REVISIONARY TEST PAPER

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INTERMEDIATE

GROUP - I

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

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INTERMEDIATE EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - I

Paper-5 : FINANCIAL ACCOUNTING

Q. 1. State whether following statements are True/False :

- **(i) Hire purchase stock represents the installments from Hire Purchase Debtors not yet due.**
- **(ii) Gaining Ratio is applicable at the time of retirement of a partner.**
- **(iii) AS 4 deals with prior period adjustments.**
- **(iv) Issue of Sweat Equity shares is a non-cash transaction.**
- **(v) For buy back of shares, a company has to open a Current Account with the Bank.**
- **(vi) As per AS 28 recoverable amount of an asset is lower of Net selling price and Value in use.**
- **(vii) The hire purchaser can record the asset at its hire purchase price.**
- **(viii) Depreciation is charged on "Wasting Assets".**
- **(ix) Income and Expenditure Account is prepared by adopting accrual principle of accounting.**
- **(x) Depreciation is an item of Expenditure.**
- **(xi) Short workings is the amount by which the minimum rent falls short of the actual royalty.**
- **(xii) The debit balance in the Profit & Loss A/c is treated as surplus.**
- **(xiii) Goodwill is an estimation of the earning power of the capital employed by an entity.**
- **(xiv) Intrinsic value is EPS X PE Ratio.**
- **(xv) Buy back of shares helps to alter the capital structure of a company.**

Answer 1.

(i) **True.**

Hire purchase stock represents the installments receivable from hire purchase debtors but yet due Example : Total Installments for 11 months × 2,000 p.m out of which current month due but not received

HP Debtors

	Current Month	Not Due- H.P Stock A/c
Installment	Due but not received ₹ 2,000	10 × ₹ 2,000 = ₹ 20,000

(ii) **False.**

There may be Gaining Ratio of an old partner even at the time of admission of a partner.

(iii) **False.**

AS -4 deals with Contingencies and Event Occurring after the Balance Sheet Date

(iv) **True.**

Sweat Equity Shares are Equity Shares issued to employees as a non cash incentive.

(v) **True.**

For buy back of shares, a company has to open a Current Account with the Bank.

(vi) **False.**

As per AS 28 recoverable amount of an asset is higher of net selling price and Value in use.

(vii) **False.**

The hire purchaser can record the asset at Cash Price. Cash Price = Payment on the date of signing of contract + (Balance along with the interest in equal installments × Annuity factor).

(viii) **False.**

Depreciation is not charged on Wasting Assets. Depreciation is charged on all assets except the following :

(a) Forests, Plantation

(b) Wasting Assets, Minerals and Natural Gas

(c) Expenditure on research and development

(d) Goodwill

(e) Live stock – Cattle, animal Husbandry

(ix) **True.**

Income and Expenditure Account which is prepared for the particular period is used to quantify the surplus (excess income over expenditure) or deficit (excess of expenditure over income) for the particular period.

(x) **True.**

Depreciation is a measure of wearing out, consumption or other loss of value of a depreciable assets arising from use passage of time. Depreciation is nothing but distribution of total cost of assets over its useful life.

(xi) **False.**

Shortworkings is the amount by which the minimum rent exceeds the actual royalty).

(xii) **False.**

Debit balance in the Profit and Loss A/c is treated as loss.

(xiii) **True.**

Goodwill refers to the reputation of a business enterprise which it acquires by its record of successful operations and customers' satisfaction. It is an unidentifiable attribute of a business which enables it to earn more than normal profits to induce the entrepreneurs to remain in business and it is an estimation of earning power of capital employed by an entity.

(xiv) **False.**

Intrinsic Value per share = $\frac{\text{Net Assets}}{\text{No. of Shares Outstanding}}$.

(xv) **True.**

Due to buy back of shares the number of shares outstanding gets reduced, accordingly the amount of paid up share capital also gets reduced. Buy back is the indicator of sound financial status of an entity which is exercised by using the excess reserve.

Q. 2. Fill in the blanks :

(i) Debenture holders are _________ of a company.

(ii) The terms owners equity and _________ are used interchangeably

(iii) The contract of insurance is a contract of _________ .

(iv) Capital is shown on the liability side because of _________ concept.

(v) Current Ratio is a _________ Ratio.

(vi) As per Revised Schedule VI of the Companies Act,1956 'unclaimed dividends' are to be shown under the head _________ .

(vii) AS 13 is related to _________ .

(viii) Stock Velocity $= \dfrac{\textbf{Cost of Goods Sold}}{\_\_\_\_\_\_\_\_\_\_}$.

(ix) Minimum partners required for a non-banking partnership firm are _________ .

(x) Yield method of valuing shares is also known as _________ method.

Answer 2.

(i) Creditors/Providers of Loan Capital

(ii) Net worth

(iii) Guarantee

(iv) Business Entity

(v) Solvency

(vi) Current liabilities

(vii) Accounting for Investment

(viii) Average Stock

(ix) 2

(x) Earning Capacity

Q. 3. Choose the correct alternative :

(i) Bank Reconciliation Statement is prepared to :

(a) rectify the mistakes in pass book

(b) to rectify the mistakes in cash book

(c) to arrive at balance as per bank statement

(d) to find the reasons to differences in balances as per Cash Book and Bank Statement

(ii) Which of the following is a Revenue Expenditure?

(a) Construction of Factory shed

(b) Sales Tax paid in connection with purchase of Office Equipment

(c) Legal Expenses in connection with defending a title to firm's property

(d) Installation of new Machinery

(iii) Capital is shown on the liability side because of :

(a) Business Entity Concept

(b) Conservatism Concept

(c) Accrual Concept

(d) Duality Concept

(iv) Depreciation is a process of :

(a) apportionment

(b) valuation

(c) allocation

(d) appropriation

(v) For Sales Return at Branch, in case of dependent branches, entry to be passed in HO books,

(a) Debit Branch Debtors A/c, Credit Branch Stock A/c

(b) Debit Sales A/c, Credit Branch Debtors A/c

(c) Debit Sales A/c, Credit Branch Stock A/c

(d) Debit Branch Stock A/c, Credit Branch Debtors A/c

(vi) Which of the following is treated as contingent liability as per AS 4?

(a) Obligations under retirement benefit plan

(b) Commitments arising from long term lease contract

(c) Arrears of fixed cumulative dividends

(d) Liabilities of Life and General Insurance out of policies issued by enterprise

(iii) Which of the following is not a unsecured loan in Balance sheet of a Company?

a) Acceptance of Fixed Deposits

b) Creation of Sinking Funds

c) Loans and advances from others

d) Short term loans from Banks

(viii) Any profit prior to incorporation may be :

a) Credited to Capital Reserve A/c

b) Debited to Goodwill A/c

c) Debited to Suspense A/c

d) None of the above

(ix) Which of the following terms is related to Accounts of Electricity Companies?

a) Clear profit

b) Work uncertified

c) NPA

d) Claims outstanding

(x) Current Ratio is a :

a) Efficiency Ratio

b) Profitability Ratio

c) Solvency Ratio

d) Yield Ratio

Answer 3.

(i) (d) to find the reasons of differences in balance as per Cash Book and Bank Statement.

(ii) (c) Legal Expenses in connection with defending a title to firm's property.

(iii) (a) Business Entity Concept

(iv) (c) allocation

(v) (d) Debtit Branch Stock A/c, Credit Branch Debtors A/c.

(vi) (c) Arrears of fixed cumulative dividends.

(vii) (b) Creation of Sinking Funds.

(viii) (a) Credited to Capital Reserve A/c.

(ix) (a) Clear profit

(x) (c) Solvency Ratio

Q. 4. (a) State four items which are not to be included in determining the cost of inventories in accordance with paragraph 6 of AS 2?

(b) Briefly describe with reference to Accounting Standard 7 on Accounting for construction contracts, the methods which may be used for recognizing revenue on construction contracts.

(c) Advise D Ltd.about the treatment of the following in the financial statement of the company for the year ended 31st March, 2012.
A claim lodged with the Railways in March, 2010 for loss of goods of ₹ 5 lakhs had been passed for payment in March, 2012 for ₹ 4 lakhs. No entry was passed in the books of the company, when the claim was lodged.

(d) What is meant by Sweat Equity Shares?

(e) State the conditions of buy-back.

Answer 4. (a)

In determining the cost of inventories in accordance with paragraph 6 of AS 2 , it is appropriate to exclude certain costs and recognize therein as expenses in the period in which they are incurred. Examples of such cost are- —

(i) abnormal amounts of waste materials, labour or other production costs,

(ii) storage costs unless those costs are necessary in the production process prior to a further production stage,

(iii) administrative overheads that do not contribute to bring the inventories to their present location and condition, and

(iv) selling and distribution cost.

Answer 4. (b)

As per Accounting Standard 7 on "Accounting for Construction Contracts", two methods of accounting are commonly followed by contractors for recognizing revenue on construction contracts : (i) the percentage of completion method and (ii) the completed contract method.

Under **the percentage of completion method**, revenue is recognized as the contract activity progresses based on the stage of completion reached. The costs incurred in reaching the stage of completion are matched with this revenue, resulting in the reporting of results which can be attributed to the proportion of work completed. Although (as per the principle of 'prudence') revenue is recognized only when realized, under this method, the revenue is recognized as the activity progresses even though in certain circumstances it may not be realized.

Under **the completed contract method**, revenue is recognized only when the contract is completed or substantially completed; that is, when only minor work is expected other than warranty obligation. Costs and progress payments received are accumulated during the course of the contract but revenue is not recognized until the contract activity is substantially completed.

Under both methods, provision is made for losses for the stage of completion reached on the contract. In addition, provision is usually made for losses on the remainder of the contract.

It may be necessary for accounting purposes to combine contracts made with a single customer or to combine contracts made with several customers if the contracts are negotiated as a package or if the contracts are for a single project. Conversely, if a contract covers number of projects and if the costs and revenues of such individual projects can be identified within the terms of the overall contract, each such project may be treated as equivalent to a separate contract.

Answer 4. (c)

The financial statements of the company are prepared for the year ended 31.3.2012.

There was a loss of goods of ₹ 5 lakhs in 2009-10 and the claim was lodged in March 2010 with the Railway authorities. No entry was passed in the books of the company when the claim was lodged and the said treatment was correct in view of AS-9, which states that if uncertainty exists as to collectability, the revenue recognition should be postponed.

Since, the claim is passed for payment of ₹ 4 lakhs in March, 2012, it should be recognized as revenue in the financial statements prepared for the year ended 31.3.2012.

As per AS-5 Revised, the claim amount received will not be treated as extraordinary item. AS-5 Revised further states that when items of income and expense within profit or loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately.

Answer 4. (d)

The Companies (Amendment) Act, 1999 introduced through section 79A a new type of equity shares called 'Sweat Equity Shares. The expression 'sweat equity shares' means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions by whatever name called. However , specified guidelines in this respect must be followed.

Answer 4. (e)

As per Section 77A(2) of the Companies Act, 1956 the conditions for buy-back are:

The company's articles should authorize the buy-back. If not, the same has to be amended to include a provision to that effect;

A special resolution should be passed in the general meeting authorizing the buy-back;

(i) The buy-back should be less than 25% of the total paid-up capital and free reserves of the company;

(ii) The buy-back of equity shares in any financial year should not exceed 25% of its total paid-up equity capital in that financial year.

(iii) The Companies (Amendment) Act, 2001 has authorized the buy-back by means of a resolution at the company's Board provided the buy-back does not exceed 10% of the total paid-up equity capital and free reserves of the company. But, there cannot be more than one such buy-back in a period of 365 days.

(iv) Debt-equity ratio shall not exceed 2:1 after such buy-back. The Central Government may however, prescribe a higher ratio for a class or classes of companies;

(v) All the shares or other specified securities are fully paid up;

(vi) The buy-back of the shares or other securities listed on any recognized stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf;

(vii) The buy-back of shares or other securities not listed on any recognized stock exchange is in accordance with the guidelines as may be prescribed.

Q. 5. (a) A Company purchased following machines on different dates as follows :-

- **On April 1, 2009 for ₹ 90,000**
- **On October 1, 2010 for ₹ 60,000**
- **On July 1, 2005 for ₹ 30,000**

The depreciation is to be charged @ 10% p.a. on original cost. On February 1, 2012 it sold one-third of first machine which was bought on April 1, 2009 for ₹ 9,000 and one-half of the second machine bought on October 1, 2010 on 31st March 2012 for ₹ 28,000 because it had become obsolete.

Prepare Machinery Account for 3 years.

Answer 5. (a)

Dr. **Machinery Account** ***Cr.***

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2009			2010		
Jan 1	To Bank A/c (I)	90,000	Mar 31	By Depreciation A/c (I)	9,000
			By	Balance c/d	81,000
		90,000			90,000
2010			2010		
April 1	To Bank A/c (I)	90,000	Mar 31	By Depreciation A/c	
				I- 9,000	
				II- 3,000	12,000
Oct.1	To Balance b/d	81,000		By Balance c/d	
	To Bank (II)			I- 72,000	
				II- 57,000	1,29,000
		1,41,000			1,41,000
2011			2012		
April 1	To Balance b/d		Feb 1	By Depreciation A/c (I)	2,500
	I- 72,000			By Bank A/c (Sale)	19,000
	II- 57,000	1,29,000		By P&L A/c (Loss)	2,500
Mar 31	To P&L A/c	2,500	Mar 31	By Depreciation	3,000
	(Profit on sale			(On half of Machine II)	
	of Machine II)			By Bank (Sale)	28,000
			Mar 31	By Depreciation	
				I- ($\frac{2}{3}$ of Machine-I)	6,000
				II- ($\frac{1}{2}$ of Machine-II)	3,000
				By Balance c/d	
				I- 42,000	
				II- 25,500	67,500
		1,31,500			**1,31,500**

Working Notes :

(i)	Depreciation on Machinery I	$\frac{90{,}000 \times 10}{100}$	₹ 9,000 p.a.
(ii)	Depreciation on Machinery II	$\frac{60{,}000 \times 10}{100}$	₹ 6,000 p.a.
(iii)	Calculation of gain or loss on machinery I Depreciation on One- third Machine I till date of Sale for 10 months		**₹ 2,500**

₹ 9,000 is annual depreciation. One-thired is the portion machine sold which is further calculated for 10 months of its use in business in the year 2011-12.

Book value of machine on on the date of sale = Opening balance of one third machinery as on 1-4-2011— Depreciation till date of sale

= ₹ ($\frac{1}{3}$ × 72,000) – ₹ 2,500

= ₹ (24,000-2,500) = ₹ 21,500

Loss on sale of machine = Sale Proceeds on sale- Value on Sale

= ₹ (19,000 – 21,500) = ₹ (2,500)

iv. Calculation of gain or loss on sale of Machinery II

Depreciation on One-half of Machinery II till date of sale.

₹ 6,000 × ½ = ₹ 3,000

₹ 6,000 is full amount of depreciation divided by as only one- half of the machine is sold.

Book value for one-half machinery on date of sale

₹ (½ × 57,000) – 3,000 = ₹ 28,500 – ₹ 3,000 = ₹ 25,500

Gain on sale of Machinery II = ₹ 28,000 – ₹ 25,500 = ₹ 2,500

Q. 5. (b) M/s Sadhana Chemicals has imported a machine on 1st July 2010 for $ 6,000, paid customs duty and freight ₹ 52,000 and incurred rection charges ₹ 20,000. Another local machinery costing ₹ 1,00,000 was purchased on January 1, 2011. On 1st July 2012, a portion of the imported machinery (value one-third) got out of order and was sold for ₹ 34,800. Another machinery was purchased to replace the same for ₹ 50,000. Depreciation is to be calculated at 20% p.a. on straight-line method. Prepare the Machinery Account and Machinery Disposal Account for 2010, 2011 and 2012. Exchange rate is ₹ 38 per $.

Answer 5. (a)

In the Books of M/s. Sadhana Chemicals

Dr. **Machinery Account** *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2010			2010		
Jan 1	To Bank—Purchase	2,28,000	Dec. 31	By Depreciation	
	(6000 × ₹ 38)			— for 6 months	30,000
	To Bank—Duty etc.	52,000		(₹ 3,00,000 ×20/100 ×½)	
	To Bank—Erection charges	20,000		By Balance c/d	2,70,000
		3,00,000			3,00,000
2011			2011		
Jan. 1	To Balance b/d	2,70,000	Dec. 31	By Depreciation	
	To Bank—purchase	1,00,000		(i) 3,00,000×20/100	60,000
				(ii) 1,00,000×20/100	20,000
				By Balance c/d	2,90,000
		3,70,000			3,70,000
2012			2012		
Jan. 1	To Balance b/d	2,90,000	July 1	By Machinery Disposal A/c	70,000
July 1	To Bank—purchase	50,000	Dec. 31	By Depreciation :	
				(i) 2,00,000×20/100	40,000
				(ii) 1,00,000×20/100	20,000
				(iii) 50,000×20/100×½	5,000
				By Balance c/d	2,05,000
		3,40,000			3,40,000
Jan. 1	To Balance b/d	2,05,000			

Dr. **Machinery Disposal Account** *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2012			2012		
July 1	To Machinery A/c	70,000	July 1	By Depreciation	10,000
				(1,00,000 × 20/100×½)	
				By Bank — sale proceeds	34,800
				By Profit & Loss A/c	25,200
		70,000			70,000

Note: 1. Written down value of Machinery as on July 1, 2012 will be as follows :

	₹
Original cost on July 1, 2010 (3,00,000 × 1/3)	1,00,000
Less : Depreciation for 2010 (for 6 months)(1,00,000 × 20/100 × ½)	10,000
	90,000
Less : Depreciation for 2011(1,00,000 × 20/100)	20,000
	70,000

2. If 'Machinery Disposal Account' is not kept, then, Machinery account for the year 2012 will be prepared as under :

Dr. **Machinery Account (for 2012)** ***Cr.***

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2012			2012		
July 1	To Balance b/d	2,90,000	July 1	By Depreciation (For 6 months)	10,000
	To Bank	50,000		By Bank — sale proceeds	34,800
				By Profit & Loss A/c Loss on sale (70,000–44,800)	25,200
				By Depreciation	65,000
				By Balance c/d	2,05,000
		3,40,000			3,40,000
2013					
Jan. 1	To Balance b/d	2,05,000			

Q. 6. (a) State with reasons whether the following are Capital Expenditure or Revenue Expenditure :

(i) Expenses incurred in connection with obtaining a licence for starting the factory were ₹ 12,000.

(ii) ₹ 3,000 paid for removal of stock to a new site.

(iii) Rings and Pistons of an engine were changed at a cost of ₹ 7,000 to get full efficiency.

(iv) ₹ 2,500 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the Plaintiff. The suit was not successful.

(v) ₹ 12,000 were spent on advertising the introduction of a new product in the market, the benefit of which will be effective during four years.

(vi) A factory shed was constructed at a cost of ₹ 1,00,000. A sum of ₹ 5,000 had been incurred for the construction of the temporary huts for storing building materials.

Answer 6. (a)

(i) ₹ 12,000 incurred in connection with obtaining a license for starting the factory is a Capital Expenditure. It is incurred for acquiring a right to carry on business for a long period.

(ii) ₹ 3,000 incurred for removal of stock to a new site is treated as a Revenue Expenditure because it is not enhancing the value of the asset and it is also required for starting the business on the new site.

(iii) ₹ 7,000 incurred for changing Rings and Pistons of an engine is a Revenue Expenditure because, the change of Rings and Piston will restore the efficiency of the engine only and it will not add anything to the capacity of the engine.

(iv) ₹ 2,500 incurred for defending the title to the firm's assets and the suit was not seuccessful hence is a Revenue Expenditure.

(v) ₹ 12,000 incurred on advertising is to be treated as a Deferred Revenue Expenditure because the benefit of advertisement is available for 4 years, ₹ 3,000 is to be written off every year.

(vi) Cost of construction of Factory shed of ₹ 1,00,000 is a Capital Expenditure, similarly cost of construction of small huts for storing building materials is also a Capital Expenditure.

Q. 6. (b) Mr.Vinay who was closing his books on 31.03.2012 failed to take the actual Stock which he did only on 09.04.2012, when it was ascertained by his to be worth ₹ 40,500

It was found that sales are entered in the sales book on the same day of dispatch and return inwards in the returns book as and when the goods are received back. Purchases are entered in the purchases day book once the invoices are received.

It was found that sales between 31.03.2012 and 09.04.2012 as per Sales day book are ₹ 4,080. Purchases between 31.03.2012 and 09.04.2012 as per purchases day book are ₹ 255, out of these goods amounting to ₹ 120 were not received until after the stock was taken. Goods invoiced during the month of March, 2012 but goods received only on 04th April, 2012 amounted to ₹ 300 rate of gross profit is 25 % on cost.

Ascertain the Value of Physical stock as on 31.03.2012.

Answer 6. (b)

Value of Physical Stock as on 31.03.2012

Particulars		Amount
Stock on 09.04.2012		40,500
Add : Cost goods sold during 1st to 9th April, 2012	₹	
Sales	4,080	
Less : Profit (20% of sales)	816	3,264
		37,236
Less : Goods purchased and received during 1st to 9th April, 2012		
	(255-120)	135
Value of Stock on 31.03.2012		37,101
Less : Goods purchased before 31.03.2012 But delivered on 04.04.2012		300
Value of physical stock on 31.03.2012		36,801

It must be noted that physical stock on 31.03.2012 is ₹ 36,801. But value of stock on 31.03.2012 is ₹ 37,101 because ₹ 300 goods delivered on 04.04.2012 are purchases of the year ending on 31st March, 2012 as purchases are entered in the purchases day book once the invoices are received.

Q. 7. (a) Everything Stores Ltd., Delhi, has its branches at Kolkata and Chennai. It charges goods to its Branches at cost plus 25% . Following information is available of the transactions of the Kolkata Branch for the year ended on 31st March 2012.

	₹
Balances on 1.04.2011	
Stock (at invoice price)	**30,000**
Debtors	**10,000**
Petty Cash	**50**
Transactions during 2011-2012 (Kolkata Branch) :	
Goods send to Kolkata Branch (at invoice price)	**3,25,000**
Goods returned to Head Office (at invoice price)	**10,000**
Cash Sales	**1,00,000**
Credit Sales	**1,75,000**
Goods pilfered (at invoice price)	**2,000**
Goods lost by fire (at invoice price)	**5,000**
Insurance Co. paid to H.O. for loss by fire at Kolkata	**3,000**
Cash sent for petty expenses	**34,000**
Bad debts at Branch	**500**
Goods transferred to Chennai Branch under H.O. advice	**15,000**
Insurance charges paid by H.O.	**500**
Goods returned by Debtors	**500**
Balance on 31.03.2012	
Petty Cash	**230**
Debtors	**14,000**

Goods worth ₹ 15,000 (included above) sent by Kolkata Branch to Chennai Branch was in transit on 31.03.2012.

Show the following accounts in the books of Everything Stores Ltd. :

(a) Kolkata Branch Account;

(b) Kolkata Branch Debtors Account;

(c) Kolkata Branch adjustment Account;

(d) Kolkata Profit & Loss Account; and

(e) Stock Reserve Account.

Answer 7. (a)

In the books of H.O

Dr. **Kolkata Branch Stock Account** ***Cr.***

Date	Particulars	Amount ₹	Date	Particulars		Amount ₹
2011			2012			
Apr. 1	To Balance b/d	30,000	Mar. 31	By Branch Cash A/c		
2012				Cash Sales	1,00,000	
Mar. 31	To Goods Sent to Branch A/c	3,25,000		Branch Debtors A/c		
				Credit Sales	1,75,000	2,75,000
	To Branch Debtors A/c – Returns Inward	500		By Goods Sent to Branch A/c - Return from Branch		10,000
				By Pilferage A/c		2,000
				By Lost by Fire A/c		5,000
				By Chennai Branch A/c - Goods Transferred in transit		15,000
				By Balance c/d		48,500
		3,55,000				3,55,000

Dr. **Kolkata Branch Stock Adjustment Account** ***Cr.***

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2012 Mar. 31	To Goods sent to Branch A/c - Load of goods returned $\left(₹\,10{,}000\times\frac{1}{2}\right)$	2,000	2012 Mar. 31	By Balance b/d -Loading on Operning Stock $\left(₹\,30{,}000\times\frac{1}{5}\right)$	6,000
	To Branch Stock A/c :			By Goods sent to Branch A/c - Loading $\left(₹\,3{,}25{,}000\times\frac{1}{5}\right)$	65,000
	To Pilferage A/c - Loading $\left(₹\,2{,}000\times\frac{1}{5}\right)$	400			
	To Lost by fire - Loading $\left(₹\,5{,}000\times\frac{1}{5}\right)$	1,000			
	To Chennai Branch A/c -Loading $\left(₹\,15{,}000\times\frac{1}{5}\right)$	3,000			
	By Branch P & L A/c -Gross Profit transferred (Bal. fig.)	54,900			
	By Balance c/d (-Loading on closing stock $\left(₹\,48{,}500\times\frac{1}{5}\right)$	9,700			
		71,000			71,000

Dr. **Branch Profit & Loss Account** *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2011			2011		
Mar. 31	To Branch Debtors A/c		Mar. 31	By Branch Stock	
	- Bad Debts	500		Adjustment A/c	54,900
	- Insurance	500		- Gross Profit	
	- Pilferage (at Cost)	1,600			
	- Stock lost by fire	1,000			
	- Petty Expenses	33,820			
	To General P&L A/c				
	- Branch Profit Transferred	17,480			
		54,900			54,900

Dr. **Stock Reserve Account** *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2012			2012		
Mar. 31	To Stock Adjustment A/c	6,000	Apr. 31	By Balance b/d	6,000
	- Transfer		2012		
	To Balance c/d	9,700	Mar. 31	By Branch Stock	9,700
				Adjustment A/c	
		15,700			15,700

Dr. **Stock Lost by Fire Account** *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2012			2012	By Branch Stock	1,000
Mar. 31	To Kolkata Branch Stock A/c	5,000	Mar. 31	Adjustment A/c	
				By Bank (Insurance Claim)	3,000
				By Branch P & L A/c (bal. fig.)	1,000
		5,000			5,000

Dr. **Petty Cash Account** *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2011			2012		
Apr. 1	To Balance b/d	50	Mar. 31	By Branch P & L A/c	33,820
2011				- Expenses (bal. fig.)	
Mar. 31	To Cash - General	34,000		By Balance c/d	230
		34,050			34,050

Q. 7. (b) Department D sells goods to Department E at a profit of 25% on cost and to Department F at 10% profit on cost. Department E sells goods to D and F at a profit of 15% and 20% on sales, respectively. Department F charges 20% and 25% profit on cost to Department D and E, respectively.

Department Managers are entitled to 10% commission on net profit subject to unrealised profit on departmental sales being eliminated. Departmental profits after charging Managers' commission, but before adjustment of unrealised profit are as under :

	₹
Department D	**1,44,000**
Department E	**1,08,000**
Department F	**72000**

Stock lying at different departments at the end of the year are as under :

	Dept. D	Dept. E	Dept. F
Transfer from Department D	—	60,000	44,000
Transfer from Department E	56,000	—	48,000
Transfer from Department F	24,000	20,000	—

Find out the correct departmental Profits after charging Managers' commission.

Answer 7. (b)

Calculation of correct Profit

	Department–D ₹	Department–E ₹	Department–F ₹
Profit after charging managers' commission	1,44,000	1,08,000	72,000
Add back : Managers' commission (1/9)	16,000	12,000	8,000
	1,60,000	1,20,000	80,000
Less : Unrealized profit on stock (Working Note)	16,000	18,000	8,000
Profit before Manager's commission	1,44,000	1,02,000	72,000
Less : Commission for Department Manager @10%	14,400	10,200	7,200
	1,29,600	91,800	64,800

Working Note :

Stock lying with

	Department-D	Department-E	Department-F	Total
Unrealized Profit of :				
Department-D	—	1/5×60,000 =12,000	1/11×44,000 = 4,000	**16,000**
Department-E	0.15×56,000 = 8,400	—	0.20×48,000 = 9,600	**18,000**
Department-F	1/6 × 24,000 = 4,000	1/5 × 20,000 = 4,000	—	**8,000**

Q. 8. A fire occurred in the office premises of lessee Mukta Ltd. in the evening of 31.3.2012 destroying most of the books and records. From the documents saved, the following information is gathered :

***Short-working recovered* :**

2009-10 ₹ 2,000 (towards short-workings which arose in 2005-06)

2010-11 ₹ 4,000 (including ₹ 1,000 for short-working 2006-07)

2011-12 ₹ 1,000

***Short-working lapsed* :**

2008-09 ₹ 1,500

2009-10 ₹ 1,800

2011-12 ₹ 1,000

A sum of ₹ 25,000 was paid to the landlord in 2008-09. The agreement of Royalty contains a clause of Minimum Rent payable for fixed amount and recoupment of short-workings within 3 years following the year in which Short-workings arise.

Information as regards payments to landlord subsequent to the year 2008-09 is not four years ended 31.3.2012.

Answer 8.

Before preparing the respective ledger accounts we are to compute the following information :

Year	Royalty	Short-working recovered	Short-working Lapsed	Short-working	Payment to Landlord
2008-09	—	—	—	1,500	25,000
2009-10	—	—	₹ 2,000 (for 2006-07)	8,800	—
2010-11	—	—	₹ 4,000 (including ₹ 1,000 for 2007-08)	—	—
2011-12	—	—	1,000	1,000	—

From the above statement it is quite clear that :

(i) Short-working lapsed in 2011-12 ₹ 1,000 which relates to 2008-09 as per terms, short-working should be recouped within three years i.e., 2011-12 is the last year for recoupment. Short-working recovered in 2010-11 ₹ 4,000, out of which ₹ 1,000 for 2007-08 and the balance ₹ 3,000 for the year 2008-09.

Short-working recovered in 2011-12 ₹ 1,000 which is also related to 2008-09 in which year actually is arose.

Thus, the total short-working balance in 2008-09 amounted to ₹ 5,000 (i.e., ₹ 1,000 + ₹ 3,000 + ₹ 1,000).

Now, we can prepare our usual statement as under :

Actual Royalty	= Payment to Landlord + Recoupment – Short-working
2008-09	= ₹ 25,000 + Nil – ₹ 5,000 = ₹ 20,000
2009-10	= ₹ 25,000 + ₹ 2,000 – NIL = ₹ 27,000
2010-11	= ₹ 25,000 + ₹ 4,000 – NIL = ₹ 29,000
2011-12	= ₹ 25,000 + ₹ 1,000 – NIL = ₹ 26,000

Memorandum Royalty Statement

Year	Royalty ₹	Short-working ₹	Recoupment ₹	Tr. to P&L A/c ₹	Payment to Landlord ₹
2008-09	20,000	5,000	—	1,500	25,000
2009-10	27,000	—	2,000	1,800	25,000
2010-11	29,000	—	4,000	—	25,000
2011-12	26,000	—	1,000	1,000	25,000

In the books of Mukta Ltd.

Dr. **Royalty Account** *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
31.03.09	To Landlord A/c	20,000	31.03.09	By Profit and Loss A/c	20,000
		20,000			20,000
31.03.10	To Short workings A/c	2,000	31.03.10	By Profit and Loss A/c	27,000
	To Landlord A/c	25,000			
		27,000			27,000
31.03.11	To Short workings A/c	4,000	31.03.11	By Profit and Loss A/c	29,000
	To Landlord A/c	25,000			
		29,000			29,000
31.03.12	To Short workings A/c	1,000	31.03.12	By Profit and Loss A/c	26,000
	To Landlord A/c	25,000			
		26,000			26,000

Dr. **Short Working Account** *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
31.03.09	To Balance b/d	6,300	31.03.09	By Profit and loss A/c	1,500
	To Landlord A/c	5,000		By Balance c/d	9,800
		11,300			11,300
31.03.10	To Balance b/d	9,800	31.03.10	By Royalty A/c	2,000
				By Profit and Loss A/c	1,800
				By Balance c/d	6,000
		9,800			9,800
31.03.11	To Balance b/d	6,000	31.03.11	By Royalty A/c	4,000
				By Balance c/d	2,000
		6,000			6,000
31.03.12	To Balance b/d	2,000	31.03.12	By Royalty A/c	1,000
				By Balance c/d	1,000
		2,000			**2,000**

This is includes the following :

		₹
Lapsed :	in 2008-09	1,500
	in 2009-10	1,800
Recoupment :	in 2009-10	2,000
	in 2010-11	1,000
		6,300

Q. 9. A machinery is sold on hire purchase. The terms of payment is four annual instalments of ₹ 6,000 at the end of each year commencing from the date of agreement. Interest is charged @ 20% and is included in the annual payment of ₹ 6,000.

Show machinery account and hire purchase vendor account in the books of the purchaser who defaulted in the payment of the third yearly payment whereupon the vendor repossessed the machinery. The purchaser provides depreciation on the machinery @ 10% per annum on written down value basis.

All workings should form part of your answer.

Answer 9.

In the books of Hire Purchaser

Dr. **Machinery Account** ***Cr.***

Particulars	Amount ₹	Particulars	Amount ₹
1st Year			
To Hire Purchase Vendor A/c	15,533	By Depreciation A/c	1,553
		By Balance c/d	13,980
	15,533		15,533
2nd Year			
To Balance b/d	13,980	By Depreciation A/c	1,398
		By Balance c/d	12,582
	13,980		13,980
3rd Year			
To Balance b/d	12,582	By Depreciation A/c	1,258
		By Hire Purchase Vendor A/c	11,000
		By Balance c/d	324
	12,582		12,582

Dr. **Hire Purchase Vendor Account** **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Bank A/c	6,000	1st year	
To Balance	12,639	By Machinery A/c	15,533
		By Interest A/c	3,106
	18,639		18,639
To Bank A/c	6,000	2nd year	
To Balance	9,167	By Machinery A/c	12,639
		By Interest A/c	2,528
	15,167		15,167
To Machinery A/c		3rd year	
(Repossession vendor)	11,000	By Balance b/d	9,167
		By Interest	1,833
	11,000		11,000

Working Notes :

	Installment ₹	Interest ₹	Principal ₹
4th Instalment	6,000		
Less : Interest $\frac{20}{120}\times 6{,}000$	1,000	1,000	5,000
	5,000		
Add: 3rd Instalment	6,000		
	11,000		
Less : Interest $\frac{20}{120}\times 11{,}000$	1,833	1,833	4,167
	9,167		
Add: 2nd Instalment	6,000		
	15,167		
Less : Interest $\frac{20}{120}\times 15{,}167$	2,528	2,528	3,472
	12,639		
Add: 1st Instalment	6,000		
	18,639		
Less : Interest $\frac{20}{120}\times 18{,}639$	3,106	3,106	2,894
	15,533	8,467	15,533

Q. 10. Name of the Company Super Star Ltd.

Balance Sheet as at 31st March, 2012 **[as per Revised Schedule VI]**

₹ in lakhs

Particulars	*Note No.*	*Figures as at the end of current reporting period*	*Figures as at the end of previous reporting period*
I EQUITY AND LIABILITIES			
(1) Shareholders' funds			
(a) Share Capital	**1**	**21,000**	**—**
(b) Reserves and Surplus	**2**	**16,200**	**—**
(c) Money received against share warrants		**—**	**—**
(2) Share application money pending allotment		**—**	**—**
(3) Non-current liabilities			
(a) Long-term borrowings	**3**	**10,000**	**—**
(b) Deferred tax liabilities (Net)		**—**	**—**
(c) Other long term liabilities		**—**	**—**
(d) Long –term provisions		**—**	**—**
(4) Current Liabilities			
(a) Short-term borrowings :			
(b) Trade Payables	**4**	**4,600**	**—**
(c) Other current liabilities		**—**	**—**
(d) Short term provisions	**5**	**2,000**	**—**
Total		**53,800**	**—**
II. ASSETS			
(1) Non-current assets			
(a) Fixed assets			
(i) Tangible assets		**28,000**	**—**
(ii) Intangible assets		**—**	**—**
(iii) Capital work-in progress		**—**	**—**
(iv) Intangible assets under development		**—**	**—**
(b) Non-current Investment		**6,000**	**—**
(c) Deferred tax assets (net)		**—**	**—**
(d) Long-term loans and advances		**—**	**—**
(e) Other non-current assets		**—**	**—**
(2) Current assets			
(a) Current investments		**—**	**—**
(b) Inventories		**—**	**—**
(c) Trade receivables		**—**	**—**
(d) Cash and Cash equivalents	**6**	**3,300**	**—**
(e) Short-term loans and advances		**—**	**—**
(f) Other Current assets		**16,500**	**—**
Total		**53,800**	**—**

Annexure

Note 1. Share Capital (₹ in lakhs)

Particulars	Amount (₹)
10% Redeemable Preference Share of ₹ 10 each fully paid up	5,000
Equity Shares of ₹ 10 each fully paid up	16,000
Total	21,000

Note 2. Reserves and Surplus (₹ in lakhs)

Particulars	Amount (₹)
Capital Redemption Reserve	2,000
Securities Premium	1,600
General Reserve	12,000
Profit & Loss A/c	600
Total	16,200

Note 3. Long-term borrowings (₹ in lakhs)

Particulars	Amount (₹)
9% Debenture	10,000
Total	10,000

Note 4. Trade Payables (₹ in lakhs)

Particulars	Amount (₹)
Sundry Creditors	4,600
Total	4,600

Note 5. Short-term Provisions (₹ in lakhs)

Particulars	Amount (₹)
Sundry Provisions	2,000
Total	2,000

Note 6. Cash and Cash Equivalents (₹ in lakhs)

Particulars	Amount (₹)
Cash at Bank	3,300
Total	3,300

On 1st April, 2012 the company redeemed all of its preference shares at a premium of 10% and bought back 25% of its equity shares @ ₹ 20 per share. In order to make cash available, the company sold all the investments for ₹ 6,300 lakh and raised a bank loan amounting to ₹ 4,000 lakhs on the security of the company's plant.

Pass journal entries for all the above mentioned transactions including cash transactions and prepare the company's balance sheet immediately thereafter. The amount of securities premium has been utilized to the maximum extent allowed by law.

Answer 10.

Journals

Particulars		***Dr.*** Amount ₹	***Cr.*** Amount ₹
Bank A/c	Dr.	6,300	
To Investment A/c			6,000
To Profit and Loss A/c			300
(Being sale of investments and profit thereon)			
Bank A/c	Dr.	4,000	
To Bank Loan A/c			4,000
(Being loan taken from bank)			
10% Redeemable preference Share capital A/c	Dr.	5,000	
Premium on redemption of preference shareholder A/c	Dr.	500	
To Preference shareholder A/c			5,500
(Being redemption of preference shares)			
Preference shareholders A/c	Dr.	5,500	
To Bank A/c			5,500
(Being payment of amount due to preference shareholders)			
Securities premium A/c	Dr.	500	
To Premium on redemption of preference share A/c			500
(Being use of securities premium to provide premium onredemption of preference shares)			
Equity Share capital A/c	Dr.	4,000	
Securities premium A/c [1,600 - 500]	Dr.	1,100	
General reserves A/c	Dr.	2,900	
[(400 × 20) – 4,000 – 1,100]			
To Equity shareholders A/c			8,000
(Being buy back of equity shares)			
Note : Balance of General Reserve [12,000 – 2,900] = ₹ 9,100			

General Reserves A/c	Dr.	9,000	
To Capital redemption reserve A/c			9,000
(4,000 + 5,000)			
(Being creation of capital redemption reserve to the extent of the face value of preference share redeemedand equity shares bought back).			
Note : Balance in General reserve as on 01.04.03			
(9,100 – 9,000) = ₹ 100			
Equity shareholders A/c	Dr.	8,000	
To Bank A/c			8,000
(Being payment of amount due to equity shareholders).			
Note : Cash at Bank [3,300+6,300+4,000-5,500-8,000] = ₹ 100			

Name of the Company Super Star Ltd.

Balance Sheet as at 1st April, 2012 **[as per Revised Schedule VI]**

₹ in lakhs

Particulars	**Note No.**	**Figures as at the end of current reporting period**	**Figures as at the end of previous reporting period**
I EQUITY AND LIABILITIES			
(1) Shareholders' funds :			
(a) Share Capital	1	12,000	—
(b) Reserves and Surplus	2	12,000	—
(c) Money received against share warrants		—	—
(2) Share application money pending allotment		—	—
(3) Non-current liabilities :			
(a) Long-term borrowings	3	10,000	—
(b) Deferred tax liabilities (Net)		—	—
(c) Other long term liabilities		—	—
(d) Long –term provisions		—	—
(4) Current Liabilities :			
(a) Short-term borrowings	4	4,000	—
(b) Trade Payables	5	4,600	—
(c) Other current liabilities		—	—
(d) Short term provisions	6	2,000	—
Total		44,600	—

II. ASSETS			
(1) Non-current assets :			
(a) Fixed assets			
(i) Tangible assets		28,000	—
(ii) Intangible assets		—	—
(iii) Capital work-in progress		—	—
(iv) Intangible assets under development		—	—
(b) Non-current Investment		—	—
(c) Deferred tax assets (net)		—	—
(d) Long-term loans and advances		—	—
(e) Other non-current assets		—	—
(2) Current assets :			
(a) Current investments		—	—
(b) Inventories		—	—
(c) Trade receivables		—	—
(d) Cash and Cash equivalents	7	100	—
(e) Short-term loans and advances		—	—
(f) Other Current assets		16,500	—
Total		44,600	—

Annexure

Note 1. Share Capital **(₹ in lakhs)**

Particulars	**Amount (₹)**
Equity Shares of ₹ 10 each fully paid up	12,000
Total	12,000

Note 2. Reserves and Surplus **(₹ in lakhs)**

Particulars	**Amount (₹)**
Capital Redemption Reserve	11,000
General Reserve	100
Profit & Loss A/c	900
Total	12,000

Note 3. Long-term borrowings **(₹ in lakhs)**

Particulars	**Amount (₹)**
9% Debenture	10,000
Total	10,000

Note 4. Short-term borrowings **(₹ in lakhs)**

Particulars	**Amount (₹)**
Bank Loan	4,000
Total	4,000

Note 5. Trade Payables **(₹ in lakhs)**

Particulars	**Amount (₹)**
Sundry Creditors	4,600
Total	4,600

Note 6. Short-term Provisions **(₹ in lakhs)**

Particulars	**Amount (₹)**
Sundry Provisions	2,000
Total	2,000

Note 7. Cash and Cash Equivalents **(₹ in lakhs)**

Particulars	**Amount (₹)**
Cash at Bank	100
Total	100

Q. 11. OMR Limited recently made a public issue in respect of which the following information is available :

(a) No. of partly convertible debentures issued 4,00,000; face value and issue price ₹ 100 per debenture

(b) Convertible portion per debenture 60%, date of conversion on expiry of 6 months from the date of closing of issue

(c) Date of closure of subscription lists 1.5.2011, date of allotment 1.6.2011, rate of interest on debenture 15% payable from the date of allotment, value of equity share for the purpose of conversion ₹ 60 (Face Value ₹ 10)

(d) Underwriting Commission 2.5 %

(e) No. of debentures applied for 300000

(f) Interest payable on debentures half-yearly on 30th September and 31st March

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2012 (including cash and bank entries).

Answer 11.

In the books of OMR Ltd.

