of refunds under Excise have been kept out of the bar of unjust enrichment:

- (i) Rebate on account of exports
- (ii) Unspent advance deposits lying in balance in PLA
- (iii) Refund of CENVAT Credit
- (iv) Duty of Excise paid and borne by the manufacturer
- (v) Duty of Excise paid and borne by the buyer
- (vi) Duty of Excise paid by such class of applicant as the Central Government may by notification in the Official Gazette specify.

Note: The doctrine of unjust enrichment is applicable to similar matters under Customs and Service Tax also.

Question No. 5

- (a) *What is VAT and what is its need ?* (5 marks)
- (b) *Explain the salient features of levy of Service Tax.* (5 marks)
- (c) *Write in short note on Adjustment of excess amount of service tax paid.* (5 marks)
- (d) *What do you mean by Negative list of services? Give some examples.* (5 marks)

Answer to Question No. 5(a)

VAT or Value Added Tax is a tax on local sale imposed under a state law. VAT is based on the value addition to the goods, and the related VAT liability of the dealer is calculated by deducting input tax credit from tax collected on sales during the payment period. The essence of VAT is in providing set-off for the tax paid earlier; and this is given effect through the concept of input tax credit/ rebate. This input tax credit in relation to any period means setting off the amount of input tax by a registered dealer against the amount of his output tax. VAT is different from the sales tax being imposed earlier. VAT has the following features:

- (1) It is a tax on value addition. It means tax paid on purchases is allowed to be set off against the tax payable on sale. Thus VAT = tax on output sale – tax on

input purchase. Unlike the earlier tax system based on gross value, VAT removes cascading effect.

- (2) VAT is a tax on domestic consumption. When the consumption is outside India on export, no VAT is levied on such export sale and VAT paid on earlier purchases of goods exported is refunded.
- (3) VAT is destination based. It means VAT is payable finally by ultimate consumer. Origin based tax becomes the part of cost and it results in cascading effect.

Need for introducing VAT

1. VAT is more equitable way of taxing as all dealers share the tax burden.
2. VAT is more transparent as easy procedures exist under it and only there are a few rates of tax.
3. Simpler, easy computation and easy compliance.
4. Credit for input taxation leading to cost efficiency.
5. Better compliance through self policing.
6. Prevents cascading effect by providing input rebate.
7. Avoids distortions in trade and economy due to uniform tax rates.

VAT promotes exports as well as ancillarisation.

Answer to Question No. 5(b)

Service Tax is levied vide Finance Act, 1994 (the Act). The Finance Act, 1994 applies all over India except the state of Jammu & Kashmir.

With effect from 1st July 2012, a new charging Section 66B has been inserted by the Finance Act 2012. Section 66B provides that there shall be levied a tax (hereinafter referred to as the service tax) at the rate of twelve per cent on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed.

The taxation of services is completely overhauled from positive approach or selective services to negative list approach. Moreover, service tax has been made payable on accrual basis.

The salient features of the new system of taxation are as follows:

1. 'Service' has been defined in clause (44) of section 65B of the Act.
2. Section 66B is the new charging section. It specifies that service tax shall be levied on all services provided or agreed to be provided in a taxable territory, other than services specified in the negative list.
3. The negative list of services is contained in section 66D of the Act.
4. Section 66C empowers the Central Government to make rules for determination of place of provision of service.

5. Place of Provision of Services Rules, 2012 have been made.
6. Certain activities have been specifically defined by description as services and are referred as Declared Services in section 66E.
7. Certain exemptions have been given. Most of the exemptions have been consolidated in a single mega exemption for easy reference.
8. Principles have been laid down in section 66F of the Act for interpretation wherever services have to be treated differentially for any reason and also for determining the taxability of bundled services.
9. Certain offences have been made cognizable provisions have also been made for arrest of persons involved in serious violations under the law.

Answer to Question No. 5(c)

Adjustment of service tax : Rule 6 of Service tax Rules contains the provisions regarding adjustment of service tax.

1. *Adjustment of excess service tax paid on the services which are not so provided*

Rule 6(3) : Where an assessee has issued an invoice, or received any payment, against a service to be provided which is not so provided by him either wholly or partially for any reason, or where the amount of invoice is renegotiated due to deficient provision of service, may take the credit of such excess service tax paid by him, if the assessee,

- (a) has refunded the payment or part thereof, so received along with the service tax payable;
- (b) has issued a credit note for the value of the service tax not so provided to the person to whom such an invoice had been issued.