Journals

Date	Particulars		Dr. Amount ₹	Cr. Amount ₹
1.5.2011	Bank A/c	Dr.	3,00,00,000	
	To Debenture Application A/c			3,00,00,000
	(Application money received on 3,00,000 debentures @ ₹ 100 each)			
1.6.2011	Debenture Application A/c	Dr.	3,00,00,000	
	Underwriters A/c	Dr.	1,00,00,000	
	To 15% Debentures A/c			4,00,00,000
	(Allotment of 3,00,000 debentures to applicants and 1,00,000 debentures to underwriters)			
	Underwriting Commission	Dr.	10,00,000	
	To Underwriters A/c			10,00,000
	(Commission payable to underwriters @ 2.5 % on ₹ 4,00,00,000)			
	Bank A/c	Dr.	90,00,000	
	To Underwriters A/c			90,00,000
	(Amount received from underwriters in settlement of account)			
30.9.2011	Debenture Interest A/c	Dr.	20,00,000	
	To Bank A/c			20,00,000
	(Interest paid on debentures for 4 months @ 15% on ₹ 4,00,00,000)			

30.10.2011	15% Debentures A/c Dr.	2,40,00,000	
	To Equity Share Capital A/c		40,00,000
	To Securities Premium A/c		2,00,00,000
	(Conversion of 60% of debentures into shares of ₹ 60 each with a face value of ₹ 10)		
31.3.2012	Debenture Interest A/c Dr.	15,00,000	
	To Bank A/c		15,00,000
	(Interest paid on debentures for the half year)		

Working Note :

Calculation of Debenture Interest for the half year ended 31st March, 2012

On ₹ 1,60,00,000 for 6 months @ 15% = ₹ 12,00,000

On ₹ 2,40,00,000 for 1 months @ 15% = ₹ 300,000

₹ 15,00,000

Q. 12. King Limited issued 10,000 equity shares of ₹ 100 each at premium of ₹ 25 per share. Under the terms of the issue, the shares were to be paid for as follows :

	₹
2012 January 1, on application (including ₹ 25 premium on issue per share)	**50**
February 1, on allotment	**50**
April 1, balance of	**25**

The issue was over subscribed. The applications received are summarised below :

	A	*B*	*C*
Number of applicants in categories	**40**	**20**	**1**
Shares Applied for by each applicant in the three categories	**200**	**2000**	**8000**
Shares Issued to each applicant	**100**	**200**	**2000**

One of the conditions of the issue was that amounts over-paid on application were to be retained by the company and used in redudction of further sums due on shares allotted. All surplus contributions were refunded on 15th February, 2012.

Mohan who had subscribed 100 on an application for 200 shares was unable to meet the claim due on April 1. On May 5, the directors forfeited his shares. All other shareholders paid the sums requested on the due dates. On June 10, 2012 the directors re-issued the forfeited shares as fully paid to Gopal, on receiving a payment of ₹ 10,500.

(a) To prepare a statement as on February 1, 2012, showing the over-payment, under-payment to in respect of category of applicants : and

(b) To show how the above transactions would appear in the journal of the company.

Answer 12.

(a) **King Ltd.**

Statement of Shares Applied, Allotted and Amounts Adjusted

	Catetories		
	A	B	C
(a) Applied (Nos.)	8,000	40,000	8,000
(b) Allotted (Nos.)	4,000	4,000	2,000
	₹	₹	₹
(c) Application money Received (Applied ×Application per share)	4,00,000	20,00,000	4,00,000
(d) Application Money required (Alloted × Application per share)	2,00,000	2,00,000	1,00,000
(e) Excess Application Money to be Adjusted with Allotment [c-d]	2,00,000	18,00,000	3,00,000
(f) Allotment Money Due (Alloted × Allotment per share)	2,00,000	2,00,000	1,00,000
(g) Balance of Excess Application Money for Adjustment with calls [e-f]	Nil	16,00,000	2,00,000
(h) Call Money Due (Allotment × Call per share)	1,00,000	1,00,000	50,000
(i) Excess/(Shortage)	(1,00,000)	15,00,000	1,50,000

In case of shortage, the shareholders will deposit the dues.

(b) **Journals**

2012	***Particulars***		***L.F.***	***Dr.*** (₹)	***Cr.*** (₹)
Jan. 01	Bank A/c	Dr.		28,00,000	
	To Equity Share Application A/c				28,00,000
	(Application money received on 56,000 shares @ ₹ 50 per share)				
Feb. 01	Equity Share Application A/c	Dr.		5,00,000	
	To Equity Share Capital A/c				2,50,000
	To Securities Premium A/c				2,50,000
	(Being application money on 10,000 shares transferred to share Capital and Securities Premium vide Board's resolution no. dated...)				
	Equity Share Application A/c	Dr.		16,50,000	
	To Bank A/c				16,50,000
	(Being excess application money refunded of vide Board's resolution no. dated...)				

	Equity Share Allotment A/c Dr. To Equity Share Capital A/c (Being allotment money due on 10,000 shares @ ₹ 50 per share vide Board's resolution no. dated...)		5,00,000	 5,00,000
	Equity Share Application A/c Dr. To Equity Share Allotement A/c (Being excess of Equity share application money adjusted with allotment)		5,00,000	 5,00,000
	Equity Share First & Final Call A/c Dr. To Equity Share Capital A/c (Being first & final call money due on 10,000 shares @ ₹ 25 per share vide Board's resolution no. dated...)		2,50,000	 2,50,000
Apr. 01	Bank A/c Dr. Calls in Arrear A/c Dr. Equity Share Application A/c Dr. To Equity Share First & Final Call A/c (Being amount received and adjusted, except a holder of 100 share who failed to pay the call)		97,500 2,500 1,50,000	 2,50,000
	Equity Share Capital A/c Dr. To Shares Forfeited A/c To Calls in Arrear A/c (Being 100 shares held by Mohan forfeited for non-payment of call @ ₹ 25 per share vide Board's resolution no. dated...)		10,000	 7,500 2,500 7,500
May 05	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being 100 forfeited shares resissued at 10,500)		10,500	 10,000 500
	Share Forfeited A/c Dr. To Captial Reserve (Being balance of shares forfeited transferred to captial reserve)		7,500	 7,500

Q. 13. The following balances appeared in the books of River Ltd. on 1.04.2011.

(i) Debenture Redemption Fund Account- ₹ 80,000 represented by investment at cost of an equal amount (nominal value ₹ 1,00,000)

(ii) The 12% debenture Stood at ₹ 1,80,000

The Company sold ₹ 60,000 investments at ₹ 90 for the purpose of redemption of ₹ 50,000 Debentures at a premium of 2% during the year.

Show (a) 12% Debentures account, (b) Debenture Redemption Fund a/c (c) Debenture Fund Investment A/c for the year ended 31.03.2012.

Answer 13.

In the books of River Ltd.

Dr. **12% Debentures Account for the year ended 31.03.2012** ***Cr.***

Particulars	₹	Particulars	₹
To Debenture Holders A/c	50,000	By Balance b/d	1,80,000
To Balance c/d	1,30,000		
	1,80,000		1,80,000

Dr. **Debenture Redemption Fund Account for the year ended 31.03.2012** ***Cr.***

Particulars	₹	Particulars	₹
To Premium Payable on Redemption of Debentures A/c	1,000	By Balance b/d	80,000
To General Reserve A/c	53,000	By Debenture Redemption Fund Investment A/c (Profit on realization of investments)	6,000
To Balance c/d	32,000		
	86,000		86,000

Dr. **Debenture Fund Investment Account for the year ended 31.03.2012** ***Cr.***

Particulars	₹	Particulars	₹
To Balance b/d (Nominal Value ₹ 1,00,000)	80,000	By Bank A/c (Sale of ₹ 60,000 investment at ₹ 90)	54,000
To Debenture Redemption Fund A/c	6,000	By Balance c/d	32,000
	86,000		86,000

Dr. **Debenture Holders Account for the year ended 31.03.2012** ***Cr.***

Particulars	₹	Particulars	₹
To Bank A/c	51,000	By 12 % debenture A/c	50,000
		By Premium on redemption A/c	1,000
	51,000		51,000

Q. 14. The firm of ABC was dissolved on 31.3.2012 at which date its Balance Sheet stood as :

Liabilities	Amount ₹	Assets	Amount ₹
Creditors	**6,00,000**	**Fixed Assets**	**1,35,00,000**
Bank Loan	**15,00,000**	**Cash at Bank**	**6,00,000**
A's Loan	**30,00,000**		
Capital :			
A	**45,00,000**		
B	**30,00,000**		
C	**15,00,000**		
	1,41,00,000		**1,41,00,000**

Partners share profits equally. A firm of Chartered Accountant is retained to realise the assets and distribute the cash after discharge of liabilities. Their fees which are to include all expenses is fixed at ₹ 3,00,000. No loss is expected on realization; semi-fixed assets include valuable land and building.

Realisation are :

1. ₹ 15,00,000 (including Cash and Bank); 2. ₹ 45,00,000; 3. ₹ 45,00,000; 4. ₹ 90,00,000.

The Chartered Account firm decided to pay off the partner in High Relative Capital Method.

You are required to prepare a statement showing distribution of Cash with necessary working.

Answer 14.

Computation of Absolute Surplus :

	A ($\frac{1}{3}$)	**B ($\frac{1}{3}$)**	**C ($\frac{1}{3}$)**
Capital as per Balance Sheet	45,00,000	30,00,000	15,00,000
Less : Capital as per profit-sharing ratio taken C's capital as basis	15,00,000	15,00,000	15,00,000
	30,00,000	15,00,000	—
Less : Capital as per profit-sharing ratio, Taken B's Capital as basis	15,00,000	15,00,000	
Absolute Surplus	15,00,000		

Statement showing the Distribution

Particulars	Total Realisation ₹	Creditors	Loan	Bank/A's Loan	Capital A ₹	Capital B ₹	Capital C ₹
Amount Due		6,00,000	15,00,000	30,00,000	45,00,000	30,00,000	15,00,000
Payment out of 1st Realisation	15,00,000						
Less: Liquidation Expenses	3,00,000						
Balance to creditors and Bank	12,00,000	3,42,858	8,57,142				
Loan in 2:5		2,57,142	6,42,858				
Payment out of 2nd Realisation							
₹ 2,52,142 To Creditor							
₹ 6,42,858 To Bank Loan		2,57,142	6,42,858				
₹ 30,00,000 To A's Loan							
₹ 6,00,000 Balance to A				30,00,000	6,00,000		
₹ 45,00,000	45,00,000				39,00,000		
Payment out of 3rd Realization					9,00,000		
₹ 9,00,000 To A					30,00,000	30,00,000	
₹ 15,0,000 To A					15,00,000	15,00,000	
₹ 15,0,000 To B					15,00,000	15,00,000	15,00,000
₹ 6,00,000 To A, B and C					2,00,000	2,00,000	2,00,000
₹ 45,00,000	45,00,000				13,00,000	13,00,000	13,00,000
Payment out of 4th Realisation							
₹ 45,00,000 to A,B and C equally	90,00,000				30,00,000	30,00,000	30,00,000
Profit Realisation	90,00,000				17,00,000	17,00,000	17,00,000

Alternatively, applying Maximum possible loss method :

Particulars	₹	Total ₹	Creditors ₹	Loan ₹	Bank/A's ₹	Capital A ₹	Capital B ₹	Capital C ₹
Balance Due		1,41,00,000	6,00,000	15,00,000	30,00,000	45,00,000	30,00,000	15,00,000
Cash at Bank	6,00,000							
(+)1st Realisation	9,00,000							
	15,00,000							
(-)Liquidation Exp.	3,00,000							
Available Cash	12,00,000	12,00,000	3,42,858	8,57,142	—	—	—	—
To be distributed in o/s liability ratio (30:75)								
		1,29,00,000	2,57,142	6,42,858	30,00,000	45,00,000	30,00,000	15,00,000
2nd Realisation	45,00,000							
(-) payment to Creditors	3,57,142							
(-) payment of		2,57,142						
Bank Loan	6,42,858							
Available cash	36,00,000	6,42,858	2,57,142	6,42,858				
		1,20,00,000						
(-)L's Loan	30,00,000	30,00,000			30,00,000			
		90,00,000	Nil	Nil	Nil	45,00,000	30,00,000	15,00,000

Balance Due								
Available cash	6,00,000	(-)6,00,000						
Maximum Loss (in Capital contribution ratio) i.e. 3:2:1		84,00,000				(42,00,000)	(28,00,000)	(14,00,000)
Payment to Partners						3,00,000	2,00,000	1,00,000
Balance Due	84,00,000					42,00,000	28,00,000	14,00,000
3rd Realisation	45,00,000							
Maximum Loss (in Capital contribution ratio) i.e. 3:2:1	39,00,000					(19,50,000)	(13,00,000)	(6,50,000)
Payment to Partners						22,50,000	15,00,000	6,50,000
Balance Due	39,00,000					19,50,000	13,00,000	6,50,000
4th Realisation	90,00,000							
Profit (in Capital contribution ratio) i.e. 3:2:1	51,00,000					25,50,000	17,00,000	8,50,000
						45,00,000	30,00,000	15,00,000

Q. 15. M/s AB Co., having A and B as equal partners, decided to amalgamate with M/s CD Co., having C and D as equal partners on the following terms and conditions :

1. **The new firm XY Co. to pay ₹ 12,000 to each firm for Goodwill.**
2. **The new firm to take over investments at 90% of the value, land at ₹ 66,800, premises at ₹ 53,000, machinery at ₹ 9,000 and only the trade liabilities of both the firms and the debtors at book value.**
3. **Typewriters, worth ₹ 800, belonging to CD Co., not appearing in the Balance Sheet. That is not taken over by the new firm.**
4. **Bills payable pertaining to trade transactions only.**
5. **All the four partners in the new firm to bring in ₹ 1,60,000 as capital in equal shares.**

The following were the Balance Sheets of both the firms on the date of amalgamation :

Liabilities	AB Co. ₹	CD Co. ₹	Assets		AB Co. ₹	CD Co. ₹
Trade creditors	20,000	10,000	Cash		15,000	12,000
Bills payable	5,000	-	Investments		10,000	8,000
Bank overdraft	2,000	10,000	Debtors	10,000		
A's Loan	6,000	-	Less: Provision	1,000	9,000	4,000
Capitals:			Furniture		12,000	6,000
A	35,000	-	Premises		30,000	-
B	22,000	-	Land		-	50,000
C	-	36,000	Machinery		15,000	15,000
D	-	20,000	Goodwill		9,000	9,000
General Reserve	8,000	3,000				
Investment Fluctuation Fund	2,000	1,000				
	1,00,000	80,000			1,00,000	80,000

Assuming immediate discharge of bank overdraft, pass necessary Journal entries to close the books of AB Co. Also pass Journal entries in the books of XY Co. and prepare the Balance Sheet of the firm.

Answer 15.

In the books of AB Company
Journals

Date	Particulars		Dr. ₹	Cr. ₹
	Bank Overdraft A/c To Cash A/c (Payment of overdraft)	Dr.	2,000	 2,000
	Realisation A/c To Cash A/c To Investments A/c To Debtors A/c To Furniture A/c To Premises A/c To Machinery *A/c* To Goodwill A/c (Transfer of different assets)	Dr.	99,000	 13,000 10,000 10,000 12,000 30,000 15,000 9,000
	Provision for Bad Debts A/c Trade Creditors A/c Bills Payable A/c To Realisation A/c (Transfer of different Liabilities)	Dr. Dr. Dr.	1,000 20,000 5,000	 26,000
	M/s Lucky & Co. A/c To Realisation A/c (Note 1) (Purchase consideration due)	Dr.	80,000	 80,000
	A Capital A/c B Capital A/c To Realisation *A/c* (Furniture taken over by the partners)	Dr. Dr.	6,000 6,000	 12,000
	General Reserve A/c Investment Fluctuation Fund A/c To A Capital A/c To B Capital A/c (Reserve and Surplus distributed)	Dr. Dr.	8,000 2,000	 5,000 5,000
	Realisation A/c To A Capital A/c To B Capital A/c (Profit on realisation transferred)	Dr.	19,000	 9,500 9,500
	A's Loan A/c To A Capital A/c (A's loan transferred to his Capital A/c)	Dr.	6,000	 6,000
	Cash A/c To B Capital A/c (Cash brought in by B)	Dr.	9,500	 9,500
	Capital in M/s XY Co. A/c To M/s XY Co. A/c (Settlement of purchase consideration)	Dr.	80,000	 80,000
	A's Capital A/c To Capital in XY Co. A/c To Cash A/c (Final adjustment to close the books)	Dr.	49,500	 40,000 9,500
	B's Capital A/c To B's Cap. In XY Co. A/c (Final adjustment to close the books)	Dr.	40,000	 40,000

Q. 16. P, Q and R were in partnership sharing profits and losses in the ratio of 9 : 4 : 2. B retired from the partnership on 31st March, 2012, when the firm's balance sheet was as under :

₹ in thousand

		₹		₹
Sundry Creditors		**900**	**Cash and Bank**	**426**
Capital Accounts :			**Sundry Debtors**	**600**
P	**4,050**		**Stock**	**1,200**
Q	**1,800**		**Furniture**	**399**
R	**900**	**6,750**	**Plant**	**1,275**
			Land and Building	**3,750**
		7,650		**7,650**

Q's share in goodwill and capital was acquired by P and R in the ratio of 1 : 3, the continuing partners bringing in the necessary finance to pay off Q. The partnership deed provides that on retirement or admission of a partner, the goodwill of the firm is to be valued at three times the average annual profits of the firm for the four years ended on the date of retirement or admission. The profits of the firm during the four years ended 31st March, 2012 in thousands of rupees were :

	₹
2008-09	**675**
2009-10	**375**
2010-11	**900**
2011-12	**1,050**

The deed further provided that goodwill account is not to appear in the books of accounts at all. The continuing partners agreed that with effect from 1st April, 2012, G, son of P is to be admitted as a partner with 25% share of profit.

P gifts to G, by transfer from his capital account, an amount sufficient to cover up 12.5% of capital and goodwill requirement. The balance 12.5% of capital and goodwill requirement is purchased by G from P and R in the ratio of 2 : 1.

The firm asks to you :

(i) Prepare a statement showing the continuing partners' shares;

(ii) Pass journal entries including for bank transactions; and

(iii) Prepare the balance sheet of the firm after G 's admission.

Answer 16.

(i) **Statement showing the partners' shares**

	P	*Q*	*R*	*G*
Ratio before retirement of Q	$\frac{9}{15}$	$\frac{4}{15}$	$\frac{2}{15}$	—
Adjustment on retirement	(+) $\frac{1}{15}$	—	(+) $\frac{3}{15}$	—
New ratio before admission of G	$\frac{10}{15}$	—	$\frac{5}{15}$	—

On admission of G Gift by P ($\frac{12.5}{100}$)	(–) $\frac{1}{8}$	—	—	$\frac{1}{8}$
Purchase from P & R *	(–) $\frac{2}{24}$	—	(–) $\frac{1}{24}$	(+) $\frac{3}{24}$
New ratio	$\frac{11}{24}$	—	$\frac{7}{24}$	$\frac{6}{24}$

* Purchase from P i.e. = 2/3 × 1/8 = 2/24

Purchase from R i.e. = 1/3 × 1/8 = 1/24

(ii) **Journal Entries**

			Dr. ₹	*Cr.* ₹
1.	P's Capital A/c	Dr.	1,50,000	
	R's Capital A/c	Dr.	4,50,000	
	To Q's Capital A/c			6,00,000
	(Being purchase of goodwill by P and R from Q)			
2.	P's Capital A/c	Dr.	11,25,000	
	To G's Capital A/c			11,25,000
	(Being gift made by P to G)			
3.	Bank A/c	Dr.	46,50,000	
	To P's Capital A/c			11,62,500
	To Q's Capital A/c			20,81,250
	To G's Capital A/c			14,06,250
	(Being capital brought in by the partners)			
4.	Q's Capital A/c	Dr.	24,00,000	
	To Bank A/c			24,00,000
	(Being final payment made to Q on retirement)			
5.	G's Capital A/c	Dr.	2,81,250	
	To P's Capital A/c			1,87,500
	To R's Capital A/c			93,750
	(Being goodwill adjusted on admission)			

(iii) **Balance Sheet as on 1st April, 2012**

Liabilities		₹	**Assets**	₹
Sundry Creditors		9,00,000	Cash and Bank	2676,000
Capital Accounts :			Sundry Debtors	6,00,000
P	4125,000		Stock	12,00,000
R	2625,000		Furniture	399,000
G	2250,000		Plant	1275,000
		90,00,000	Land and Building	3750,000
		99,00,000		**99,00,000**

Working Notes :

(₹ in thousand)

(1) Adjustment of Goodwill on Retirement :

Value of Goodwill = Average Profits × Years of Purchase

Share of Q = 2250 × 4/15 = 600

Average Profits $= \dfrac{675+375+900+1050}{4}$

∴ Value of Goodwill = 750 × 3 = 2250

Adjustment through partners' capital accounts

P : ¼ × 600=150(Dr.)

Q : 4/15 × 2250=600(Cr.)

R : ¾ × 600=450(Dr.)

(2) Closing Balances of Capital Accounts

Q's share of capital (including goodwill) = (1,800 + 600) = 2400

This represents 4/15th share of capital requirement of the firm.

Thus, total capital = 2400 × 15/4=9000

Hence, closing capital balances (in new profit sharing ratio of 11 : 7 : 6) should be adjusted as follows :

P : 11/24 × 9000=4125

R : 7/24 × 9000=2625

G :6/24 × 9000=2250

Gift by P to G : ½ × 2250=1125

(Debit to P's capital A/c and credit to G's capital A/c)

(3) Adjustment of Goodwill on Admission

Goodwill of the firm = 2250

G's share of goodwill = 6/24 × 2250

= 562.50

(a) Gift by P = ½ × 562.50

= 281.25

(Included in the gift of 1,125 – see W.N. 3)

(b) Purchase from A and C = 281.25

(in 2 : 1 ratio)

Thus, adjustment of goodwill purchased through capital accounts

P : 2/3 × 281.25 = 187.50 (Cr.)

R : 1/3 × 281.25 = 93.75 (Cr.)

G : ½ × 562.50 = 281.25 (Dr.)

(4) Amount brought in by Partners

Dr. **Partners' Capital Accounts** *Cr.*

(₹ in thousand)

	P ₹	Q ₹	R ₹	G ₹		P ₹	Q ₹	R ₹	G ₹
To Q	150	—	450	—	By Balance b/d	4,050	1,800	900	—
To G	1,125	—	—	—	By P and R	—	600	—	—
To P & R	—	—	—	281.25	By Cash and Bank	1,162.5	—	2,081.25	1,406.25
To Cash and Bank	—	2,400	—	—	(Bal. figure)				
To Balancd c/d	4,125	—	2,625	2250	By P	—	—	—	1,125.00
					By G	187.5	—	93.75	—
	5,400	2,400	3,075	2,531.25		5,400	2,400	3,075	2,531.25

(5) Cash and Bank	₹
Amount given (as on 31.3.2012)	426
Amount brought in by partners (1162.50 + 2081.25 + 1406.25)	4650
	5076
Less : Payment to Q	2400
Balance as on 1.4.2012	2676

Net increase = ₹ 2676

(Equivalent to the value of goodwill)

Q. 17. (a) The partners of Urvashi Enterprises Decided to convert Partnership Firm into a Private limited Company Urvashi (P) Ltd. with effect from 1st January 2011. However, Company could be incorporated only on 1st June 2011. The business was continued on behalf of the company and consideration of ₹ 6,00,000 was settled on that day along with interest at 12% per annum.The Company availed loan of ₹ 9,00,000 at 10% per annum on first June 2011, to pay Purchase Consideration and for Working Capital . The Company closed its accounts for the first time on 31st March 2012, and presents you the following summarized Profit and Loss Account.

You are also informed that sales form June 2011 to Dec 2011 were 2½ times of average sales, which further increased to 3½ times in January to March quarter,2012. The company recruited additional work force to expand the business . The salaries from July 2011 doubled. The company also acquired additional showroom at monthly rent of ₹ 10,000 from July 2011.

You are required to prepare a Profit & Loss Account showing apportionment of cost and revenue between Pre- Incorporation and Post Incorporation periods. Also suggest how the Pre-Incorporation Profit/ Loss are to dealt with.

Particulars	₹	₹
Sales		**19,80,000**
Less:		
Cost of Goods Sold	**11,88,000**	
Discount to Dealers	**46,200**	
Directors' Remuneration	**60,000**	
Salaries	**90,000**	
Rent	**1,35,000**	
Interest	**1,05,000**	
Depreciation	**30,000**	
Office Expenses	**1,05,000**	
Sales Promotion Expenses	**33,000**	
Preliminary expenses (to be written off in first year)	**15,000**	**(18,07,200)**
		1,72,800

Answer 17. (a)

(i) Computation of Ratios for apportionment purpose

Particulars	Pre- Incorporation	Post- incorporation	Total
(a) Period in Months	1^{st} Jan to 31^{st} May= 5 months	1^{st} June to 31^{st} Mar = 10 months	5:10 =1:2
(b) Sales per Month Ratio (given) (c) Overall Sales Ratio (a) × (b)	Say, Re. 1 × 5 months 1 × 5=5	(₹ 2.5 × 7 months + ₹ 3.5 × 3 months) (2.5 × 7) + (3.5 × 3)=28	 5:28
(d) Salary Ratio (e) Total salary Ratio (a) × (d)	Say, Re. 1 1 × 5 months = 5	Doubled from July = ₹ 2 (1 × 1) + (2 × 9)=19	 5:28
(f) Rent for additional showroom (g) So, Balance Rent (1,35,000 – 90,000) in Time Ratio	— 15,000	10,000 × 9=90,000 30,000	
(h) Total Rent (f) + (g)	15,000	1,20,000	
(i) Interest Charged to Company (9,00,000 × 10% × 10/12)	—	75,000	
(j) So, Balance Interest for Pre-Inc. (1,05,000-75,000)	30,000	—	

(ii) Profit & Loss Account for 15 months ended 31st March,2012

Particulars	1st Jan to 31st May ₹	1st June to 31st March ₹	Particulars	1st Jan to 31st May ₹	1st June to 31st March ₹
To Cost of Goods Sold (5:28)	1,80,000	10,08,000	By Sales (5:28)	3,00,000	16,80,000
To Discount to dealers (5:28)	7,000	39,200	By Net Loss prior to incorporation	750	
To Director's Remuneration	–	60,000			
To Salaries (5:19)	18,750	71,250			
To Rent (i)	15,000	1,20,000			
To Interest (i)	30,000	75,000			
To Depreciation (1:2)	10,000	20,000			
To Office Expenses (1:2)	35,000	70,000			
To Sales Promotion Expenses (5:28)	5,000	28,000			
To Preliminary Expenses	–	15,000			
To Net Profit (Post Incorporation Profit) (bal. fig)	–	1,73,550			
Total	3,00,750	16,80,000	Total	3,00,750	16,80,000

Note : It is assumed that Preliminary Expenses are fully written off against Post-Incorporation Profits.

Q. 17. (b) The following is the Profit and Loss Account of the Ambani Paper Ltd. for the year ended 31st March, 2012.

Particulars	Amount ₹	Particulars		Amount ₹
To Admn, Selling & Finance Expenses	**5,75,000**	**By Balance b/d**		**4,53,000**
To National Defence Fund	**29,000**	**By Balance from Trading Account**		**38,60,400**
To Directors Fees	**55,000**	**By Interest on Investment**		**11,000**
To Interest on Debentures	**20,750**	**By Transfer Fee**		**1,050**
To Managing Director's Remuneration	**3,80,000**	**By Profit on Sale of Plant**		
To Depreciation of Fixed Assets	**4,64,700**	**Amount realized**	**40,000**	
To Provision for Taxation	**11,45,000**	**Less: Book Value**	**(32,000)**	**8,000**
To General Reserve	**5,49,000**			
To Debenture Sinking Fund	**14,000**			
To Investment Revaluation Reserve	**9,000**			
To Balance c/d	**10,92,000**			
	43,33,450			**43,33,450**

As an Auditor you are required to comment on the Managerial Remuneration.

Answer 17. (b)

1. Computation of Net Profit under Section 349 of Companies Act 1956

Particulars	₹	₹
Balance from Trading Account		38,60,400
Add:interest on Investment		11,000
Transfer Fee received		1,050
Profit on Sale of Plant		8,000
Total		38,80,450
Less: Admn, Selling & Finance Expenses	5,75,000	
Contribution to National Defence Fund	29,000	
Directors Fees	55,000	
Interest on Debentures	20,750	
Depreciation of Fixed Assets	4,64,700	11,44,450
		27,36,000

2. Maximum Remuneration Payable to the Managing Director u/s 309
   = 5% of Net Profit u/s 349 = 5% × ₹ 27,36,000 = ₹ 1,36,800
   However, Managing Director's Remuneration as per the above P & L Account is ₹ 3,80,000
3. Maximum Remuneration Payable under Schedule XIII- Inadequate Profit :
   By virtue of Section 310, where the Company has no profits or its profits is inadequate, it may pay Remuneration to any Managerial Person, within the limits specified in Schedule XIII, Part II, Section II. The ceiling limits are based on the Effective Capital of the Company. In the above case, the Effective Capital of the Company is not known. However, presuming the basic limit of Effective Capital of "Less than ₹ 1 Crore", the maximum permissible remuneration is ₹ 75,000 per month or ₹ 9,00,000 per annum.
4. Audit Observation: Remuneration of ₹ 3,80,000 paid to Managing Director exceeds the limits u/s 309, but is within the limit specified by Section 310 and Schedule XIII.

Q. 18. (a) Surat Rajya Setu Nigam Ltd. was awarded a contrsct of construction of a bridge for ₹ 200 Crores on 1.6.2008. Total contract cost estimated was ₹ 160 Crores. The position of the contract cost on 31.03.2011 and 31.03.2012 was under :

	As on 31.03.2011	**As on 31.03.2012**
Contract Price (₹ Crores)	**200**	**200**
Contract Cost incurred up to date (₹ Crores)	**50**	**180 (100 % complete)**
Estimated contract cost of completion (₹ Crores)	**120**	**NIL**

While closing books of account on 31.03.2012, the chief accountant treated excess cost of ₹ 20 Crores incurred as against estimated of ₹ (50+120)=170 Crores as on 31.03.2011 as mistakes in estimation of cost, hence categorized ₹ 20 Crores (190-170) as prior period expenses. Comment.

Answer 18. (a)

Cost originally estimated by Surat Rajya Setu Nigam Ltd.	₹ 170
Excess Cost incurred	₹ 20
Treatment given by the company	Prior period item

As clearly provided in AS-5, a change in estimate is neither a prior period item nor an extraordinary item. Hence, the treatment given by the company is incorrect.

Q. 18. (b) Raw material was purchased at ₹ 200 per kg. Price of raw materials on the decline . The finished goods in which the raw material is incorporated are expected to be sold at below cost. 10,000 kgs. of raw material is in stock at the year end. Replacement cost is ₹ 160 per Kg. How will you value the inventory?

Answer 18. (b)

As per para 24 of AS-2 on valuation of inventories, material and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that that the cost of finished products will exceed net realisable value, the material are written down to net realisable value and in that case replacement cost will be its the best available measure of its net relisable value.

Q. 18. (c) On 1st December, 2011, Amrit Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 2012 the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of additional cost for completion aws ₹ 32,01,000. What is the additional provision for foreseeable loss, which must be made in the final accounts for the year ended 31st March,2011 as per provision of AS-7 on "Accounting for Construction Contructs".

Answer 18. (c)

Contract Price	₹ 85 Lakhs
Cost Incurred	₹ 64.99 Lakhs
Estimated cost to completion	₹ 32.01 lakhs

Loss to be provided for the year ending 2011-2012

As per AS-7 31.03.2012

Loss to be recognised (64.99/97 × 100) = (67 / 100 × 12) = ₹ 8.04 lakhs

Loss to be provided (provision) = ₹ 3.96 lakhs.

Q. 19. (a) On December 1, 2012 , BB Co. purchased ₹ 2,00,000 worth of land for a factory site. BB Co. razed an old building on the property and sold the materials it salvaged from the demolition. BB Co. incurred additional costs and realized salvaged proceeds during December 2012 as follows :

	₹
Demolition of old building	**25,000**
Legal fees for purchase contract and recording ownership	**5,000**
Title guarantee insurance	**6,000**
Proceeds from sale of salvaged materials	**4,000**

In its December 31, 2012 Balance Sheet, BB Co. should report a balance in the land account.

Answer 19. (a)

As per Para 20 of AS-10, The cost of land should include all expenditure incurred preparing it for its ultimate use (such as factory size) is considered part of the cost of land. Before the land can be used as a building site, it must be purchased (involving costs such as purchase price, legal fees, and title insurance) and the old building must be razed (cost of demolition less proceeds from sale of scrap). The total balance in the account should be ₹ 2,32,000.

Computation of total balance in the Land Account

Particulars	₹
Purchase price	2,00,000
Legal Fees	5,000
Title Insurance	6,000
Net cost of demolition (₹ 25,000 – ₹ 4,000)	21,000
	2,32,000

Q. 19. (b) River Ltd. manufacturing machinery used in steel plants. It quotes prices in various tenders issued by steel plants. As per terms of contract, full price of machinery is not released by the steel plants, but 10% thereof is retained and paid after one year if there is satisfactory performance of the machinery supplied. The company accounts for only 90% of the invoice value as sales income and the balance amount in the year of receipt to the extent of actual receipts only.

Answer 19. (b)

Revenue should be recognized for the entire 100%. The 10% withheld is generally termed as retention monies and is a normal practice buyers/contractors resort to in the construction industry to cover the risk of performance. River Ltd. will have to make a provision for expected warranty costs that may be incurred on the machinery during the free warranty period and any anticipated cost of ensuring performance of the plant during the one year performance period.

Q. 19. (c) Explain in brief as how you will deal with the following as the auditor of the company. Based on the exchange rates prevailing as on 31st March, 2012, the value of fixed assets in the books of Utkal Ltd., appears to be lower by ₹ 10 lakhs. Utkal Ltd. has treated the above exchange difference of ₹ 10 lakhs as an addition to its fixed assets during the year and has provided depreciation thereon accordingly.

Answer 19. (c)

M/s Utkal Ltd. has adjusted the Exchange difference of ₹ 10 lakhs in the cost of asset based on the exchange rates prevailing as on 31st March, 2012. As per (revised) AS 11-'Accounting for the Effects of Changes in Foreign Exchange Rates' such costs cannot be capitalized henceforth. The auditor will have to qualify the true and fair view and also qualify the compliance with mandatory accounting standards i.e. revised AS-11.

Q. 20. (a) Briefly explain the discloser requirement of Accounting Standard-6.

Answer 20. (a)

Disclosure requirements: Following information should be disclosed in the financial statements:

- Historical cost or revalued amount of each class of depreciable assets;
- Total depreciation for the period for each class of assets; and
- Accumulated depreciation
- Depreciation methods used; and
- Depreciation rates or useful lives, if different from rates specified in the statute.

Q. 20. (b) Describe briefly the term "Accounting Policies".

Answer 20. (b)

Accounting policies refers to

- The specific accounting principles (e.g., lower of cost and net realizable value as the basiss of valuation of inventories) as well as
- The methods of applying those principles (e.g., cost formula such as FIFO applied in calculating the cost of inventories)
- Adopted by an enterprise in the preparation and presentation of financial statement.

Q. 20. (c) On 30.4.2012 MNC Ltd.obtained a loan from the bank for ₹ 5 Crores to be utilized as under :

(i)	**Construction of a factory shed**	**₹ 2 Crores.**
(ii)	**Purchase of Machinery**	**₹ 1.5 Crores.**
(iii)	**Working Capital**	**₹ 1 Crore.**
(iv)	**Advance for Purchase of truck**	**₹ 0.5 Crores**

In March 2012, construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ended 31.3.12 was ₹ 90 lakhs. Show the treatment of interest as per AS-16.

Answer 20. (c)

As per AS-16, borrowing cost(interest) should be capitalized if borrowing cost is directly attributable to the acquisition, construction or production of qualifying asset. ₹ 5 crores borrowed from Bank was utilized for four different purposes, only construction of factory shed is a qualifying asset as per AS-16, while the other three payments are not for the qualifying asset. Therefore, borrowing cost attributable to the construction of a factory shed should only be capitalized which will be equal to ₹ 90 lakhs × 2/5= ₹ 36 lakhs.

The balance of ₹ 54 lakhs (₹ 90 lakhs – ₹ 36 lakhs) should be treated as an expense and debited to Profit and Loss Account.

Q. 21. The Balance Sheet of Delhi City College as at 31st March 2011 was as follows :

Liabilities	₹	Assets	₹
Capital Fund	**21,00,000**	**Land and Building**	**20,00,000**
Building Construction Fund	**8,00,000**	**Furniture**	**3,00,000**
General Fund Outstanding	**6,40,000**	**Laboratory Equipment**	**2,50,000**
Salary (teachers)	**1,60,000**	**Library Books**	**3,60,000**
		Investments	**6,50,000**
		Accrued Tuition Fee	**10,000**
		Cash and Bank	**1,30,000**
	37,00,000		**37,00,000**

The Receipts and Payments account for the year ended 31st March 2012 was drawn as under :

Particulars	₹	Particulars	₹
To Opening Balance (1.4.2011)	1,30,000	By Salaries & Allowances (teachers)	42,00,000
To Govt . Grants	50,00,000	By Non- teaching staff	20,00,000
To Donation for Building Construction	2,00,000	By Printing & Stationary	80,000
To Tuition fees & session charges	18,20,000	By Lab. Exp	60,000
To Investment Income	70,000	By Lab. Equipment	1,20,000
To Rental Income (College Hall)	40,000	By Library Books	2,50,000
		By Office Equipment	60,000
		By Electricity & Telephone	75,000
		By Audit Fees	2,000
		By Municipal Taxes	1,000
		By Building Repairs	40,000
		By Purchase of Furniture	80,000
		By Games and Sports	20,000
		By Welfare Exp.	30,000
		By New Investments	1,50,000
		By Closing Balance (31.3.2012)	92,000
	72,60,000		72,60,000

Other information :

(i) Tuition fee outstanding as on 31.3.2012 – ₹ 40,000

(ii) Salary of teaching staff outstanding for March 2012-₹ 2,50,000

(iii) Books received as donations from various parties- ₹ 30,000(valued)

(iv) Outstanding building repair expenses as on 31.3.2012-₹ 15,000

(v) Applicable depreciation rates :

Land and Building	2%
Furniture	8%
Lab. Euipment	10%
Library Books	20%

You are required to prepare the Income and Expenditure A/c for the year ended 31st March 2012 and a Balance Sheet as on that date.

Answer 21.

Delhi City College
Income and Expenditure Account for the year ended 31.3.2012

Particulars		₹	Particulars		₹
To Salaries :			Tuition Fees	18,20,000	
Teaching staff	42,00,000		Add: Outstanding	40,000	
Add: Outstanding	2,50,000			18,60,000	
	44,50,000		Less: Accrued last Year	10,000	18,50,000
Less: Last yr. Liabilities	1,60,000	42,90,000	Revenue Grant		50,00,000
Non-teaching staff		20,00,000	Investment income		70,000
Building Repairs	40,000		Rental Income		40,000
Add: Outstanding	15,000	55,000	Value of donation of books		30,000
Office Expenses		60,000			
Printing & Stationary		80,000			
Lab. Exp		60,000			
Electricity & Telephone		75,000			
Audit Fee		2,000			
Municipal Tax		1,000			
Games & Sports		20,000			
Welfare Expenses		30,000			
Depreciation : Building	40,000				
Furniture	30,400				
Lab. Equip	37,000				
Book	1,28,000	2,35,400			
Excess of Income over Expenditure transferred to General Fund		81,600			
		69,90,000			69,90,000

Balance Sheet as at 31.03.2012

Liabilities	₹	₹	Assets	₹	₹
Capital Fund		21,00,000	Land & Buildings	20,00,000	
Building Construction Fund	8,00,000		Less: Dep	40,000	19,60,000
Add: Donation	2,00,000	10,00,000	Furniture	3,00,000	
General Fund	6,40,000		Additions	80,000	
Add: Transfer from Income &					
Expenditure A/c	81,600	7,21,600		3,80,000	
Outstanding Teachers' Salary		2,50,000	Less: Dep	30,400	3,49,600
Outstanding Building		15,000	Lab Equipment	2,50,000	
Repair Exp.			Addition	1,20,000	
				3,70,000	
			Less: Dep	37,000	3,33,000
			Library Books	3,60,000	
			Addition	2,50,000	
			Donated Value	30,000	
				6,40,000	
			Less: Dep	1,28,000	5,12,000
			Investments	6,50,000	
			Addition	1,50,000	8,00,000
			Tuition Fee accrued		40,000
			Cash and Bank		92,000
		40,86,600			**40,86,600**

Q. 22. The following particulars relate to Winner Club :

Dr. **Income and Expenditure Account for the year ended 31st Dec.2011** ***Cr.***

Particulars	Amount ₹	Particulars	Amount ₹
To Salaries	**6,000**	**By Admission Fees**	**15,000**
To Printing & Stationery	**2,500**	**By Subscription**	**25,000**
To Advertising	**1,000**	**By Rent Receipts**	**4,800**
To Insurance Charges	**900**		
To Electricity	**500**		
To Depreciation on Sports Equipment	**12,000**		
To Surplus	**21,900**		
	44,800		**44,800**

Dr. **Receipts and Payments Account for the year ended 31st Dec.2011** ***Cr.***

Particulars		Amount ₹	Particulars	Amount ₹
To Balance b/d		**5,000**	**By Salary (including advance)**	**7,500**
To Admission fee			**By Printing and Stationery**	**2,500**
2011	**2,500**		**By Advertising**	**1,000**
2012	**13,500**	**16,000**	**By Insurance (part for next year)**	**1,200**
To Subscription			**By Electricity**	**500**
2011	**1,000**		**By Fixed Asset Purchased**	**20,000**
2012	**23,000**		**By Balance c/d**	**17,900**
2013	**2,000**	**26,000**		
To Rent		**3,600**		
		50,600		**50,600**

On 1.1.2011 the club had the following assets : Land and Building ₹ 60,000; Sports Equipment Rs.30,000; Furniture ₹ 4,500. Prepare Opening and closing Balance Sheet.

Answer 22.

In the books of Winner Club

Balance Sheet as at 1.1.2012

Liabilities	Amount ₹	Assets	Amount ₹
Capital fund (bal. fig)	1,06,600	Land and building	60,000
		Sports Equipment	30,000
		Furniture	4,500
		Rent receivable	3,600
		Admission Fees Receivable	2,500
		Outstanding Subscription	1,000
		Cash and Bank	5,000
	1,06,600		1,06,600

In the books of Winner Club

Balance Sheet as at 31st December, 2011

Liabilities		Amount ₹	Assets		Amount ₹
Capital Fund	1,06,600		Land and building		60,000
Add: Surplus	21,900	1,28,500	Sports Equipment	30,000	
Subscription Received in Advance		2,000	Less: Depreciation	12,000	18,000
			Furniture		4,500
			Fixed assets (other)		20,000
			Prepaid Insurance		300
			Prepaid Salary		1,500
			Rent Receivable		4,800
			Outstanding subscription		2,000
			Outstanding Admission Fees		1,500
			Cash and Bank		17,900
		1,30,500			1,30,500

Q. 23. Khush Raho Insurance Co. Ltd. furnishes you the following information :

(i) On 31.3.2011 it had reserve for unexpired risks to the tune of Rs.100 crore. It comprised of Rs.32 crore in respect of machine insurance business; Rs.40 crore in respect of fire insurance business and Rs.14 crore in respect of miscellaneous insurance business.

(ii) It is the practice of Khush Raho Insurance Co. Ltd. to create reserve at 100% of net premium income in respect of marine insurance policies and at 50% of net premium in respect of fire and miscellaneous insurance business.

iii) During the year 31st March , 2012 the following business was conducted :

	Marine ₹ crores	Fire ₹ crores	Miscellaneous ₹ crores
Premia collected from :			
(a) Insured (other than insurance companies) in respect of policies issued	**40**	**84.6**	**30**
(b) Other insurance companies in respect of risks undertaken	**16**	**18**	**10**
Premia paid/payable to other insurance companies on business ceded	**13.6**	**8.6**	**16**

Khush Raho Insurance Co. Ltd. asks you to :

(i) Pass journal entries relating to "unexpired risks reserve"

(ii) Show in columnar form Unexpired Risks Reserve Account for the year ended 31st March, 2012.

Answer 23.

Journals

Date	Particulars		L.F	*Dr.* ₹ Crore	*Cr.* ₹ Crore
2012					
March.31	Marine Revenue A/c	Dr.		10.4	
	To Unexpired Risks Reserve A/c				10.4
	(Excess of closing provision for unexpired risks of ₹ 42.40 crore over opening provision of ₹ 32 crore charged to Marine Revenue A/c)				
March.31	Fire Revenue A/c	Dr.		7.00	
	To Unexpired Risks Reserve A/c				7.00
	(Excess of closing provision for unexpired risks of ₹ 47.00 crore over opening provision of ₹ 40.00 crore charged to Fire Revenue A/c)				
March.31	Unexpired Risks Revenue A/c	Dr.		2.00	
	To Miscellaneous Revenue A/c				2.00
	(Excess of opening provision for unexpired risks of ₹ 14.00 crore over the required closing balance of ₹ 12.00 crore in the provision account credited to Miscellaneous Reserve Account.)				

Working Notes :

Required closing balance in Unexpired Risks Reserve Account:

For Marine business = ₹ (40+16-13.6)= ₹ 42.40

For Fire business = $\frac{₹\,(84.6+9.4)}{2}$ = ₹ 47.00

For miscellaneous business = $\frac{₹\,(30+10-16)}{2}$ = ₹ 12.00

Dr. **Unexpired Risks Reserve Account** *Cr.*

Date	Particulars	Marine	Fire	Misc.	Date	Particulars	Marine	Fire	Misc.
2012		₹ in crore	₹ in crore	₹ in crore	2012		₹ in crore	₹ in crore	₹ in crore
Mar. 31	To, Revenue A/c	—	—	2.00		By, Balance b/d	32.00	40.00	14.00
Mar. 31	To, Balance c/d	42.40	47.00	12.00		By, Revenue A/c	10.40	7.00	—
		42.40	47.00	14.00			42.40	47.00	14.00

Q. 24. (a) Safety Life Insurance Co. furnishes you the following information:

	₹
Life Insurance fund on 31.3.2012	**2,60,00,000**
Net liability on 31.3.2012 as per actuarial valuation	**2,00,00,000**
Interim bonus paid to policyholders during intervaluation period	**15,00,000**

You are required to prepare :

(i) Valuation Balance Sheet;

(ii) Statement of Net Profit for the valuation period; and

(iii) Amount due to the policyholders.

Answer 24. (a)

(i) Safety Life Insurance Co.

Valuation Balance Sheet as at 31st March, 2012

Particulars	₹	Particulars	₹
To Net Liability as per actuarial valuation	200,00,000	By Life Assurance Fund	2,60,00,000
To Surplus	60,00,000		
	2,60,00,000		2,60,00,000

(ii) Statement showing Net Profit for the valuation period

Particulars	₹
Surplus as per Balance Sheet (i.e., Valuation Balance Sheet)	60,00,000
Add: Interim bonus paid	15,00,000
	75,00,000

(iii) Amount due to policyholders

Particulars	₹
95% of net profit due to policyholders (95% of ₹ 75,00,000)	71,25,000
Less: Interim bonus already paid	15,00,000
Amount due to policyholders	56,25,000

Q. 24. (b) From the following figures of Well Life Assurance Co. Ltd. prepare a Valuation Balance Sheet and Profit Distribution Statement for the year ended 31st March, 2012, also necessary Journal entries to record the above transactions with narration.

	₹ in lakhs
Balance of Life Assurance Fund as on 1.4.2011	**167.15**
Interim Bonus paid for the valuation period	**25.00**
Balance of Revenue account for the year ended 31.3.2012	**240.00**
Net Liability as per Valuer's cerftficate as on 31.3.2012	**165.00**

The company declared a reversionary bonus of ₹ 185 per ₹ 1,000 and gave the policyholders an option to take bonus in cash ₹ 105 per ₹ 1,000. Total business conducted by the company was

₹ 600 lakhs. The company issued with profit policy only. 3/5 of the policyholders in value opted for cash bonus.

Answer 24. (b)

Well Life Assurance Co. Ltd.

Valuation Balance Sheet as on 31st March, 2012

₹ in Lakhs.

To, Net Liability	165.00	By, Life Fund as on 31.3.2012	240.00
To, Profit & loss A/c	75.00		
	240.00		240.00

Distribution Statement **₹ in Lakhs.**

Profit as per Valuation Balance Sheet	75.00
Add: Interim Bonus paid	25.00
	100.00
Policy holder's share (95%)	95.00
Less: Interim Bonus paid	25.00
	70.00

Journal Entries **₹ in Lakhs**

	Life Assurance Fund A/c	Dr.	75.00	
	To, Profit & Loss A/c			75.00
	(Being profit transferred as per Valuation Balance Sheet)			
	Profit & Loss A/c	Dr.	37.80	
	To, Bonus Payable in Cash A/c			37.80
	(Cash bonus payable @ ₹ 105 per 1,000 on 3/5 of 600 lakhs)			
	Profit & Loss A/c	Dr.	44.40	
	To, Life Assurance Fund A/c			44.40
	(Being profits @ of ₹ 185 per 1,000 on 2/5 of 600 lakhs transferred to Life Fund for revisionary bonus)			

Q. 25. The following information is extracted from the accounting records of Mumbai State Electricity Supply Ltd. for the financial year ended 31st March, 2012 :

	₹ (in Crores)
Share Capital	**120.00**
Fixed Assets (tangible) at cost	**232.00**
Accumulated Depreciation	**80.00**
Intangible Assets	**12.00**
Investments:	
Depreciation Reserve Fund	**80.00**

Contingencies Reserve	**8.00**
Loan form State Electricity Board	**20.00**
12% Debentures	**40.00**
Tariff and Dividend Control Reserve	**12.00**
Net Profit after Tax	**24.40**
Customers' Security Deposits	**12.00**
Monthly average of Current Assets	**14.00**

The monthly average of current assets includes ₹ 2,00,00,000 (2 Crore) due from customers. Investments yield 10% return p.a. The applicable bank rate is 9% p.a.

You are required to calculate :

(i) Capital Base;

(ii) Reasonable Return;

(iii) Disposal of Profit.

Answer 25.

Calculation of -

		₹	₹
(i)	**Capital Base :**		
	Tangible fixed assets at cost	232,00,00,000	
	Intangible Assets	12,00,00,000	
	Contingency Reserve Investment	8,00,00,000	
	Current Assets (Net)	12,00,00,000	264,00,00,000
	Deduct :		
	Accumulated Depreciation	80,00,00,000	
	S.E.B. Loan	20,00,00,000	
	12% Debentures	40,00,00,000	
	Customer's Security Deposit	12,00,00,000	
	Tariff and Dividend Control Reserve	12,00,00,000	164,00,00,000
	Capital Base		100,00,00,000
(ii)	**Reasonable Return :**		
	Standard Yield on Capital Base 9% +2% =11%	11,00,00,000	
	Return on Depreciation Fund Investments		
	10% of ₹ 80 Crores	8,00,00,000	
	½ on SEB Loan	10,00,000	
	½ on Debentures	20,00,000	
		19,30,00,000	
	Profit after Tax	24,40,00,000	
	Less: Reasonable Return	19,30,00,000	
	Disposable Surplus	5,10,00,000	
	Excess upto 20% of Reasonable Return	3,86,00,000	
	Amount to be credited to Customers"		
	Rebate Reserve	1,24,00,000	

Allocation of Surplus of ₹ 3,86,00,000	**₹**
(a) $\frac{1}{3}$ for the Company subject to 5% of Reasonable Return	96,50,000
(b) ½ of the balance to Tariff and Dividend Control Reserve	1,44,75,000
(c) ½ of the balance to be credited to Customer's Rebate Reserve	1,44,75,000
	3,86,00,000

Q. 26. The Indian Gas Company rebuilt and re-equipped part of their works at a cost of ₹ 5,00,000.

The part of the old works thus superseded cost ₹ 3,00,000. The capacity of the new works is doubled the capacity of the old work. ₹ 20,000 is realized by the sale of old materials, and old materials worth ₹ 10,000 are used in the construction of the new works and included in the total cost of ₹ 5,00,000 mentioned above. The costs of Labour and Materials are 25% higher than when the old works were built.

Answer 26.

Journal Entries

Date	Particulars		*Dr.* ₹	*Cr.* ₹
	Replacement A/c	Dr.	3,75,000	
	New works A/c	Dr.	1,15,000	
	To, Bank A/c			4,90,000
	[Being the amount written off i.e. (₹ 3,00,000 + 25%) and the amount capitalised out of the ₹ 4,90,000, spent on reconstruction in cash, i.e. ₹ 5,00,000 – ₹ 10,000]			
	New Works A/c	Dr.	10,000	
	To, Replacement A/c			10,000
	(Being the materials used in the new works)			
	Bank A/c	Dr.	20,000	
	To, Replacement A/c			20,000
	(Being the amount realized by the sale of old materials)			
	Revenue A/c	Dr.	3,45,000	
	To, Replacement A/c			3,45,000
	(Being the transfer of balance of Replacement A/c to Revenue A/c)			

Working notes :

	₹
Cost of old works	3,00,000
Add: Increase in cost ₹ $\frac{3,00,000 \times 25}{100}$	75,000
Current cost of old works	3,75,000

Cash cost of new works = 5,00,000 – ₹ 10,000 = ₹ 4,90,000

Account to be capitalised = ₹ 4,90,000 – ₹ 3,75,000 = ₹ 1,15,000.

Q. 27. (a) From the following trial balance and the additional information, prepare a Balance Sheet of Lakshmi Bank Ltd. as at 31st March,2012:

Debit balance	₹ (in Lakhs)
Cash Credits	1,218.15
Cash in hand	240.23
Cash with Reserve Bank of India	67.82
Cash with other Banks	132.81
Money at call and short notice	315.18
Gold	82.84
Government securities	365.25
Current Accounts	42.00
Premises	133.55
Furniture	95.18
Term Loan	1,189.32
	3,882.33

Credit balance	₹ (in Lakhs)
Share Capital (29,70,000 equity shares of ₹ 10 each, fully paid up)	297.00
Statutory Reserve	346.50
Net Profit for the year (before appropriation)	225.00
Profit & Loss Account (Opening balance)	618.00
Fixed deposit Accounts	775.50
Savings Deposit Accounts	675.00
Current Accounts	780.18
Bills Payable	0.15
Borrowings from other Banks	165.00
	3,882.33

***Additional Information* :**

(i) **Bills for collection : ₹ 18, 10,000**

(ii) **Acceptance and endorsements : ₹ 14, 12,000**

(iii) **Claims against the bank not acknowledged as debts : ₹ 55, 000**

(iv) **Depreciation charged on premises : ₹ 1,10,000 and Furniture : ₹ 78,000**

Answer 27. (a)

Lakshmi Bank Ltd.
Balance Sheet as on 31.3.2012

Details	Schedule No.	Amount (₹ in Lakhs)
Capital and Liabilities:		
Capital	1	297.00
Reserves and Surplus	2	1,189.50
Deposits	3	2,230.68
Borrowings	4	165.00
Other Liabilities and Provisions	5	0.15
Total		3,882.33

Details	Schedule No.	Amount (₹ in Lakhs)
Assets :		
Cash and Balance with RBI	6	308.05
Balances with Banks and Money at Call and Short Notice	7	489.99
Investments	8	448.09
Advances	9	2,407.47
Fixed Assets	10	228.73
Total		3,882.33
Contingent Liabilities	12	14.67
Bills for Collection		18.10

Schedules

Schedule 1 - Capital **₹ (in lakh)**

Issued, Subscribed and Called – up Capital (29,70,000 @₹ 10)	297.00

Schedule 2 - Reserves and Surplus

1. Statutory Reserve		346.50	
Add: 20% of ₹ 2,25,00,000		45.00	
(Assumed to be an unscheduled Bank)		391.50	
2. Profit & Loss A/c Opening	6,18,000		
Add: Current Year			
₹ (2,25,00,000 – 45,00,000)	1,80,000	798.00	
		1,198.50	1,189.50

Schedule 3 - Deposit

1. Demand Deposits	780.18
2. Savings Bank Deposits	675.00
3. Term Deposit	775.50
	2,230.68

Schedule 4 - Borrowings

Borrowings from other Banks	165.00

Schedule 5 - Outstandings and Provisions

Bills Payable	0.15

Schedule 6 - Cash and Balances with RBI

Cash in Hand	240.23
Balances with RBI	67.82
	308.05

Schedule 7 - Balances with Banks and Money at Call and Short Notice

Cash with other Banks	132.81
Money at Call and short Notice	315.18
Current Accounts	42.00
	4,89.99

Schedule 8 - Investment

Government securities	365.25
Gold	82.84
	4,48.09

Schedule 9 - Advances

Cash Credit	1,218.15
Term Loans	1,189.32
	2,407.47

Schedule 10 - Fixed Assets

Premises	1,34,65,000	
Less : Depreciation	(1,10,000)	133.55
Furniture	95,96,000	
Less : Depreciation	(78,000)	95.18
		228.73

Schedule 11 - Other Assets

Schedule 12 - Contingent Liabilities

Acceptance and Endrosements	14.12
Claims against the Bank not acknowledge as Debts	0.55
	14.67

Q. 27. (b) The following information for the year ended 31st March, 2012 is available for City Bank Ltd. :

	₹	₹
Standard Assets		**5,50,00,000**
Sub-standard Assets		**31,50,000**
Doubtful Assets but secured—		
Up to one year	**29,00,000**	
One to three years	**17,00,000**	
More than three years	**7,00,000**	**53,00,000**
Loss Assets		**21,00,000**

You are required to ascertain the amount of provision required to be made by the Bank.

Answer 27. (b)

City Bank Ltd.

Statement showing the amount of provision for the year ended 31st March 2012

	Assets	**Amount**	**Rate of Provision ₹**	**Amount of Provision ₹**
1.	Standard Assets	5,50,00,000	0.004	2,20,000
2.	Sub-standard	31,50,000	0.10	3,15,000
3.	Doubtful Assets :			
	Upto one year	29,00,000	0.20	5,80,000
	One to three years	17,00,000	0.30	5,10,000
	More than three years	7,00,000	1.00	7,00,000
	Loss Assets	21,00,000	1.00	21,00,000
	Total amount of required for provision			44,25,000

(Rates of provision as per Master Circular issued by RBI 'DBOD No. BP. BC. 11/21.04, 048/2005-06 dated November 4, 2005')

Q. 28. Fivestar Ltd. undertook a contract No. 444 for ₹ 7,50,000. The contract account showed the following particulars :

***2010* :**

Materials ₹ 30,000, Wages ₹ 25,000, Overheads ₹ 10,000, Plant ₹ 1,00,000 and Materials at site at close ₹ 3,000.

***2011* :**

Materials ₹ 1,00,000, Wages ₹ 60,000, Overheads ₹ 15,000, Materials returned, ₹ 8,000. The Plant at its depreciated value was transferred to contract No. 88. Uncertified work ₹ 15,000.

***2012* :**

Materials ₹ 1,60,000, Wages ₹ 1,00,000, Overheads Rs. 28,000 and Materials ₹ 4,000.

The amount of work certified at the end of the first year was ₹ 1 ,00,000. The work certified upto the end of the second year was ₹ 4,00,000 and the work certified in the third year was ₹ 3,50,000. 80 percent of the certified work was received in cash.

Profit to be taken credit for are one-third and one-half on cash basis in each of the two years respectively.

Depreciate plant by 10 percent on balance at the beginning of each year.

Prepare accounts in respect of the contract at the end of each year.

Answer 28.

Particulars	**₹**	**Particulars**	**₹**
2010		2010	
To Materials	30,000	By Work-n-Progress A/c :	
To Wages	25,000	Materials	3,000
To Overheads	10,000	Plant	90,000
To Plant	1,00,000	Plant	1,00,000
To Balance c/d	28,000		
	1,93,000		1,93,000

Particulars	₹	Particulars	₹
2010		2010	
To Profit & Loss Account	7,467	By Balance b/d	28,000
To Work-in-Progress Account	20,533		
	28,000		28,000
2011:		2011:	
To Work-in-Progress — Opening balance transferred:		By Work-in-Progress — Opening provision transferred	20,533
Materials	3,000	By Materials — returned	8,000
Plant	90,000	By Contract No. 88— Plant transferred	81,000
Certified Work	1,00,000		
To Materials	1,00,000	By Work-in-Progress c/d:	
To Wages	60,000	Uncertified Work	15,000
To Overheads	15,000	Certified Work	4,00,000
To Balance c/d	1,56,533		
	5,24,533		5,24,533
To Profit & Loss Account	62,613	By Balance b/d	1,56,533
To Work-in-Progress	93,920		
	1,56,533		1,56,533
2012:		2012:	
To Work-in-Progress :		By Work-in-Progress	93,920
Uncertified Work	15,000	By Bank — sale of materials	4,000
Certified Work	4,00,000	By Contractee's Account	7,50,000
To Materials	1,60,000	(4,00,000 + 3,50,000)	
To Wages	1,00,000		
To Overheads	28,000		
To Profit & Loss Account	1,44,920		
	8,47,920		8,47,920

Notes :

Profit credited in 2010 and 2011 :	**2010** (₹)	**2011** (₹)
Accounting Profit	28,000	1,56,533
Cash Profit — on 80% basis	22,400	1,25,226
Proportionate profit to be credited	$\frac{1}{2} \times 22,400$	$\frac{1}{3} \times 1,25,226$
	= 7,467	= 62,613

In absence of specific direction, on profit in 2008 would have been considered as extent of completion was less than one-third.

In 2012 the entire work was certified and hence no provision is necessary.

Q. 29. From the following information relating to Virat Ltd., prepare a Balance Sheet as on 31.3.2012.

Current Ratio	**3**
Fixed Assets/Shareholders' Networth	**0.9**
Reserve & Surplus/Share Capital	**0.25**
Average Debt Collection period	**2 months**
G.P Ratio	**25 %**
Cost of Sales/Closing Stock	**13.5 times**
Net Working Capital	**₹ 600,000**
Liquid Ratio	**2.25**

Answer 29.

Current Ratio = CA/CL=3
Or, CA = 3 CL

Net Working Capital = CA – CL = 6,00,000
Or, 3 CL- CL = 6,00,000
Or, 2 CL = 6,00,000
Or, CL = 3,00,000
Thus, CA = 9,00,000

Liquid Ratio = (CA – Stock)/CL = 2.25
Or, (9,00,000-Stock)/3,00,000 = 2.25
Or, Stock = 2,25,000

Cost of Sales/Closing Stock = 13.5
Cost Of Sales = 2,25,000 × 13.5 = ₹ 30,37,500

G/P Ratio = 25%
Cost of Sales/Sales = 75%
Sales = ₹ 30,37,500 / 75% = ₹ 40,50,000

Average Debt Collection period = 2 months = 6 times
Or, Sales/Debtors = 6
Or, Debtors = ₹ 40,50,000 / 6 = ₹ 6,75,000

Fixed Assets/Networth = 0.9
Or, Working Capital/ Net worth = 1 – 0.9 = 0.1
Or, Networth = ₹ 6,00,000 / 0.1 = ₹ 60,00,000
Fixed Asset (Tangible) = 0.9 × ₹ 60,00,000 = ₹ 54,00,000

Reserves & Surplus/Share Capital = 0.25/1
Reserves & Surplus + Share Capital = 1+0.25 = 1.25
Reserves & Surplus = ₹ 60,00,000 × 0.25/1.25 = ₹ 12,00,000
Share Capital = ₹ 12,00,000/0.25 = ₹ 48,00,000

Name of the Company ST Ltd.

Balance Sheet as at 31st March, 2012 **[as per Revised Schedule VI]**

₹ in lakhs

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
I EQUITY AND LIABILITIES			
(1) Shareholders' funds :			
(a) Share Capital		48,00,000	—
(b) Reserves and Surplus		12,00,000	—
(c) Money received against share warrants		—	—
(2) Share application money pending allotment		—	—
(3) Non-current liabilities :			
(a) Long-term borrowings			
(b) Deferred tax liabilities (Net)		—	—
(c) Other long term liabilities		—	—
(d) Long –term provisions		—	—
(4) Current Liabilities :			
(a) Short-term borrowings		—	—
(b) Trade Payables		—	—
(c) Other current liabilities		3,00,000	—
(d) Short term provisions		—	—
Total		63,00,000	—
II. ASSETS			
(1) Non-current assets :			
(a) Fixed assets			
(i) Tangible assets		54,00,000	—
(ii) Intangible assets		—	—
(iii) Capital work-in progress		—	—
(iv) Intangible assets under development		—	—
(b) Non-current Investment		—	—
(c) Deferred tax assets (net)		—	—
(d) Long-term loans and advances		—	—
(e) Other non-current assets		—	—
(2) Current assets :			
(a) Current investments		—	—
(b) Inventories		2,25,000	—
(c) Trade receivables		6,75,000	—
(d) Cash and Cash equivalents		—	—
(e) Short-term loans and advances		—	—
(f) Other Current assets		—	—
Total		63,00,000	—

Q. 30. Using the following data, complete the Balance Sheet given below :

Gross Profit	**₹ 54,000**
Shareholders funds	**₹ 6,00,000**
Gross profit margin	**20%**
Credit sales to Total sales	**80%**
Total assets turnover	**0.3 times**
Inventory turnover	**4 times**
Average collection period (a 360 days year)	**20 days**
Current ratio	**1.8**
Long-term debt to equity	**40%**

Calculate (i) Credit Sale, (ii) Total Asset and (iii) Debtors

Answer 30.

Calculation of Credit Sales

Gross profit = ₹ 54,000 (given)

Gross profit margin = 20% or 0.20 (given)

$$\text{Gross profit margin} = \frac{\text{Gross profit}}{\text{Sales}}$$

$$\text{Sales} = \frac{\text{Gross profit}}{\text{Gross profit margin}}$$

$$\text{Sales} = \frac{₹54{,}000}{0.20} \qquad = ₹\ 2{,}70{,}000$$

Calculation of Total Assets

Total assets turnover = 0.3 times (given)

$$\text{Total assets turnover} = \frac{\text{Sales}}{\text{Total assets}}$$

$$0.3 = \frac{₹2{,}70{,}000}{\text{Total assets}}$$

Total assets = ₹ 2,70,000/0.3 = ₹ 9,00,000

Calculation of Debtors

Credit sales to Total sales = 80% (given)

Credit sales = ₹ 2,70,000 × 80/100 = ₹ 2,16,000

Average collection period = 20 days (given)

$$\text{Debtors turnover} = \frac{360 \text{ days}}{\text{Average collection period}}$$

$$\text{Debtors turnover} = \frac{360 \text{ days}}{20 \text{ days}} \qquad = 18$$

$$\text{Debtors} = \frac{\text{Credit Sales}}{\text{Debtors turnover}}$$

$$\text{Debtors} = \frac{₹\ 2{,}16{,}000}{18} \qquad = ₹\ 12{,}000$$

INTERMEDIATE EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - I

Paper-6 : COMMERCIAL AND INDUSTRIAL LAW AND AUDITING

SECTION - I
(Commercial and Industrial Law)

Q. 1. Comment on the following :

(a) **'X' stands surety for 'Y' for any amount which 'Z' may lend to Y from time to time during the next three months subject to a maximum of ₹ 150,000. One month later X revokes the guarantee, when Z had lent to B ₹ 15,000. Referring to the provisions of the Indian Contract Act, 1872 decide whether 'X' is discharged from all the liabilities to 'Z' for any subsequent loan. What would be your answer in case 'Y' makes a default in paying back to 'Z the money already borrowed i.e. ₹ 15,000?**

(b) **S delivered his car to M for repairs. M completed the work, but did not return the car to S within reasonable time, though S repeatedly reminded M for the return of car. In the meantime a big fire occurred in the neighborhood and the car was destroyed. Decide whether M can be held liable under the provisions of the Indian Contract Act. 1872.**

(c) **S started "self service" system in his shop. X entered the shop, took a basket and after taking articles of his choice into the basket reached the cashier for payments. The cashier refuses to accept the price. Can S be compelled to sell the said articles X ? Decide.**

(d) **H lends a sum of ₹ 15,000 to D, on the security of two shares of a Limited Company on 1st April 2011. On 15th September, 2011, the company issued two bonus shares. D returns the loan amount of ₹ 15,000 with interest but H returns only two shares which were pledged and refuses to give the two bonus shares. Advise D in the light of the provisions of the Indian Contract Act, 1872.**

(e) **Mr. D of RB Textile Ltd. enters into a contract with RS Garments Show Room for supply of 1,000 pieces of Cotton Shirts at ₹ 300 per shirt to be supplied on or before 31st December, 2011. However, on 1st November, 2011 RB Textiles Ltd informs the RS Garments Show Room that he is not willing to supply the goods as the price of Cotton shirts in the meantime has gone upto ₹ 350 per shirt. Examine the rights of the Retail Garments Show Room in this regard.**

(f) **B holds agricultural land on a lease granted by A, the owner. The land revenue payable by A to the Government being in arrear, his land is advertised for sale by the Government. Under the Revenue law, the consequence of such sale will be termination of B's lease. B, in order to prevent the sale and the consequent termination of his own lease, pays the Government, the sum due from A. Referring to the provisions of the Indian Contract Act, 1872 decide whether A is liable to make good to B, the amount so paid ?**

(g) **G's goods were seized by Custom Authorities. Whether this is bailment under Indian Contract Act,1872?**

(h) **In an agreement between P and Q, there is a condition that they will not institute legal proceeding against each other without consent. Is the contract valid or void?**

(i) R sent a consignment of goods worth ₹ 160,000 by railway and got railway receipt. He obtained an advance of ₹ 80,000 from the bank and endorsed and delivered the railway receipt in favour of the bank by way of security. The railway failed to deliver the goods at the destination. The bank filed a suit against the railway for ₹ 160,000. Decide in the light of provisions of the Indian Contract Act, 1872, whether the bank would succeed in the said suit?

(j) Z transferred his house to his daughter P by way of gift. The gift deed, executed by Z, contained a direction that P shall pay a sum of ₹ 15,000 per month to Q (the sister of the executant). Consequently P executed an instrument in favour of Q agreeing to pay the said sum. Afterwards, P refused to pay the sum to Q saying that she is not liable to Q because no consideration had moved from her. Decide with reasons under the provisions of the Indian Contract Act, 1872 whether P is liable to pay the said sum to Q.

Answers 1.

(a) The problem as asked in the question is based on the provisions of the Indian Contract Act 1872, as contained in Section 130 relating to the revocation of a continuing guarantee as to future transactions which can be done mainly in the following two ways :

1. *By Notice :* X continuing guarantee may at any time be revoked by the surety as to future transactions, by notice to the creditor.
2. *By death of surety :* The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions. (Section 131).

The liability of the surety for previous transactions however remains.

Thus applying the above provisions in the given case, X is discharged from all the liabilities to Z for any subsequent loan.

Answer in the second case would differ i.e. X is liable to Z for ₹ 15,000 on default of Y since the loan was taken before the notice of revocation was given to Z.

(b) The problem asked in the question is based on the provisions of section 160 and 161 of the Indian Contract Act 1872. Accordingly, it is the duty of the bailee to return or deliver the goods bailed according to the bailor's directions, without demand, as soon as the time for which they were bailed has expired, or the purpose for which they were bailed for any loss, destruction of the goods from that time (Section 161), notwithstanding the exercise of reasonable care on his part.

Therefore, applying the above provisions in the given case, Mahesh is liable for the loss, although he was not negligent, but because of his failure to deliver the car within a reasonable time *(Shaw & Co. v. Symmons* & Sons).

(c) The offer should be distinguished from an invitation to offer. An offer is the final expression of willingness by the offeror to be bound by his offer should the party chooses to accept it. Where a party, without expressing his final willingness, proposes certain terms on which he is willing to negotiate, he does not make an offer, but invites only the other party to make an offer on those terms. This is the basic distinction between offer and invitation to offer.

The display of articles with a price in it in a self-service shop is merely an invitation to offer. It is in no sense an offer for sale, the acceptance of which constitutes a contract. In this case, X in selecting some articles and approaching the cashier for payment simply made an offer to buy the articles selected by him. If the cashier does not accept the price, the interested buyer cannot compel him to sell. [*Fisher V. Bell (1961) Q.B. 394 Pharmaceutical society of Great Britain V. Boots Cash Chemists*].

(d) As per provisions of Section 163(4) of the Indian Contract Act,1872, "in the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, any increase or profit which may have accrued from the goods bailed."

Applying the provisions to the given case, the bonus shares are an increase on the shares pledged by D to H. So H is liable to return the shares along with the bonus shares and hence D the bailor, is entitled to them also.

(e) In the given problem RB Textiles Ltd has indicated its unwillingness to supply the cotton shirts on 1st November 2011 it self when it has time upto 31st December 2011 for performance of the contract of supply of goods. It is therefore called anticipatory breach of contract. Thus RS Garments show room can claim damages from RB Textiles Ltd immediately after 1st November, 2011, without waiting upto 31st December 2011. The damages will be calculated at the rate of ₹ 50 per shirt i.e. the difference between ₹ 350 (the price prevailing on 1st November) and ₹ 300 the contracted price.

(f) Yes, A is bound to make good to B the amount so paid. Section 69 of the Indian Contract Act, 1872, provides that "A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other. In the given case has made the payment of lawful dues of A in which B had an interest. Therefore, B is entitled to get the reimbursement from A.

(g) Yes, the possession of the goods is transferred to the custom authorities. Therefore bailment exists and section 148 of Contract Act, 1872 is applicable.

(h) An agreement in restraint of legal proceedings is void as per Section 28 of the Indian Contract Act, 1872.

(i) As per Sections 178 and 178A of the Indian Contract Act, 1872 the deposit of title deeds with the bank as security against an advance constitutes a pledge. As a pledge, a banker's rights are not limited to his interest in the goods pledged. In case of injury to the goods or their deprivation by a third party, the pledgee would have all such remedies that the owner of the goods would have against them. In *Morvi Mercantile Bank Ltd. vs. Union of India*, the Supreme Court held that the bank (pledgee) was entitled to recover not only the amount of the advance due to it, but the full value of the consignment. However, the amount over and above his interest is to be held by him in trust for the pledgor. Thus, the bank will succeed in this claim of ₹ 160,000 against Railway.

(j) As per Section 2 (d) of the Indian Contract Act, 1872, in India, it is not necessary that consideration must be supplied by the party, it may be supplied by any other person including a stranger to the transaction.

The problem is based on a case *"Chinnaya Vs. Ramayya"* is which the Court clearly observed that the consideration need not necessarily move from the party itself, it may move from any person. In the given problem, the same reason applies. Hence, P is liable to pay the said sum to Q and cannot deny her liability on the ground that consideration did not move from Q.

Q. 2. (a) What is meant by Anticipatory Breach of Contract?

(b) What do you understand by "Agency by Ratification"? What is the effect or ratification?

(c) What is meant by 'Undue Influence'?

(d) State the circumstances where under an agent is personally liable to a third party for the acts during the course of agency?

(e) When a contract need not be performed?

Answer 2. (a)

Anticipatory breach of contract occurs when the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived. In such a situation the promisee can claim compensation by way of loss or damage caused to him by the refusal of the promisor. For this, the promisee need not wait till the time stipulated in the contract for fulfillment of the promise by the promissor is over.

Answer 2. (b)

A person may act on behalf on another without his knowledge or consent. Later on such another person may accept the act of the former or reject it. If he accepts the act of the former done without his consent, he is said to have ratified that act and it places the parties in exactly the same position in which they would have been the former had later's authority at the time he made the contract. Likewise, when an agent exceeds the authority bestowed upon him by the principal, the principal may ratify the unauthorised act.

Effect of Ratification : The effect of ratification is to tender the acts done by one person (agent) on behalf of another (principal), without his (principal's) knowledge or authority, as binding on the other person (principal) as if they had been performed by his authority (Section 196: Indian Contract Act, 1872).

Further, ratification relates back to the date when the act was done by the agent. This means the agency comes into existence from the moment the agent first acted and not from the time when the principal ratified the act.

Answer 2. (c)

Section 16 of the Indian Contract Act, 1872, states that a contract is said to be induced by undue influence where the relations subsisting between the parties are such that the parties are in a position to dominate the will of the other and used that position to obtain an unfair advantage over the other.

A person is deemed to be in that position :

(i) where he holds real or apparent authority over the other or stands in a fiduciary relation to him;

(ii) where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of old age, illness or mental or bodily distress.

(iii) where a man who is in position to dominate the will of the other enters into contract with him and the transaction appears to be unconscionable, the burden of proving that it is fair, is on him, who is in such a position.

When one of the parties who has obtained the benefits of a transaction is in a position to dominate the will of the other, and the transaction between the parties appears to be unconscionable, the law raises a presumption of undue influence [section 16(3)]. Every transaction where the terms are to the disadvantage of one of the parties need not necessarily be considered to be unconscionable. If the contract is to the advantage of one of the parties but the same has been made in the ordinary course of business the presumption of undue influence would not be raised.

Answer 2. (d)

Under the following circumstances an agent is personally liable.

1. When he represents that he has authority to act on behalf of his principal, but who does not actually posses such authority or who has exceeded that authority and the alleged employer does not ratify his acts. Any loss sustained by a third party by the acts of such a person (agent) and who relies upon the representation is to be made good by such an agent.

2. Where a contract is entered into by a person apparently in the character if agent, but in reality on his own account, he is not entitled to required performance of it.

3. Where the contract expressly provides for the personal liability of the agent.

4. When the agent signs a negotiable instrument in his own name without making it clear that he is signing as an agent.
5. Where the agent acts for a principal who cannot be sued on account of his being a foreign Sovereign, Ambassador, etc.
6. Where the agent works for a foreign principal.
7. Where a Government Servant enters into a contract on behalf of the Union of India in disregard of Article 299 (1) of the Constitution of India, In such a case the suit against the agent can be instituted by the third party only and not by the principal (*Chatturbhuj v. Moheshwar*).
8. Where according to the usage of trade in certain kinds of business, agents are personally liable.
9. Where his authority is coupled with interest, he can be sued only to the extent of his interest in the subject matter.

Answer 2. (e)

A contract need not be performed under following circumstances :

(i) When performance becomes impossible.

(ii) When parties to contract agree to substitute it with a new one or rescind it or alter it. (Sec. 6)

(iii) When the promisee waives or remits the performance of promise made to him, wholly or in part or extends the time of performance or accepts any other satisfaction for it. (Sec.63)

(iv) When a person at whose option it is voidable, rescinds it (Sec. 64)

(v) When the promisee refuses or neglects to provide reasonable facilities to the promissor for performance of the promise. (Sec.67)

(vi) When the contract is illegal.

Q. 3. (a) A sold his car to B for ₹ 175,000. After inspection and satisfaction, B paid ₹ 87,500 and took possession of the car and promised to pay the remaining amount within a month. Later on A refuses to give the remaining amount on the ground that the car was not in a good condition. Advise A as to what remedy is available to him against B.

(b) C contracts to sell D, by showing sample, certain quantity of butter described as 'Made in Gokul'. The butter when delivered matches with the sample, but is not 'Made in Gokul'. Referring to the provisions of Sale of Goods Act, 1930 advise the remedy, if any, available to D.

(c) R an agent of a buyer, had obtained goods from the Railway organization and loaded the goods on his truck. In the meantime, the Railway organization received a notice from P, a seller, for stopping goods in transit as the buyer had become insolvent. Referring to the provisions of the Sale of Goods Act, 1930 decide whether the Railway organization can stop the goods in transit, as instructed by the seller?

(d) K the owner of a Fiat car wants to sell his car. For this purpose he hand over the car to M, a mercantile agent for sale at a price not less than ₹ 100, 000. The agent sells the car for ₹ 75, 000 to B, who buys the car in good faith and without notice of any fraud. M misappropriated the money also. K sues B to recover the Car. Decide given reasons whether K would succeed.

Answer 3. (a)

As per the section 55 of the Sale of Goods Act, 1930 an unpaid seller has a right to institute a suit for price against the buyer personally. The said Section lays down that—

(i) Where under a contract of sale the property in the goods has passed to buyer and the buyer wrongfully neglects or refuses to pay for the goods, the seller may sue him for the price of the goods [Section 55(1)].

(ii) Where under a contract of sale the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may sue him for the price. It makes no difference even if the property in the goods has not passed and the goods have not been appropriated to the contract [Section 55(2)].

This problem is based on above provisions. Hence, A will succeed against B for recovery of the remaining amount. Apart from this Suraj is also entitled to :

(1) Interest on the remaining amount.

(2) Interest during the pendency of the suit.

(3) Costs of the proceedings.

Answer 3. (b)

D has a remedy to repudiate the contract. According to section 15 of the Sale of Goods Act, 1930, when the goods are sold by sample as well as by description, there shall be an implied condition that the goods shall correspond to the sample as well as description. In this case, C supplied ghee which did correspond with the sample but was not correspond to the description of 'Made in Gokul'. Hence the D has the right to repudiate the contract.

Answer 3. (c)

The right of stoppage of goods in transit can be exercised only so long as the goods are in the course of transit. In the given case the transit was at an end as soon as the agent of the buyer obtained goods from the Railway Organisation. Therefore Railway Organisation cannot act as instructed by the seller, who has lost the right of stoppage of the goods in transit as provided in Section 30 of the Sale of Goods Act, 1930.

Answer 3. (d)

The problem in this case is based on the provisions of the Sale of Goods Act, 1930 contained in the proviso to Section 27. The proviso provides that a mercantile agent is one who in the customary course of his business, has, as such agent, authority either to sell goods, or to consign goods, for the purpose of sale, or to buy goods, or to raise money on the security of goods [Section 2(9)]. The buyer of goods from a mercantile agent, who has no authority from the principal to sell, gets a good title to the goods if the following conditions are satisfied :

(1) The agent should be in possession of the goods or documents of title to the goods with the consent of the owner.

(2) The agent should sell the goods while acting in the ordinary course of business of a mercantile agent.

(3) The buyer should act in good faith.

(4) The buyer should not have at the time of the contract of sale notice that the agent has no authority to sell.

In the instant case, M, the agent, was in the possession of the car with K's consent for the purpose of sale. B, the buyer, therefore obtained a good title to the car. Hence, K in this case, cannot recover the car from B. A similar decision, in analogous circumstances, was taken in *Folke*s v. *King*.

Q. 4. (a) What are the consequences of "destruction of goods" under the Sale of Goods Act, 1930, where the goods have been destroyed after the agreement to sell but before the sale is affected.

(b) Point out the differences between the transactions of "Sale" and "hire-purchase" in the light of the provisions of the Sale of Goods Act, 1930.

(c) What are the rules relating to the transfer of ownership of goods sent 'on approval, or sale or return' basis?

(d) At an auction sale, H made the highest bid for an article of Y. State the legal position in the following cases :

***Case I* : If H withdrew the bid before the fall of hammer though he knew that one of the condition of the sale was bid once made cannot be withdrawn'.**

***Case II* : If H appointed two persons A and B , to bid on his behalf. The sale was notified subject to a right to bid.**

Answer 4. (a)

Destruction of Goods-Consequences :

(i) In accordance with the provisions of the Sale of Goods Act, 1930 as contained in Section 7, a contract for the sale of specific goods is void if at the time when the contract was made; the goods without the knowledge of the seller, perished or become so damaged as no longer to answer to their description in the contract, then the contract is void ab initio. This section is based on the rule that where both the parties to a contract are under a mistake as to a matter of fact essential to a contract, the contract is void.

(ii) In a similar way Section 8 provides that an agreement to sell specific goods becomes void if subsequently the goods, without any fault on the par of the seller or buyer, perish or become so damaged as no longer to answer to their description in agreement before the risk passes to the buyer. This rule is also based on the ground of impossibility of performance as stated above.

It may, however, be noted that section 7 & 8 apply only to specific goods and not to unascertained goods. If the agreement is to sell a certain quantity of unascertained goods, the perishing of even the whole quantity of such goods in the possession of the seller will not relieve him of his obligation to deliver the goods.

Answer 4. (b)

Following are the differences between sale and hire purchase :

Sale	**Hire Purchase Agreement**
1. Ownership is transferred from the seller to the buyer as soon as the contract is entered into.	1. Ownership is transferred from the seller to the hire-purchaser only when a certain agreed number of instalments are paid.
2. The position of the buyer is that of the owner.	2. The position of the hire-purchaser is that of the bailee.
3. The buyer cannot terminate the contract and as such is bound to pay the price of the goods.	3. The hire-purchaser has an option to terminate the contract at any stage, and cannot be forced to pay the further instalments.
4. If the payment is made by the buyer in instalments, the amount payable by the buyer to the seller is reduced, for the payment made by the buyer is towards the price of the goods.	4. The instalments paid by the hire-purchaser are regarded as hire charges and not as payment towards the price of the goods till option to purchase the goods is exercised.
5. The Sale agreements are governed by the Sales of Goods Act, 1930.	5. The hire-purchase agreements are governed by the Hire-Purchase Act, 1972.

Answer 4. (c)

Goods sent 'on approval' basis mean those goods in respect of which the buyer has option either to return or retain.

The rules relating to transfer of ownership of such goods are as follows :

Case	Time of transfer of ownership
(i) When the buyer signifies his approval or acceptance to the seller.	When approval or acceptance is communicated to the seller.
(ii) When the buyer does any other act of adoption.	When act of adoption is done.
(iii) When the buyer fails to return the goods: (A) If time has been fixed for return of goods. (B) If no time has been fixed for return of goods.	 (A) On expiry of fixed time. (B) On expiry of reasonable time. What is reasonable time is a question of fact depending on circumstances of each case.

Answer 4. (d)

Case I : H's bid was an offer to buy and he was entitled to withdraw his bid before the sale is completed as per express provision of Section 64(2). [*Payne* v. *Cave*]

Case II : It amounts to fraud and sale is voidable at the option of the buyer because the seller could appoint only one person to bid on his behalf. [Sec 64(3) and Sec 64(6)]. Here the intention of the seller was not to protect his interest but to raise the price. [*Thornett* v *Haines*].

Q. 5. (a) Employees of an electricity generation station claimed that their unit is covered under the definition of 'factory' considering the process of transforming and transmission of electricity generated at the power station as a 'manufacturing process. Will their claim succeed?

(b) FBG Ltd. was running in continuous losses for 5 years. As a result, the company's financial position worsened. The company declared lay-off of 10 of its employees. The employees protested the lay-off. Is this action of employer justified?

(c) An electrician, who had to go frequently to a heating room from a cooling plant, contracted pneumonia which resulted in his death. Is the employer liable to pay compensation under the Employees Compensation Act, 1923?

Answer 5. (a)

As per section 2(k) of The Factories Act, 1948, manufacturing process means any process for-

(i) Making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking-up, demolishing, or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal, or

(ii) Pumping oil, water, sewage or any other substance; or

(iii) Generating, transforming or transmitting power; or

(iii) Composing types for printing, printing by letter press, lithography, photogravure or other similar process or book binding; lra-6] [lra-7 or lra-7]

(iv) Constructing, reconstructing, repairing, refitting, finishing or breaking up ships or vessels; (Inserted by the Factories (Amendment) Act, 1976, w.e.f. 26-10-1976.)

(v) Preserving or storing any article in cold storage;

Process undertaken at electricity generating station , substation transferring and transmitting electricity is not a manufacturing process and are not thus factory- [*Delhi Electricity Supply Undertaking vs. Management of DESU, AIR* (*1973*)*SCC 365*].