2. *Adjustment of excess service tax paid in other cases*

Rule 6(4A) : where an assessee has paid to the credit of Central Government any amount in excess of the amount required to be paid towards service tax liability he may adjust such excess amount paid by him against his service tax liability for the succeeding month or quarter, as the case may be.

Rule 6(4B): The adjustment of excess amount paid, under sub-rule (4A), shall be subject to the condition that the excess amount paid is on account of reasons not involving:

- (i) interpretation of law,
- (ii) taxability,
- (iii) valuation or
- (iv) applicability of any exemption notification.

Answer to Question No. 5(d)

By the virtue of section 66B, service tax is levied on all services provided in the taxable territory by a person to another for a consideration other than the services

specified in negative list. Services specified in the negative list therefore go out of the ambit of chargeability of service tax. The negative list of service is specified in the Act itself in section 66D. In all there are 17 heads of services that have been specified in the negative list. These 17 services are not chargeable to service tax. Some examples are:

1. Services by the Reserve Bank of India.
2. Services by a foreign diplomatic mission located in India.
Services provided by any person for the official use of a foreign diplomatic mission has been exempted vide Notification No. 27/2012 S.T., dated 20.6.2012 subject to prescribed conditions.
3. Funeral, burial, crematorium or mortuary services including transportation of the deceased.
4. Services by way of renting of residential dwelling for use as residence.
5. Transmission or distribution of electricity by an electricity transmission or distribution utility.
6. Trading of goods.
7. Manufacture of Goods.

Question No. 6

(a) Explain the residual method of valuation under Rule 9 of the Customs Import Valuation Rules, 2007. (5 marks)

(b) Compute the customs duty from the following data:

<i>Machinery imported from USA by air (inclusive of accessories of market value US\$2000) compulsorily supplied along with the machine.</i>	US\$ 10000
<i>Air freight</i>	US\$ 3000
<i>Insurance</i>	US\$100
<i>Local agent's commission</i>	₹4500
<i>Exchange Rate</i>	1 US\$ = ₹40
<i>Customs duty on machine</i>	10% ad valorem
<i>Customs duty on accessory</i>	20% ad valorem
<i>Additional duty of Customs 14%, but effective rate by exemption notification</i>	8%
<i>Additional duty of customs under Section 3(5) of Customs Tariff Act, 1975</i>	4%
<i>Education Cess + Secondary and Higher Education Cess</i>	2% + 1%

Note : The date of import of the machinery by the assessee is October 28, 2012. (5 marks)

Answer to Question No. 6(a)**Residual method (Rule 9)**

Subject to the provisions of rule 3, where the value of imported goods cannot be determined under the provisions of any of the preceding rules, the value shall be determined using reasonable means consistent with the principles and general provisions of these rules and on the basis of data available in India;

However, the value so determined shall not exceed the price at which such or like goods are ordinarily sold or offered for sale for delivery at the time and place of importation in the course of international trade, when the seller or buyer has no interest in the business of other and price is the sole consideration for the sale or offer for sale [Rule 9(1)].

As per rule 9(2), no value shall be determined under the provisions of this rule on the basis of;

- (i) the selling price in India of the goods produced in India;
- (ii) a system which provides for the acceptance for customs purposes of the highest of the two alternative values;
- (iii) the price of the goods on the domestic market of the country of exportation;
- (iv) the cost of production other than computed values which have been determined for identical or similar goods in accordance with the provisions of rule 8;
- (v) the price of the goods for the export to a country other than India;
- (vi) minimum customs values; or
- (vii) arbitrary or fictitious values.

Value of imported goods determined under the provisions of rule 9 should to the greatest extent possible, be based on previously determined customs values.

The methods of valuation to be employed under rule 9 may be those laid down in rules 3 to 8, inclusive, but a reasonable flexibility in the application of such methods would be in conformity with the aims and provisions of rule 9.

Answer to Question No. 6(b)**Calculation of Assessable Value**

<i>Particulars</i>	<i>US \$</i>
Cost of machinery inclusive of accessory (FOB)	10,000
Add : cost of insurance	100
Add : air freight (restricted to 20% of FOB)	2,000
Total	<u>12,100</u>
	₹
Total (in Indian ₹) US\$ 12,100 x ₹ 40 (being exchange rate)	4,84,000
Add : agency commission	4,500
CIF Value	<u>4,88,500</u>
Add : landing charges (@ 1% of CIF value)	4,885
Assessable value in rupees	<u>4,93,385</u>