Answer 5. (b)

As per section 2(kkk) of the Industrial Dispute Act **lay-off** - means failure, refusal or inability of an employer to give employment to a workman (a) whose name is borne on the muster –rolls of his industrial establishment, and (b)who has not been retrenched. The failure, refusal or inability of an employer to give employment may be due to- (1) shortage of coal, power, or raw materials, (2) the accumulation of stocks (3) breakdown of machinery (4) natural calamity or any other connected reasons.

In the given problem, because of continuous losses, the company's financial position worsened. The company declared lay-of of 10 of its employees. The words 'for any other reason' used in the definition is analogous to the reasons given in the definition. But the cause stated by the company is not covered under the definition.As such, the action of the employer is not justified. Similar observation was made in *J. K Hosiery vs. LAT of India.*

Answer 5. (c)

According to Section 3 of the Employees Compensation Act, 1923 , employer is liable to pay compensation if personal injury is caused in course of employment. The course of employment is not interrupted by intervals of rest.

In the given problem, an employee had to frequently go into a heating room and from there to a cooling room in course of his duties. He suffered pneumonia and died. This is out of employment and employer is liable to pay compensation. [*Indian News Chronicle Ltd. vs Lazarus(1951) 3 FJR 190*]

Q. 6. (a) F failed to give details of travelling expenses on account of tour inspite of several reminders. His company deducted the amount of tour advance from F's salary after expiry of 3 months. Is the company justified under the *Payment of Wages Act, 1936*?

(b) X, an out worker prepared goods at his residence and later on supplied these goods to the M/s ABC . Is he an employee under the *Minimum Wages Act, 1948?*

(c) Y, on retirement withdrew the entire amount of his accumulation in the provident fund. Later on, he was re-appointed for a fixed tenure. The PF Inspector claimed contribution in respect of salary paid to Y. Is the demand made by PF Inspector tenable in law under *The Employees 'Provident Funds and Miscellaneous Provisions Act, 1952*?

Answer 6. (a)

According to Sec. 7(2) f and Sec . 12 of the Payment of Wages Act, 1936 no recovery can be made of such advances given for travelling expenses. The recovery of such advance is governed by rules made by appropriate Government in this regard. So the company on its own cannot make such recovery.

Answer 6. (b)

As per section 2(i) of the Minimum Wages Act, 1948 an "employee" means any person who is employed for hire or reward to do any work, skilled or unskilled, manual or clerical, in a scheduled employment in respect of which minimum rates of wages have been fixed; and includes an out- worker to whom any articles or materials are given out by another person to be made up, cleaned, washed, altered, ornamented, finished, repaired, adapted or otherwise processed for sale for the purposes of the trade or business of that other person where the process is to be carried out either in the home of the out- worker or in some other premises not being premises under the control and management of that other person; and also includes an employee declared to be an employee by the appropriate Government; but does not include any member of the Armed Forces of the 2 [Union].

So X is an employee under the Minimum Wages Act, 1948.

Answer 6. (c)

An employee who has been member of PF, withdrew the full amount of his accumulations is an 'excluded employee.' However , once he is reappointed in connection with work of the company, he attracts definition of 'employee' and the Act becomes applicable to him afresh. In *Harrison Malayalam Ltd*. and *Ors* vs. *RPFC & Ors. (CAL H.C)* 2001 I LLJ 1160, the company was held liable to cover an employee who took VRS and later appointed for a lump sum basis. Thus the demand made by authorities is tenable.

Q. 7. (a) Referring the provisions of the Payment of Bonus Act, 1965, state whether the following persons are entitled to bonus under the Payment of Bonus Act, 1965 :

(i) An apprentice;

(ii) An employee dismissed on the ground of misconduct;

(iii) A temporary workman;

(iv) A piece-rated worker.

(b) G absented himself from duty without applying for leave and left the job. When he claimed gratuity, the company refused to pay gratuity quoting his absence from duty without proper leave resulted in break in service. Will he get gratuity?

(c) P has take an insurance policy on his life. While he was travelling in a car with his friend, accidentally the car caught fire and all the occupants including the driver were seriously injured. Later on, P succumbed to the injuries in hospital. His wife filed a claim with insurance company which was refused on the ground that the driver did not have a valid licence.She filed a case with the Consumer Disputes Redressal Forum. Will she succeed? Decide with relevant case law, if any.

Answer 7. (a)

(i) An Apprentice is not entitled to bonus [*Wheel RIM Co.* Vs. *Govt. of Tamil Nadu* (1971)]

(ii) An employee dismissed on the ground of misconduct is disqualified for any is note entitled to bonus. [*Pandian Roadways Corporation Ltd.* Vs. *Presiding Officer* (1996)]

(iii) A temporary workman is entitled to bonus on the basis of the total number of days worked by him.

(iv) A piece-rated worker is entitled to bonus. [*Mathurads Kani* Vs. *L.A. Tribunal* (1958)]

Answer 7. (b)

Section 2A of the Payment of Gratuity Act, 1972 provides that an employee shall be said to be in continuous service for a period if he has, for that period, been in uninterrupted service, including service which may be interrupted on account of sickness, accident, leave, absence from duty without leave (not being absence in respect of which an order 3 [treating the absence as break in service has been passed in accordance with the standing orders, rules or regulations governing the employees of the establishment), lay- off, strike or a lock- out or cessation of work not due to any fault of the employee, whether such uninterrupted or interrupted service was rendered before or after the commencement of this Act.

Therefore G is eligible and will get Gratuity.

Answer 7. (c)

The facts of the case are similar to that of Jitendra Kumar vs. Oriental Insurance Co. Ltd. In this case, The Supreme Court has held that the Insurance Company cannot refuse claim of P's wife as he has taken life insurance and on event of his death irrespective of the fact whether the person who was driving the car had valid licence or not had nothing to do with policy of life insurance. Hence, P's wife case is maintainable and she is entitled to receive the claim i.e the insured amount on event of P's death.

Q. 8. (a) What do you understand by the terms 'premises' and 'precincts' under the Factories Act, 1948.

(b) Explain the terms 'Arbitration' and 'Conciliation' for resolution of industrial dispute under the *Industrial Dispute Act, 1947*.

Answer 8. (a)

Premises means the building or shed where the factory machineries are set up and manufacturing process are carried on. Precincts means the surrounding areas like open space inside the factory boundary, roads, gardens, open godowns etc where the workers move inside the factory boundary.

Answer 8. (b)

Arbitration: A process in which a neutral third party listens to the disputing parties, gathers information about the dispute, and then takes a decision which is binding on both the parties. The conciliator simply assists the parties to come to a settlement, whereas the arbitrator listens to both the parties and then gives his judgement.

Advantages of Arbitration :

- It is established by the parties themselves and therefore both parties have good faith in the arbitration process.
- The process in informal and flexible in nature.
- It is based on mutual consent of the parties and therefore helps in building healthy Industrial Relations.

Disadvantages :

- Delay often occurs in settlement of disputes.
- Arbitration is an expensive procedure and the expenses are to be shared by the labour and the management.
- Judgment can become arbitrary when the arbitrator is incompetent or biased.

There are two types of arbitration:

Voluntary Arbitration : In voluntary arbitration the arbitrator is appointed by both the parties through mutual consent and the arbitrator acts only when the dispute is referred to him.

Compulsory Arbitration : Implies that the parties are required to refer the dispute to the arbitrator whether they like him or not. Usually, when the parties fail to arrive at a settlement voluntarily, or when there is some other strong reason, the appropriate government can force the parties to refer the dispute to an arbitrator.

Conciliation refers to the process by which representatives of employees and employers are brought together before a third party with a view to discuss, reconcile their differences and arrive at an agreement through mutual consent. The third party acts as a facilitator in this process. Conciliation is a type of state intervention in settling the Industrial Disputes. The Industrial Disputes Act empowers the Central & State governments to appoint conciliation officers and a Board of Conciliation as and when the situation demands.

Conciliation Officer : The appropriate government may, by notification in the official gazette, appoint such number of persons as it thinks fit to be the conciliation officer. The duties of a conciliation officer are :

(i) To hold conciliation proceedings with a view to arrive at amicable settlement between the parties concerned.

(ii) To investigate the dispute in order to bring about the settlement between the parties concerned.

(iii) To send a report and memorandum of settlement to the appropriate government.

(iv) To send a report to the government stating forth the steps taken by him in case no settlement has been reached at.

The conciliation officer however has no power to force a settlement. He can only persuade and assist the parties to reach an agreement. The Industrial Disputes Act prohibits strikes and lockouts during that time when the conciliation proceedings are in progress.

Q. 9. (a) How do you define 'disablement' under the Workmen's Compensation Act, 1923?

(b) On whom does the responsibility for payment of wages lie under the Payment of Wages Act, 1936?

Answer 9. (a)

Disablement implies loss of capacity to work or move. Disablement leads to loss or reduction in earning capacity of workman. Disablement may be partial or total. Further it may be temporary or permanent.

Partial disablement reduces the earning capacity of workman as a result of some accident. It may be temporary or permanent. Temporary partial disablement reduces the earning capacity of workman in any employment in which he was engaged at the time of employment.

Permanent partial disablement reduces the earning capacity in every employment the worker was capable of doing at the time of employment.

Total disablement u/s 2(1) (l) means worker becomes incapable in performing any work which he could perform before accident. Total disablement is deemed to result from every injury specified in Part I of Schedule I or combination of injuries specified in Part II resulting in loss of earning capacity to the extent of 100% or more.

Answer 9. (b)

Every employer shall be responsible for payment to persons employed by him of all wages required to be paid under the Payment of Wages Act, 1936 (Sec 3). But in the case of persons employed (otherwise than by a contractor) in factories, industrial establishments or upon railways, the following persons shall also be responsible for the payment of wages :

(i) in factories if a person has been named as the manager of the factory under clause (f) of sub-section (1) of section 7 of the Factories Act, 1948;

(ii) in industrial or other establishments if there is a person responsible to the employer for the supervision and control of the industrial or other establishments;

(iii) upon railways (other than in factories) if the employer is the railway administration and the railway administration has nominated a person in this behalf for the local area concerned.

(iv) in the case of contractor, a person designated by such contractor who is directly under his charge; and

(v) in any other case, a person designated by the employer as a person responsible for complying with the provisions of the Act, the person so named, the person responsible to the employer, the person so nominated or the person so designated, as the case may be, shall be responsible for such payment.

Notwithstanding anything contained in sub-section(1), it shall be the responsibility of the employer to make payment of all wages required to be made under this Act in case the contractor or the person designated by the employer fails to make such payment.

Q. 10. (a) What is the procedure of fixing minimum wages under the Minimum Wages Act, 1948?

(b) Explain the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 relating to liability of a transferee employer in case of transfer of establishment by an employer.

Answer 10. (a)

Section 5 of the Minimum Wages Act, 1948 provides for fixing and revising minimum wages under the minimum wages which states that—

(1) In fixing minimum rates of wages in respect of any scheduled employment for the first time under this Act or in revising minimum rates of wages so fixed the appropriate government shall either—

  (a) appoint as many committees and sub-committees as it considers necessary to hold enquiries and advise it in respect of such fixation or revision as the case may be, or

  (b) by notification in the Official Gazette, publish its proposals for the information of persons likely to be affected thereby and specify a date not less than two months from the date of the notification on which the proposals will be taken into consideration.

(2) After considering the advice of the committee or committee appointed under clause (a) of sub-section (1) or as the case may be, all representations received by it before the date specified in the notification under clause (b) of that sub-section, the appropriate government shall by notification in the Official Gazette, fix or as the case may be revise the minimum rates of wages in respect of each scheduled employment and unless such notification otherwise provides it shall come into force on the expiry of three months from the date of its issue :

Provided that where the appropriate government proposes to revise the minimum rates of wages by the mode specified in clause (b) of sub-section (1) the appropriate government shall consult the Advisory Board also.

Answer 10. (b)

Liability of a transferee employer in case of transfer of establishment by the employer : (Section 17-B of *the Employees' Provident Funds and Miscellaneous Provisions Act, 1952*).

Where an employer in relation to an establishment, transfers that establishment in whole or in part by sale, gift, lease or licence or in any other manner whatsoever, the employer and the person to whom the establishment is so transferred shall Jointly or severally be liable to pay the contribution and other sums due from the employer under any provisions of the Act of the Scheme or the Pension Scheme, as the case may be, in respect of the period up to the date of such transfer. It is provided that the liability of the transferee shall be limited to the value of the assets obtained by him by such transfer.

Section 17-B deals with the liability of transferor and transferee in regard to the money due under—

(a) the Act: or

(b) the Scheme;

(c) Pension Scheme.

in the case of transfer of the establishment brought in by sale, gift, lease, or any other manner whatsoever, the liability of the transferor and the transferee is joint and several, but is limited with respect to the period upto the date of the transferor. Also the liability of the transferee is further limited to the assets obtained by him from the transfer of the establishment.

Q. 11. (a) Explain the provisions of the Payment of Bonus Act, 1965 relating to application of the Act to the establishments in public sector. What is the time limit within which payment of bonus due to an employee under the Act, be paid ?

(b) Explain the following terms in relation to the Payment of Gratuity Act, 1972:

(i) Wages

(ii) Rate of Gratuity.

(c) Who can file complaint under the Consumer Protection Act, 1986?

Answer 11. (a)

Application of the Act to the establishment in public sector : Section 20 of the Payment of Bonus Act, 1965 provides that if in any accounting year, an establishment in public sector may sell any goods produced or manufactured by it or it may render any services in competition with an establishment in private sector. And if the income from such sale or service or both is not less than 20% of the gross income of establishment in public sector, then the provisions of Bonus Act shall apply in relation to establishment in private Sector (Sub-section 1) Save as otherwise provided in Subsection (1), nothing in this Act shall apply to the employees employed by any establishment in the public sector (Sub-section2).

The time limit for a payment of bonus : The employer is bound to pay his employee bonus within one month from the date on which the award becomes enforceable or the settlement comes into operation, if a dispute regarding payment of bonus is pending before any authority under Section 22 of the Act. In other cases, however, the payment of the bonus is to be made within a period of 8 months from closing of the accounting. But this period of 8 months may be extended upto a maximum of 2 years by the appropriate Government or by any authority specified; by the appropriate Government. This extension is to be granted on the application of the employer and only for sufficient reasons.

Answer 11. (b)

(i) The term wages as per sec. 2 of Payment of Gratuity Act, 1972 includes basic plus D.A but does not include bonus, commission, house rent allowance, overtime wages or any other allowance. The main feature of **wages** as described aforesaid is that it refers to payment made in cash and not in any other form. Thus supply of food at factory canteen free is not included in wages.

(ii) Rate of Gratuity: Gratuity is payable @ 15 days wages for every year of completed service or part thereof in excess of six months. In case of seasonal industries it is payable @ 7 days wages for each season.

Answer 11. (c)

Complaints may be filed with the District Forum/State Commission/National Commission by :-

1. The consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided.
2. Any recognised consumer association, whether the consumer to whom goods sold or delivered or agreed to be sold or delivered or service provided or agreed to be provided, is a member of such association or not.
3. One or more consumers, where there are numerous consumers having the same interest with the permission of the District Forum, on behalf of or for the benefit of, all consumers so interested.
4. The Central or the State Government.

Every compliant filed shall be filed along with such amount of fee as may be prescribed.

Q. 12. (a) Limited Liability Partnership is distinct from limited partnership according to Limited Liability Partnership Act, 2008. Do you agree?

(b) Under the *Right to Information Act, 2005* competent authority means authority competent to seek information. Comment.

Answer 12. (a)

The statement is true. The distinction between the two are as follows:

Limited Liability Partnership	Limited Partnership
(i) Limited liability partnership is granted to all partners.	(i) Limited partnership is granted to a set of non managing partners only.
(ii) The law relating to partnership is not applicable.	(ii) The law relating to partnership is very much applicable

Answer 12. (b)

Under the Right to *Information Act, 2005* competent authority means—

(i) the Speaker in the case of the House of the People or the Legislative Assembly of a State or a Union territory having such Assembly and the Chairman in the case of the Council of States or Legislative Council of a State;

(ii) the Chief Justice of India in the case of the Supreme Court;

(iii) the Chief Justice of the High Court in the case of a High Court;

(iv) the President or the Governor, as the case may be, in the case of other authorities established or constituted by or under the Constitution;

(v) the administrator appointed under article 239 of the Constitution.

The competent authority may, by notification in the Official Gazette, make rules to carry out the provisions of this Act.

Q. 13. (a) XYZ Ltd. made an initial public offer of certain number of equity shares. Examine whether these shares can be considered as 'Goods' under the Competition Act, 2002 before allotment.

(b) Promissory note dated 1st February, 2012 payable two months after date was presented to the maker for payment 10 days after maturity. What is the date of Maturity? Explain with reference to the relevant provisions of the 'Negotiable Instruments Act, 1881 whether the endorser and the maker will be discharged by reasons of such delay.

Answer 13. (a)

Section 2(i) of Competition Act, 2002 defines 'goods' as follows:

'Goods' means goods as defined the Sale of Goods Act, 1930 and includes –

(i) products manufactured, processed or mined;

(ii) debentures, stock and shares after allotment

(iii) in relation to goods supplied, distributed or controlled in India, goods imported into India.

Hence, debentures and shares can be considered as 'goods' within the meaning of section 2(i) of Competition Act, 2002 only after allotment and not before allotment.

Answer 13. (b)

If a promissory role is made payable a stated number of months after date, it becomes payable three days after the corresponding date of months after the stated number of months (Section 23 read with Section 22 Negotiable Instruments Act 1881). Therefore- in this case the date of maturity of the promissory note is 4th April, 2012.

In this case the promissory note was presented for payment 10 days after maturity. According to Section 64 of Negotiable Instruments Act read with Section 66, a promissory note must be presented for payment at maturity by on behalf of the holder. In default of such presentment, the other parties the instrument (that is, parties other than the parties primarily liable) are not liable to such holder. The indorser is discharged by the delayed presentment for payment. But the maker being the primary party liable on the instrument continues to be liable.

Q. 14. (a) Explain the term 'designated partners' under LLP Act, 2008.

(b) Explain 'third party information' under RTI Act, 2005.

Answer 14. (a)

Designated partners is defined in Section 7 of LLP Act, 2008.

(1) Every limited liability partnership shall have at least two designated partners who are individuals and atleast one of them shall be a resident in India :

Provided that in case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners.

Explanation : For the purposes of this section, the term "resident in India" means a person who has stayed in India for a period of not less than one hundred and eighty-two days during the immediately preceding one year.

(2) Subject to the provisions of sub-section (1),—

(i) if the incorporation document—

(a) specifies who are to be designated partners, such persons shall be designated partners on incorporation; or

(b) states that each of the partners from time to time of limited liability partnership is to be designated partner, every partner shall be a designated partner;

(ii) any partner may become a designated partner by and in accordance with the limited liability partnership agreement and a partner may cease to be a designated partner in accordance with limited liability partnership agreement.

(3) An individual shall not become a designated partner in any limited liability partnership unless he has given his prior consent to act as such to the limited liability partnership in such form and manner as may be prescribed.

(4) Every limited liability partnership shall file with the registrar the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.

(5) An individual eligible to be a designated partner shall satisfy such conditions and requirements as may be prescribed.

(6) Every designated partner of a limited liability partnership shall obtain a Designated Partner Identification Number (DPIN) from the Central Government and the provisions of sections 266A to 266G (both inclusive) of the Companies Act, 1956 shall apply mutatis mutandis for the said purpose.

Answer 14. (b)

This is dealt in Section 11 of the RTI Act, 2005.

(1) Where a Central Public Information Officer or a State Public Information Officer, as the case may be, intends to disclose any information or record, or part thereof on a request made under this Act, which relates to or has been supplied by a third party and has been treated as confidential by that third party, the Central Public Information Officer or State Public Information Officer, as the case may be, shall, within five days from the receipt of the request, give a written notice to such third

party of the request and of the fact that the Central Public Information Officer or State Public Information Officer, as the case may be, intends to disclose the information or record, or part thereof, and invite the third party to make a submission in writing or orally, regarding whether the information should be disclosed, and such submission of the third party shall be kept in view while taking a decision about disclosure of information :

Provided that except in the case of trade or commercial secrets protected by law, disclosure may be allowed if the public interest in disclosure outweighs in importance any possible harm or injury to the interests of such third party.

(2) Where a notice is served by the Central Public Information Officer or State Public Information Officer, as the case may be, under sub-section (1) to a third party in respect of any information or record or part thereof, the third party shall, within ten days from the date of receipt of such notice, be given the opportunity to make representation against the proposed disclosure.

(3) Notwithstanding anything contained in section 7, the Central Public Information Officer or State Public Information Officer, as the case may be, shall, within forty days after receipt of the request under section 6, if the third party has been given an opportunity to make representation under sub-section (2), make a decision as to whether or not to disclose the information or record or part thereof and give in writing the notice of his decision to the third party.

(4) A notice given under sub-section (3) shall include a statement that the third party to whom the notice is given is entitled to prefer an appeal under section 19 against the decision.

Q. 15. (a) The Central Government has formed the opinion that Mr. RX (A member of the Competition Commission of India) has abused his position which may be prejudicial to public interest as a member of the commission. Examine the powers of the Central Government in this regard.

(b) Who is a holder in due course of a Negotiable Instrument? In what respects does he differ from a holder?

Answer 15. (a)

Section 11(2) (e) of the Competition Act, 2002 empowers the Central Government to remove by an order, a member of the Competition Commission of India from his office if such member has abused his position as to render his continuance in office prejudicial as a member of competition commission. However provision of Section 11(3) of the said act puts some restrictions on such powers of the Central Government. According to this section, in case as stated in the question, Central Government wants to remove a member or the Competition Commission from his office on the above ground, it has to make a reference to the Supreme Court. The Supreme Court shall hold an enquiry in accordance with the procedure formulated by it and then report that the member in question ought to be removed form his office on such ground. Thus the Central Government can remove a member of Competition Commission from his office by following the above procedure.

Answer 15. (b)

Holder In Due Course: It means any person who, for consideration became its possessor before the amount mentioned in it became payable. In the case of an instrument payable to order, 'holder in due course' means any person who became the payee or endorsee of the instrument before the amount mentioned in it became payable. In both the cases, he must receive the instrument without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. In other words, holder in due course means a holder who takes the instrument bona fide for value before it is overdue, and without any notice of defects in the title of the person, who transferred it to him. Thus a person who claims to be 'holder in due course' is required to prove that :

1. on paying a valuable consideration, he became either the possessor of the instrument if payable to order;

2. he had come into the possession of the instrument before the amount due thereunder became actually payable; and
3. he had come to possess the instrument without having sufficient cause to believe that any defect existed in the title of transferor's from whom derived his title.

Distinction between Holder & Holder in Due Course :

1. A holder may become the-possessor or payee of an instrument even without consideration, whereas a holder in due course is one who acquires possession for consideration.
2. A holder in due course as against a holder, must become the possessor payee of the instrument before the amount thereon become payable.
3. A holder in due course as against a holder, must have become the payee of the instrument in good faith i.e., without having sufficient cause to believe that any defect existed in-the transferor's title.

SECTION - II
(Auditing)

Q. 16. Comment on the following statements based on legal provisions :

(a) Audit is concerned with ethics of business.

(b) In auditing, the concept of materiality can be judged only in relative context.

(c) Contingent Liabilities do not form part of Balance Sheet, hence need not be verified.

(d) Auditing in depth means checking all the transactions in minute details.

(e) All expenses /losses incurred during construction period should be capitalized including abnormal losses.

(f) Test check approach and random sampling approach are same.

(g) Auditor should qualify audit report if any Secret Reserve is created.

(h) When separate Branch Auditors are appointed, the company auditor need not visit the branches.

(i) For ascertaining minority interest, there is a need to distinguish between capital and revenue profits of subsidiary.

(j) Assets given on lease should be disclosed as part of fixed assets in the financial statements of the lessor.

(k) The principal auditor of a limited company is entitled to rely on the work of another auditor of its component part.

(l) Contingent Gains are recognized in Financial Statements.

(m) Audit in EDP environment is easier as the Trial Balance always tallies.

(n) When the auditor doesn't agree with Financial Statements on certain grounds he gives 'disclaimer' of opinion.

(o) In the Balance Sheet of the Company , Debenture to be redeemed during the subsequent year are shown under the head " Current Liabilities and Provisions".

Answer 16.

(a) The statement is false. Audit is not concerned with ethics of business unless the business itself is illegal or unlawful.

(b) The statement is true. Materiality can be judged only in relative context. In a small business, Rs 5000/- may be a material amount, whereas in a giant undertaking, Rs. 50,000 may not be so material as to merit a separate disclosure.

(c) The auditor should verify that a proper disclosure about contingent liabilities is made in the financial statements as a footnote to the Balance Sheet as contingent liabilities may become actual liabilities on happening or not happening of certain events. As per para 68 of AS-29 an organisation should disclose for each class of contingent liabilities separately on Balance Sheet date . So the above statement is false.

(d) The statement is false. Auditing in depth means the tracing of a transaction through its various stages from origin to conclusion, examining the supporting records at each stage and ascertaining whether all the requirements laid down in the system of internal check have been complied with.

(e) The statement is false. Abnormal losses during construction period should not be capitalized but should be written off over a period of 3-5 years after commencement of production.

(f) The statement is false. Test check approach is different from random sampling approach.

Test check is based on intuition while random sampling approach is scientific verification on selective basis. In case of test check samples drawn may be biased but in statistical random sampling, samples are based on random number tables, so there will be no element of bias.

(g) Auditor should carefully examine the necessity of creating Secret Reserve and need not qualify the audit report if it is found that intention of the company is honest and the amount is reasonable.

(h) It is totally at the discretion of the company auditor as to whether he should visit the branches and to the degree he would rely on branch auditors' report. The company auditor is however not responsible for work done by branch auditor.

(i) The statement is false. Minorities are concerned with their stake in the Holding Company. Their right consists in share capital, and reserves and surplus. To ascertain minority interests neither capital profit nor revenue profit is necessary.

(j) The statement is false. The lessor cannot account for assets given on financial lease as all risks and refunds incidental to the ownership of such assets stand transferred to the lessee. He has to treat lease amount receivable from lessee as 'Receivables' on the asset side of the Balance Sheet.

(k) The statement is true. The principal auditor may adopt the remarks and qualifications of the auditor of component part if he is satisfied with work done by the other auditor. Otherwise, if he is not satisfied, the principal auditor can draft his report of the entity as a whole after verifying the accounts including component part. In practice, The principal auditor will discuss the issues with the other auditor about the nature of remarks and finalize his report for entity as a whole.

(l) The statement is false. As per para 12 of AS 4, contingent gains should not be recognised in the financial statements till it is realized.

(m) In today's complex business environment, the importance of trial balance in an audit has to be gauzed not from the view point of arithmetical accuracy but the nature of transaction to be recorded which in fact have become very complex. The emergence of new forms of financial instruments like option and futures, derivatives, off-balance sheet financing, etc. have given rise to further complexities in recording and disclosure of transactions. A tallied Trial Balance may still contain errors of omissions like omission of certain entries, compensating errors, duplication of entries, etc. In an audit besides the tallying of a trial balance, there are also other issues like estimation of depreciation, valuation of inventories, etc. which still require judgment to be exercised by the auditor. So responsibility of auditor will still remain even in an EDP environment.

(n) The statement is false. When the auditor states that he is unable to form an opinion for want of necessary evidence, the it is 'disclaimer' of opinion.

(o) The statement is false. The amount should be shown under the first sub- head under "Secured Loans" irrespective of the due date of redemption as per Part – I, Schedule VI of the Companies Act, 1956.

Q. 17. (a) The Board of Directors of FBG Ltd. refused to Minute Book to the Statutory Auditor on the ground of secrecy. State the legal position.

(b) Mention briefly the conditions or events, which increase the risk of fraud or error leading to material misstatement in Financial Statements.

Answer 17. (a)

Section 227 of the Companies Act, 1956 states that every auditor has a right of access, at all times, to the books and account including all statutory records such as minute books, fixed assets register, etc. of the company for conducting the audit.

In order to verify actions of the company and to vouch and verify some of the transactions of the company, it is necessary for the auditor to refer to the decisions of the shareholders and/or the directors of the company.

So it is essential for the auditor to refer to the Minute Books. In the absence of the Minute Books, the auditor may not be able to vouch/verify certain transactions of the company.

In case the directors have refused to produce the Minute Books, the auditor may consider extending the audit procedure as also consider qualifying his report in any appropriate manner.

Answer 17. (b)

In planning and performing his examination, the auditor should take into consideration the risk of material misstatements of the financial information caused by fraud or error. Weaknesses in the design of the internal control system and non-compliance with identified control procedures amongst other conditions or events which increase the risk of fraud or error are :

(i) Weaknesses in the design of internal control system and non-compliance with the laid down control procedures, e.g., a single person is responsible for the receipt of all letters and marking it to the relevant sections or two persons are responsible for receipt of letters but the same is not followed in actual practice, etc.

(ii) Doubts about the integrity or competence of the management, e.g., domination by one person, high turnover rate of employees, frequent change of legal counsels or auditors, significant and prolonged understaffing of the accounts department, etc.

(iii) Unusual pressures within the entity, for example, industry is doing well but the company is not performing all right, heavy dependence on a single line of product, inadequate working capital, entity needs raising share prices to support the market price in the wake of public offer, etc.

(iv) Unusual transactions such as transactions with related parties, excessive payment for certain services to lawyers, etc.

(v) Problems in obtaining sufficient and appropriate audit evidence, e.g., inadequate documentation, significant differences between the figures as per the accounting records and confirmation received from third parties, etc.

Q. 18. As an auditor, how will you vouch and/or verify the following?

(a) Receipt of capital subsidy

(b) Provision for income tax

(c) Deferred Revenue Expenditure

(d) Sales Commission Expenditure

(e) Purchase return

Answer 18. (a)

Receipt of Capital Subsidy :

(i) Refer to application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.

(ii) Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.

(iii) See that conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.

(iv) Check relevant entries for receipt of subsidy.

(v) Check compliance with requirements of AS 12 on "Accounting for Government Grants" i.e. whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements.

Answer 18. (b)

Provision for Income Tax :

(i) Obtain the computation of income prepared by the auditee and verify whether it is as per the Income-tax Act, 1961 and Rules made thereunder.

(ii) Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.

(iii) Examine relevant records and documents pertaining to advance tax, self assessment tax and other demands.

(iv) Compute tax payable as per the latest applicable rates in the Finance Act.

(v) Ensure that overall provisions on the date of the balance sheet is adequate having regard to current year provision, advance tax paid, assessment orders, etc.

Answer 18. (c)

Deferred Revenue Expenditure :

This is a type of revenue expenditure, whose benefit extends to more than one accounting year during which it is actually incurred. Accountancy principles require that only that part of the expenditure which is pertaining to the accounting period should be debited to the profit and loss account of the year. Remaining amount should be carried forward in the balance sheet and it should be written off against the future income, depending upon the number of years during which the benefit of expenditures is likely to be enjoyed. This type of expenditure is known as deferred revenue expenditure. Part of such revenue expenditure is to be treated as assets for the purpose of disclosure in the balance sheet for the time till the benefit of such expenditure is fully exhausted.

Some examples of deferred revenue expenditure are expenditure on an advertisement campaign to launch a product in the market, discount allowed on subscription to debentures, development expenses in the case of mines and plantations, etc. While verifying deferred revenue expenditure, this may satisfy himself that :

(i) it is proper to defer the expenditure;

(ii) the period of amortisation of the expenditure is reasonable;

(iii) the expenditure shown to have been incurred during the year actually occurred during the year and there is proper authority for the expenditure and for its deferral;

(iv) the criteria which previously justified the deferral of the expenditure continue to be met and the expected future revenue / other benefits related to the expenditure continue to exceed the amount of unamortized expenditure.

Answer 18. (d)

Sales Commission Expenditure :

(i) Ascertain agreement, if any, in respect of sales transaction actually occurred during the year carried out by authorized parties on its behalf. If yes, the commission should be in accordance with the terms and conditions as specified.

(ii) Check evidence of services rendered by the party to whom commission is paid with reference to correspondence etc.

(iii) Ensure that the sales in fact have taken place and the same has been charged to profit and loss account.

(iv) Compare the amount incurred in previous years with reference to total turnover.

Answer 18. (e)

Purchase Return :

(i) Examine debit note issued to the supplier which in turn may be confirmed by corresponding credit note issued by the supplier acknowledging the same. The relevant correspondence may also be examined.

(ii) Verify by reference to relevant corresponding record in goods outward book or the stores records. Further, the figures in these documentary evidence should be compared with the supplier's original invoices for rates and other charges and calculation should also be checked.

(iii) Examine in depth to eliminate the possibility of fictitious purchase returns for covering bogus purchases recorded earlier when such returns outwards are in substantial figure either at the beginning or end of the accounting year.

(iv) Cross-check with reference to original invoices any rebates in price or allowances if any given by suppliers on strength of their Credit Notes.

Q. 19. As an auditor, comment on the following situations :

(a) In the course of audit of a trade, you noticed that although there is no change in either selling or purchase price of the goods, there is considerable increase in Gross Profit Ratio in comparison to previous year. What matters would you examine to assess the reason for such increase?

(b) The company has sent semi-finished goods to third parties for further processing, which is lying with them at the end of the year.

Answer 19. (a)

In assessing the reason for considerable increase in Gross Profit Ratio, the auditor should examine the followings :

(i) Under valuation of opening stock due to non-inclusion of certain items or applying lower rate to one or more items of stock.

(ii) Over valuation of closing stock either by the inclusion of fictitious items or over valuing some of the items of Stock.

(iii) Change in the method of valuation of opening and closing stock. For example, opening stock was valued at lower of cost and market value, whereas closing stock has been valued at market price which is higher than cost.

(iv) Goods sold but not delivered are included in stock.

(v) Goods delivered last year but sales invoice raised in current year.

(vi) Recording of fictitious sales to boost up profits.

(vii) Goods returned to supplier awarding dispatch and included in closing stock.

(viii) Goods returned by customers but not debited to sales return and included in closing stock.

(ix) Inclusion in the closing stock of goods received for sale on approval or consignment basis.

(x) Treatment of goods sent on consignment basis as regular sales.

(xi) Non-provision of outstanding expenses like wages, carriage inward etc.

(xii) Wrong allocation of expenses in Trading and Profit & Loss Account.

Answer 19. (b)

Semi-finished goods being composite part of the inventories, normally, constitute significant item in case of any entity. It is the duty of the auditor to ensure that entire inventories which are owned by the enterprise exist on that date and valuation thereof is also proper. Since the semi-finished goods belong to the company, it is necessary to ensure that the same have been included for in valuation of inventories. The auditor should also obtain direct confirmation about the quantity of inventories lying with the processors at the end of the year. Also, the auditor should see that the valuation has been made properly with reference to the stage of completion in respect of work-in-process inclusive of expenses incurred in sending the goods for processing. In case, the amount happens to be material, such stock may be disclosed separately as stocks with processors.

Q. 20. Give your comments and observations on the following :

(a) Fixed assets have been revalued and the resulting surplus has been adjusted against the brought forward losses.

(b) A sum of ₹ 10,00,000 is received from an Insurance company in respect of a claim for loss of goods in transit costing ₹ 12,00,000. The amount is credited to the Purchases Account.

Answer 20. (a)

The revaluation of fixed assets is a normally accepted practice which involves writing up the book value of fixed assets. AS 10 on 'Accounting for Fixed Assets' requires that "an increase in net book value arising on revaluation of fixed assets is normally credited directly to owner's interests under the heading of revaluation reserves and is regarded as not available for distribution". Thus, creation of revaluation reserves does not result into any cash inflows and represents unrealised gains. However, brought forward losses are in the nature of revenue losses. As a matter of prudence, revenue losses can be adjusted against revenue reserves only and not the capital reserves. Therefore, the accounting treatment followed by the entity is not correct and the auditor should qualify the audit report by mentioning the above fact.

Answer 20. (b)

AS 5 on "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" requires that all items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period. The claim for loss of goods in transit is arising out of ordinary activities of the enterprise as a part of its normal course of business. However, the cost of goods lost in transit is only ₹ 10,00,000 while the insurance money received is ₹ 12,00,000. Purchases Account need not be credited since it would distort the purchases done during the year and as also the gross profit. Therefore, entire amount of ₹ 12 lacs needs to be taken to profit and loss account under an appropriate head. This is an income arising from an ordinary activities of the enterprise but having regard to amount involved and exceptional nature, a separate disclosure be made in the profit and loss account. Such disclosure would enable the users to understand the performance of an enterprise for the period.

Q. 21. As an auditor, how will you verify the following?

(a) Retirement Gratuity to Employees.

(b) Discounted bills receivable dishonoured

(c) Plant and machinery

(d) Purchase of quoted investment

Answer 21. (a)

Retirement Gratuity to Employees :

(i) Examine the basis on which the gratuity payable to employees is worked out. The liability for gratuity may either be worked out on actuarial rules or agreement or on the presumption that all employees retire on the balance sheet date.

(ii) Verify computation of liability of gratuity on the aggregate basis.

(iii) Check the amount of gratuity paid to employees who retired during the year with reference to number of years of service rendered by them.

(iv) See that the annual premium has been charged to Profit and Loss account.

(v) Ensure that the accounting treatment is in accordance with AS 15, "Accounting for Retirement Benefits in the Financial Statements".

Answer 21. (b)

Discounted Bills Receivable Dishonoured :

(i) Obtain the schedule of discounted bills receivable dishonoured.

(ii) Check the entry in bank statement regarding the amount of bills dishonoured and see that the bank has debited the account of client.

(iii) Verify the bills receivable returned by the bank along with bank's advice.

(iv) See that the dishonoured bills have been noted and protested by following the proper procedure and the account of the drawee or the debtor is also debited.

(v) Check that bank commission, if any, charged by the bank has been recovered from the party.

Answer 21. (c)

Plant and machinery :

(i) Verify the existence of plant and machinery by reference to documentary evidence available and by evaluation of internal controls. Plant and machinery in existence at the commencement of the year is normally verified by examining the schedule of plant and machinery and the fixed assets register. Acquisition during the year can be verified by reference to the Board's minutes, purchase invoice and entry in the fixed assets register.

(ii) Vouch the cost price of any plant and machinery including freight and insurance plus any cost of installation with relevant invoices, etc. The auditor should verify that due provision for depreciation has been made. When an asset has been revalued, depreciation should be provided on the revised value and not on the historical value. The mode of disclosure in the balance sheet should also be seen. Check that requirement of relevant accounting standards, viz., AS 6, AS 10, etc. regarding accounting treatment, presentation and disclosures have been followed.

(iii) See that the various items of plant and machinery possessed by the client at the year end are recorded in the financial ledger and in the fixed assets register. Proper inquiry should be made to ensure that plant and machinery scrapped, destroyed or sold during the year has been properly adjusted in the books of account as also in the fixed assets register. If on physical verification material discrepancies are found, the auditor should see that the discrepancies have been properly adjusted in the books of account.

(iv) Comment on physical verification made by the management. Under the Companies Auditor's Report Order applicable to companies, physical verification of the fixed assets including plant and machinery is the responsibility of the management. This they can do by examination of physical verification instruction programme and working papers.

Answer 21. (d)

Purchase of Quoted Investment :

(i) Ascertain the date of purchase, rate of purchase, nature of investments purchased and nature of transaction, i.e., error cum-dividend/interest/right/bonus.

(ii) Compare the rate of purchase with quotation available. Obtain suitable explanations in case of significant variations.

(iii) Verify the amount paid towards purchase of investments.

(iv) Trace the amount in the cheque book counterfoils and bank statements.

(v) Obtain a schedule of investment from Management for physical verification at the year end.

(vi) Verify the investment certificate to confirm title.

(vii) Confirm compliance with statutory provisions such as 227(1A) and CARO, 2003 under section 227(4A) of the Companies Act, 1956.

(viii) Verify whether investments are duly disclosed in financial statements in accordance with recognized accounting policies and practices and relevant statutory requirements.

Q. 22. Comment on the following situations :

(a) At an Annual General Meeting, Mr. B a retiring auditor claims that he has been reappointed automatically, as the intended resolution of which a notice had been given to appoint Mr. A, could not be proceeded with, due to Mr. A's death.

(b) KBK Ltd. in which 24 per cent of the subscribed capital is held by a public financial institution at the time of issuing the notice for the Annual General Meeting, appoints AB & Co. as auditors by an ordinary resolution at the Annual General Meeting when the Public Financial Institution increased its stake in KBK Ltd. to 25 per cent of its subscribed capital.

(c) At the Annual General Meeting of the Company, a resolution was passed by the entire body of shareholders restricting some of the powers of the Statutory Auditors. Whether powers of the Statutory Auditors can be restricted?

(d) The auditor of HGI Ltd. did not report on the matters specified in sub-section (1A) of Section 227 of the Companies Act, 1956, as he was satisfied that no comment is required.

Answer 22. (a)

Section 224(2) of the Companies Act, 1956 dealing with reappointment of auditors specifies that subject to the provisions of sub-section (1B) and section 224A, at any Annual General Meeting a retiring auditor, by whatsoever authority appointed, shall be re-appointed unless, *inter alia* :

"Where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of the death, incapacity or dis-qualification of that person or of all those persons, as the case may be, the resolution cannot be proceeded with."

However, it should be noted that even for the re-appointment of a retiring auditor, the passing of a resolution is essential. Section 224 of the Companies Act, 1956, requires that a resolution has to be passed by the company every year. In the absence of a resolution, the retiring auditor is not re-appointed automatically.

Thus, the claim of Mr B would not hold good.

Answer 22. (b)

Section 224A of the Companies Act, 1956 does not specify the date on which 25% of the subscribed share capital should be held by the specified institutions to require the appointment of the auditors by a special resolution.

The Department of Company Affairs has opined that the material date is the date of the AGM at which the special resolution is required to be passed. In some cases, it is possible that the shareholding of the specified bodies is less than 25% of the subscribed share capital of a company at the time of issuing the notice for the AGM, but exceeds this limit on the date of the AGM. In such a case, it is advisable for the company to adjourn the meeting, issue another notice to the members for appointment of auditors by special resolution and pass the special resolution at the adjourned meeting.

Hence, KBK Ltd. should appoint AB & Co. as auditors in the above mentioned manner.

Answer 22. (c)

Section 227(1) of the Companies Act, 1956 provides that an auditor of a company shall have right of access at all times to the books and accounts and vouchers of the company whether kept at the Head Office or other places and shall be entitled to require from the offices of the company such information and explanations as the auditor may think necessary for the purpose of his audit. These specific rights have been conferred by the statute on the auditor to enable him to carry out his duties and responsibilities prescribed under the Act, which cannot be restricted or abridged in any manner. Hence' any such resolution even if passed by entire body of shareholders is ultra vires and therefore void. In the case of Newton vs. Birmingham Small Arms Co., it was held that any regulations which preclude the auditors from availing themselves of all the information to which they are entitled under the Companies Act, are inconsistent with the Act.

Answer 22. (d)

Section 227(1A) of the Act deals with duties of an auditors requiring auditor to make an enquiry in respect of specified matters. The matters in respect of which the enquiry has to be made by the auditor include relating to loans and advances, transactions represented merely by book entries, investments sold at less than cost price, loans and advances shown as deposits, personal expenses, etc. Since the law requires the auditor to make an enquiry, the auditor is not required to report on the matters specified in sub-section (1A) unless he has any special comments to make on any of the items referred to therein. If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. Therefore, the auditor of HGI Ltd. is correct in non-reporting on the matters specified in Section 227(1A).

Q. 23. As a Company Auditor, how would you deal with the following situations?

(a) G Ltd. gave a guarantee to the Court for payment of excise dues of Rs.10 lacs for one of its subsidiaries. According to the company, since the guarantee was given on behalf of its subsidiary, no disclosure was required.

(b) ANM Ltd. received a subsidy of Rs.1 crore for establishing an undertaking in the backward/ notified area.

(c) KBC Prakashan Ltd undertook repair and overhauling of its machinery at a cost of Rs.350 lakhs to maintain them in good condition and capitalised the amount as it is more than 25% of the original cost of the machinery.

(d) Directors of SPW Ltd. declared a final dividend of 30% for 2011-12 in their meeting held on 11-8-2012.

Answer 23. (a)

G Ltd., in its books of account is required to record a contingent liability of Rs.10 lacs for the guarantee given by it for payment of excise dues of its subsidiary, to the Court. In the event, the subsidiary failed to meet its obligation, G Ltd. would be required to pay Rs.10 lacs to the authorities concerned.

AS 4 also states that the existence and amount of guarantees undertaken by an enterprise are generally disclosed in financial statements by way of a note, even though the possibility that the loss will occur, is remote.

Thus, the amount of any guarantee given by a company on behalf of its subsidiary is required to be stated and where practicable, the general nature of such contingent liability, if material, be specified. Accordingly, the views expressed by the company cannot be accepted.

Answer 23. (b)

The company had received a subsidy of ₹ 1 crore, for establishing an undertaking in the backward/ notified area.

The accounting treatment of such subsidy shall depend upon the nature and purpose for which it has been given. As per AS 12 on "Accounting for Government Grants", the grant given for acquisition of fixed assets is in the nature of promoter's contribution.

As per facts of the case, the grant has been given with reference to the total investment in the undertaking by way of contribution towards its total capital outlay for the establishment of the undertaking which is having similar characteristics to those of promoter's contribution.

In such cases, no repayment is ordinarily expected and thus the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Accordingly, the amount of Rs.1 crore should be kept in a special reserve account and treated as a part of shareholders' funds.

Answer 23. (c)

The money spent on the repair and overhaul of the machinery can be treated as capital expenditure, irrespective of the amount, only if it results in increasing the earning capacity or reduction in the cost of production. In this case, neither the earning capacity has increased nor there is any reduction in the cost of production.

In the absence of both these criteria, it is to be treated as revenue expenditure. The mere fact that maintenance expenditure is more than 25% of the original cost of the machinery would not change its nature, i.e. in revenue expenditure.

If any expenditure of a revenue nature is treated as capital, then it would have the effect of inflating the profit for the year. Consequently, the auditor would be required to qualify his report.

Answer 23. (d)

As per provisions of the law, the final dividend of a company shall be declared only by the shareholders based on the recommendation of Board of Directors. The Board can only propose the dividend which shall become final only after approval by shareholders at the AGM.

The Board is empowered to declare the interim dividend only. Hence in the given case, the action of SPW Ltd.'s directors is not in accordance with the law and the auditor should have qualified his report to this effect. The auditor would also have to confirm whether the provision for the same has been made in Part II of Schedule VI to the Companies Act, 1956.

Q. 24. (a) Draft a 'checklist' for carrying out the " Buy Back of Own Securities.".

(b) Draft an audit programme to audit the receipts of an amusement park owned by a partnership firm.

Answer 24. (a)

Section 77A of the Companies (Amendment) Act, 1999 contains elaborate provisions enabling a company to buy-back its own securities.

The auditor should ensure the compliance of all the provisions relating to buy-back and also see that proper accounting entries have been passed. Audit procedure to be followed may be as under :

(i) Ensure that the buy-back has been done only out of the company's free reserves or its securities premium account or out of the proceeds of any shares or other specified securities other than out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

(ii) Check authorisation in the Articles of Association which is a prerequisite of any buyback.

(iii) Examine special resolution passed in the general meeting authorising buyback.

(iv) Ascertain that quantum of buy-back is either equal to or less than 25% of the total paid up share capital and free reserves but in case of buy-back of equity shares in any financial year it should not exceed 25% of its total paid-up equity capital in that financial year.

(v) Check that the debt equity ratio should not be more than 2 : 1 except in cases where Central Government allows higher ratio for a class or classes of companies.

(vi) Ensure that shares or other specified securities to be bought back should be fully paid-up.

(vii) Buy-back should be completed within 12 months from the date of passing the special resolution.

(viii) Ascertain that declaration of solvency in Form No.4A was filed with the SEBI and/or the Registrar of Companies before making buy-back but subsequent the passing of the special resolution.

(ix) See that SEBI (buy-back of securities) Regulations, 1998 have been followed by listed company.

Answer 24. (b)

Audit programme for checking the receipts of an amusement park of a partnership firm.

(1) The partnership deed should be first scrutinized.

(2) The receipts of the cash from partners on capital and current accounts should be vouched with reference to the relative terms in the deed.

(3) The internal control for collections from sale of tickets should be checked.

(4) See that the tickets are serially numbered and effective custody of un-issued tickets are in existence.

(5) Check the rough cash book and reconcile from the stock of ticket books issued, the cash to be collected each day.

(6) Check that the cash balance and ticket sales from stock is daily checked by the manager.

(7) Check that the collections are banked daily, the very next day.

(8) See rates for each class and the ticket rates are as per current prices.

(9) The entertainment tax collected should be separately accounted for its subsequent payment to the government agencies.

(10) Check the relation between the amounts of tax collected and sales.

(11) The collections from the advertising and publicity materials should be checked with reference to the terms of agreement.

(12) Income from canteen, stalls, parking facilities should also be checked and see that the income are fairly booked without any seepage.

(13) The cash collections should not be used for meeting petty cash expenses. There should be separate impressed system.

(14) Do surprise checking of cash balances.

(15) See that cash collections are insured and the policy is in force.

(16) Compute analytical ratios in respect of the receipts pattern i.e. on week ends, holidays, etc. and make comparisons to draw conclusions.

Q. 25. State the reporting requirements of Company Auditor is respect of the following under CARO-2003?

(a) Inventory.

(b) Records of dealing in securities.

(c) Preferential allotment of shares.

(d) Internal control on purchases of Assets and Sale of Goods.

Answer 25. (a)

Inventory : The auditor has to make following statements on verification and valuation of inventories.

(i) Whether physical verification of Inventory has been conducted at reasonable intervals by the management.

(ii) Are the procedures of physical verification of inventories followed by the management reasonable and adequate in relation to the size of the company and the nature of its business? If not, the inadequacies in such procedures should be reported.

(iii) Whether the company is maintaining proper records of inventory and whether any material discrepancies have been noted on physical verification and if so, whether the same have been properly dealt with in the books of account.

Answer 25. (b)

Records of Dealing in Securities : If the company is dealing or trading in shares, securities, debentures and other investments, whether proper records have been maintained of the transactions and contracts and whether timely entries have been made there in, also, whether the shares, securities, debentures and other investments have been held by the company in it's own name, except to the extent of the exemption if any, granted under section 49 of the Companies Act.

Answer 25. (c)

Preferential Allotment of Shares : Whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under Section 301 of the Companies Act and if so whether the price at which shares have been issued is prejudicial to the interest of the company.

Answer 25. (d)

Internal Control on Purchases of Assets and Sale of goods : Is there an adequate internal control procedure commensurate with the size of the company and the nature of its business for the purchase of inventory and Fixed Assets, and the sale of goods? Whether there is a continuing failure to correct major weaknesses in internal control?

Q. 26. (a) Mention the special points in the case of an audit of the organisation from Incomplete Records.

(b) What points you would consider framing a system of Internal Check?

Answer 26. (a)

The examination of records and documents is one of the most important techniques through which an auditor collects evidence. Therefore, in case the records and documents maintained by an enterprise are incomplete, it would prove to be a great handicap to the auditor.

An auditor may face the situation of incomplete records under the following circumstances :

(i) Where records are kept on single entry basis; or

(ii) Where records are kept on double entry basis, but some of the records are destroyed accidentally, or are seized by authorities, or are otherwise not available for the auditors examination due to similar reasons.

Under the second circumstance, an ideal approach for carrying out audit would be that the auditor may direct the management of the enterprise to complete or reconstruct the accounting records, e.g., if vouchers are available but the cash book, journal and the ledger are not maintained, then the cash book, journal and ledger should be written up. However, if vouchers are also not available, then cash book/journal/ledger will have to be prepared by correlating the evidence available, e.g., memoranda records, bank statements, statements from outside parties, etc. Even though such books which are prepared may not be complete, but may still contain useful information for the auditor.

On the other hand, when books are maintained on single entry basis, then the management of the enterprise would be asked to write up the books, to the extent possible, as they would have been written up under double entry system.

In any case, the following steps would be required to conduct an audit :

(i) Ascertain that the balance sheet or statement of affairs as at the beginning of the year should be prepared and all the relevant accounts should be opened in the ledger. Normally, under the single entry system, cash, bank, and personal accounts are maintained.

(ii) Confirming that all entries on receipt side of the cash book are posted in the ledger, even by opening new account(s) wherever necessary.

(iii) Check that all entries on the payment side of cash book are posted in the ledger.

(iv) Confirming that all entries appearing in bank account are posted in the ledger.

(v) Analyse personal accounts of debtors. This will provide vital information regarding credit sales, sales returns, discounts allowed, bills received, bills dishonoured, etc. It would be necessary to post such items to relevant accounts, to complete the double entry from the debtors accounts.

Similarly, it would be necessary to analyse the creditors' accounts and post entries relating to credit purchase made, discounts earned, purchases returns, bills payable issued to suppliers, bills payable dishonoured, etc., to relevant accounts.

From an auditor's view point, the supervisory controls exercised by the owners are generally less reliable and hence while auditing incomplete records, auditor will largely depend on extensive substantive procedures and obtain external evidence, physical examination/ observation, management representation and perform analytical procedures.

Answer 26. (b)

The term "internal check" is defined as the "checks on day to day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being the prevention or early detection of errors or fraud". The following aspects should be considered in framing a system of internal check :

(i) No single person should have an independent control over any important aspect of the business. The work done by one person should automatically be checked by another person in routine course.

(ii) The duties/work of members of the staff should be changed from time to time without any previous notice so that the same officer or subordinate does not, without a break, perform the same function for a considerable length of time.

(iii) Every member of the staff should be encouraged to go on leave at least once in a year so that frauds successfully concealed by such a person can be detected in his absence.

(iv) Persons having physical custody of assets must not be permitted to have access to the books of account.

(v) There should be an accounting control in respect of each important class of assets, in addition, these should be periodically inspected so as to establish their physical condition.

(vi) The system of Budgetary Control should be introduced.

(vii) For stock-taking, at the close of the year, trading activities should, if possible, be suspended. The task of stock-taking, and evaluation should be done by staff belonging to other than stock section.

(viii) The financial and administrative powers should be sub divided very judicially and the effect of such division should be reviewed periodically.

(ix) Finally, the system must be capable of being expanded or contracted to correspond to the size of the concern.

Q. 27. An Audit of expenditure is one of the major components of Government Audit. In the context of "Government Expenditure Audit" write in brief, what do you understand by :

(i) Audit against Rules and Orders

(ii) Audit of Sanctions

(iii) Audit against Provision of Funds

Answer 27. (a)

Audit of government expenditure is one of the major components of government audit conducted by the office of C & AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorized by competent authority fixing the limits within which expenditure can be incurred. Briefly, these standards are explained below :

(i) **Audit against Rules & Orders :** The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority. It is the function of the executive government to frame rules, regulations and orders, which are to be observed by its subordinate authorities. The job of auditor is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. But, it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that :

(*a*) they are not inconsistent with any provisions of the Constitution or any laws made thereunder;

(*b*) they are consistent with the essential requirements of audit and accounts as determined by the C & AG;

(*c*) they do not come in conflict with the orders of, or rules made by, any higher authority; and

(*d*) in case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power.

(ii) **Audit of Sanctions :** The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure. The audit of sanctions is directed both in respect of ensuring that the expenditure is properly covered by a sanction, and also to satisfy that the authority sanctioning it is competent for the purpose by virtue of the powers vested in it by the provisions of the Constitution and of the law, rules or orders made thereunder, or by the rules of delegation of financial powers made by an authority competent to do so.

(iii) **Audit against Provision of Funds :** It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriation made.

Q. 28. (a) What are the review areas of an IS Auditor?

(b) Discuss the control procedures which the auditor should adopt in applying CAAT (Computer Assisted Audit Technique) in an audit under EDP environment.

Answer 28. (a)

The IS auditors may focus on following review areas :

(i) **Computerised systems and applications :** The auditor should verify that systems and applications are appropriate to the users' needs, efficient and adequately controlled to ensure valid, reliable, timely and secure input, processing and output at current and projected levels of system activity.

(ii) **Information Processing Facilities :** This facility must be controlled to ensure timely, accurate and efficient processing of applications under normal and potentially disruptive conditions.

(iii) **Systems Development :** An IS auditor should ensure that systems under development meet the objectives of the organization, satisfy user requirements and provide efficient, accurate and cost effective systems and applications. The auditor should also ensure that these systems are written, tested and installed in accordance with generally accepted standards for systems development.

(iv) **Management of Information Systems :** MIS must develop an organizational structure and procedures to ensure a controlled and efficient environment for information processing. This plan should also specify the computers and peripheral equipments required to support all functions in an economic and timely manner.

(v) **Client/Server, Telecommunications and Intranets :** In a client/server environment, all applications that can be dedicated to a user are put on the client. All resources that need to be shared are put on the server. Auditors must ensure that controls are in place on the client as well as on the server and on the network. Auditors must provide the same level of control assurance in an Internet/Intranet environment as in a client/server environment, with special emphasis on TCP/IP and HTTP.

Answer 28. (b)

The common types of CAATs are audit software and test data. Audit software consists of computer programmes used by the auditor to process data of audit significance from the entity's accounting systems. It may consist of package programmes, purpose-written programmes and utility programmes. Regardless of the source of programme, the auditor should substantiate their validity for audit purposes prior to use.Test Data techniques on the other hand are used in conducting audit procedures by entering data (a sample transactions) into an entity's computer systems and comparing the results obtained with the predetermined results. Test data is used to test specific controls in computer programmes, such as, on line password and data access.

Controlling the CAAT Application : The use of a CAAT should be controlled by the auditor to provide reasonable detailed specifications of the CAAT have been met and that the CAAT is not improperly manipulated by the entity's staff. The specific procedures necessary to control the use of a CAAT will depend on the particular application in establishing audit control which require the auditor should consider the need to –

(I) Approve the technical specifications and carry out a technical review of the work involving the use of the CAAT.

(II) Review the entity's general IT controls which may contribute to the integrity of the CAAT, e.g., control over programme changes and access to computer files. When such controls cannot be relied upon to ensure the integrity of the CAAT, the auditor may consider processing the CAAT applications at another suitable computer facility.

(III) Ensure appropriate integration of the output by the auditor into the audit process.

Procedures carried out by the Auditor to control Audit Software Application :

(I) Participating in the design and testing of the computer programmes.

(II) Checking the coding of the programme to ensure that it conforms with detailed programme specifications.

(III) Requesting the entity's computer staff to review the operating system instructions to ensure that the software will run in the entity's computer installation.

(IV) Running the audit software on small test files before running on the main data files.

(V) Ensuring that the correct files were used, e.g. by checking with external evidence, such as control totals maintained by the user.

(VI) Obtaining evidence that the audit software functioned as planned, for example, returning output and control information.

(VII) Establishing appropriate security measures to safeguard against manipulations of the entity's data files.

The presence of the auditor is not necessarily required at the computer facility during the running of a CAAT to ensure appropriate control procedures. However, it may provide practical advantages, such as being able to control distribution of the output and ensuring the timely corrections of errors.

Procedures carried out by the Auditor to Control Test Data Applications :

(I) Controlling the sequence of submissions of test data where it spans several processing cycles.

(II) Performing test runs containing small amounts of test data before submitting the main audit test data.

(III) Predicting the results of the test data and comparing it with the actual test data output, for the individual transactions and in total.

(IV) Confirming that the answered version of the programmes was used to process the test data.

(V) Obtaining reasonable assurance that the programmes used to process the test data were used by the entity throughout the applicable audit period.

When using a CAAT, the auditor may require the co-operation of the entity's staff who have extensive knowledge of the computer installation. In such circumstances, the auditor should have reasonable assurance that the entity's staff did not improperly influence the results of the CAAT. Finally, the standard of working papers and retention procedures for a CAAT should be consistent with that on the audit as a whole. It may be convenient to keep the technical papers relating to the use of the CAAT separate from the other audit working papers. The working papers should contain sufficient documentation to describe the CAAT application.

Q. 29. (a) Mention the difference between 'audit report' and 'audit certificate.'

(b) Discuss flow chart technique for evaluation of internal control system in an organization.

Answer 29. (a)

A audit certificate is written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. A audit report on the other hand, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon. These words are fundamentally distinct from each other. Etymologically, the word 'certificate' is derived from Latin words certus (Certain) and facere (to make). So, the certificate connotes verification of certain and exact facts. However, the rendition of this type of statement is an impossible task and the auditor's duty indeed becomes onerous. The dictionary meaning of the word 'report' refers to formal account of results after an enquiry, examination or review given by an authorised person or group of persons.

In other words, when a certificate is issued, the auditor is responsible for the factual accuracy of what is contained therein. However, when a report is given, the auditor is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts and that it is arrived at by the application of due care and skill.

Answer 29. (b)

A flow-chart is a graphic presentation of the flow of transactions and documents in an organisation. Evaluation of the internal controls forms an important part of the auditing process as it enables the auditor to know the weaknesses and strengths of the accounting system. A properly drawn up flow chart can provide a neat visual picture of the whole activities of the organization or department involving flow of documents and activities. More specifically it can show :

(i) at what point a document is raised internally or received from external sources;

(ii) the number of copies in which a document is raised or received;

(iii) the intermediate stages set sequentially through which the document and the activity pass;

(iv) distribution of the documents to various sections, departments or operations;

(v) checking authorisation and matching at relevant stages;

(vi) filing of the documents; and

(vii) final disposal status.

The flow-chart method provides the most concise but comprehensive way of recording the operating controls along with the flow of transactions and documents. In the flow-chart, a total and complete visual picture and control system is available and as such its reception in the human mind is direct. In drawing a flow-chart, organised and concentrated application of mind is essential to reflect the control system in a rational manner. Even in a large and complex organisation, the control system could be depicted by few sheets of neatly drawn flow-charts. However, in drawing the flow chart, the auditor has to take few precautions, e.g., flow-charts should not be lengthy and cumbersome, should be neat, should portray the flow completely with final disposal of papers and there should be proper use of symbols and lines. The auditor will be able to visually correlate the functions and the related controls and assess the adequacy and effectiveness thereof much quickly than a possibly in any other method.

Q. 30. (a) Why do we need Management Audit?

(b) What are the steps involved in carrying out management audit?

Answer 30. (a)

The following are the circumstances wherein the management audit is useful—

(i) To overcome the human limitations of Top Management.

(ii) To improve the management's production.

(iii) Circumstances of corporate planning deficiencies, organization's structured defects, ineffective management control system etc. warrants the necessity of management audit.

(iv) In the circumstances of acquisition of another business entity, the acquiring organization needs to evaluate financial aspects, technical aspects and management aspects and analysis of these aspects takes the form of management audit.

(v) Society at large likes to be assured that the top and middle level management discharge their functions efficiently and to the best advantage to the society, the management audit satisfy the different interest of groups like customers, employees, citizens, government etc. of the society and also guide the management in the application of scientific methods of business management for social well being.

(vi) The statutory financial audit is generally annual and concerned with the past without having any forward approach. Statutory financial audit and internal audit along with statutory cost audit are essentially legalistic in terms of time given for its completion and nature of certification fails to provide the insight to the management in regard to unsuitability of structure to meet the entity's needs, poor leadership, inability to make decisions, poor vision and the enlightened managers realizes this fact and feels the need of management audit to identify the problems and guidance to overcome them.

(vii) Foreign collaborators, while investing in other organizations feel the necessity of management audit to ensure that the funds invested are to be used properly for growth and expansion.

(viii) Financial institutions conduct the management audit, while participating in equities of a company to avoid possible losses arising from inefficient management.

(ix) Company itself feels the need of management audit to assess its managers' performances and link an incentive system to the results of such assessment.

(x) While advancing loans, banks like to get the management audit conducted.

Answer 30. (b)

Management audit basically comprises of following three steps :

(i) Examination of management performance. This involves-
- Detailed diagnosis and study of activities.
- Determination of purpose and relationships.

(ii) Reporting defects and irregularities
- Looking for shortcomings
- Searching for problems

(iii) Presenting suggestions for improvement.
- Determination of alternatives
- Testing of effectiveness
- Ascertainment of solutions to problems
- Presenting methods of improvement.

Paper 7

Applied Direct Taxation

Question No. 1:

(a) State the situations, when previous year and assessment years are same.

Answer: Previous year & Assessment year are same in the following cases:

(i) Shipping business of nonresident [Section 172]
(ii) Persons leaving India [Section 174]
(iii) AOP or BOI or Artificial Juridical Person formed for a particular event or purpose [Sec. 174A]
(iv) Persons likely to transfer property to avoid tax [Section 175]
(v) Discontinued business [Section 176]

(b) State the undisclosed sources of income.

Answer: The undisclosed sources of income are:

(i) Unexplained Cash Credits u/s 68
(ii) Unexplained investments u/s 69
(iii) Unexplained money, bullion or jewel or valuable article u/s 69A
(iv) Undisclosed investments u/s 69B
(v) Unexplained expenditure u/s 69C
(vi) Amount borrowed or repaid on hundi, other than by way of account payee cheque u/s 69D.

(c) State the difference between Application of Income and Diversion of income.

Answer: An application of income is an obligation to apply income, which has accrued or has arisen or has been received amounts to merely the apportionment of income. Therefore the essentials of the concept of application of income under the provisions of the Income Tax Act are :

(i) Income accrues to the assessee
(ii) Income reaches the assessee
(iii) Income is applied to discharge an obligation, whether self-imposed or gratuitous.

Diversion of Income is an obligation to apply the income in a particular way before it is received by the assessee or before it has arisen or accrued to the assessee results in diversion of income. The source is charged with an overriding title, which diverts the income. Therefore the essentials are the following:

(i) Income is diverted at source,
(ii) There is an overriding charge or title for such diversion, and
(iii) The charge / obligation is on the source of income and not on the receiver.

Examples of diversion by overriding title are -

(i) Right of maintenance of dependants or of coparceners on partition
(ii) Right under a statutory provision
(iii) A charge created by a decree of a Court of law.

(d) Mr. Hari, an employee of Hello India Ltd. is transferred from Mumbai to Bhubaneswar. On his transfer, he was provided accommodation in Bhubaneswar for a period of 15 days. Hotel room rent paid ₹33,708/- (inclusive of service tax @12.36%). His basic salary is ₹35,000 per month. Dearness allowances @ 50%. Discuss the taxability of hotel accommodation at Bhubaneswar.

Answer: In cases, where an assessee is provided a hotel accommodation, on the event of his transfer, if the period of stay does not exceed 15 days, then the payment made for hotel accommodation, would not be considered as perquisite.

If the accommodation exceeded more than 15 days, then the perquisite value would have been calculated as follows:

Lower of the followings:

(i) 24% of Salary

(ii) Actual hotel accommodation charges paid

Note:

(1) 24% of Salary refers to the salary of the time period during which the assessee was in the hotel accommodation [example: if assessee was in hotel accommodation for 19 days, then salary would be calculated as follows: Salary per month x 19/30 x 24%]

(2) Salary for hotel accommodation = Basic Pay + Dearness Allowance (forming part of retirement benefit) + Bonus + Commission (if received as a fixed percentage on turnover)+ any other monetary benefits + All taxable allowances.

(e) Chris, an employee of Beautiful World Ltd. was presented a gift voucher of Pantaloons amounting to ₹ 7,000, on the occasion of his marriage. Discuss taxability. Would your answer differ, if the same was presented to Chris on the occasion of her first marriage anniversary?

Answer: As per Rule 3(7)(iv), value of any gift or voucher or token other than gifts made in cash or convertible into money (e.g. gift cheques) on ceremonies, would be taxable as a perquisite, if the amount exceeds ₹5,000. However, since this gift was received on the occasion of marriage, this gift received would not be considered as a taxable income.

If this gift was presented on the occasion of her first marriage anniversary, then , the same would be considered as a taxable income to the extent it exceeds ₹5,000. In this case, the amount involved is ₹7,000. Hence, taxable income would be ₹2,000 [₹7,000 – ₹5,000]

(f) Aakansha holds 18% shares in a Private Limited Company. She gifted all her shares to her husband Mr.Dolichand on 1.10.2011. After a month, Mr.Dolichand obtained loan of ₹ 50,000 from the company, when the company's accumulated profit was ₹ 75,000. What are the tax implications of the above transactions?

Answer: U/s 2(22)(e), payment of any sum by a company in which the public are NOT substantially interested, as advance or loan, to the extent the Company possesses accumulated profits, to a shareholder, who is the beneficial owner of shares with not less than 10% voting power, shall be deemed to be dividend.

In view of the above, since Mr.Dolichand has 18% shareholding in a Private Limited Company, the loan amount of ₹50,000 would be considered as deemed dividend u/s 2(22)(e) in his hands.

Since the shares were gifted to Mr. Dolichand, by his wife, Aakansha, the said amount of ₹50,000 shall be clubbed in his total income of Ms. Aakansha.

(g) Mr. Bhanu, sold a house property in Mumbai for ₹45 lacs in March 2012. The property was purchased by him during 2004-05 for ₹ 30 lacs. The Stamp duty was collected on the value of ₹ 52 lacs. Determine the capital gains. The value adopted was not disputed in any court of law.

Answer: If an assessee transfers land, building or both and if the sale consideration is less than the value adopted or assessed or assessable by the State Government Authority, then the value adopted by the Stamp Valuation Authority would be taken as "Consideration" for determining "Capital gains".

In this case, the computation of capital gains would be as follows:

Consideration for Transfer: = Stamp Duty Value	52,00,000
Less: Indexed Cost of Acquisition [30,00,000 x 785/480]	49,06,250
Long-term Capital Gains	**2,93,750**

(h) Explain the concept of Reverse Mortgage and discuss its tax implications.

Answer: Reverse mortgage is a scheme for the benefit of senior citizens who own a residential house property. The senior citizens can mortgage their house with a scheduled bank or housing finance company, in return for a lump sum amount or for a regular monthly/quarterly/annual income.

Senior citizens can continue to live in the house and receive regular income without the botheration of having to repay the loan. They can use the loan amount for renovation and extension of residential property, family's medical expenditure and emergency expenditure, etc, but not for speculative or trading purpose. The bank will recover the loan along with the accumulated interest by selling the house after the death of the borrower. The excess amount, if any, will be given to the legal hei₹ However, before resorting to the sale of the house, preference will be given to the legal heirs to repay the loan and interest and vacate the mortgaged property.

(i) Mohini, a non-resident Indian, purchased 5,000 shares in Happy Days Ltd, an Indian Company, in foreign currency for $50,000 in August 2010. She sold these shares to Mrigakshi, another non-resident in Singapore, in March 2012 for $67,000. Discuss the impact of the given transactions, if any, in the assessment of Mohini.

Answer: As per Sec.47(viia), where a Non-resident Indian acquires or bonds in foreign currency, and the same is transferred outside India to another non-resident in foreign currency, then the transaction is not a transfer and hence not chargeable to capital gains.

However, if the asset was transferred in India, then provisions of Sec.115AC shall apply and the Capital Gain shall be chargeable to tax @ 10%, as it is a Long-Term Capital Asset.

(j) X Ltd. having an issued capital of ₹50,00,000 in equity shares of ₹100 each. On March 2012, Company decided to buy-back equity shares to the extent of 20%. Tushar, holding 500 shares of the company, has received the buy-back consideration on the shares bought-back, @ ₹130 per share. He had purchased these shares 14 months earlier @ ₹105 per share. Discuss the taxability.

Answer: Where a shareholder receives any consideration from the company for purchase of its own shares or other specified securities, it is a transfer chargeable under the head capital gains. Such capital gain is chargeable to tax in the previous year in which the shares or securities are purchased by the company.

Computation of Capital Gains

Consideration for transfer of 100 equity shares [500 shares x 20%] @ ₹130 per share	13,000
Less: Indexed Cost of Acquisition [100 equity shares x 105 x 785/711]	11,592
Long term Capital Gains	**1,408**

(k) Mr. Kashyap, a Government servant, died on 15th April, 2009, while in service. In terms of the rules governing his service, his widow Mrs.Kashyap, is paid a family pension of ₹5,937 p.m. and a dearness allowance @ 58% thereof. For the assessment year 2012-13, is Mrs. Kashyap assessable on the receipt and if no, under what head of Income? Is she entitled to any relief or deduction on the above receipt?

Answer: Family pension received by Mrs. M is chargeable under the head Income from other sources. She can claim the lower of ₹15,000 or 1/3rd of her family pension, as deduction u/s 57 in respect of such income.

Computation of Taxable Family Pension

Family Pension Received [₹ 5,937 x 12 months]	71,244
Add: Dearness Allowance @ 58% of ₹71,244	41,322
Total Pension Received	1,12,566
Less: Deduction u/s 57 : Least of the followings:	
(i) 1/3rd of Gross Pension (₹1,12,566 x 1/3) = ₹37,522 (ii) Maximum deduction ₹15,000	15,000
Taxable Family Pension	**97,566**

(l) A company issued discount coupons to its shareholders which entitled them to purchase the products of the company at a discount. The Assessing Officer is of the opinion that this is to be considered as deemed dividend. Discuss the tenability.

Answer:

(i) Arguments for treating discount coupons as deemed dividend u/s 2(22)(e):

- ❖ Since the shareholders are only entitled to receive those coupons, therefore, these coupons can be considered as release of profits, otherwise, than by way of actual cash payment/outflow;
- ❖ The company suffers a reduction in the gross value of sales to the extent of discount coupons are used and therefore it can be inferred that the assets to that extent get released indirectly in favour of the shareholders.

(ii) Arguments against treatment of discount coupons as deemed dividend u/s 2(22)(e):

- ❖ Issue of discount coupons is a managerial decision and hence cannot be considered at par with dividend;
- ❖ There is no certainty that each shareholder will use the discount coupons.
- ❖ The discount coupons do not necessarily confer any vesting right in favour of the shareholders and it does not create any liability for the company to the shareholder.

(m) Ashim incurred an expenditure of ₹ 5 lakhs, on the occasion of his daughter's marriage on 14th February, 2012. He has no explainable source of this expenditure. What is the tax implication, if any?

Answer: Vide Sec. 69C, unexplained expenditure incurred by the assessee shall be treated as income under the head "Income from Other Sources". It is chargeable to tax as income of the previous year, in which the expenditure was incurred.

In view of the above, the sum of ₹ 5 lakhs, expended by Ashim, on his daughter's marriage, shall be treated as income for the financial year 2011-12 and chargeable to tax.

(n) Aniket was holding 5,000 listed shares in Blue Arrow Ltd. purchased by him on 15.9.2010 at ₹50 per share. He gifted them to his girlfriend, Chitralekha on 14.2.2011. Aniket married Chitralekha on 17.2.2011. Chitralekha was allotted bonus shares by the company at the rate of one for every four shares held on 21.9.2011. She sold all shares including bonus shares at ₹135 per share. State in whose hands capital gain on sale of shares is taxable. Also compute the capital gain.

Answer: U/s 64(1)(vi), where an individual transfers an asset to his/her spouse for inadequate consideration, then the income from such asset shall be clubbed in the hands of the individual. The spouse relationship shall exist both at the time of transfer of asset, and at the time of accrual of income. In this case, spouse relationship between Aniket and Chitralekha did not exist on the date of transfer, i.e. on 14.2.2011., and so income of Chitralekha shall not be clubbed in the hands of Aniket.

Computation of Capital Gains in the hands of Chitralekha for the assessment year 2012-13

Particulars	**Original Shares**	**Bonus Shares**
Consideration for Transfer (No. of shares x Sale Price per share)	5,000 x ₹135 = ₹6,75,000	5,000 x ¼ x ₹135 = ₹ 1,68,750
Less: Indexed Cost of Acquisition of Shares	5,000 x 50 x 785/711= ₹2,76,020	NIL
Capital Gains	₹3,98,980	1,68,750
Nature of Capital Gains	**LTCG**	**STCG**

(o) A proprietary business was started by Mr.Ratnesh in 2010. As on 1.4.2010, his capital was ₹4,00,000. His wife, gifted ₹ 5,00,000 on that day, which was also invested by him in the business. For the financial year 2010-11 and 2011-12, profits earned from business ₹1,90,000 and ₹4,50,000. Discuss taxability of income, to be clubbed in the hands of Mrs. Ratnesh for the assessment year 2012-13.

Answer: The amount of profit to the extent of gifted amount to total capital on the first day of the previous year must be clubbed in the hands of M₹ Ratnesh. Income arising from transferred asset shall only be clubbed. Any income earned out of such income should not be clubbed.

Particulars	**Financial Year 2010-11**	**Financial Year 2011-12**
Profit earned	₹1,90,000	₹4,50,000
Amount gifted	₹5,00,000	Nil
Total Capital	₹ 9,00,000 (₹4,00,000 + ₹5,00,000)	₹10,90,000 (₹9,00,000 + ₹1,90,000)
Clubbed Amount	Profit earned x Gifted amount / Total Capital = ₹ 1,90,000 x 5,00,000/9,00,000 = ₹ 1,05,555	Profit earned x Gifted amount / Total Capital = ₹4,50,000 x 5,00,000/10,90,000 = ₹2,06,422

(p) Interest of ₹15,000 on Bank Fixed Deposits, received by minor son of Ms. Soma. These FDRs were made by Ms. Soma, out of his son's earnings from stage acting. Discuss the tax treatment in this case.

Answer: If the minor receives any income by exercise of labour, hard work, skill, knowledge or experience then such income shall not be clubbed. In the given case, the income of the minor son of Ms. Soma, is from application of special talent, hence, shall not be clubbed in the hands of parents.

(q) An assessee sustained a loss under the head "Income from House Property" in the previous year relevant to the assessment year 2011-12, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed u/s 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the time allowed u/s 139(4). Can the assessee carry forward such loss for set-off against income from house property of the assessment year 2012-13?

Answer: Loss u/s 71B and Section 32(2), can be carried forward even if the return of income has been filed after the due date u/s 139(1) but before the time limit u/s 139(4) for filing belated return.

As per Sec. 139(4) of the Act, it states that, where an assessee failed to file return of income for any assessment year within the prescribed time limit u/s 139(1), the belated return can be filed either before:

(i) The expiry of one year from the end of the relevant assessment year; or

(ii) Completion of assessment, whichever is earlier.

In the instant case, the assessee has filed the return of income for the assessment year 2011-12 belatedly but within the time limit u/s 139(4). In view of the above provisions of law, the loss under the head house property, can be carried forward and set off against the income of the assessment year 2012-13.

(r) Resham & Co. started two separate industrial undertakings, which prima facie are eligible for deduction u/s 80-IB. For the year ending 31.3.2012, the profit of one unit was ₹11 lakhs while the other unit suffered a loss of ₹3 lakhs. The Assessing officer has allowed the deduction u/s 80-IB on the net profit of ₹8 lakhs. Discuss the validity of the order of the Assessing Officer.

Answer:

Vide Sec.80-IB, deduction is available in respect of the profits and gains derived from the eligible industrial undertaking of the assessee. Even u/s 80-IB, it is expressly stated that the deduction under this section shall be calculated on the gains derived from such undertaking. In view of the above, Resham & Co. is entitled for deduction u/s 80-IB at 25% of income derived from first undertaking, not on the net income of the two undertakings.

The amount, eligible for deduction = 25% of ₹11 lakhs = ₹2,25,000. Total Income = ₹ (11,00,000 – 3,00,000 – 2,25,000) = ₹5,75,000.

The action of the Assessing Officer is not valid in law.

(s) Is a firm allowed to carry forward share of accumulated loss of a retired/deceased partner?

Answer: Vide Sec.78, in case of retirement or death of a partner, the share of the retired or deceased partner in the accumulated losses of the firm, excluding unabsorbed depreciation, shall not be allowed to be carried forward by the firm.

(t) A company received a sales tax refund from the Government, which was refunded to the customers, from whom it was collected. Discuss the taxability of receipt of refund.

Answer: Sales Tax refund made by Government shall be deemed as business income u/s 41(1) unless the same was refunded to the customers from whom it was collected. **[Tirumalaiswamy Naidu & Sons 230 ITR 534(SC)].**

(u) Biswas & Co., a partnership firm, was dissolved on 31st March, 2011. The dues of the firm were received by its erstwhile partners during the period May 2011 to April 2012. Can the same be taxed in the hands of the firm for the Assessment Year 2012-13? If not, in those hands can they be taxed?

Answer: Vide Sec.176 (3A), any sum received after discontinuance of a business shall be taxable in the hands of the recipient in the year of receipt under the following circumstances:

- ❖ Business should have been discontinued;
- ❖ Any sum should have been actually received;
- ❖ Such sum would have been included in the total income of the person who carried on the business had such sum been received before such discontinuance;

In the above case, the amount received shall be taxable in the hands of the partners.

(v) Discuss the taxability of the followings:

(i) Unpaid excise credit	Taxable	Transfer of unpaid excise credit to the Profit & Loss Account of the assessee is chargeable to tax [CIT Vs. London Machinery Company 146 Taxman 326 (All.)]
(ii) Remission of unsecured loan	Not taxable	Remission of unsecured loan cannot be treated as income u/s 41(1), since there have been no allowance of deduction in any of the preceding years in respect of such loan.[Chetan Chemicals Pvt. Ltd. 139 Taxman 301 (Guj.)]
(iii) Sales tax refund received by agent	Not taxable	Amount collected as sales tax by a commission agent and paid to Department. Sales tax was found not payable and refunded. It was held as not an income of the Assessee [D.Shankariah 247 ITR 798(SC)]
(iv) Concession to sick unit	To be decided by CBDT, case to case basis	In case of financial concession or assistance to a sick unit referred to BIFR (Board for Industrial and Financial Reconstruction), then the taxability of such concession or assistance shall be considered by CBDT in each individual case in coordination with a nodal agency [Circular No.683 dated 8.6.1994]
(v) Bad debts earlier allowed, subsequently recovered by the Assessee	Taxable	Taxable for all assesses excluding successor of business. The amount received shall be taxable in the year of receipt/recovery. Predecessor's debt recovered by the successor shall not be treated as income of the successor.

(w) A soft drink manufacturer, claimed 100% depreciation on bottles and crates used by them. Subsequently, such bottles were sold. Discuss taxability, if any.

Answer: Income arising from sale of such written off bottles shall be liable to capital gains tax u/s 50. [Nectar Beverages Pvt. Ltd. (2009) (SC) 314 ITR 314]

(x) Ritu received a gift, from her mother, 6 ½ % Gold Bonds of the value of ₹5 lakhs in 1980. These bonds were redeemed by the Government on 1.10.2000 and he received gold of equivalent value, weighting 5,000 grams approximately of fair market value of ₹10 lakhs. The gold was sold by him on 1.7.2011 for ₹21 lakhs. Examine the impact of the transactions in Ritu's assessment.

Answer: Vide Circular No.415 dated 14.3.1985 [152 ITR (St.) 205], exchange of gold bonds for gold on redemption does not attract Capital gains because it is not a capital asset. In case of subsequent sale of such gold, capital gain is chargeable to tax. For this purpose:

- Date of acquisition = date of redemption of such gold bonds;
- Cost of acquisition of gold = market value of the gold on the date of redemption.

Computation of Capital Gains on sale of gold	₹
Consideration for transfer of gold	21,00,000
Less: Indexed Cost of Acquisition [₹ 10,00,000 x 785/406]	19,33,498
Long Term Capital Gains	**1,66,502**

(y) EPABX and Mobile Phones owned by a company are charged to depreciation @ 60%, similar to Computers. Discuss the tenability.

Answer: EPABX and mobile phones are not computer and therefore, not entitled to higher depreciation @ 60%, like computer. [Federal Bank Limited Vs. ACIT (2011) 322 ITR 319 (Kerala)]

(z) X Ltd. transferred unpaid excise credit to the Profit & Loss A/c. Discuss taxability, if any.

Answer: Transfer of unpaid excise credit to the Profit & Loss A/c of the assessee is chargeable to tax. [CIT vs. London Machinery Company 146 Taxman 326 (All.)]

(aa) Agricultural income in India earned by Master Soham (aged 15 years). Discuss taxability.

Answer: Agricultural income of minor son of the assessee has to be included in the income of the assessee for the purpose of determining the rate of income-tax applicable to the income of the assessee. [Suresh Chand Talera vs. Union of India 152 Taxman 348 (MP)].

(bb) A farmer resident of Bikaner sold his rural agricultural land in Nepal and received Indian Rupees of 5 lacs over the cost of acquisition of this land. Explain the taxability of sale.

Answer: U/s 2(14), only rural agricultural lands in India are not a capital asset. In this given case, the farmer has sold rural agricultural lands in Nepal and therefore, the transaction shall be attracted by the provisions of capital gains.

(cc) A Plantation company, holding several acres of land, sold trees of spontaneous growth. The Assessing officer is of the opinion that there arises capital gains. Discuss

Answer: Sale proceeds of spontaneous growth will not result in capital gains, as they do not bring in any profit or gain [Suman Tea & Plywood Industries Pvt. Ltd (1997) 226 ITR 34 (SC)].

(dd) Amit owns a plot of land acquired on 1.7.2002 for a consideration of ₹4 lakhs. He enters into an agreement to sell the property on 23.3.2012 for a consideration of ₹11 lakhs. In part performance of the contract, he handed over the possession of land on 25.3.2012 on which date, he received the full consideration. As on 31.3.2012, the sale was pending registration. Discuss liability of capital gains for the assessment year 2012-13 (no computation is required)

Answer: U/s 2(47), transfer includes part performance of a contract of the nature specified in Sec.53A of the Transfer of Property Act. In the given case, consideration was received by Amit and the possession was handed over on 25.3.2012. hence, the part performance condition is satisfied.

Capital gains on the above transaction is chargeable to tax as income for the assessment year 2012-13.

(ee) Well Wishers & Associates, a partnership firm, is holding land. This firm is not engaged in real estate business. The land was sold during the year. Discuss taxability, whether, this would be assessed to tax as business income or capital gain.

Answer: Land held by partnership firm, which is not engaged in real estate business, would be treated as fixed asset of the firm. Transfer of the same is assessable as capital asset, hence capital gains and not as business income. [Mohakampur Ice & Storage 281 ITR 354 (All.)]

(ff) Explain the tax treatment of income from Deep Discount Bonds (DDBs).

Answer: Deep discount bonds as clarified vide Circular No.2/2002 as follows:

1. Income based on market value

   (i) Income treated as interest for investors

(ii) Income treated as business income for traders

2. (i) For original subscribers, Income = difference between market value on 31^{st} March of the previous year and 1^{st} April of the previous year

   (ii) for subsequent purchases, income = difference between market value on 31^{st} march of the previous year and cost of purchase of the bond

3. If there is a transfer before maturity:

   (i) For the Investor, Short term Capital Gains = Sale Price less Cost of Bond;

   (ii) For Traders, Business Income = Sale price less cost of bond.

4. Cost of bond = Cost of acquisition + Income already taxed upto the date of transfer.

5. If there is a redemption on maturity:

   (i) For the Investor, Interest Income = Redemption Price less market value as on the last valuation date, immediately preceeding the maturity date.

   In case of a trader, this interest income would be construed as Business Income.

   (ii) For subsequent purchasers, Interest Income = Redemption price less cost of the bond to such purchaser.

   In case of a trader, this interest income would be construed as Business Income.

   Where, Cost of bond = cost of acquisition + income already taxed by the bond holder upto the date of redemption

(gg) Tina was the owner of two residential houses. On 5^{th} April,2011, she disposed one of the houses and utilized the entire sale proceeds to construct first floor on her second house which he completed by 15^{th} March,2012. She seeks your advice as to the taxability of transaction to capital gains under the provisions of Income Tax Act, 1961.