Computation of customs duty payable

<i>Description</i>	<i>Value-Cumduties (₹)</i>	<i>Duties (₹)</i>
Assessable value	4,93,385.00	
Add : Basic customs duty (10% of ₹4,93,385)[1]	49,338.50	49,338.50
Value after BCD	5,42,723.50	
Add : Additional duty of Customs u/s 3(1) @ 8% of ₹5,42,723.50	43,417.88	43,417.88
Value after CVD	586,141.38	92756.38
Education cess @ 2% of ₹92,756.38	1855.13	1855.13
SHE Cess @ 1% of ₹92,756.38	927.56	927.56
Total Before Special CVD	588924.07	95539.07
Add : Special CVD @ 4% on 603725.61	23556.96	23556.96
Total	612481.03	119096.03

Total customs duty payable is ₹119096 (Rounded off to the nearest rupee u/s 154A).

Note : Education cess and Secondary and Higher education cess on CVD is exempt with effect from 17-3-2012 vide Notification Nos13 & 14 / 2012-Customs. Hence it is not added to CVD.

Notes:

- Accessories: in case accessories are compulsorily supplied along with imported machinery and no separate charge is made for such supply, their price being included in the price of the machinery, then, in accordance with section 19 read with Accessories (Condition) Rules, 1963, the rate of duty on imported machinery shall equally apply for duty on such accessories, in this case, the accessories have been compulsorily supplied along with the machinery and their price is already included in the price of the machinery, hence such accessory will also be chargeable with duty at the rate applicable to the machinery i.e. @ 10% ad valorem.
- In case the goods are imported through air and the air freight exceeds 20% of FOB, it will be restricted to 20% of FOB value of goods.
- Local agent's commission has been presumed to be the commission payable to the agent of the exporter and hence included in value.

Question No. 7

- State provisions of transshipment of goods without payment of duty under section 54 of Customs Act, 1962. Explain briefly. (5 marks)
- Mr. Xavier, an Indian resident and a doctor by who was engaged in his profession

in Germany for 3 months, brought with him on 20.4.2011 the following items on his return to India :

- (i) Used personal effects like clothes etc. of ₹50,000;*
- (ii) Jewellery of ₹15,000;*
- (iii) His professional equipments like stethoscope and other surgical instruments worth ₹30,000;*
- (iv) A video cassette recorder of ₹25,000;*
- (v) Used household articles of ₹20,000;*
- (vi) A Laptop computer worth ₹1,20,000.*

Determine the duty payable by him. (5 marks)

- (c) Explain the procedure for removal of goods by 100% EOU for Domestic Tariff Area. (5 marks)*

Answer to Question No. 7(a)

Section 54 of the Act provides that where any goods imported into a Customs station are intended for transshipment, a bill of transshipment shall be presented to the proper officer in the prescribed form. But where the goods are being transhipped under an international treaty or bilateral agreement between the Government of India and Government of a foreign country, a declaration for transshipment instead of a bill of transshipment shall be presented to the proper officer in the prescribed form.

Section 54(2) provides that where any goods imported into a Customs station are mentioned in the Import Manifest or import report as the case may be, as for transshipment to any place outside India, such goods may be allowed to be so transhipped without payment of duty. The provisions of Sub-section (2) of Section 54 are subject to the provisions of Section 11.

Sub-section (3) of Section 54 provides that where any goods imported into a Customs station are mentioned in the Import Manifest or import report, as the case may be, as for transshipment:

- (a) to any major port as defined in the Indian Ports Act, 1908 or the Customs Airport at Mumbai, Calcutta, Delhi or Chennai or any other Customs port or Customs airport which the Board may, by Notification in the Official Gazette, specify in this behalf, or
- (b) to any other Customs station and the proper officer is satisfied that the goods are bona fide intended for transshipment to such Customs station, the proper officer may allow the goods to be transhipped without payment of duty subject to such conditions as may be prescribed for the due arrival of such goods at the Customs station to which transshipment is allowed.

Answer to Question No. 7(b)

Mr. X will be allowed following duty free allowances:

1. General free allowance under Rule 3 of used personal effects (excluding jewellery) and other articles (other than those mentioned in Annexure I) upto ₹35,000.

2. Additional Professional allowance under Rule 5 of used household articles upto ₹12,000, and professional equipments upto a value of ₹20,000.

Accordingly total customs duty payable by Mr. X shall be as follows:

	₹
Used personal effects like clothes etc.	Nil
Video cassette recorder	25,000
Jewellery	15,000
Used household articles	20,000
Professional equipments	30,000
Laptop computer	Exempt
Total	<u>90,000</u>
Less : total allowance (i.e. ₹35,000 + ₹12,000 + ₹20,000)	67,000
Balance goods on which duty payable	<u>23,000</u>
Customs duty @36.05% (inclusive of EC and SHEC) (rounded off)	8,292

Answer to Question No. 7(c)

Removal of goods by 100% EOU for Domestic Tariff Area is governed by Rule 17 of Central Excise Rules, 2002.