Answer: Vide Sec.54, where an assessee transfers a residential house being a Long-term Capital Asset and the Long-term capital gain on such transaction is utilized for construction of another residential house, within a period of 3-years from the date of transfer, is entitled for exemption.

Construction of first floor in the existing building should be treated as independent residential unit entitled for exemption u/s 54/54F. [P.V.NARASIMHAN 181 ITR 101]

(hh) Write short notes on Reverse Merger

Answer: Reverse merger refers to the arrangement where a profit making company merges with a sick company and thereby is eligible to carry forward the losses of the sick company. Profit making company becomes extinct losing its name and the surviving sick company retains its name. It is a device to avoid implications of merger u/s 72A.

The following benefits are expected to be derived from reverse merger:

❖ Losses shall be carried forward without compliance of provisions of Sec.2(1B) or Sec.72A, but only for the balance period;

❖ Goodwill of the profit making company shall also be retained.

(ii) Gross Total Income ₹5,00,000 (including LTCG ₹3,90,000]. Deductions under Chapter VIA [Sections 80C to 80U] ₹1,79,000. Compute tax liability for Mr.A.

Computation of Total Income for Mr.A

Gross Total Income	5,00,000
Less : Deduction under Chapter VIA Eligible deduction ₹1,79,000, but restricted to the balance of other income, i.e. ₹(5,00,000 – 3,90,000) = ₹1,10,000. Deductions under Chapter VIA are not deductible against LTCG.	1,10,000
Total Income (consisting of LTCG only)	₹3,90,000

Tax Liability:

On other income Nil

On LTCG = @ 20% on [LTCG – Unavailed basic exemption limit]

= 20% of [₹ 3,90,000 – (Basic exemption limit – other income)]

= 20% of [₹ 3,90,000 – (1,80,000 – Nil) = 20% of ₹ 2,10,000 = ₹ 42,000

Tax Liability = ₹42,000/- (excluding Education Cess and SHEC)

(jj) A partnership firm, consisting of two partners, X and Y is engaged in the business of civil construction, had a turnover of ₹53 lakhs for the assessment year 2012-13. The firm submitted its return of income wherein it had been stated that it wished to be governed by the provision of Sec.44AD of Income Tax Act. As authorized by the Partnership Deed, the firm paid remuneration to the partners within the limit of Sec.40(b). The Assessing officer declines to allow such remuneration in computation of the firm's business income. Discuss the validity of AO's action.

Answer: As per provision of Sec.44AD(2), where the assessee is a partnership firm, the salary and interest paid to its partners shall be deducted from the income computed on presumptive basis under this section i.e. income computed u/s 44AD shall be the book profit for the purpose of computing allowable remuneration to partners u/s 40(b)

Computation of Income of the firm

Presumptive Income u/s 44AD – 8% of ₹53,00,000	₹4,24,000
Less: Interest allowable u/s 40(b)	Nil
Book Profit	₹4,24,000
Less: Maximum remuneration on book profit : 90% of first ₹3,00,000 + 60% of ₹ (4,24,000 – 3,00,000)	₹3,44,400
Total	₹79,600

As the partners have drawn remuneration within the prescribed limits u/s 40(b), the action of the Assessing officer is not justified.

(kk) ABC LLP is liquidated. What is the liability of partners of XYZ LLP in respect of its tax dues?

Answer: U/s 167C, every person who was a partner of the limited liability partnership at any time during the relevant previous year, shall be jointly and severally liable for the payment of such tax. However, this rule will not be applicable if the partner proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the limited liability partnership.

(ll) Who shall sign and verify the return of income of a Limited Liability Partnership?

Answer: U/s 140, for LLP the return should be signed by the designated partner. Where, however, there is no designated partner as such, return of income can be signed by any partner except by minor.

(mm) Write short notes on Alternate Minimum Tax (AMT)

Answer: Where the income tax payable by a limited liability partnership is less than the alternate minimum tax payable for a previous year, it is liable to pay income tax @ 18.5% u/s 115JC. Tax would be computed on adjusted total income. Adjusted total income shall be the total income before giving effect to this chapter and must be increased by the followings:

- ❖ Deductions claimed (if any) included in Chapter VIA from Sec. 80H to 80TT ; and
- ❖ Deduction claimed (if any) under Sec.10AA

(nn) ABC LLP has income of ₹ 15,00,000 under the head profits and gains from business or profession. One of its business is eligible for deduction @ 100% of profits u/s 80IB for the assessment year 2012-13. The profit from such business included in the business income is ₹ 6,50,000. Compute Tax payable by the LLP assuming that it has no other income during the previous year 2011-12.

Solution: Computation of Tax Payable under Income Tax for the A.Y. 2012-13.

Profits and gains from Business or Profession	₹15,00,000
Less: Deduction u/s 80IB	₹6,50,000
Total Income	₹8,50,000
Tax Payable (₹8,50,000 x 30%) Add: Education Cess @ 2% Add: SHEC @ 1%	₹2,55,000 ₹5,100 ₹2,550
Total Tax Payable	₹2,62,650

Computation of Alternate Minimum Tax (AMT)

Total Income as per provisions of Income Tax Act,1961	₹8,50,000
Add: Deduction u/s 80IB	₹6,50,000
Adjusted Total Income	₹15,00,000
Alternate Minimum Tax Payable (₹15,00,000 x 18.5%) Add: Education Cess @ 2% Add: SHEC @ 1%	₹2,77,500 ₹5,550 ₹2,775
Total Tax Payable	**₹2,85,825**

Note:

(1) Income Tax payable as per the provision of Income Tax Act is less than the Alternate Minimum Tax. So the adjusted total income of ₹ 15,00,000 would be deemed to be the total income of the LLP and the LLP would be liable to pay tax @18.5% thereof.

(2) The Tax payable by the LLP for the Assessment Year 2012-13 would be ₹ 2,85,825

(3) The LLP is eligible for the credit to the extent of ₹23,175 (= ₹2,85,825 – ₹2,62,650), to be set off in the year in which tax on total income computed under the regular provisions of the Act exceeds the AMT.

(oo) Is a Company liable to pay advance tax on Book profits?

Answer: The Book profit computed u/s 115JB shall be deemed to be the Total Income of the Assessee for the purpose of payment of any tax under the Income Tax Act, 1961. Where the company fails to pay advance tax on such book profits, then it is liable to pay interest u/s 234B and 234C. [Circular No.13/2001] [Kotak Mahindra Finance Ltd.265 ITR 114 (Bom)]

(pp) A foreign company has put forth the following arguments amongst others to say that provisions of Sec.115JB regarding minimum alternate tax is not applicable to it:

(i) The company does not prepare the accounts in accordance with the provisions of part II and III of Schedule VI of the Companies Act,1956

(ii) It does not lay its accounts before the general meeting in accordance with Sec.210 of the Companies Act, since no meeting is held in India.

(iii) It does not declare any dividend in India

Answer: U/s 2(17), company includes any company incorporated outside India, i.e. a Foreign Company. The provisions of Sec.115JB are applicable for an assessee being company. Since Sec.115JB are applicable to an assessee, who is a foreign company also, it is immaterial, as to whether the company actually declares any dividend or lays its accounts in a general meeting or not.

Hence, they are liable to pay tax u/s 115JB.

(qq) A company is owning animals, which are being used for their business purpose. Cost of animals ₹5,00,000. Due to an accident, the animals died and their carcass was sold for ₹45,000. What is the tax implication arising out of this incident?

Answer: Loss in respect of dead animals is an allowable expenditure u/s 36(1) (vi). This is computed as follows:

Actual cost of animal	₹ 5,00,000
Less: Sale proceeds of carcass	₹ 45,000
Amount to be debited in P & L A/c	₹ 4,55,000

(rr) A company paid ₹35,000/- as bonus through bearer cheque to an employee, who has resigned from the company. Discuss taxability.

Answer: Expenditure for which aggregate payment made in excess of ₹20,000 in a day to a single person, otherwise by account payee cheque/bank draft shall be fully disallowed as per Sec.40A(3). Hence, bonus of ₹35,000/- should be disallowed, as this was paid by bearer cheque.

(ss) State the conditions for claiming exemption u/s 11

Answer: The conditions for claiming exemption u/s 11 are:

(i) Registration of the trust must be made with the Commissioner of Income tax;

(ii) The activities of the charitable trust should be confined within India;

(iii) Not less than 85% of such income shall be applied for charitable purposes within the previous year. It can be accumulated for a period of 5 years;

(iv) If the total income before claiming exemption exceeds the maximum amount not chargeable to tax, the accounts should be audited;

(v) Unapplied income should be invested in specified deposits. Corpus donations are not considered as income but as capital receipt;

(vi) Agricultural income will not form part of total income for the purpose of computing application of 85% as laid down u/s 11.

(tt) Income from House Property before considering arrears of rent ₹98,000. Arrears of rent received ₹42,000. Calculate net Income from House Property.

Answer: Computation of Taxable Income from House Property

Income from house property before considering arrears of rent	98,000
Add: Arrears of rent received	42,000
Less: Deduction u/s 25B : [30% of ₹42,000]	12,600
Net Income from House Property	1,27,400

(uu) An assessee, whose turnover in the previous year was ₹16 lakhs had neither opted to be taxed u/s 44AE of the Act nor had kept and maintained books of accounts. Discus the consequences, which the assessee may likely have to come across.

Answer: If the assessee has not opted for Sec.44AE, he has to maintain the books of accounts u/s 44AA and get them audited u/s 44AB. In the given case, since the assessee has not maintained the books of accounts, he is liable for penalty u/s 271A. Where the books of accounts for preceding assessment years were not upto date, it is not possible to get the books audited. Hence, penalty u/s 271B cannot be imposed for subsequent yea₹

(vv) State the conditions stated in Sec. 44AA.

Answer: As per Sec.44AA, maintenance of books of accounts is compulsory in the following cases:

Specified Professionals	Assessees carrying on profession of :- (i) Law, (ii) Medicine , (iii) Accountancy; (iv) Architecture (iv) Technical Consultancy (v) Interior Decoration (vi) Authorized Representative (vii) Film Artist (viii) Information Technology Professionals Whose gross receipts exceed ₹1,50,000, in all the prior three years or during current previous year in which the business is commenced
Others	(i) Where income from business or profession exceeds ₹1,20,000 in any of the 3 preceeding previous years or likely to exceed during current year; (ii) Where the turnover or sales or gross receipts exceeds ₹10,00,000 in any of the 3

		preceding previous years or likely to exceed during the current year;
	(iii)	Upto Assessment Year 2010-11, declaring lower income than as prescribed u/s 44AD/44AE/44AF/44BB/44BBB
	(iv)	W.e.f. Assessment Year 2011-12, when the Assessee has declared lower income than as prescribed u/s 44AE,44BB,44BBB;
	(v)	W.e.f. Assessment Year 2011-12, Assessee whose income exceeds basic exemption, but declaring lower income than as prescribed u/s 44AD

(ww) Discuss the allowability of the following expenditures for scientific research:

Contribution to	Amount donated (₹)	Section reference	Deduction @ (%)	Amount eligible for Deduction
Scientific Research Company	₹50,0000	Sec. 35(1)(iia)	125%	= ₹50,000 x 125% = **₹62,500**
Research Association for Scientific Research	₹1,00,000	Sec.35(1)(ii)	175%	= ₹1,00,000 x 175% = **₹1,75,000**
National Laboratory/University/IIT	₹40,000	Sec.35(2AA)	200%	= ₹40,000 x 200% =**₹80,000**
Social /Statistical Research undertaking	₹30,000	Sec.35(1)(iii)	125%	= ₹30,000 x 125% = **₹37,500**

(xx) What is arm's length price? State the methods prescribed for its computation.

Answer: Arm's length price is a price which is applied or proposed to be applied in a transaction:

(i) Between persons other than associated enterprises;

(ii) In uncontrolled conditions.

The methods prescribed u/s 92C for computation of arm's length price are:

(i) Comparable Uncontrolled Price method;

(ii) Resale Price method;

(iii) Cost Plus method;

(iv) Profit split method;

(v) Transactional net margin method;

(vi) Such other method as may be prescribed by the Board.

Question No.2. (a)

Mr. X furnishes the particulars of his income earned during previous year 2011-12:

(i) Income from agriculture in Bangladesh, received there ₹ 2,00,000, subsequently remitted to India,

(ii) Interest on Asian Development Bonds, ₹ 90,000, one-third of which received outside India,

(iii) Gift of ₹ 50,000 received in foreign currency from a relative in India,

(iv) Arrears of salary ₹ 50,000 received in India from a former employer in Pakistan.

(v) Income from property received outside India ₹ 3,00,000 (₹ 1,00,000 is used in Bahrain for the educational expenses of his son in Bahrain, and ₹ 2,00,000 later on remitted to India).

(vi) Income from business in Iran which is controlled from India (₹ 90,000 being received in India) ₹ 2,00,000.

(vii) Dividends received on 30.06.2011 outside India from an Indian company, ₹ 2,50,000.

(viii) Untaxed profit of the FY 2008-2009 brought to India in July 2011, ₹ 2,50,000.

(ix) Profit (computed) on sale of building in India received in Pakistan ₹ 2,00,000.

(x) Profit from business outside India managed from India ₹ 90,000, received outside India.

Find out gross total income of Mr. X for AY 2012-2013, if Mr. X is (a) resident and ordinarily resident; (b) resident but not ordinarily resident; (c) non-resident.

Solution: **Computation of Gross Total Income for Assessment Year 2012-2013**

Particulars	ROR ₹	RNORs ₹	Non-resident ₹
(i) Income from agriculture in Bangladesh, received there but later on remitted to India	2,00,000	—	—
(ii) Interest on Pakistan Development Bonds:			
$1/3^{rd}$ of ₹ 90,000 received outside India	30,000	---	---
$2/3^{rd}$ of ₹ 90,000 being received in India	60,000	60,000	60,000
(iii) Gift received from a relative in India: Exempt [Sec. 57(v)]	—	—	—
(iv) Salary arrears received in India from a former employer in Pakistan	50,000	50,000	50,000
(v) Income from property received outside India but later on remitted to India	3,00,000	—	—
(vi) Profit from Iran business controlled from India:			
(a) Profits received in India	90,000	90,000	90,000
(b) Profits received outside India	1,10,000	1,10,000	—
(vii) Dividends received from an Indian company, outside India, deemed to accrue or arise in India but exempt under Sec. 10(34)	—	—	—
(viii) Untaxed foreign profit of PY 2008-2009 brought to India	—	—	—
(ix) Profit on sale of building in India, received outside India deemed to accrue or arise in India	2,00,000	2,00,000	2,00,000
(x) Profit from business outside India, managed from India	90,000	90,000	----
Gross Total Income	**11,30,000**	**6,00,000**	**4,00,000**

Question No.2 (b):

An US Company invested in shares of Indian Joint Venture and RBI permitted shares to be issued in the name of its 100% Mauritius Subsidiary. On sale of share to Indian JV partners, gains accrued in India. Discuss the taxability and the company on which the tax is to be levied.

Answer: In the given case, since gains accrued in India, this would attract levy of tax and the liability shall vest in the hands of US Company and not in the hands of Mauritius Company. [Aditya Birla Nuvo Ltd. vs. DDIT(International Taxation) (2011)(Bom.)]

Question No.2(c):

An Indian Insurance Company paid to a Singapore Company for providing access to applications and to serve hardware system hosted in Singapore and related support under the terms of Service Agreement. Can this be taxed as royalty?

Answer: Payment made by an Indian Insurance Company to a Singapore Company for providing access to applications and to serve hardware system hosted in Singapore and related support under the terms of Service Agreement is not in the nature of royalty within the meaning of term in Explanation 2 to Clause (vi) of Sec.9(1). [Bharati Axa General Insurance Co. Limited, In re 2010 (AAR)]

Question No. 2(d)

A nonresident TV channel uplinks TV programme to Satellite through their own facilities situated outside India and satellite, which are not stationed over Indian Airspace amplifies and relays waves using transponders capacity and Indian Cable Operators receive the signals, merely because footprint area of Satellite Transponders includes India and ultimate viewer are watching programmes in India. The income received is taxed as royalty for business operations in India. Discuss the validity of this action.

Answer:

In this given case, the fact that viewers are viewing the telecast in India would not mean that Satellite owners are carrying on its business operations in India. Such amounts is not a royalty as defined in Explanation 2 to Sec. 9(1)(vi) [Asia Satellite Telecommunications Co. Ltd vs DIT (2011)(Del.)]

Question No. 2(e)

Mr. Harry, after 25 years of residing in India, returns to UK on 2.2.2009. He again returns to India on 19th September, 2011 to join British Company in India. Determine his residential status for the assessment year 2012-13.

Answer: No. of days physically present in India during the previous year: [19.09.2011 to 31.3.2012]

= 12 + 31 + 30 + 31 + 31+ 29+ 31= 195 days. He satisfies the basic condition of at least 182 days physically present in India during the previous year.

Further, considering the information provided in this case, it is construed that Mr. Harry satisfies both the additional conditions, i.e. at least 2 times resident out of the 10 previous years, immediately preceding the previous year and at least 730 days physically present in India during the 7 previous years immediately preceding the previous year.

Hence, Mr. Harry is a Resident and Ordinary Resident for the assessment year 2012-13.

Question No. 3(a):

Ms.A, a Sikkimese woman married Mr.B, a non-sikkimese on 17th March, 2008. During the previous year 2011-12, she received rent of ₹6 lakhs from letting out house properties situated in the State of Sikkim. Is she liable to income tax for the assessment year 2012-2013? What will be your opinion, if she married Mr.B on 10th April, 2008?

Answer: In case of an individual, being a Sikkimese, any income which accrues or arises to him:

- From any source in Sikkim, or
- As dividend or interest on securities.

This provision shall not apply to a Sikkimese woman who on or after 01.04.2008 marries an individual who is not Sikkimese.

Situation 1:
In the instant case, the assessee marries a Non-Sikkimese individual before the cut-off date, i.e. 1st April, 2008. Therefore, the exemption u/s 10(26AAA) shall continue to apply to her. Hence, Ms. J is eligible for exemption in respect of House Property income situated in the State of Sikkim.
Situation 2:
Here, since they got married on 10th April,2008, i.e. after the cut-off date, Ms. A will not be eligible for claiming exemption u/s 10(26AAA).

Question No. 3(b)
State the difference between Exemption u/s 10 and deduction under Chapter VIA of the Income Tax Act.
Answer:

Exemption u/s 10	Deduction under Chapter VIA
Income exempt does not form part of total income	Income forms part of Total Income
Expenditure in relation to income exempt is not deductible	Expenditure in relation to income is deductible
It will not be considered for the purpose of computing total income	It will be considered for the purpose of deduction from Gross Total Income
Income is normally exempt subject to certain conditions	Deduction is normally allowed based on payment or fulfillment of specified conditions

Question No.3(c):
Z is employed in A Ltd. As on 31.3.11, his basic salary ₹ 16,000 p.m. He is also entitled to a dearness allowance of 65% of basic salary. 70% of the dearness allowance is considered for retirement benefits. The company gives him HRA ₹8,000pm. With effect from 1.1.11 he receives an increment of ₹1,000 in his basic salary and was staying with his parents till 31.10.2011. From 1.11.11 he takes an accommodation on rent in Delhi and pays ₹ 10,500 pm as rent for the accommodation. Compute taxable HRA for the assessment year 2012-13.

Solution:

Salary for the purpose of HRA shall cover the time period for which the assessee, who is in receipt of HRA, resided in a rented accommodation and the rent paid by such assessee, is more than 10% of salary.

Salary for HRA (for 5 months) = Basic Pay + DA (considered for retirement benefits) + Commission (if received as a fixed percentage on turnover as per terms of employment)

Basic Pay = (15,000 × 2) + (16,000 × 3)	= 78,000
DA = 65% of Basic Pay × 70% forming part of retirement benefits	
[65 % × 78,000 × 70%]	= 35,490
Total Salary for HRA	**1,13,490**

Computation of Taxable House Rent Allowance

Particulars	₹	₹
Amount received during the financial year for HRA (8,000 × 12)		96,000
Less: Exemption u/s 10(13A) Rule 2A		
Least of the followings:		
(i) Actual amount received	96,000	
(ii) 50% of Salary[50% of 1,13,490]	56,745	
(iii) Rent paid less 10% of Salary		
[10,500x 5 – 10% of 1,13,490]	41,151	41,151
Taxable HRA		**54,849**

Question No.3 (d):

Mr. King is getting a salary of ₹5,400 pm since 1.1.10 and dearness allowance of ₹3,500 pm, 50% of which is a part of retirement benefits. He retires on 30th November 2011 after 30 years and 11 months of service. His pension is fixed at ₹ 3,800 pm. On 1st February 2012 he gets 3/4ths of the pension commuted at ₹1,59,000. Compute his gross salary for the previous year 2011-12 in the following cases:

(i) If he is a government employee, getting gratuity of ₹ 1,90,000

(ii) If he is an employee of a private company, getting gratuity of ₹ 1,90,000

(iii) If he is an employee of a private company but gets no gratuity.

Solution:

Previous Year 2011-12. Tenure of Service: 1.4.11 to 30.11.11 = 8 months

Post-retirement period: December '11 to March '12 = 4 months

Particulars	Case (i)	Case (ii)	Case (iii)
Salary	43,200	43,200	43,200
D.A	28,000	28,000	28,000
Taxable Gratuity	Exempted	82,750	Nil
Uncommuted Pension [(3,800×2)+(950×2)]	9,500	9,500	9,500
Commuted Value of Pension	Exempted	88,333	

Case (ii) <u>Gratuity received by an employee of a private company</u>

		₹
Actual amount received		1,90,000
Less: Exempted amount (least of the followings):		
(i) Actual amount received	1,90,000	
(ii) ½ x Avg. Salary x No. of years of Completed service [½ × 7,150 × 30]	1,07,250	
(iii) Maximum Limit	10,00,000	1,07,250
Taxable Gratuity		**82,750**

<u>Commuted Value of Pension</u>

(Non-govt employee, gratuity received)	
Actual commuted value of pension received	1,59,000
Less: Exempted u/s 10(10A)	
1/3rd of Full Value of Commuted Pension [1/3 × 2,12,000]	70,667
Full Value of Commuted Pension	
Taxable Commuted Value of Pension	**88,333**

Case (iii) Commuted Value of Pension (Non-govt employee, gratuity not received)

Actual commuted value of pension received	1,59,000
Less: Exempted u/s 10(10A)	
1/2 of Full Value of Commuted Pension [1/2 × ₹ 2,12,000]	1,06,000
Full Value of Commuted Pension = [₹ 1,59,000 x 4/3=2,12,000]	
Taxable Commuted Value of Pension	**53,000**

Question No. 3(e) :

M₹ Vandana retires on 16th October 2011 after 30 years and 8 months of service. Salary structure is given below:

FY 2011-12	**Salary ₹ 15,000 pm**	**D.A ₹ 7,500 pm**
FY 2010-11	**Salary ₹ 12,000 pm**	**D.A ₹ 6,000 pm**

60%of dearness allowance forms a part of superannuation benefits. Record of Earned Leave is given below:

Leave allowed for one year of completed service -23 days; Leave taken while in service-150 days; Leave encashed during the year-60 days.

Determine the gross salary in the following cases:

(i) she retires from government service

(ii) she retires from the service of Delhi Municipal Corporation

(iii) she retires from the service of Life Insurance Corporation of India

(iv) she retires from private sector

Solution:

Particulars	**Case (i)**	**Case (ii)**	**Case(iii)**	**Case(iv)**
Salary for 6months & 16 days	98,000	98,000	98,000	98,000
Dearness Allowance	49,000	49,000	49,000	49,000
Taxable amount of Leave encashment	Exempted	1,24,980	1,24,980	1,24,980
Gross Income from Salary	**1,47,000**	**2,71,980**	**2,71,980**	**2,71,980**

Working Notes:

Average monthly salary for 10 months, prior to retirement:		₹
Salary of 6 months 16 days: (1st April 2011 to 16th October 2011)		= 98,000
Salary of 3 months 14 days: (14th December 2010 to 31st March 2011)		= 41,600
Total Basic Salary		1,39,600
Add: Dearness allowance		
For 6 months 16 days: (1st April 2011 to 16th October 2011)	= 49,000	
For 3 months 14 days: (14th December 2010 to 31st March 2011)	= 20,800	
Total D.A.	69,800	
D.A. [60% of 69,800, forming part of retirement benefits]		41,880
Total salary of 10 months		**1,81,480**

Average Salary = 1,81,480 / 10 = 18,148

Computation of Taxable Leave Encashment

Amount of encashment received:		
(30 x 23) – (150 + 60) x (15,000 + 7,500)/ 30 =		3,60,000
Less: Exempted u/s 10(10AA) [Least of the followings]		
(i) Actual amount received	3,60,000	
(ii) 10 months' salary (preceding the month of retirement)	1,81,480	
(iii) Leave credit on the date of retirement [(30 × 23) – (150 + 60) × (18,148/ 30)]	2,90,368	
(iv) Maximum Limit	3,00,000	1,81,480
Taxable amount of Leave encashment		**1,78,520**

Question No.4 (a)

Mr. Z is the manager of F Ltd. his son is a student of Amity International School. School fees of ₹ 6,000 pm and hostel fees of ₹ 4,000 pm., are directly paid by F Ltd. to the school but it recovers from Mr. Z only 40%. Mr. Z also joins an advanced course of Marketing Management for 4 months at IIM, Ahmedabad, fees of the course, ₹ 4,50,000 is paid by F Ltd. Determine the perquisite value of the education facility.

Solution:

Computation of taxable value of education facility [As per Rule 3(5)]

Particulars	Taxable value of perquisite (₹)
(1)(a) School fees of his children, studying in a school run by employer:	
(₹6,000 x 12) - (2,400 x 12)	43,200
(b) Hostel fees: (4,000 x 12) – (1,600 x 12)	28,800
2) Fees paid for Marketing Management course for Mr.Z (it is a fully exempted perquisite)	Nil
Total value of taxable perquisite	**72,000**

Question No.4 (b)

Mr. D takes interest-free loan of ₹ 6,00,000 on 1.11.11 from his employer to construct his house. The loan is repayable in 40 monthly installments from January 2011. Compute the value of interest free loan. SBI Lending rate 10.5% p.a. (for housing loans not exceeding 5 years).

Solution: Computation of taxable value of Loan provided by employer [As per Rule 3(7)(i)]

Time period during which loan remains outstanding	Balance on the last day of the month
November	6,00,000
December	6,00,000
January	5,85,000
February	5,70,000
March	5,55,000
Total	**29,10,000**

Perquisite value of interest-free loan: = ₹29,10,000 × 10.5% × 1/12 = ₹ 25,463

Question No.4 (c)

Mr. Prabir Nandy is a Manager in H Ltd. He gets salary @ ₹ 30,000 pm. He is also allowed free use of computer, video-camera and television of the company. H Ltd. has purchased (i) Computer for ₹ 1,00,000 (ii) Video-camera for ₹ 30,000. Their written down value on 1.4.09 is ₹ 60,000 and ₹ 30,000 respectively. Television set has been taken on lease rent @ ₹ 100 pm. The employer recovers ₹ 500 per month for use of the assets. Compute his gross salary for the assessment year 2012-13.

Solution: Computation of taxable value of Loan provided by employer [As per Rule 3(7)(vii)]

Salary: 30,000 × 12	3,60,000
Add: Free use of computer, u/s 17(2)(vi) read with Rule 3(7)(vii)	Nil
Add: Free use of video camera, u/s 17(2)(vi) read with rule 3(7)(vii) [10% of 30,000]	3,000
Add: Free use of telephone, u/s 17(2)(vi) read with rule 3(7)(vii) (100 × 12)	1,200
Gross Salary	**3,64,200**

Question No.4 (d)

Mr. C is an accountant of D Ltd. He gets salary of ₹25,000 pm. He has purchased motor car and washing machine from the company on 1 February 2011. He was also provided with a laptop and Particulars of cost and sale price of the two assets are given below:

Year of Purchase	Particulars of the Asset	Purchase Price (₹)	Sale price (₹)
01.07.1998	Motor car	2,50,000	25,000
15.09.2007	Washing Machine	10,000	5,000

Compute the taxable value of perquisites for the assessment year 2012-13.

Solution:

Laptop provided to an employee by the employer is not taxable as a perquisite. Further, any movable asset, which is used for more than 10 years and thereafter transferred/sold to an employee, would not be considered for the purpose of valuation of perquisites.

Computation of taxable value of perquisites on transfer of moveable assets [As per Rule 3(7) (viii)]

TRANSFER OF MOVABLE ASSET TO EMPLOYEE

	Washing Machine (Actual Cost)	10,000
Less:	Depreciation @ 10% on SLM from 15.09.2007 to 14.09.2008	1,000
	WDV	9,000
Less:	Depreciation @ 10% on WDV from 15.09.2008 to 14.09.2009	1,000
	WDV	8,000
Less:	Depreciation @ 10% on WDV from 15.09.2009 to 14.09.2010	1,000
	WDV	7,000
Less:	Depreciation @ 10% on WDV from 15.09.2010 to 14.09.2011	1,000
	WDV	**6,000**

Computation of Taxable Value of Perquisite

Particulars	**Washing Machine**
WDV on the Asset	6,000
Less: Amount recovered from employee	5,000
Taxable value of perquisite	**1,000 (as the amount recovered is more than WDV)**

Question No.4 (e)

Vineet had been working with M Ltd., in a tribal area since 1-10-1997. He was entitled to the following emoluments:

1. Basic salary w.e.f. 1-1-2011 ₹ 6,000 p.m.
2. Dearness allowance 50% of basic salary (40% of which forms part of salary for retirement benefits)
3. Medical allowance ₹ 1500 p.m., (entire amount is spent on his own medical treatment).
4. Entertainment allowance ₹ 400 p.m.
5. Children education allowance ₹ 80 p.m. per child for three children.
6. Hostel expenditure allowance ₹ 100 p.m. per child for three children.
7. Uniform allowance ₹ 250 p.m. (He spends ₹ 1,500 on the purchase and maintenance of uniform)
8. House rent allowance ₹ 750 per month. He pays ₹ 1,000 per month as rent.

9. He contributes ₹ 900 per month to a recognised provident fund to which his employer contributes an equal amount.

He resigned from his job on 1.1.2012 and shifted to Delhi. He was entitled to the following benefits at the time of his retirement:

(a) Gratuity ₹ 1,35,000
(b) Pension from 1.1.2012 ₹ 3,000 p.m.
(c) Payment from recognised provident fund ₹ 3,00,000
(d) Encashment of earned leave for 150 days ₹ 36,000

He was entitled to 40 days leave for every completed year of service. He got 50% of his pension commuted in lump sum w.e.f. 1.3.2012 and received ₹ 1,20,000 as commuted pension.

He joined K Ltd. at Mumbai w.e.f 1-2-2012 and was entitled to the following emoluments:

(1) Basic salary ₹ 5,000 p.m.
(2) Dearness allowance (forming part of salary) 20% of basic salary
(3) Rent-free unfurnished accommodation in Delhi which is owned by the employer and whose fair rental value is ₹ 48,000 p.a.

He was also given the following facilities by the employer:

(a) Motor car (1.4 ltr. engine capacity) with driver, which he uses partly for official and partly for personal purposes.
(b) The monthly expenses incurred by 'A' on gas and electricity were ₹ 500 which were reimbursed by the employer.
(c) Reimbursement of educational expenses of his two children which amounted to ₹ 350 p.m.
(d) On 4.3.2011 his wife fell ill and the employer reimbursed the expenditure of medical treatment amounting to ₹ 17,500.
(e) A watchman, a sweeper, a cook and a gardener have been provided to whom the company pays a salary of ₹ 400 p.m. each.
(f) Loan of ₹ 1,00,000 @ 8% p.a. for construction of his house was given by the company. SBI rate of interest is 7% p.a.

He made the following payments during the previous year:

(1) Professional tax ₹ 500
(2) Premium on Life Insurance Policy of his own, ₹ 1,00,000 amounting to ₹ 15,000.
(3) Deposit in PPF account ₹ 50,000.

Compute his total income and tax liability for the assessment year 2012-13.

Solution:

Assessee : Mr. Vineet **A. Y : 2012-13**

Computation of Total Income and Tax Liability

Particulars	**₹**	**₹**
Employer – M Ltd		
Basic salary 6,000 × 9		54,000
DA @ 50% of Basic Salary		27,000
Medical allowance @ ₹ 1,500 pm × 9 months		13,500
Entertainment allowance @ ₹ 400 pm × 9 months		3,600
Children education allowance ₹80 × 3 × 9	2,160	
Less : Exempt u/s 10(14) = ₹80 × 2 × 9	440	720
Hostel expenditure allowance= ₹100 × 3 × 9	2,700	

Less: Exempt u/s 10(14) = ₹100 × 2 × 9		1,800	900
Uncommuted pension (₹2,000 × 2 + ₹ 1,000 × 1)			5,000
Uniform allowance (₹250 ×9 – ₹1,500)			750
House Rent Allowance			
Amount Received ₹750 × 9		6,750	
Less : Exemption u/s 10(13A) Rule 2A			
Lease of the following:			
(i) Amount Received	6,750		
(ii) 40% of Salary	25,920		
(iii) Rent paid – 10% of Salary (₹1000 × 9 – ₹6,480)	2,520	2,520	4,230
Salary for HRA = Basic Pay + Dearness Allowance (forming part of salary) + Commission (if received at a fixed percentage on turnover) = 54,000 + (40% of 27,000) = 54,000 + 10,800 = 64,800			
Employer's Contribution to RPF @ ₹ 900 pm × 9 months		8,100	
Less : Exemption u/s 10(14) upto 12% of salary			
Salary = Basic Pay + D.A (forming part)			
= 54,000 + 40% of 27,000 = 64,800			
= 12% of 64,800 =		7,776	324
Gratuity — (from A Ltd.)			
Actual Amount Received	1,25,000		
Less : Exemption u/s 10(10)			
Least of the followings:			
(i) Actual Amount Received	1,25,000		
(ii) Max. limit	10,00,000		
(iii) 1/2 months average salary for each Years' of completed service [1/2 × 7,200 × 14]	50,400	50,400	74,600

Salary for Gratuity (not covered by Payment of Gratuity Act) = Basic Pay + D/A (forming part for retirement benefits) + Commission (if received at a fixed percentage on turnover)

Again, Average Salary = Salary for 10 months preceeding the month of retirement			
B/P = 6,000 × 10 =	60,000		
D/A (forming part) = 40% × 50% × 6,000 =	12,000		
	72,000		
Therefore, Average Salary per month = ₹ 7,200			
<u>**Commuted Value of Pension**</u>			
Amount Received		1,20,000	
Less: Exemption u/s 10(10A)			
1/3 of Full Value of Commuted Pension [1/3 of ₹2,40,000]		80,000	40,000
Full Value of Commuted Pension = [₹1,20,000/50% = ₹2,40,000]			
Payment from RPF (Exempt)			—
Leave encashment – Actual amount		36,000	
Less: Exemption u/s 10(10AA)		4,800	31,200
			2,55,824

Least of the followings:

(a)	Actual encashment	₹ 36,000
(b)	Eligible encashment (7,200/30 × 20)	₹ 4,800
(c)	10 months average salary (7,200 × 10)	₹ 72,000
(d)	Amount specified	₹ 3,00,000

Leave encashment shall be exempt to the extent , calculated as follows :

Completed years of service	13 years
Number of days leave allowed every year	40
Total leave allowable	520 days
Leave encashed	150 days
Therefore leave availed (520 – 150)	370 days
Leave available on basis of 30 days (30 ×13)	390 days
Less: Leave availed	370 days
Therefore encashment eligible for exemption (390 – 370)	20 days

Employer—S Ltd

Basic salary 5,000 ×2	10,000	
Dearness Allowance @ 20% of B/Pay	2,000	
Motor Car facility (1,800 + 900) × 2 months	5,400	
Free Gas/Electricity (500 × 2)	1,000	
Education Re-imbursement (350 × 2)	700	
Medical Re-imbursement (17,500 – 15,000)	2,500	
Watchmen (400 × 2)	800	
Sweeper (400 × 2)	800	
Cook (400 ×2)	800	
Gardener (400 × 2)	800	
Interest on Loan (not taxable as interest charged is more than the rate of SBI)	—	
Perquisite for Value of Rent-free unfurnished accommodation	2,250	27,050
Valuation of unfurnished rent-free accommodation:		
15% of salary which includes the following:		
Basic (5,000 × 2)	₹ 10,000	
DA	₹ 2,000	
Uncommuted pension from R Ltd. (2,000 + 1,000)	₹ 3,000	
	₹ 15,000	
Value of the unfurnished accommodation 15% of ₹ 15,000 = ₹ 2,250		
Aggregate salary from M Ltd. and S Ltd.		2,82,874
Less : (i) Entertainment allowance u/s 16(ii)	Nil	
(ii) Professional-tax u/s 16(iii)	500	500
Income from salary		2,82,374
Other Income		Nil
Gross Total Income		2,82,374
Less : Deduction u/s 80C		
RPF (900 × 9)	8,100	
LIP	15,000	
PPF	50,000	73,100
Total Income (rounded off)		**2,09,274**

Total Income (Rounded of u/s 288)		2,09,270
Tax on ₹ 2,09,270		
upto ₹ 1,80,000	= Nil	
@ 10% on (209270 – 1,80,000) = 10% of 29270	= 2,927	2,927
Add : Education cess @ 2%		58
Add : SHEC @ 1%		29
Total tax liability		3,014
Tax Payable (Rounded off u/s 288A)		= ₹ 3010

Since he has received lump sum payment on account of gratuity, commuted pension and leave encashment, he can claim relief u/s 89 if the same is beneficial to him.

Question No.5 (a)

Discuss Deemed owner as per Section 27.

Answer: Deemed owner is defined as per Sec.27 of the Income Tax Act, 1961. Under the following circumstances, Income from House Property is taxable in the hands of the Individual, even if the property is not registered in his name —

(i) Where the Property has been transferred to spouse for inadequate consideration other than in pursuance of an agreement to live apart.

(ii) Where the Property is transferred to a minor child for inadequate consideration (except a transfer to minor married daughter)

(iii) Where the Individual holds an impartible estate.

(iv) Where the Individual is a member of Co-operative Society, Company, or other Association and has been allotted a house property by virtue of his being a member, even though the property is registered in the name of the Society / Company / Association.

(v) Where the property has been transferred to the individual's name as part-performance of a contract u/s 53A of the Transfer of Property Act, 1882. (i.e. Possession of the Property has been transferred to Individual, but the Title Deeds have not yet been transferred).

(vi) Where the Individual is a holder of a Power of Attorney enabling the right of possession or enjoyment of the property.

(vii) Where the property has been constructed on a leasehold land.

(viii) Where the ownership of the Property is under dispute.

(ix) Where the property is taken on a lease for a period of not less than 12 years, then the lessee shall be deemed as the owner of the property.

Question No.5 (b)

State the conditions for allow ability of unrealized rent.

Answer: As per Rule 4, Unrealized Rent means the rent not paid by the tenant to the owner and the same shall be deducted from the Actual Rent Receivable from the property before computing income from that property, provided the following conditions are satisfied:

(i) The tenancy is bonafide;

(ii) The defaulting tenant should have vacated the property;

(iii) The assessee has taken steps to compel the defaulting tenant to vacate the property;

(iv) The defaulting tenant is not in occupation of any other property owned by the assessee;

(v) The assessee has taken all reasonable steps for recovery of unrealised rent or satisfies the Assessing Officer that such steps would be useless.

Question No. 5(c)

Puja has occupied three houses for his self-occupancy. Their particulars for the previous year 2011-2012 are given below:

Particulars	House X ₹	House Y ₹	House Z ₹
Municipal value	3,60,000	9,60,000	9,50,000
Municipal taxes paid	40,000	80,000	90,000
Fair rent	5,40,000	8,00,000	10,00,000
Standard rent	4,50,000	6,00,000	9,00,000
Repairs	1,50,000	2,50,000	3,00,000
Ground rent paid	20,000	25,000	30,000
Insurance premium paid	5,000	6,000	7,000
Interest on loan taken for purchase of H.P.	75,000	1,20,000	2,00,000
Year of the loan	1997-98	2000-2001	2005-06

She has suffered loss in his business, amounting ₹ 3,00,000

Compute her total income, advising her which house should be specified for self-occupancy concession:

Solution: **Computation of income from house property under different options:**

(a) Assuming all the properties are self-occupied (SO)	House X (SO) ₹	House Y (SO) ₹	House Z (SO) ₹
Annual value	Nil	Nil	Nil
Less: Interest on loan	30,000	30,000	1,50,000
Loss from house property	30,000	30,000	1,50,000

(b) Assuming all the properties as Deemed Let Out (DLO)	House X (DLO) ₹	House Y (DLO) ₹	House Z (DLO) ₹
Gross annual value	4,50,000	6,00,000	9,00,000
Less: Municipal taxes paid	40,000	80,000	90,000
Net annual value	4,10,000	5,20,000	8,10,000
Less: Statutory deduction u/s 24(a) @ 30% of net annual value	1,23,000	1,56,000	2,43,000
Interest on Loan u/s 24(b)	(-) 75,000	(-) 1,20,000	(-) 2,00,000
Income from house property	2,12,000	2,44,000	3,67,000

(c) Total Income under different options for self-occupancy:

Particulars	Option 1 House X ₹	Option 2 House Y ₹	Option 3 House Z ₹
House X	(-) 30,000 (SO)	2,12,000 (DLO)	2,12,000 (DLO)
House Y	2,44,000 (DLO)	(-) 30,000 (SO)	2,44,000 (DLO)
House Z	3,67,000	3,67,000	(-) 1,50,000

	(DLO)	(DLO)	(SO)
Income from house property	**5,81,000**	**5,49,000**	**3,06,000**
Loss from business	**(-) 3,00,000**	**(-) 3,00,000**	**(-) 3,00,000**
Total income	**2,81,000**	**2,49,000**	**(-) 6,000**

Conclusion: A house with minimum income/maximum loss should be opted for self-occupancy concession to minimise the tax liability. The option can be changed from year to year.

In the instant case, House Z should be treated as self-occupied. There will be no tax-liability, and the assessee will carry forward the unabsorbed business loss of ₹ 94,000 for next 8 assessment yea₹

Question No.5 (d)

Mr. Pradipto completed construction of a residential house on 1.4.2011. Interest paid on loans borrowed for purpose of construction during the 2 years prior to completion was ₹ 40,000. The house was let-out on a monthly rent of ₹ 4,000. Annual Corporation Tax paid is ₹ 2,000. Interest paid during the year is ₹ 16,000. Amount spent on repairs is ₹ 2,000. Fire Insurance Premium paid is ₹ 1,500 p.a. Property was vacant for 3 months. Annual letting value as per corporation records is ₹ 30,000. Compute the income under the head "Income from House Property" for the A.Y. 2012-13.

Solution:

Assessee : Mr. Pradipto **Previous Year : 2011-2012** **Assessment Year : 2012-13**

Computation of Income from House Property

	Particulars			₹	₹
	Gross Annual Value u/s 23(1)(c)	(Note 1)			36,000
Less :	Municipal Taxes Paid				(2,000)
	Net Annual Value (NAV)				34,000
Less :	Deduction u/s 24 —				
	(a) 30% of Net Annual Value	(₹ 30,000 × 30%)		9,000	
	(b) Interest on Borrowed Capital:				
	Interest for Current Year		₹ 16,000		
	Interest of Prior Period	(₹ 40,000 × 1/5)	₹ 8,000	24,000	(33,000)
	Income from House Property				**1,000**

Note:

Computation of Gross Annual Value

	Municipal Value	30,000
	Annual Rent (4,000 × 12)	48,000
	(–) Unrealised Rent	Nil
	Annual Rent	48,000
	Higher of MV & Actual Rent	48,000
Less :	Vacancy Allowance	12,000
Gross Annual Value		**36,000**

Question No. 5(e)

A House property in Kolkata, having a municipal value of ₹5 lacs, Fair Rental Value ₹6 lacs, was intended for let-out to tenants. Unfortunately, during the entire previous year, there was no tenant for this house property. Municipal Tax ₹5,000 (of which ₹1,200 is payable). Interest paid on loan taken for purchase of this property ₹1,79,000. Compute Income from House Property.

Answer:

Computation of Income from House Property

Annual Value u/s 23(1)(c)	NIL
Less: Municipal tax and tax for services paid	3,500
Net Annual Value	(3,500)
Less: Deduction u/s 24(a): - Interest on borrowed capital (no limit)	(1,79,000)
Income from House Property	(1,82,500)

Question No.6 (a):

The WDV of plant and machinery on 1.4.2011 of Z Ltd. engaged in manufacturing of PVC granules is ₹ 3000 lacs. Company purchased additional plant and machinery for ₹ 1,600 lacs on 18.4.2011 inclusive of second-hand machine imported from Ireland of ₹ 400 lacs to increase its installed capacity of production from 1000 TPA to 1500 TPA. The production from new machine commenced w.e.f 1.12.2011. Work out by giving reasons the amount of allowable depreciation.

Assessee : Z Ltd. **Previous Year: 2011-12** **Assessment Year : 2012-13**

Computation of Depreciation

Particulars		Lakhs	
		₹	₹
	Opening WDV		3,000
Add:	Additions During the year		1,600
	Net Value for the purpose of Depreciation		4,600
Less:	Depreciation of the Year		
—	On Opening Block – ₹ 3,000 Lakhs × 15%	450	
—	On Additions (Period of usage less than 180 days) — ₹ 1,600 lakhs × 15% × 50%	120	
—	Additional Depreciation on Eligible Assets (Notes)	120	690
	Closing WDV		3,910

Notes:

1. Second hand machinery imported from China is not an eligible asset for the purpose of Additional Depreciation computation. Therefore, cost of eligible assets = ₹ 1,600 lakhs – ₹ 400 lakhs = ₹ 1,200 lakhs.
2. Period of usage of new machine is less than 180 days. Therefore, they are entitled to only 50% of additional depreciation rate of 20%.

Question No.6 (b)

ZED Ltd. imported machinery from South Korea on 12.5.2011 for US$ 50,000. Exchange rate on that date : US$ = ₹ 44. 70. Customs Duty paid @ 20%. Government granted subsidy of ₹ 15,00,000. The assessee had a forward contract on 2.4.2011 at US$ 45.30. Logistics services was provided by Carrywell Courier Ltd. Service

Charges paid ₹ 2,00,000 including service tax of ₹ 25,000. Engineers and labourers were engaged at site for installation of the machinery. Salary and wages paid for site engineers and labourers including their travelling expenses amounted to ₹ 4,60,000. Expenses incurred during trial run period ₹ 1,50,000. Sale of output produced during trial run period ₹ 90,000. Interest earned on deposits made to open Letter of Credit for purchase of this machinery ₹ 15,000. The machine was put to use from 05.10.11. Depreciation @ 15%. Compute Actual Cost and Written Down Value.

Solution: Assessee: ZED Ltd. **Previous Year: 2011-12**

Computation of Actual Cost and Written Down Value

Particulars		Amount (₹ crores)
Cost of the Asset (US$ 50,000 × ₹ 44.70)		22,35,000
Add :	Customs Duty paid @ 20% on ₹ 22,35,000	4,47,000
Less :	Government Subsidy granted	(15,00,000)
Add :	Exchange Rate Difference [US$ 50,000 × ₹ (45.30 - 44.70)]	30,000
Add :	Transportation charges paid ₹ 2,00,000 (including Service Tax ₹ 25,000)	2,00,000
Less :	CENVAT credit adjustment (credit for Service tax included in service charges paid to Carrywell Courier Ltd.)	(25,000)
Add :	Installation expenses incurred for payment of site engineers & labourers including travelling expenses	4,60,000
Add :	Expenses incurred during trial run period	1,50,000
Less :	Sale of output generated during trial run period	(90,000)
Less :	Interest earned on deposits made to open Letter of Credit for purchase of this machinery	(15,000)
Actual Cost for the purpose of determining depreciation		**18,92,000**
Less :	Depreciation @ 50% of 15% (since Put to Use < 180 days) for previous year 2011-12 (₹ 18,92,000 × 50% x 15%)	1,41,900
WDV as on 01.04.2012		**17,50,100**

Question No.6(c)

Mr. Hari purchased a house property on 18.11.2007 for ₹ 15,00,000. Till 1.7.2011, the same was self-occupied for own residence. Thereafter, the said building was brought into use for the purpose of his profession. Determine the amount of depreciable admissible for the Assessment Year 2012-13, given rate of depreciation @ 10%.

Solution:

(a) Property acquired by the assessee himself: As per Sec. 43(1), if a building/asset used for private purpose of the assessee is subsequently put to use for the purpose of business, the cost of acquisition shall be determined in the following manner:

Assessee : Mr. Hari Previous Year : 2011-12 Assessment Year : 2012-13

		₹
Cost of acquisition of Residential House Property as on 18.11.2007		15,00,000
Less:	Deemed depreciation for the Financial year 2007-08 @ 50% of 10% on ₹ 15,00,000 (since period of usage is less than 180 days)	75,000
WDV as on 01.04.2008		14,25,000
Less:	Deemed Depreciation for Financial year 2008-09 @ 10% on ₹14,25,000	1,42,500
WDV as on 01.04.2009		12,82,500

Less: Deemed Depreciation for Financial year 2009-10 @ 10% on ₹12,82,500	1,28,250
WDV as on 01.04.2010	11,54,250
Less: Deemed Depreciation for Financial year 2010-11 @ 10% on ₹11,54,250	1,15,425
WDV as on 01.04.2011 = Actual cost for the purpose of charging depreciation	10,38,825
Less: Deemed Depreciation for Financial year 2011-12 @ 10% on ₹10,38,825	1,03,883
WDV as on 01.04.2012	**9,34,942**

Question No.6 (d)

Jammer International Ltd. incurs an expenditure of ₹300 crores for acquiring the right to operate telecommunication services for Orissa and Jharkhand. The payment was made in August 2010 and the licence to operate the services was valid for 12 yea₹ In December 2011, the company transfers part of the licence, in respect of Orissa to Hammer International Ltd. for a sum of ₹280 crores and continue to operate the licence in Jharkhand . What is the deduction allowable u/s 35ABB to Jammer International Ltd. for the Assessment Year 2012-13?

Solution:

Assessee: Jammer International Ltd. **Previous Year: 2011-12** **Assessment Year : 2012-13**

(a) u/s 35ABB, where part of the Telecom Licence is transferred and Net Consideration received on such transfer, is more than the expenditure remaining unallowed, the amount of deduction shall be computed as follows:

(i)	Unallowed amount as on 01.04.2011	= Total Expenditure Less Deduction for Financial Year 2009-10
		= ₹300 crores Less (₹300 crores / licence period of 12 years)
		= ₹300 crores less ₹25 crores= ₹275 crores.
(ii)	Net Consideration received	= ₹280 crores
(iii)	Remaining period of licence	= 11 years (including current previous year)
(iv)	Deduction u/s 35 ABB	= ₹ (224 crores less 56 crores) / 14 years
		= ₹12 crores.

Question No.6 (e)

Sleepwell Ltd. is an existing Indian Company, which sets up a new industrial unit. It incurs the following expenditure in connection with the new unit:

	₹
Preparation of project report	4,00,000
Market survey	5,00,000
Legal and other charges for issue of additional capital required for the new unit	2,00,000
Total	11,00,000
The following further data is given:	
Cost of project	30,00,000
Capital employed in the new unit	40,00,000

What is the deduction admissible to the company under section 35D for Assessment Year 2012-13?

Solution:

The deduction admissible under section 35D is one-fifth of the expenditure incurred for the project. This works out to ₹2,20,000.

However, such expenditure should not exceed the following limits as prescribed in section (3):

(a) 5% of cost of the project or

(b) 5% of the capital employed in the new industrial undertaking (being a company) — whichever is higher.

In this case

(a) 5% of the project cost is ₹1,50,000 and

(b) 5% of the capital employed is ₹2,00,000.

Hence, the expenditure eligible for amortization under section 35D would be ₹ 2,00,000.

And the admissible deduction for the current assessment year is ₹ 2,00,000 × 1/5 = ₹ 40,000.

Question No.7 (a)

A firm comprising of four partners A, B, C and D carrying on business in partnership, sharing profits/losses equally shows a profit of ₹ 2,00,000 in its books after deduction of the following amounts for the year :

	Particulars	₹
(a)	Remuneration to partner 'A' who is not actively engaged in business	60,000
(b)	Remuneration to partners 'B' & 'C' actively engaged in business	
	Partner 'B'	80,000
	Partner 'C'	90,000
(c)	Interest to partner 'D' on loan of ₹ 1,50,000	36,000

The deed of partnership provides for the payment of above remuneration and interest to partne₹ You are required to work out the taxable income of the firm as well as partners for assessment year 2012-13.

Solution:

Computation of Income under the head Profits and Gains of Business or Profession

Particulars				₹
Net profit as per P/L A/c				2,00,000
Add : Inadmissible expenses —				
(i)	Remuneration to A (not an active partner) – disallowed u/s 40(b)			60,000
(ii)	Remuneration to B and C – (considered separately [₹ 80,000 + 90,000]			1,70,000
(iii)	Interest paid to D on Loan advanced			36,000
Net Profit before Interest and Remuneration to Partners				**4,66,000**
Less : Maximum Permissible Interest u/s 40(b) @ 12% on Loan from D = ₹ 1,50,000 × 12% p.a.				18,000
Book Profit				**4,48,000**
Less : Maximum Permissible Remuneration to B and C u/s 40(b)				
(i)	upto ₹ 3,00,000 – ₹ 1,50,000 or 90% of Book Profits, whichever is higher	= 2,70,000		
	Balance of Book Profits – 60% of Book Profits = 60% of 1,48,000	= 88,800	3,58,000	
(ii)	Actual Remuneration paid			
	lower of (i) & (ii), allowed as deduction		1,70,000	1,70,000
	Taxable Income			**2,78,000**

Taxable Income of the partners

Particulars	A	B	C	D
Remuneration	Nil	80,000	90,000	Nil
Interest	Nil	Nil	Nil	18,000
Taxable income	**Nil**	**80,000**	**90,000**	**18,000**

Working notes:

(1) In the case of a firm, remuneration to a partner who is not a working partner is not eligible for deduction. In the case of working partners the remuneration paid is disallowed if it exceeds the limit prescribed u/s 40(b) with reference to "book profit".

Book working partners remuneration is worked out as under:

	₹
First ₹ 3,00,000 of the book profit @ 90%	2,70,000
On the balance ₹ 1,98,000 of book profit @ 60%	1,18,800
Total	3,88,800

(2) Any interest and salary to partners disallowed in the firm's case shall not be included in the total income of the partner and shall not be chargeable to tax in the partner's hands.

(3) Share of profits of the partners is exempt u/s 10(2A) of the Income-tax Act and therefore, not included in the partner's taxable income.

Question No. 7(b)

D Ltd., carrying on business in manufacture, sale and export of tyres, tubes and accessories, has disclosed a net profit of ₹ 21,00,000 in its P & L account for the period ending March 31, 2012. On the basis of the following particulars furnished by the company and ascertained on inquiry, compute, giving reasons, its total income for the assessment year 2012-13. The company follows the mercantile system of accounting:

(a) A sum of ₹ 20,000 is debited to compensation account. The company had placed an order for machinery to manufacture tyres with a UK company. However, due to a sudden increase in the price of machinery by the vendor, the assessee, had to cancel the contract, in lieu of compensation The company claims the said amount as deduction on revenue account or, in the alternate, as loss under the head "Capital gains" as the payment was mode towards extinguishment of right to acquire a capital asset.

(b) "Loss on export of accessories account" shows a debit of ₹ 4 lakh. In this connection it is explained that two trucks belonging to the company carrying tyres accessories were intercepted at the international border and seized by customs authorities for illegal export. The goods were confiscated by the customs authorities and a fine of ₹ 2 lakh was levied. The company claims the value of confiscated goods as a trading loss under section 28 and the payment of the fine of ₹ 2 lakh which is debited to rates and taxes account as on expenditure in the course of business under section 37(1).

(c) The company had set up a separate unit for manufacture of plastic tubes at Bangalore in 1996. The said unit suffered heavy losses. As a result the same was closed down and the plant and machinery were sold away. The company, however, claims unabsorbed depreciation amounting to ₹ 8 lakh in its return of income. It is not debited to the profit and loss account.

(d) During the previous year 1996-97, the assessee-company acquired 5,000 shares of E Ltd., on Indian company, as a result, the entire share capital of the said company is now held by the assessee-company. In May 2011, the assessee-company sold to E Ltd. plant and machinery for ₹ 6,00,000. The actual cost is ascertained at ₹ 4,00,000 and written down value at ₹ 1,50,000.

(e) In the years 2001-2002 and 2002-03, the Government of India arranged exports of tyres and tubes through the Federation of Tyre Dealers of which the company was a member. The exports which were made to For Eastern countries resulted in loss which was shared by all members including the company. The Federation thereafter took up the questions of reimbursement of losses with the Government, which after protracted discussion and correspondence agreed to grant a subsidy calculated at a certain percentage of exports. The assessee-company received its share of subsidy amounting to ₹ 3 lakh in the previous year. The amount stands credited to the "Capital reserve account" and claimed as exempt.

Solution: **Computation of Total Income for A.Y. 2012-13**

	₹
Net profit as per Profit and Loss Account	21,00,000
Adjustments:	
(i) Payment of compensation [not allowable since payment is in the nature of capital expenditure, being made to avoid unnecessary investment in capital asset ; nor can it be allowed as capital loss as there is no transfer of capital asset]	(+) 20,000
(ii) Loss arising out of confiscation of stock by customs authorities [not deductible by virtue of Explanation to section 37(1)]	(+) 4,00,000
(iii) Fine [not allowable as penalty paid for breach of law is not normal incidence of business	(+) 2,00,000
(iv) Unabsorbed depreciation of a unit closed before the commencement of previous year [allowable as deduction]	(–) 8,00,000
(v) Recovery of loss [taxable under section 41 (1)]	(+) 3,00,000
(vi) Compensation paid on voluntary retirement of employees [under section 35DDA, one-fifth of such compensation is deductible in the year in which the expenditure is incurred and the balance is deductible in the next four years; section 35DDA is applicable even if the voluntary retirement scheme has not been framed in accordance with the guidelines given under section 10(10C);	(+) 22,40,000
Business Profit	**44,60,000**
Capital gain on sale of machinery to wholly owned subsidiary company [since transferee-company is wholly owned Indian subsidiary company of the assessee, the transaction is not treated as transfer under section 47(iv) and surplus arising on transfer is not taxable as capital gain]	—
Net Income	**44,60,000**

Question No. 7(c)

During the previous year 2011-12, profit and loss account of Shri Amarnath, proprietor of Free Bird Enterprises engaged in the business of dye-made garments, shows profits of ₹ 4,50,000. With the following information, compute his taxable income from business :

(a) Interest on capital ₹ 5,000

(b) Purchases include goods of ₹ 42,000 from his younger brother in cash. However, market value of such goods is ₹ 35,000.

(c) Interest paid outside India ₹ 1,00,000 without deducting tax at source.

(d) Penalty paid to local government for non-filing of sales tax return ₹ 5,000

(e) Penalty paid to customer for non-fulfilling of order within time ₹ 10,000

(f) Bad debts ₹ 1,00,000. Money has been advanced for purchase of Building.

(g) Revenue expenditure on promoting family planning among employees ₹ 10,000.

(h) Premium paid on health of employees ₹ 6,000 in cash

(i) Premium paid on health of his relatives ₹ 6,000 in cheque

(j) Employer's contribution to RPF ₹ 12,000. One-half of the amount is paid after due date as per relevant Act but before 31.3.2011

(k) Employees contribution to RPF ₹ 10,000. ½ of the amount is paid after due date as per relevant Act.

(l) Interest on late payment of sales tax ₹ 1,000 (yet to be paid)

(m) Interest on loan from State Bank of India ₹10,000 (₹ 5,000 is not paid till due date of filing of return)

(n) Interest on late refund from income tax department ₹ 500

(o) Sale includes sale to Raj ₹ 10,000. (Cost of such goods ₹ 8,000; Market value of such goods ₹ 12,000)

(p) He received ₹ 80,000 from a debtor at a time in cash.

(q) Recovery of bad debt ₹10,000 (out of which ₹ 8,000 was allowed as deduction during AY. 2007-08)

(r) Depreciation (being not debited in accounts) ₹ 20,000 allowed as deduction u/s 32

Solution:

Computation of Profits and Gains of business or profession of Shri Amarnath for the AY. 2012-13

Particulars	Note	Details	Amount
Net profit as per Profit and Loss account			4,50,000
Add : Expenditure disallowed but debited in P &L A/c			
Interest on capital	1	15,000	
Payment to relative in excess of market value of goods	2	7,000	
Interest paid outside India without deducting tax at source	3	1,00,000	
Penalty paid to local government for non-filling of sales tax return	4	5,000	
Bad debt	6	1,00,000	
Premium paid on health of employees in cash	8	6,000	
Premium paid on health of his relatives in cheque	9	6,000	
Employees contribution to RPF	11	5,000	
Interest on loan from State Bank of India	13	5,000	
Cost of goods sold to himself	14	8,000	2,43,000
			6,93,000
Less: Expenditure allowed but not debited in P & L A/c			
Depreciation u/s 32		20,000	
Less: Income not taxable but credited to P & L A/c			
Sales to himself (goods withdrawn for personal purpose)	14	10,000	
Recovery of bad debts	15	2,000	
Less: Income taxable under other head but credited to P & L A/c			
Interest on late refund from income tax department	16	500	32,500
Profits and Gains of business or profession			**6,60,500**

Notes:

(1) Interest on capital to proprietor is not allowed as no one can earn from a transaction with himself. The provider of loan and receiver of loan are same hence does not involves any actual expenses.

(2) Any unreasonable payment to relative is disallowed u/s 40A(2). Hence, ₹3,000 is disallowed. Since cash payment towards allowed expenditure (i.e. ₹19,000) does not exceed ₹ 20,000, hence provision of sec. 40A (3) is not applicable.

(3) Any salary paid outside India without deducting tax at source is disallowed u/s 40(a).

(4) Any payment made for infringement of law is disallowed.

(5) Payment made for non-fulfilling of contract is not a payment for infringement of law Hence, allowed u/s 37(1).

(6) Bad debt is allowed only when such debt has been taken into account as income of previous year or any earlier previous year(s) [Sec. 36(1)(vii)]. Since, the debt is in respect of purchase of a building, which was not considered as income of any previous year, hence it is disallowed.

(7) Any expenditure for promoting family planning is allowed to company assessee [Sec. 36(1)(ix)]. However, such expenditure (revenue in nature) incurred by assessee other than company shall be allowed u/s 37(1).

(8) Payment of insurance premium on health of employees in cheque is allowed u/s 36(1)(ib).

(9) Payment of insurance premium on health of relative is not related to business, hence disallowed.

(10) Employer's contribution towards RPF is allowed if payment is made before due date of filing of return irrespective of fact that such payment was made after due date prescribed in the relevant Act.

(11) Any sum received from employees as their contribution towards RPF is allowed only when such sum has been credited to such fund within the due date prescribed in the relevant Act [Sec. 36(1)(va)].

(12) Interest on late payment of sales tax is not a penalty but compensatory in nature. Hence, it is allowed u/s 37(1) Further such interest is not governed by the provisions of sec. 43B.

(13) Any interest payable to any scheduled bank is allowed on cash basis [Sec. 43B]. Hence, unpaid amount is disallowed.

(14) Any expenditure of personal nature is not allowed. Further, no one can earn from a transaction with himself. Hence, sale made to himself is not treated as income.

(15) Bad debt recovery is treated as income in the year of recovery to the extent of bad debt allowed in the earlier year [Sec. 41(4)]

(16) Interest on late refund of income tax is taxable under the head 'Income from other sources'.

(17) Receipt from debtor ₹ 80,000 in cash is not attracted by provision of sec. 40A (3).

Question No. 7(d)

Discuss the admissibility or otherwise of any five of the following claims in connection with assessment to income-tax. They do not necessarily relate to the same assessee:

(i) An expenditure of ₹ 1,00,000 was incurred on the occasion of the silver jubilee of the company for presentation of silver mementos to shareholders and directors, the value of each memento being ₹ 1,000 only.

(ii) An assessee carries on business in respect of which it holds tenancy rights. It carries out improvements to the said building at a cost of ₹ 2,00,000 and claims depreciation @ 10% thereon. The assessing officer rejects the claim on the ground that the assessee is not the owner of the building.

(iii) Excise duty amounting to ₹ 2,00,000 for the period 2010-11 was paid by the company by 30-9-2011 before furnishing the return of income for the assessment year 2011-12.

(iv) A criminal case was filed against a company under the Essential Commodities Act, 1955. The company incurred litigation expenses amounting to ₹ 50,000 to defend the directo₹ The directors were ultimately acquitted.

(v) A company was generating electricity privately for its factory. Later, at its expense, electric lines were laid from the trunk road to the factory. It paid ₹ 5,00,000 to the State Electricity Board as its contribution for this purpose. The ownership of the power-line was to vest with the State Electricity Board.

(vi) X and Y are two shareholders of Pooja Ltd., a closely held company. X holds 55% share capital on 30-1-2011, X transfers his shares to A. Pooja Ltd. wants to set off brought forward loss of ₹ 4,00,000 (business loss ₹ 1,00,000; unadjusted depreciation ₹ 3,00,000) of the previous year 2009-10 against the income of the previous year 2010•11 (i.e., ₹ 9,00,000). Can it do so?

Solution:

(i) As per the decision of the Apex Court in the case of *Aluminum Corporation of India Ltd.* v *CIT* (1972) 86 ITR 11 (SC) and various other decisions, where an expenditure is incurred for commercial expediency, the same shall be allowed as deduction under section 37(1). If at the time the expenditure is incurred, commercial expediency justifies it, it will be taken to be for the purpose of the business even though not supported by any prevailing practice.

Presentation of silver mementos to the directors and shareholders on the occasion of silver jubilee is to motivate both the directors and the shareholde₹ The expenditure has been incurred on account of commercial expediency and should qualify for deduction under section 37(1).

(ii) According to Explanation to section 32(1) where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy and any capital expenditure is incurred by the assessee for the purposes of the business or profession on the construction of any structure or doing of any work, in or in relation to, and by way of renovation or extension of, or improvement to, the building, then, the provisions of section 32 shall apply as if the said structure or work is a building owned by the assessee. Hence, depreciation in this case will be allowable.

(iii) As the excise duty has been paid or before the due date of furnishing return under section 139(1) in respect of the previous year in which the liability to pay such sum was incurred, the same shall be allowed as deduction on due basis as per section 43B.

(iv) Section 37(1) does not make any distinction between expenditure incurred in civil litigation and that incurred in criminal litigation. All that the court has to see is whether the legal expenses were incurred by the assessee in his character as a trader, in other words, whether the transaction in respect of which proceedings are taken arose out of and was incidental to assessee's business. Further, it is to be seen whether the expenditure was *bona fide* incurred wholly and exclusively for the purpose of the business. [CIT v Birla Cotton Spg. & Wvg. Mills Ltd. (1971) 82 ITR 166 (SC)]. In view of this, the litigation expenses of ₹ 50,000 incurred in detending directors is deductible under section 37(1).

(v) The new electric power lines were laid to run the factory efficiently but since the ownership of the power lines was to vest with the State Electricity Board, the contribution of ₹ 5,00,000 paid to the State Electricity Board shall be allowable as revenue expenditure under section 37(1).

(vi) According to section 79 the losses of a closely held company can be carried forward and set off in the subsequent assessment year only when at least 51% of the shares of the company carrying voting rights are held by the same persons as on the last day of the previous year in which the loss was incurred and the last day of the previous year in which the losses are set off. In this case business loss will not be allowed to be set off but unabsorbed depreciation is not a loss and shall be allowed to be set off.

Question No. 7(e)

Discuss the correctness or otherwise of the following propositions with reasons thereof:

(a) Where a person draws from his own stock-in-trade for personal use, there can be no taxable profit.

(b) Even an outlay for acquiring an enduring advantage for business may be deductible as revenue expenditure.

Solution:

(a) The Supreme Court in CIT v. Kikabhai Premchand (1953) 24 ITR 506 held that when a person draws from his own stock-in-trade for personal use, there can be no taxable profit as in this case the vendor and the vendee are not different. To constitute a sale these should be one buyer and seller. The buyer and seller has to be different entity to constitute a proper sale.

(b) Normally, an amount spent for acquiring an enduring advantage for business is of capital nature but there can be certain cases when the amount spent on acquiring an enduring advantage may be treated as revenue expenditure. The Supreme Court in *CIT* v. *Empire Jute Co. Ltd.* (1980) 124 ITR 1 held that when a jute mill as a result of an arrangement with other Jute mil had undertaken to work only for specified hours during a week but exceeded the same and paid for such excess period to other members of the pooling arrangement, such payment is known as purchasing loom hou₹ Though looms are capital assets, the payment was for their operations. By the purchase of loom hours no new asset was created and there was no addition to or expansion of the profit-making apparatus of the company. Hence, such payment is of revenue nature.

Question No. 8(a)

Mr. Tony has estates in Rubber, Tea and Coffee. He derives income from them. He has also a nursery wherein he grows plants and sells. For the previous year ending 31.3.2012, he furnishes the following particulars of his sources of income from estates and sale of Plants. You are requested to compute the taxable income for the Assessment year 2012-2013.

(a)	Manufacture of Rubber	₹ 5,00,000
(b)	Manufacture of Coffee grown and cured	₹ 3,50,000
(c)	Manufacture of Tea	₹ 7,00,000
(d)	Sale of Plants from Nursery	₹ 1,00,000

Solution:

Assessee : Mr. Tony **Previous Year : 2011-12** **Assessment Year : 2012-2013**

From the words 'Mr. Tony has estates', it is presumed that the had grown Tea, Coffee and Rubber, and also Plants in his Estates, and the amount given is the Profits of the Business.

Computation of Taxable Income

Particulars	Agricultural Income	Non-Agricultural Income
Growing and Manufacture of Rubber [Rule 7A]	5,00,000 × 65% = ₹ 3,25,000	5,00,000 × 35% = ₹ 1,75,000
Grown and Cured Coffee [Rule 7B]	3,50,000 × 75% = ₹ 2,62,500	3,50,000 × 25% = ₹ 87,500
Growing and Manufactured of Tea [Rule 8]	7,00,000 × 60% = ₹ 4,20,000	7,00,000 × 40% = ₹ 2,80,000
Growing & Sale of Plant by Nursery [See Note]	₹ 1,00,000	—
Total	₹ 11,07,500	₹ 5,42,500
	Taxable Income	Exempt u/s 10(1)

Question No. 8(b)

Romit acquired a plot of land on 1.6.75 for ₹ 5,00,000. He converts the plot into stock in trade of his real estate dealing business on 18.2.2007 when the fair market value of the plot was ₹ 39,00,000. The stock-in-trade is sold by him on 18.5.2011 for ₹ 40,00,000 (FMV as on 1.4.81 was ₹ 7,00,000 and FMV as on 1.4.76 ₹4,50,00).

Solution: The conversion of capital asset into stock-in-trade is treated as a transfer as per sec. 2(47). Capital asset was converted into stock-in-trade on 18.2.2007 i.e. previous year 2006-07.

Computation of Capital Gains

		₹
Consideration for Transfer (FMV)		39,00,000
Less :	Indexed Cost of Acquisition [7,00,000 x 519/100]	36,33,000
	Long term Capital Gains	2,67,000

Computation of Business Income

	Sale Proceeds of HP	40,00,000
Less :	FMV on the date of conversion	39,00,000
		1,00,000

Question No. 8(c)

Mr. B acquired a house property for ₹ 50,000 in 1969-70. On his death in October 1985 the house was acquired by his son C. The market value of the house as on 1/4/81 was ₹ 3,50,000. This house was acquired by the Government on 15.3.2008 and a compensation of ₹ 16 lacs is paid to him on 25.3.2011. C filed a suit against the Government challenging the quantum of compensation and the court ordered for giving additional compensation of ₹ 24,00,000. He incurred an expenditure of ₹ 60,000 as an expenditure in connection with the suit. The additional compensation was received on 25.3.2012. Compute capital gains chargeable to tax.

Solution:

Capital Gain on initial compensation shall be chargeable in the A.Y. 2011-12.

Computation of Long Term Capital Gains for the A.Y. 2011-12

		₹
Consideration for transfer (being the compensation)		16,00,000
Less :	Indexed Cost of Acquisition [3,50,000 x 711/133]	18,71,053
	Long Term Capital Loss	**2,71,053**

Note: This loss shall be carried forward for adjustment only against Long Term Capital Gains arising within the next 4 assessment yea₹

Computation of Long Term Capital Gains for the A.Y. 2012-13

		₹
Enhanced Compensation received		24,00,000
Less :	Cost of Acquisition	NIL
	Cost of Improvement	NIL
	Expenses on Transfer	(60,000)
	Long Term Capital Gains	23,40,000
Less :	Long Term Capital loss – Set off from the A.Y. 2011-12	(2,71,053)
	Balance of LTCG	20,68,947

Question No. 8(d)

A holds 15,000 shares (10% of total share holding) in B Ltd. which he had purchased on 10.2.96 for ₹ 7,00,000. The company went into liquidation on 16.7.2011 and paid a sum of ₹ 23 per share in cash and an asset whose market value as on the date of distribution i.e. 5.10.11 was ₹ 18,20,000 to A. the accumulated profits of the company were ₹ 15 lacs.

(a) Compute the income of A for the A.Y. 2012-13 assuming that he has no other income.

(b) Compute the capital gain chargeable to tax if the asset of B Ltd. is sold by A for ₹ 25 lacs on 28.3.12.

Solution:

Computation of Capital Gains of Mr. B for the A.Y. 2012-13

	₹
(a) (i) Capital Gain on transfer of shares	
Total consideration (15,000×23+ 18,20,000)	21,65,000
Less: Proportionate amount of deemed dividend	
(10% of ₹ 12,86,353)	1,28,635

Less: Indexed Cost of Acquisition [₹7,00,000 x 785/281]	19,55,516
Long Term Capital Gains	80,849
(ii) Income from others Sources	
Dividend from Indian Company	Exempted
	80,849
(b) Capital Gain on transfer of asset (B Ltd.)	
Full Value of Consideration	25,00,000
Less: Cost of Acquisition (being the market value as on the date of distributions)	18,20,000
Short Term Capital Gains	**6,80,000**
Accumulated Profits	15,00,000

Dividend tax @ 16.60875% (= 15% + 7.5% + 2% Education Cess + 1% SHEC)

Hence, the amount to be distributed plus tax @ 16.60875% on such amount should be ₹ 15,00,000

- Amount of tax = ₹ 2,13,647
- Profits available for distribution = ₹ (15,00,000 – 2,13,647) = ₹ 12,86,353.

Question No. 8 (e)

(a) P commenced a business on 10.5.92. The said business is sold by P on 25.8.11 and he received ₹ 12 lacs towards goodwill.

(b) What will be your answer in the above case, if P had acquired the goodwill for this business for a consideration of ₹ 3,00,000.

Solution :

Computation of Long Term Capital Gains for the A.Y. 2012-13

		₹
(a)	Consideration for transfer	12,00,000
	Less: Indexed Cost of Acquisition (Self-Generated)	NIL
	Long term Capital Gains	**12,00,000**
(b)	Consideration for transfer	12,00,000
	Less: Indexed Cost of Acquisition = [₹ 3,00,000 x 785/223]	10,56,054
	Long term Capital Gains	**1,43,946**

Question No. 9(a)

R has been living in a rented accommodation since August 1983, and he is paying a rent of ₹ 4000 per month. The landlord got the house vacated from R on 16.7.2011 and paid a sum of ₹ 5 lacs for vacating the house.

Compute Capital Gains, if any, in the hands of R.

Solution:

Computation of Long Term Capital Gains for the A.Y. 2012-13

	₹
Consideration for transfer	15,00,000
Less : Indexed Cost of Acquisition (Self-Generated asset)	NIL
Long term Capital Gains	15,00,000

Question No. 9(b)

Rohit purchased a house in Delhi in December 2003 for ₹ 2,50,000. In March 2011, he entered into an agreement to sell the property to Z for a consideration of ₹ 5,00,000 and received an earnest money of ₹ 50,000. As per the terms of agreement, the balance payment was to be made within 30 days of the agreement. If the intending purchaser does not make the payment within 30 days, the earnest money would be forfeited. As Z could not make the payment within the stipulated time the amount of ₹ 50,000 was forfeited by Rohit. Subsequently, on 16.6.11, Rohit sold the house to Mohit for ₹ 9,00,000. He paid 2% brokerage on sale of the house. Compute capital gains chargeable to tax for the assessment year 2012-13.

Solution:

Computation of Capital Gains for the A.Y. 2012-13

		₹
Consideration for transfer		9,00,000
Less : Expenses on transfer (Brokerage @ 2% on 6,00,000)		18,000
Net Consideration		8,82,000
Less : Indexed Cost of Acquisition		
Cost of Acquisition	2,50,000	
Less : Amount received and forfeited (u/s 51 to be adjusted against cost)	50,000	
Net Cost of Acquisition	2,00,000	
Indexed Net cost of Acquisition [₹ 2,00,000 x 785/463]		3,39,093
Long Term Capital Gains		**5,42,907**

Question No. 9(c)

Ravi owns a residential house which was purchased by him in 1975 for ₹ 2,40,000. The FMV as on 1.4.81 was ₹ 2,00,000. This house is sold by him on 16.7.2011 for a consideration of ₹ 25,00,000. The brokerage and expenses on transfer was ₹ 55,000. Compute capital gains for the assessment year 2012-13.

If he invests ₹ 6,00,000 for purchase of a new house on 15.3.2012.

If the HP so purchased in 15.3.2012 is again sold in 21.10.12 for ₹ 12 lacs, what will be the tax liability?

Solution:

Computation of Capital Gains for the A.Y. 2012-13

	₹
Consideration for transfer	25,00,000
Less: Expenses on transfer	55,000
Net Consideration	24,45,000
Less: Indexed Cost of Acquisition [₹2,40,000 x 785/100]	18,84,000
[Since FMV as on 1.4.1981 was less than the original cost, the original cost is considered for indexation purpose]	
Long term Capital Gains	5,61,000
Less: Exemption u/s 54	
Cost of New HP Purchased ₹ 6,00,000	
(exemption restricted upto the balance of LTCG)	5,61,000
Taxable Long term Capital Gains	**NIL**

If the HP purchased in 15.3.2012 is again sold on 21.10.12 for ₹ 12 lacs, there share a rise short term capital gains. The cost of acquisition shall be adjusted to the extent of long term capital gains exemption already availed.

Computation of Capital Gains for the A.Y. 2013-14

		₹
Consideration for transfer		12,00,000
Less: Cost of Acquisition		
Cost of purchase	6,00,000	
Less: Exemption u/s 54 availed during A.Y. 2012-13 now withdrawn	5,61,000	39,000
Short term Capital Gains		**11,61,000**

Question No. 9 (d)

Saptarshi acquired shares of G Ltd. on 15.12.98 for ₹ 5 lacs which were sold on 14.6.11 for ₹ 19 lacs. Expenses on transfer of shares ₹ 40,000. He invests ₹ 8 lacs in the bonds of Rural Electrification. Corporation Ltd. on 16.10.2011.

(a) Compute capital gain for the assessment year 2012-13.

(b) State the period for which the bonds should be held by the assessee. What will be the consequences if such bonds are sold within the specified period?

(c) What will be the consequences if Saptarshi takes a loan against the security of such bonds.

Solution:

Computation of Capital Gains for the A.Y. 2012-13

	₹
Consideration for transfer	19,00,000
Less : Expenses on Transfer	40,000
Net Consideration	18,60,000
Less : Indexed Cost of Acquisition [5,00,000 x 785/351]	11,18,234
Long-term Capital Gains	7,41,766
Less : Exemption u/s 54EC	7,41,766
Taxable long-term Capital Gain	**NIL**

(b) Saptarshi should not transfer or convert (otherwise than transfer) into money such bonds within 3 years from the date of their acquisition.

If these bonds are transferred or converted into money within 3 years, capital gain exempted earlier shall attract taxability towards long-term capital gain of the previous year in which such asset is transferred or converted into money.

(c) If any loan is taken against security of such bonds, it shall be taxable as long-term capital gains of the previous year in which such loan is taken against the security of such bonds.

Question No. 9 (e)

Mr. N is employed at a gross salary of ₹ 8,00,000. He gets ₹ 15,000 interest on bank deposit. He has made the following investment/deposit during the year 2010-2012:

		₹
1.	Life insurance premium:	
	(i) Own life, insured for ₹ 80,000	15,000

	(ii) Brother's life, dependent on him	5,000
	(iii) Major son, not dependent on him	4,000
2.	Contribution to unrecognised provident fund	60,000
3.	Contribution to public provident fund	20,000
4.	Contribution to ULIP	5,000
5.	Repayment of loan to SB1 to purchase a residential house: 50% repayment is towards interest.	1,20,000
6.	Infrastructure bonds of an Indian public company under Sec. 80C(2)(xix)	10,000
	He has paid education fees for his 3 children:	
	A	12,000
	B	9,000
	C	6,000

Besides, interest of ₹ 1,632 on NSC-VIII, (purchased during the year 2008-2009) has been credited on them during the year 2011-2012.

Compute deduction u/s 80C for the assessment year 2012-2013.

Solution: Computation of Deduction u/s 80C of Mr. N for the assessment year 2012-2013

Particulars	₹	₹
Deduction in respect of contribution to approved savings (Sec. 80C) :		
1. Life insurance premium;		
(i) Own life-	15,000	
(ii) Brother's life	—	
(iii) Major son	4,000	
2. Contribution to unrecognised provident fund	—	
3. Contribution to ULIP	5,000	
4. Contribution to public provident fund	20,000	
5. Repayment of housing loan to SBI	60,000	
6. Infrastructure bonds of Indian public company [Sec. 80C(xix)]	10,000	
7. Accrued interest on NSC- VIII issue	1,632	
8. Education fees for two children:		
A	12,000	
B	9,000	
	1,33,632	
Deduction restricted upto ₹ 1,00,000		**1,00,000**

Question No.10 (a)

Mr Jamal, a resident assessee, runs a manufacturing business in Delhi. For the previous year 2011-2012, he disclosed his taxable income as below:

	₹
Business profits	2,55,000
Long-term capital gains	25,000
Short-term capital gain	15,000

He has hired furnished accommodation for his own use and pays ₹ 4,000 p.m. He has paid donation amounting to ₹10,000 to National Defence Fund. He has deposited ₹ 50,000 under a scheme framed by the Life Insurance Corporation for maintenance of his dependant brother with a disability. The disability is certified by the medical authority. Compute his total income for the assessment year 2012-2013.

Solution: Computation of Total Income of Mr. Jamal — Assessment Year 2012-2013

Particulars	₹	₹
Income from business (computed)		2,55,000
Long-term capital gain (computed)		25,000
Short-term capital gain (computed)		15,000
Gross Total Income		**2,95,000**
Deductions from gross total income:		
(i) Deposit for maintenance of a dependent with disability [Sec. 80DD]:	50,000	
(ii) Charitable donations to National Defence Fund [Sec. 80G]:	10,000	
Amount of Deduction @ 100% of ₹ 10,000		
	60,000	
(iii) Expenditure incurred on rent [Sec. 80GG] [W.N.1]	17,000	77,000
Total Income		**2,18,000**

Workings Note 1:

Particulars	₹	₹
Expenditure incurred on rent [Sec. 80GG]:		
• [Rent paid -10% of ATI], i.e. 48,000 -21,000 = 17,000, or		
• 25% of AGTI, i.e. 25% of 2,10,000 = 52,500, or		
• ₹ 2,000 p.m. = ₹ 24,000		
whichever is less, is to be deducted, i.e. ₹ 17,000		
Adjusted Total Income for Sec. 80GG:		
Gross total income		
Less: Aggregate of		2,95,000
(i) All permissible deduction from GTI except for deduction for u/s 80GG	60,000	
(ii) Any long-term capital gain	25,000	85,000
Adjusted Gross Total Income [AGTI] for Sec. 80GG		**2,10,000**

Question No.10 (b)

M, resident in India, furnishes the following particulars of his receipts and outgoings during the previous year 2011-2012.

		₹
Receipts:		
(i)	Income from salary	2,00,000
(ii)	Income from house property	3,00,000
(iii)	Gross winning from crossword puzzle	3,00,000
Outgoing :		
(i)	Contribution to LIC annuity plan	15,000
(ii)	Medical insurance premium:	
(a)	For himself	4,000
(b)	His wife, not dependent	3,000
(c)	Mother, non-resident, 67 years, dependent	5,000

(d)	Nephew, wholly dependent with disability	3,000
(e)	Grandson, dependent	2,000
(iii)	Expenditure on medical treatment and maintenance of the nephew referred to	30,000
(iv)	Medical treatment for grandson, suffering from a disease specified under income-tax rules(v)	50,000
(v)	Donation to Gujarat government for family planning	50,000
(vi)	Scholarship to a poor but meritorious student	20,000
(vii)	Contribution to approved scientific research association	30,000
(viii)	Contribution to Delhi Municipal Corporation for sewage scheme for slum-dwellers, approved by National Committee	50,000
(ix)	Donation to Political party paid during November 2011	20,000

Compute his total income for the assessment year 2012-2013. Make necessary assumptions and clarify them.

Solution: **Computation of Total Income for AY 2012-2013**

Particulars		₹	₹
Income from salary			2,00,000
Income from house property			3,00,000
Gross winnings from crossword puzzle			3,00,000
Gross Total Income			8,00,000
Less: Deductions under Chapter VIA :			
Contribution to LIC annuity plan [Sec. 80CCC]		10,000	
Medical insurance premium [Sec, 80D]			
Self	4,000		
His wife	3,000		
Mother, 67 years old	5,000		
Nephew dependent with disability	x		
Grand son	x	12,000	
Maintenance and medical treatment of a dependent with disability [Sec. 80DD]			
Expenditure for medical treatment of grandson [Sec. 80DDB]		Nil	
Donations for scientific research or rural development [Sec. 80-GGA]			
(a) Donation to approved scientific research association		30,000	
(b) Contribution to MCD for slum-dwellers scheme, approved by National Committee		50,000	
Donations to political party [Sec. 80GGC w.e.f. 22.9.2004]		20,000	
Charitable donations [Sec. 80G]			
(a) Scholarship to a poor meritorious student		xxx	
(b) Gujarat government for family planning: 100% of qualifying amount			
1. Actual donation = 50,000, or			
2. 10% of specified GT1 = 37,800			
8,00,000 – (3,00,000 + 10,000 + 12,000 + 30,000 + 50,000 + 20,000) = ₹3,78,000			
whichever is less, is QA 37,800= 100% of 37,800		37,800	1,59,800
Total Income			**6,40,200**

Question No.10 (c)

SK Industries, a diversified group, discloses profit from the following sources for the previous year 2011-2012:

		(₹ in lakhs)
(i)	Profits from small-scale unit, started in 2002-2003	6.00
(ii)	Profit from industrial undertaking 2003-2004, in Vidisha, a B-class industrially backward district.	10.00
(iii)	Profit from multiplex theatre, started in 2007-2008	
	(a) Delhi	4.00
	(b) Allahabad	2.00
(iv)	Profits from convention centre, started in 2009-2010	
	(a) Delhi	5.00
	(b) Allahabad	3.00
(v)	Profits from Hill View, a hotel started in 2003-2004 at Manali in Himachal Pradesh. Hotel is approved by prescribed authority	10.00
(vi)	Profits from undertakings engaged in refining of mineral oil since 1 January 2005 in Uttar Pradesh, not listed in backward state in Eighth Schedule.	10.00

Compute the total income for the assessment year 2012-2013.