- (1) The EOU has to remove goods under invoice. The appropriate duty [import duty as per Proviso to Section 3 (1)] has to be paid by utilizing the CENVAT credit or by crediting the duty payable to the account of the Central Government in the manner specified in rule 8.
- (2) Proper accounts regarding goods, description duty paid etc. as prescribed by BOARD have to be maintained.
- (3) Appropriate monthly return in the prescribed form [E.R 2] has to be submitted by 10th of the following month relating to inputs, capital goods and goods manufactured.
- (4) The proper officer may on the basis of information contained in the return filed by the unit under sub-rule (3), and after such further enquiry as he may consider necessary, scrutinise the correctness of the duty assessed by the assessee on the goods removed, in the manner to be prescribed by the Board.
- (5) Every assessee shall make available to the proper officer all the documents and records for verification as and when required by such officer.

Question No. 8

- (a) *What are the specific exclusions from Transaction Value? (5 marks)*
- (b) *Mr. Suresh is providing taxable as well as exempted services. The value of taxable services is ₹10 lakh while that of exempted services is ₹14 lakh. All the inputs/input services used by him are commonly used in providing taxable as well as exempted services for which separate account are not maintained. The total input credit is ₹4 lakh.*

Find the amount payable by Mr. Suresh as per Rule 6(2). (5 marks)

(c) How is the assessable value determined when the excisable goods are not sold for delivery at the time and place of removal. (5 marks)

Answer to Question No. 8(a)

'Transaction value' means the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organisation expenses, storage, outward handling, servicing, warranty, commission or any other matter but doesn't include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods".

Specific exclusions from Transaction Value are:

1. Sale price is after deducting all the discounts.
2. Durable and returnable packing expenses charged from the buyer are eligible for deduction.
3. Erection/ installation bringing about immovable property are not included in value. Octroi and other taxes are not to be included as they are in the nature of taxes.
4. Interest on delayed payments is not includible.
5. Duties and taxes actually paid or payable are to be excluded.
6. Bought out accessories cost is not includible if they are not essential part of the main product.
7. Subsidies given by Government to the manufacturer need not be included in the transaction value.

Answer to Question No. 8(b)

Rule 6(2) provides that where inputs/input services are used for both taxable and non-taxable goods or services, credit can be taken only on that quantum of inputs used for dutiable goods or taxable services. Separate accounts have to be maintained.

Since Mr. Suresh has not maintained books of account so he is left with following options-

1. Take full credit but pay 6% on the value of exempted goods/ exempted Services i.e. pay 6% of 14,00,000 = ₹84,000,
2. Take full credit and pay back the amount of credit attributable to exempted goods or exempted services by following the procedure specified in Rule 6(3A); Take credit of ₹4 lakhs and pay back the amount of ₹2.33 Lakhs (4 Lakhs * 14lakhs/24lakhs).

Answer to Question No. 8(c)**When there is no sale at the time of removal**

There is no sale in the following cases:

- (i) *Stock transfer or branch transfer.* In this case price charged at the branch, sales depot etc. where the goods are sent for sale on the date of removal from factory shall be taken. (Rule 7)
- (ii) *Captive consumption* : find out cost of production as per CAS-4 and get it certified by a cost accountant or a chartered accountant and take 110% of such cost of production as value. (Rule 8)
- (iii) *Cases other than the above* : Rule 4. eg. Gifts, free samples etc.
 - Take the price of such goods sold at the time nearest to the time of removal.
 - Make reasonable adjustments. These adjustments may be with reference to any price fluctuations during the time lag between these two removals, difference in the quality, and packing material used and so on.

Delivery for sale not at the place of removal

Rule 5 is applicable when there is a sale at the time of removal, but delivery is not at factory, but at some other place, say, at the place of buyers. This is a situation where price is quoted in the invoice includes freight and insurance charges. Since, the price is not ex-factory price, transaction value cannot be applied. Hence, valuation is done under Rule 5.

Conditions necessary for the application of Rule 5:

- Place of removal and place of delivery are not same.
 - Price quoted is, inclusive of the cost of transportation and insurance from the factory to the place of buyer.
 - The price for the purpose of valuation will be the price charged from the buyer
 - If the manufacturer uses his own vehicles freight charges as certified by a C.A./CWA are allowed to be deducted from the price.
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