Solution: **Computation of Total Income**

Particulars	(₹ lakhs)	(₹ lakhs)
(i) Profits from SSI		6.00
(ii) Profits from undertaking located in industrially backward B-class district		10.00
(iii) Profits from multiplex theatre: (4 + 2) =		6.00
(iv) Profits from convention centre: (5+3) =		3.00
(v) Profits from Hill View Hotel		10.00
(vi) Profits from refining undertaking		10.00
Gross Total Income		**50.00**
Less: Deduction in respect of profits and gains from certain industrial undertaking, other than infrastructure undertakings (Sec. 80-IB) :		
1. Profits from SSI [Sec. 80-IB (3)] : 25% of ₹ 6 Lakh :	1.50	
2. Profits from undertaking in B-class industrially backward district [Sec. 80-IB (4)] 25% of ₹ 10 lakh	2.50	
3. Profits from multiplex theatre [Sec. 80-IB(7A) 50% of ₹ 2 lakh (No deduction for Delhi)	1.00	
4. Profits from convention centre [Sec. 80-IB(7B)] 50% of ₹ 8 lakh	4.00	
5. Profits from Hill View Hotel [Sec. 80-IB(7)] Allowed only for Indian company	Nil	
6. Profits from refining undertaking [Sec. 80-IB(9)]-100% of profits for 7 assessment years	10.00	19.00
Total Income		**31.00**

Question No.10 (d)

Mekon Ltd., an Indian company, starts an industrial undertaking on 1 April 2011. During the previous year, it earns profits of ₹ 80 lakh before allowing any deduction for wages. Compute its total income for the previous year 2011-2012 taking into account the following employment schedules of workers:

Date of employment	Number of workers	Status of workers	Rate of wages
1-5-2011	90	Casual	300 p.m.
1-6-2011	20	Reuglar	4000 p.m.
1-7-2011	10	Regular	4000 p.m.

Solution: **Computation of Total Income for the AY 2012-2013**

Particulars	₹	₹
Profits before allowing deduction for wages		80,00,000
Less: Wages paid to workers [Sec. 37(1)] :		
(i) 90 × ₹ 3000 × 11	29,70,000	
(ii) 20 × ₹ 4000 × 10	8,00,000	
(iii) 10 × ₹4000 × 9	3,60,000	(-) 41,30,000
Business Profits and Gross Total Income		38,70,000
Less: Deduction in respect of employment of new workmen [Sec. 80 JJAA] 30% (₹ .4000 x 10 x 10)		(-) 1,20,000
Total Income		**37,50,000**

Question No.10 (e)

Mr. R has developed an improved economical model of a motor cycle and got it patented on 31-3-2011 under the Patent Act, 1970. He allowed Z Ltd. to use his patent rights and licenses has been granted to it under the Patent Act, 1970. He has received royalty of ₹ 8,00,000 during the previous year 2011-2012. However, the royalty in accordance with the terms and conditions of the license settled by the Controllers under the said Act is ₹ 2,80,000. He has incurred ₹ 1,00,000 expenses in developing his invention and getting it patented.

Compute his total income for the assessment year 2012-2013 (i) if he is resident in India, (ii) non-resident India.

Solution: **Computation of Total Income for the Assessment Year 2012-2013**

Particulars	(i) ₹	(ii) ₹
Income from other sources	8,00,000	8,00,000
Less : Expenses	60,000	60,000
Gross Total Income (GTI)	**7,40,000**	**7,40,000**
Less : Deduction for respect of royalty on patent (Sec. 80-RRB)		
Least of the followings:		
(a) Income from royalty 5,00,000; or		
(b) Royalty under the terms of license settled by the Controller 2,80,000;		
(c) Maximum limit ₹ 3,00,000		
Whichever is less, is to be deducted	2,80,000	xxx
Total Income	**2,20,000**	**7,00,000**

Question No.11 (a)

Mr. J is suffering with 60% locomotor disability which is certified by medical authority. He is employed as Technical Supervisor with Air Tel at a salary of ₹ 20,000 p.m.

	Particulars	₹
(i)	Income from government securities	20,000
(ii)	Long-term capital loss	(-) 40,000
(iii)	Short-term capital gain (Sec. 111A)	1,00,000
(iv)	Insurance commission (gross)	1,00,000
(v)	Interest on Saving Fund a/c from bank	10,000

He has incurred the following expenses:

(i) Medical insurance paid by cheque for his father, resident in India and 70 years 18,000 (ii)

Deposit with LIC for maintenance of father, mainly dependant on him for support and maintenance and suffering from low-vision with a severe disability of 80%, as per certificate of the medical authority

(iii) Rent paid for the year 2011-2012 for accommodation hired by him. 40,000

Compute his total income for the assessment year 2012-2013.

Solution: **Computation of Total Income for the Assessment Year 2012-2013**

Particulars	₹	₹
1. Income from salaries		2,40,000
2. Income from capital gains :		
(a) Short-term capital gains (Sec. 111A)		
(b) Long-term capital loss to be carried forward		1,00,000
3. Income from others sources :		Nil
(a) Interest government securities	20,000	
(b) Interest on savings fund a/c with Bank	10,000	
(c) Insurance commission	1,00,000	1,30,000
Gross Total Income		**4,70,000**
Less : Deductions under Chapter VIA:		
Medical insurance (Sec. 80D)	18,000	
Deduction in respect of maintenance including medical treatment of a department, a person with severe disability (Sec. 80DD)	1,00,000	
Deduction in case of a person with disability (Sec. 80U) :	50,000	
Deduction u/s 80GG :(Least of the followings)		
(a) (i) Rent paid less 10% of Adjusted Gross Total Income 40,000-23,300 = 16,700,		
(b) (ii) 25% of 2,33,000 Adjusted Gross Total Income=58,250,		
(iii) 2,000 p.m. × 12 = 24,000	16,700	1,84,700
Whichever is less, is or be deducted		
Total Income		**2,85,300**

Question No.11 (b)

Mr. Krishna is a lawyer of Allahabad High Court. He keeps his accounts on cash basis. His Receipts and Payments A/c for the year ending 31-03-2012 is given below :

Dr. **Cr.**

Receipts	₹	Payments	₹
Balance b/d	3,820	Purchase of Infrastructure Bonds	20,000
Legal fees	3,45,000	Subscription and membership	4,500
Special commission fees	5,500	Purchase of legal books	17,500
Salary from Law College as part time lecture	87,000	Rent	47,500
		Municipal Tax paid on H. P.	3,000
Exam. Remuneration	1,480	Car expenses	44,000
Interest on Bank Deposit	3,500	Office expenses	38,500
Sale proceeds of residential property	3,01,000	Electricity Expense	4,000
		Income tax	8,000
Dividend from Co-operative society	1,000	Gift to daughter	12,000
		Domestic expenses	85,000
Dividend received from units of UTI	2,000	Donation to Institutions approved u/s 80G	12,000
Rent from house property	15,000	Car purchased	3,27,000
		Life Insurance premium	16,000
		Balance c/d	1,26,300
	7,65,300		**7,65,300**

Following information are available:

1. The Rent and electric expenses are related to a house, of which half portion in used for self residence and remaining half portion in used for office.
2. Car is used only for professional purposes.
3. Outstanding legal fees ₹ 10,000.
4. Rent has been paid for 10 months only.
5. Car was purchase on 25-09-2011. Law books purchased are annual publications out of which books of ₹ 2,000 were purchased on 6-4-2011 and balance on 31-10-2011.
6. The house was purchased in January 1987 for ₹ 50,000 and sold on 1-7-2011.
7. Rent of the property which has been sold was ₹ 5,000 p.m. The property was vacated by the tenant on 30-6-2011.

   Compute his Total Income for the assessment year 2012-13.

Solution:

Computation of Total Income of Mr. Sen for the assessment year 2012-13

	Particulars	₹	₹
1.	Income from salary		
	Salary as a part time lecturer	87,000	
	Less: Deduction	Nil	87,000
2.	Income from House Property		
	Annual Rent	60,000	
	Less: Vacancy Allowance	45,000	
	Gross Annual Value (GAV)	15,000	
	Less: M/ Tax paid	3,000	

	Net Annual Value (NAV)		12,000	
	Less: Standard deduction @ 30% of NAV		3,600	8,400
3.	Income from Profession			
	Professional Earnings:			
	(i) Legal fees		3,45,000	
	(ii) Special commission		5,500	
			3,50,500	
	Less: Allowable expenses			
	(i) Subscription etc.	4,500		
	(ii) 1/2 Rent (Office)	23,750		
	(iii) Car expenses	44,000		
	(iv) 1/2 electric charges	7,000		
	(v) Office expenses	38,500		
	(vi) Depreciation on car @ 15% on 3,27,000	49,050		
	(vii) Depreciation on books			
	[@ 100% on Annual Publication of ₹ 2,000 = 2,000			
	@ 50% on Others of 15,500 = 7,750	9,750	1,76,550	1,73,950
4.	Capital gains:			
	Sale consideration		3,01,000	
	Less: Indexed cost of acquisition 50,000 ×		2,80,357	20,643
5.	Income from Other Sources :			
	Interest on bank deposit		3,500	
	Examiner's fees		1,480	
	Dividend from Co-operative Society		1,000	
	Dividend from UTI		Exempt	5,980
	Gross Total Income			2,95,973
	Less : Deductions			
	(i) 80C - LIP		16,000	
	(ii) 80G - Donation @ 50% of ₹ 12,000		6,000	
	(iii) 80CCF - Purchase of Infrastructure Bonds		20,000	42,000
	Total Income			2,53,973
	Total Income (rounded off u/s 288A)			**2,53,970**

Notes:

1. As the assessee follows the cash system of accounting, amount actually received and payment actually made on account of expenditure, during the year, shall be considered for computing the income. Therefore, any outstanding receipts will not be included in the Total Income. Similarly rent not paid for two months will not be allowed as deduction.

2. The system of accounting does not affect the computation of income from salary, house property and capital gains. Therefore, in this case, rent for three months, though not received (as it has not been shown in the Receipt and Payment Account) shall be taken into account in computing the income under the head house property.

3. Car was purchased and put to use for more than 180 days. Therefore, full depreciation @15% has been claimed.

4. Law books worth ₹ 2,000 were purchased and put to use for more than 180 days and are. therefore, eligible for depreciation @100%. The balance books worth ₹ 15,500 were purchased on 31-10-2011; therefore, 50% of the normal depreciation will be allowed as the books were purchased and put to use for less than 180 days. The total depreciation shall, therefore, be ₹ 2,000 + 50% of ₹15,500 = ₹ 9,750.

Question No.11 (c)

From the following details compute the total income of Mr. X, a resident of Delhi, for the AY 2012-13.

	Particulars	₹
(a)	Salary including Dearness Allowance	6,30,000
(b)	Bonus	57,600
(c)	Contribution to a Recognised Provident Fund	36,000
(d)	Life Insurance Premium	57,000
(e)	Rent paid by the Employer for flat provided to Mr. X	90,000
(f)	Cost of Furniture provided by the employer at the aforesaid flat	80,000
(g)	Rent recovered from Mr. X by employer	36,000
(h)	Bills paid by the employer for gas, electricity and water provided free of cost at the above flat	18,000
(i)	Mr. X was provided with Company's car (self-driven) also for personal use, not possible to determine expenditure on personal use and all expenses were borne by the employer.	

Mr. X owns a house. The particulars are :	₹
Rent received (12 months)	72,000
Municipal valuation	48,000
Municipal taxes paid	12,000
Ground rent	2,000
Insurance charges	1,000
Collection charges	3,400
Interest on borrowing used for construction of house (constructed in June 2004)	48,000
Other Information :	
Dividend received from UTI India	14,000
Deposits under National Saving Certificate	20,000

Solution:

Assessee: Mr. X **Previous Year: 2011-12** **Assessment Year: 2012-13**

Computation of Total Income

Particulars	₹	₹
Income under the head Salary		
Salary including Dearness Allowance		6,30,000
Bonus		57,600
Gross Salary before including value of perquisites		6,87,600
Value of Concessional Furnished Accommodation [Rule 3(1)]		
Least of Rent Paid by employer		
[₹ 90,000 or 15% of Salary ₹ 6,87,600]		62,000
10% of Furniture Value		
[₹ 80,000 × 10%]	8,000	
Less : Rent recovered from Mr. X	(36,000)	
Gas, Electricity and Water provided by the employer		18,000
Motor Car provided to the employee for use (assumed capacity upto 1.6 liitres)		32,400
([₹ 1,800 p.m. + ₹ 900 p.m. for chauffeur] × 12 Months) as per Rule 3		
Gross Income from Salary		**8,00,000**

Income from House Property:

Gross Annual Value u/s 23(1) Higher of Municipal Value ₹ 48,000		
or Rent Received ₹ 72,000	72,000	
Less : Municipal Taxes paid	(12,000)	
Net Annual Value	60,000	
Less : Deduction		
Standard deduction @ 30% of Net Annual Value u/s 24(a)	(18,000)	
Interest on borrowed capital u/s 24(b)	(48,000)	(6,000)
Income from Other Sources:		
Income from UTI	14,000	
Exemption u/s 10(35)	(14,000)	Nil
GROSS TOTAL INCOME		**7,94,000**
Less : Deduction under Chapter VIA - Section 80C		
- Contribution to RPF	36,000	
- LIC Premium	57,000	
- Deposits in NSC	20,000	
	1,13,000	
Deduction u/s 80C restricted to ₹1,00,000 [sec. 80CCE]		(1,00,000)
TOTAL INCOME (Rounded Off u/s 288A)		**6,94,000**

Question No.11 (d)

Mr. X, Finance Manager of K Ltd. Mumbai, furnishes the following particulars for the previous year 2011-2012.

		₹
(a)	Gross Salary (per month) [Tax deducted from Salary ₹ 1,09,000]	64,000
(b)	Valuation of medical facility in a hospital maintained by the Company	7,000
(c)	Rent Free Accommodation owned by the Company	
(d)	Housing Loan of ₹ 6,00,000 at the interest rate of 5% p.a. (no repayment made during the year, to be repaid within 10 years)	
(e)	Gift made by the Company on the occassion of wedding anniversary of X	4,750
(f)	A wooden table and 4 Chairs were provided to X at his residence (Dining Table). This was purchased on 1.5.2008 for ₹ 60,000 and sold to X on 1.8.2011 for ₹ 30,000	
(g)	Personal purchases through Credit Card provided by the Company amounting to ₹ 20,000 was paid by the Company. No part of the amount was recovered from X.	
(h)	A Maruti Esteem Car which was purchased by the Company on 16.7.2007 for ₹ 5,50,000 was sold to the assessee on 14.8.2011 for ₹ 1,30,000.	
(i)	Other income received by the assessee during the previous year 2011-2012 are :	₹
	Interest on Fixed Deposits with a Company	5,000
	Income from specified mutual fund	3,000
	Interest on bank deposits of a minor married daughter	3,000
	Income from UTI received by his handicapped minor son	1,200
(j)	Contribution to LIC towards Premium u/s 80CCC	10,000

(k) Deposit in PPF Account made during the year 2011-2012 75,000

(l) Bonds of ICICI (Tax Savings) eligible for tax deduction 25,000

Compute the Taxable Income of Mr. X and the tax liability for the Asst. Year 2012-2013.

Solution:

Assessee: Mr. X **Previous Year: 2011-12** **Assessment Year : 2012-13**

Computation of Total Income

Particulars		₹	₹
Income from Salaries :			
Basic Salary (₹ 64,000 × 12)			7,68,000
Add : Value of Perquisites :			
1. Value of Medical Facility in hospital maintained by K Ltd.			
— Treatment in hospital maintained by Employer — Fully Exempt			Nil
2. Rent Free Accommodation owned by Company — Explanation 1 to Sec. 17(2)			1,15,200
15% of salary = 15% of ₹ 7,68,000 (Population > 25 Lakhs)			
3. Housing Loans at concessional rate – Rule 3(7)(i)			
= ₹ 6,00,000 × (10% – 5%)			30,000
4. Use of Furniture & Fittings upto 1.8.2011 - Rule 3(1)(vii)			
= 10% × ₹ 60,000 × 4/12			2,000
5. Transfer of Assets - Rule 3(7)(viii)			
— Dining Table as per WN 1 (a)		12,000	
Motor Car as per WN 1 (b)		95,280	1,07,280
6. Gifts made by the Company on the occasion of the Wedding Anniversary			Nil
7. Credit Card Purchases taxable as perquisite u/s 17(2)			20,000
Gross Income from Salary			**10,42,480**
Less : Deduction u/s 16			Nil
Net Income from Salaries			**10,42,480**
Income from Other Sources :			
Interest on Fixed Deposits with a Company		5,000	
Income from specified mutual fund	3,000		
Less : Exempt u/s 10(35)	(3,000)		
Interest on Bank Deposits of minor married daughter	3,000		
Less : Exempt u/s 10(32)	(1,500)	1,500	
Income received by handicapped minor son - not clubbed u/s 64(IA)		Nil	6,500
GROSS TOTAL INCOME			**10,48,980**
Less : Deduction under Chapter VI-A			
U/s 80CCC – Contribution towards Pension Fund			10,000
U/s 80C – Contribution towards PPF			75,000
U/s 80CCF – Bonds of ICICI (Long term infrastructure bonds)			25,000
TOTAL INCOME			**9,38,980**
TAX PAYABLE			1,33,694
Add : Education Cess @ 2%			2,674
Add : Secondary and Higher Education Cess @ 1%			1,337
Gross Tax Payable			**1,37,705**
Less : Tax Deducted at source			1,09,000
Net Tax Liability			**28,705**

Working Notes:

1. Valuation of Perquisites on transfer of Movable Assets :

(a) Transfer of Assets: Dining Table

	(₹)
Purchase Price	60,000
Less: Depreciation till date of Sale (₹ 60,000 × 3 × 10%)	(18,000)
WDV as at date of transfer	42,000
Less: Deduction for collection from Employee	(30,000)
Value of Perquisite	**12,000**

(b) Motor Car

	₹
Cost of Purchase (16.7.2007)	5,50,000
Less : Depreciation @ 20% (16.7.2007 - 15.7.2008)	1,10,000
16.7.2008 WDV	4,40,000
Less : Depreciation for 16.7.2008 - 15.7.2009	88,000
16.7.2009 WDV	3,52,000
Less : Depreciation for 16.7.2009 - 15.7.2010	70,400
16.7.2010 WDV	2,81,600
Less : Depreciation for 16.7.2010 - 15.7.2011	56,320
16.7.2011 WDV	2,25,280
Less : Amount Recovered on Transfer	1,30,000
Value of Perquisite	**95,280**

2. Gifts received from the employer on the occasion of the wedding anniversary
   (a) Taxable as perquisite u/s 17(2).
   (b) As per Rule 3(7)(vi), value of any gift or voucher or token (other than made in cash) or convertible ; in cash on ceremonial occasion or otherwise shall be taxable if the aggregate value of Gift during the previous year is ₹ 5,000 or more. Since the value of gifts received is less than ₹ 5,000, it shall be exempt from tax.

Question No.11 (e)

M, an individual, retired from the services of a Company on 31.10.2011. He joined another employer on 1.11.2011 and was in service till end of March 2012, when he furnishes the following details and information —

1. Salary and Allowances for the period

From First Employer	₹ Per month
Basic Salary	30,000
Dearness Allowance	16,000
Conveyance Allowance	6,000

From Second Employer	₹ Per month
Basic Salary	35,000
Fixed Conveyance Allowance	8,000

2. While he was with the first employer, M contributed 10% of his basic salary to a Provident Fund Account with the Regional Provident Fund Commissioner. He did not become a member of the Provident Fund maintained by the second employer.
3. M was permitted by the second employer to encash 15 days leave he had accumulated during his service and received ₹12,500 from his employer.
4. M had constructed a residential house in Chennai in February 2008 for ₹30 Lakhs. Part of the costs of construction was met by borrowals of ₹ 20 lakhs from the Housing Development Corporation, at interest of 12.5% p.a. The loan was taken on June 2006. The loan outstanding at the beginning of the current year was ₹12,00,000. The rate of interest applicable for the current year was reduced to 9% p.a. due to reduction in rates. [He had also borrowed from some relatives ₹4,00,000 on which interest at 15% p.a. was due.] The property had been let-out soon after completion.
5. In the Assessment Year 2008-09, M was allowed a deduction of ₹50,000 for irrecoverable rents. The annual value decided by the Corporation of Chennai for the property is ₹ 80,000. The property was let-out in the current year to a Company on a rent of ₹20,000 p.m. The half-yearly municipal taxes on the property were fixed by the Corporation of Chennai only in August 2011 at ₹15,000 for every half year from 1.4.2008. M paid the taxes due in September 2011 upto the half-year ending 31.3.2011.
6. M also received from the previous tenant ₹ 40,000 (out of the dues of ₹ 50,000).
7. After retirement from the first employer, M received ₹ 4,50,000 from the Regional Provident Fund Commissioner, money was fully invested by him in the 15% Non-Redeemable Debentures issued by the Indian Oil Corporation interest on these had not come in by the end of March 2012.
8. M received interest of ₹ 60,000 on long-term fixed deposits with Banks, ₹ 25,000 as interest on Post Office Savings Bank Accounts and ₹ 20,000 as income from units.
9. M owns a car which is used for office purposes also and it is found that the entire conveyance allowance from his employer had been fully spent on travel for official purposes.
10. One of the policies of insurance taken by M had matured for payment and ₹ 8,00,000 received by him in June 2011 from the LIC was invested by him, in the name of his 16-year old son, in fixed deposits with companies. Interest received uplo 31.3.2012 on these deposits was ₹ 90,000. On one of the continuing policies of insurance, M paid a premium of ₹ 60,000 in the year.

Compute M's total income for the Assessment Year 2012-13.

Solution :

Assessee : Mr. M **Previous Year : 2011-12** **Assessment Year : 2012-13**

Computation of Total Income

			₹	₹	₹
Income under the head Salaries					
From First Employer					
	Basic Pay	(₹ 30,000 × 7)		2,10,000	
	Dearness Allowance	(₹ 16,000 × 7)		1,12,000	
	Conveyance Allowance	(₹ 6000 × 7)	42,000		
Less:	Exempt u/s 10(14)		(42,000)	Nil	3,22,000
	Amount received from Regional Provident Fund Commissioner	4,50,000			
Less:	Exempt u/s 10(12)		(4,50,000)	Nil	
From Second Employer					
	Basic Salary	(₹ 35,000 × 5)		1,75,000	
	Conveyance Allowance	(₹ 8,000 × 5)	40,000		
Less:	Exempt u/s 10(14) (incurred for official performance of duties)		(40,000)	Nil	

Leave Encashment - Fully taxable while in service		12,500	1,87,500
Gross Income from Salary			**5,09,500**
Income from House Property:			
Gross Annual Value u/s. 23(1) — Higher of Municipal Value of ₹80,000 or Actual Rent of ₹ 2,40,000		2,40,000	
Less: Municipal Taxes paid during the year @ ₹ 15,000 for every half year from 1.4.2008 upto 31.3.2011 (Current Year - Not Paid)		(90,000)	
Net Annual Value (NAV)		1,50,000	
Less: Deduction			
@ 30% of NAV u/s 24(a)		(45,000)	
Interest on Borrowed Capital u/s 24(b)			
Loan from Housing Development Corporation:			
Current Period Interest: ₹12,00,000 × 9%	1,08,000		
Prior Period Interest (Interest upto 31.3.2007) [(₹20,00,000 × 12.5%) + (4,00,000 × 15%)] × 10/12 × 1/5	51,667		
Loan from Relative - Current Period Interest (₹ 4,00,000 x 15%)	60,000	(2,19,667)	
Add: Unrealised Rent recovered (taxable in the year of recovery u/s 25AA]		40,000	(74,667)
Income from Other Sources			
Interest on Long-term Fixed Deposits with Bank		60,000	
Interest on Post Office Savings Bank A/c	25,000		
Less: Exempt u/s 10(15)	(25,000)	Nil	
Income from Units of UTI	20,000		
Less: Exempt u/s. 10(35)	(20,000)	Nil	
LIC Policy matured	8,00,000		
Less: Exempt u/s. 10(1D)	(8,00,000)	Nil	
Interest from Fixed Deposits with Companies in the name of minor son	90,000		
Less: Exemption u/s. 10(32)	(1,500)	88,500	1,48,500
Gross Total Income			**5,83,333**
Less: Deduction under Chapter VI–A			
u/s 80C –LIC Premium		(60,000)	
– RPF – 10% of ₹ 1,40,000		(14,000)	(74,000)
Total Income			**5,09,333**
Total Income (Rounded Off u/s 288A)			**5,09,330**

Assumptions:

1. It is presumed that Mr. M accounts for his interest income on receipt basis.
2. Assumed that there has been no repayment of Housing Loan Principal during the year ending 31.3.2006 for the purpose of calculation of prior period interest.

3. Recognised Provident Fund received on retirement shall not be taxable u/s 10 (assuming conditions are satisfied).
4. Unrealised Rent recovered : Since the assessee has been allowed a deduction of ₹ 50,000 from his house property income in ealier years in respect of Unrealised Rent, entire ₹ 40,000 recovered during current year becomes taxable.
5. Deduction of Interest u/s 24 shall be allowed even if the amount is borrowed from any person other than the Banks/Financial Institutions in respect of Let Out property.

Question No.12 (a)

Mr. A, a Senior Citizen, has furnished the following particulars relating to his House Properties —

Particulars	House I — ₹	House II — ₹
Nature of Occupation	Self Occupied	Let-out
Municipal Valuation	60,000	1,20,000
Fair Rent	90,000	1,50,000
Standard Rent	75,000	1,40,000
Actual Rent per month	—	12,000
Municipal Taxes paid	6,000	12,000
Interest on Capital borrowed	90,000	80,000

Loan for both Houses were taken on 1.4.2007. House II remained vacant for 4 months.

Besides the above two house, A has inherited during the year 1987-88 an old house from his grandfather. Due to business commitments, he sold the house immediately for a sum of ₹ 250 Lakhs. The house was purchased in 1962 by his grandfather for a sum of ₹ 2 Lakhs. However, the Fair Market Value as on 1.4.1981 was ₹ 30 Lakhs. With the sale proceeds, A purchased a new house in March 2011 for a sum of ₹ 140 Lakhs and the balance was used in his business.

The other income particulars of Mr. A besides the above are as follows (AY 2012–2013) —

- Business Loss ₹ 9 Lakhs
- Income from Other Sources (Bank Interest) ₹ 1 Lakh
- Investments made during the year PF ₹ 70,000
- ICICI Infrastructure Bond Purchased (u/s 80CCF) ₹ 30,000

Compute Total Income of Mr. A and his Tax Liability for the Assessment Year 2012–2013.

Solution:

Assessee : Mr. A **Previous Year : 2011-12** **Assessment Year : 2012-13**

Computation of Total Income

Particulars	₹	₹	₹
1. Income from House Property :			
(a) House I : Self Occupied — Annual Value u/s 23(2)	Nil		
Less : Deduction u/s 24(b) = Interest on Housing Loan			
taken on 1.4.2007 (Note 1)	90,000	(90,000)	
(b) House II : Let-out – (Note 2)		(21,000)	(1,11,200)
2. Profits and Gains of Business or Profession – Loss			(9,00,000)
3. Capital Gains — Sale of Residential House Property — Long Term Asset			
Sale Consideration		2,50,00,000	

Less :	Expenses on Transfer	Nil	
	Net Consideration	2,50,00,000	
Less :	Indexed Cost of Acquisition — Fair Market Value as on 1.4.81 × CII of year of Sale /CII of year of first holding (₹ 20 Lakhs × 785/150)	1,04,66,667	
	Long Term Capital Gain	1,45,33,333	
Less :	Exemption u/s 54 — New House purchased	1,40,00,000	5,33,333
4. Income from Other Sources: Bank Interest			1,00,000
	Gross Total Income [representing unabsorbed business loss to be carried forward]		**(3,77,867)**

Hence, no Deduction under Chapter VI-A is allowed in this year.

Notes:

1. Assumed that loss from House Property & Loss from Business are at first adjusted inter-head, against Long Term Capital Gains and then against Income from other sources since it is beneficial to the assessee.
2. It is assumed that the construction of the house was completed within 3 years from the end of the financial year in which the loan was taken.
3. Annual Value of House Property II is computed as under —

(i)	Municipal Value (MV)	1,20,000
(ii)	Fair Rental Value (FRV)	1,50,000
(iii)	Higher of MV + FRV	1,50,000
(iv)	Standard Rent	1,40,000
(v)	Reasonable Expected Rent (RER) [lower of (iii) + (iv)]	1,40,000
(vi)	Annual Rent @ ₹ 12,000 pm	1,44,000
(vii)	Unrealised Rent	Nil
(viii)	Actual Rent [(vi) – (vii)]	1,44,000
(ix)	Vacancy Allowance	48,000
(x)	Gross Annual Value [(viii) – (ix)]	96,000
	Less: Municipal Tax paid	12,000
	Net Annual Value (NAV)	84,000
	Less: Standard deduction @ 30% of NAV u/s 24(a)	25,000
	Less: Interest on borrowed Capital u/s 24(b)	80,000
	Income for House II	(21,200)

Question No.12 (b)

Mr. Anurag is a Cost Accountant in practice. The Income & Expenditure Account for the year ending March 31, 2012 read as follows:

	Expenses	₹		Income	₹
To	Employees cost	1,50,000	By	Professional earnings	12,00,000
To	Travelling & Conveyance	50,000	By	Dividend income	
To	Administration & Office exp.	4,00,000	–	from shares	6,00,000
To	Interest	1,50,000	–	from equity oriented mutual funds	1,00,000
To	Demat Charges	10,000			
To	Net profit	11,40,000			
Total		**19,00,000**	**Total**		**19,00,000**

Other Information:

(a) Entire Dividend income is claimed as exempt from taxation by virtue of Section 10(34) and 10(35).

(b) Anurag claims that no expenditure has been incurred against the dividend income, which is claimed as exempt from tax.

(c) The value of investment in shares as on the first day and the last day of the previous year is ₹ 7,50,000 and ₹ 9,00,000 respectively.

(d) The value of investment in units of Mutual Funds as on the first day and the last day of the previous year is ₹ 5,00,000 and 2,00,000 respectively.

(e) All expenditure including interest expenditure of ₹ 1,50,000 incurred by Anurag are relating to taxable and non taxable Income. Demat charges are directly attributable to exempt income.

(f) The value of the total assets as appearing in the Balance sheet of the assessee as on the first day and last day of the previous year is ₹ 60,00,000 and ₹80,00,000 respectively.

You are required to compute the taxable income of Anurag for the assessment year 2012-13.

Solution:

Computation of Taxable Income A.Y. 2012-13

Particulars		₹
Income from Profits & Gains of Business or Profession(W.N.1)		4,40,000
Income from other sources (W.N. 2)		Nil
	Total	4,40,000
Add : Disallowance u/s 14A – as per Working Note 3		31,804
	Taxable Income	**4,71,804**

Working Note 1 — Profits & Gains of Business or Profession

	₹	₹
Net profit as per Income & Expenditure Account		11,40,000
Less : Income considered under other heads		
– Dividend Income from shares	6,00,000	
– Income from UTI	1,00,000	7,00,000
Taxable Income from Profession		**4,40,000**

Working Note 2 — Income from other sources

		₹	₹
1.	Dividend Income from Shares	6,00,000	
	Less : Exempt under sec 10(34)	6,00,000	Nil
2.	Income from units in Mutual funds	1,00,000	
	Less : Exempt under sec 10(35)	1,00,000	Nil
	Taxable income from other sources		**Nil**

Working Note 3 — Disallowance u/s 14A

		₹
(a)	Amount of expenditure directly relating to exempt income (Other than interest) — Demat charges	10,000
(b)	Amount of interest incurred by way of expenditure other than those included above (1,50,000 × 8,25,000 / 70,00,000)	17,679
(c)	Amount equal to 0.5% of the average value of Investments (8,25,000 × 0.5%)	4,125
	Total amount disallowed u/s 14A (a) + (b) + (c)	31,804

Note :

1. Average value of Investment = (7,50,000 + 9,00,000) / 2 = ₹ 8,25,000.
2. Average value of Total Assets = (60,00,000 + 80,00,000) / 2 = ₹ 70,00,000.

Question no. 12(c)

XY & Co., a partnership concern had established an undertaking for manufacturing computer software in Free Trade Zone. It furnishes the following particulars of its second year operations, ending on 31-03-2012:

Particulars	₹ (in lakh)
Total sales of business	100.00
Export sales	80.00
Profit of the business	10.00

Out of the total sales, realisation of sale of ₹ 7 lakh is difficult because of the deficiency of the buyer. realisation of rest of the sales is received in time. The plant and machinery used in the business had been depreciated @ 15% on SLM basis of depreciation and depreciation of ₹ 3 lakh was charged to the Profit and Loss Account. Compute the taxable income of XY & Co for the assessment year 2012-2013.

Solution: **Computation of Taxable Income for the A.Y. 2012-13**

Particulars	₹ (in lakh)
Profit of business	10,00,000
Add : Depreciation charged on SLM basis	3,00,000
	13,00,000
Less : Depreciation on WDV basis @ 15% of 17,00,000 – [See Note below]	2,55,000
	10,45,000
Less : Deduction under Sec. 10A : 10,45,000 × 73 ÷ 100	7,62,850
Taxable income	**2,82,150**

Note :

	₹
1. Computation of Depreciation :	
Total purchase price of machine : 3,00,000 15 × 100	20,00,000
Less : Depreciation in the first year @ 15%	3,00,000
WDV at the end of first year	17,00,000
Less: Depreciation for second year @ 15%	2,55,000
WDV at the end of second year	14,45,000
2. Export Turnover:	
Export Sales	80,00,000
Less: Remittance not received due to insolvency of buyer	7,00,000
	73,00,000

Question no. 12(d)

Mr.B holds agricultural fields for growing sugarcane to manufacture sugar in his factory. The data for the financial year 2011-12 is as follows:

Cost of cultivation of sugarcane	₹ 8,00,000
Market value of sugarcane when transferred to factory	₹ 12,00,000
Other manufacturing cost (excluding overheads)	₹ 9,00,000
Sales of sugar	₹ 23,00,000
Overhead expenses related to production	₹ 4,00,000

Solution:

(1) Business Income:

Sales of Sugar	₹ 23,00,000
Less: Market value of sugarcane when transferred to factory	₹ 12,00,000
Other manufacturing cost (excluding overheads)	₹ 9,00,000
Overhead expenses related to production	₹ 4,00,000
Business Loss	**(₹ 2,00,000)**

This business loss shall have to be carried forward for adjustment, against profits from business, arising within the immediately succeeding 8 previous years.

(2) Agricultural Income:

Market value of sugarcane when transferred to factory	₹ 12,00,000
Less: Cost of cultivation	₹ 8,00,000
	₹ 4,00,000

Question no. 13(a)

The following is the profit and loss account for the year ending 31.3.2012 of XYZ (LLP) having 3 partners:

Profit and Loss Account

		₹		₹
Establishment & other expenses		48,00,000	Gross profit	68,20,000
Interest to partner @ 15%			Profit on sales of equity shares sold after	
X	90,000		2 years through recognised stock exchange	1,40,000
Y	1,20,000			
Z	60,000	2,70,000		
Salary to designated partners			Rent from house property	60,000
X	2,40,000		Interest on bank deposits	10,000
Y	1,80,000	4,20,000	Profit on equity shares sold after	
Net profit		17,60,000	10 months through RSE	1,20,000
		72,50,000		**72,50,000**

Additional information:

(1) Establishment expenses include ₹ 1,20,000 on account of bonus which was due on 31.3.2012.

(2) The LLP is eligible for 100% deduction under section 80-IC as it is established in notified area in Himachal Pradesh.

(3) Shares were sold through recognized stock exchange and securities transaction tax of ₹ 1000 is included in the establishment expenses on account of the same.

Compute the tax payable by the Limited Liability Firm

Solution :

Computation of total income of XYZ (LLP) for the A.Y. 2012-13

Income under the head house property	₹	₹	₹
Actual rent		1,60,000	
Less : Deduction 30%		48,000	1,12,000

Income from Business			
Net profit as per P&L A/c		16,60,000	
Less: Income credited but either exempt or taxable under other head			
Rent	60,000		
Profit on sale of shares sold after 2 years	1,40,000		
Interest on bank deposit	10,000		
Profit on sale of shares sold after 10 months	1,20,000	3,30,000	
		13,30,000	
Add : Expenses disallowed			
Bonus as per section 43B	1,20,000		
Securities Transaction Tax	1,000		
Interest to partners in excess of 12%	54,000		
Salary to partners	4,20,000	5,95,000	
Book profit		19,25,000	
Less : Salary as per section 40(b) (See working note)		4,20,000	15,05,000
Short-term capital gain on sale of equity shares			1,20,000
Income from other sources			10,000
Gross Total Income			**17,47,000**
Less : Deduction under section 80-IC			15,05,000
Total income			**2,42,000**

Regular income tax payable on total income

(1) Short-term capital gain of ₹ 1,20,000 @ 15%	18,000
(2) Balance total income ₹ 1,22,000 @ 30%	36,600
	54,600
Adjusted total income	
Total income	2,42,000
Add : Deduction u/s Chapter VIA	15,05,000
	17,47,000

Alternate Minimum Tax (AMT) 18.5% on ₹ 17,47,000 = ₹ 3,23,195

Hence, adjusted total income shall be total income and the tax (payable shall be the alternate minimum tax i.e. on ₹ 17,47,000 @ 18.5% + 3% (EC + SHEC).

Tax payable

	₹
Alternate minimum tax 18.5% on ₹ 17,47,000	3,23,195
Add: Education Cess @ 2% & SHEC @ 1%	9,696
	3,32,891
Rounded off	**3,32,890**

<u>Working Note</u>

Book profit	19,25,000
Maximum salary allowed	
First 3,00,000 of book profit — 90%	2,70,000
Balance ₹ 16,25,000 of book profit 60%	9,75,000
	12,45,000

Salary allowed shall be ₹ 12,45,000 or ₹ 4,20,000 whichever is lower i.e. ₹ 4,20,000.

Question no. 13(b)

D Ltd., a closely-held Indian company, is engaged in the business of manufacture of chemical goods (value of plant and machinery owned by the company is ₹ 55 lakh). The following information for the financial year 2011-12 are given :

D Ltd. is engaged in the business of manufacture of garments.

	₹
Domestic Sales	20,00,000
Export Sales	7,00,000
Amount withdrawn from general reserve (reserve was created in 1997-98 by debiting P&L A/c)	2,00,000
Amount withdrawn from revaluation reserve	1,50,000
Total	**35,50,000**
Less : Expenses	
Depreciation (normal)	6,16,000
Depreciation (extra depreciation because of revaluation)	2,70,000
Salary and wages	2,10,000
Wealth tax	10,000
Income-tax	3,50,000
Outstanding customs duty (not paid as yet)	17,500
Proposed dividend	60,000
Consultation fees paid to tax expert	21,000
Other expenses	1,39,000
Net Profit	**13,56,500**

For tax purposes the company wants to claim the following:

—Deduction under section 80-1B (30 per cent of ₹ 14,56,500).

—Depreciation under section 32 (₹ 5,36,000)

The company wants to set off the following losses/allowances:

	For tax purposes ₹	For accounting purposes ₹
Brought forward loss of 2004-05	14,80,000	4,00,000
Unabsorbed depreciation	—	70,000

Compute the net income and tax liability of D Ltd. for the assessment year 2012-13 assuming that D Ltd. has a (deemed) long-term capital gain of ₹ 60,000 under proviso (i) to section 54D(2) which is not credited in profit and loss account.

Solution:

Computation of Book Profit & Minimum Alternate Tax

	₹
Net profit as per P&L A/c	13,56,500
Add :	
Excess depreciation [i.e., ₹ 6,16,000 + ₹ 2,70,000 — ₹ 5,36,000]	3,50,000
Wealth tax	10,000
Income tax	3,50,000
Customs duty which is not paid	17,500
Proposed dividend	60,000
Total	**21,44,000**
Less : Amount withdrawn from reserve (i.e., ₹ 2,00,000+ ₹ 1,50,000)	3,50,000
Business income	**17,94,000**
Less : Unabsorbed loss carried forward, now adjusted	14,80,000
Business Income (after adjustment of carried forward unabsorbed business losses)	**3,14,000**
Long-term capital gain	60,000
Gross Total Income	**3,74,000**
Less : Deductions under section 80-IB [30% of ₹ 3,14,000] (= ₹3,74,000 – ₹60,000 LTCG)	91,200
Net Income (rounded off)	**2,82,800**
Tax liability (under normal provisions) [20% of ₹ 60,000 + 30% of ₹ 2,22,800, plus 3% of tax as cess]	**81,205**

<u>Computation of Book Profit</u>

Net Profit as per Profit & Loss A/c	13,56,500
Add :	
Depreciation (i.e. ₹ 6,16,000 + ₹ 2,70,000)	8,86,000
Wealth tax	Nil
Income-tax	3,50,000
Proposed dividend	60,000
Less : Amount withdrawn from general reserve	(–) 2,00,000
Unabsorbed depreciation	(–) 70,000
Depreciation (normal)	(–) 6,16,000
Amount withdrawn from revaluation reserve to the extent it does not exceed extra depreciation because of revaluation	(–) 1,50,000
Book profit	**16,16,500**
Tax liability (19.055% of ₹ 16,16,500)	3,08,024

D Ltd. will pay ₹ 3,08,024 as tax for the assessment year 2012-13 as per section 115JB. Tax credit is however, available in respect excess tax (=₹2,26,819 = ₹ 3,08,024 – 81,205) under section 115JB.

Question no. 13(c)

Y Ltd. is a company in which 60% shares are held by P Ltd. Y Ltd declared a dividend amounting to ₹45 lakhs to its share holders for the financial year 2010-11 in its AGM held on 12th May,2011. Dividend Distribution Tax was paid by Y Ltd. on 14th May,2011. P Ltd declared an interim dividend amounting to ₹70 lakhs on 15th October, 2011 for the year ended 31st March, 2012.

Compute:

(i) The amount of tax on dividend payable by P Ltd.

(ii) What would be your answer, if 58% shares of P Ltd are held by K Ltd. an Indian company?

(iii) Does the position change further, if K Ltd. is a foreign company?

Answer:

Assessee : P Ltd. Previous Year: 2011-12 Assessment Year : 2012-13

Status: Residential Company

1. Principle:

   (a) Since P Ltd holds more than 50% of nominal value of equity shares in Y Ltd., Y Ltd is a subsidiary of P Ltd.

   (b) Dividends subject to Dividend Distribution Tax shall be reduced by the dividend received by the domestic company during the financial year if:

   - Such dividend is received from its subsidiary
   - Subsidiary has paid dividend distribution tax
   - Domestic company is not a subsidiary of any other company

2. **Computation of Dividend Distribution Tax**

Particulars	Case I (Note 2) ₹	Case II & III (Note 3) ₹
(a) Dividend declared by P Ltd	70,00,000	70,00,000
(b) Less: Dividend received by P Ltd from Y Ltd, being a subsidiary [60% of ₹45,00,000]	27,00,000	Nil
Net Dividend on which Dividend Distribution Tax is payable [(a) –(b)]	**43,00,000**	**70,00,000**
Dividend distribution tax @ 15%	**6,45,000**	**10,50,000**
Add: Surcharge @ 5% on DDT	32,250	52,500
Dividend Distribution Tax + Surcharge	**6,77,250**	**11,02,500**
Add: Education Cess @ 2% on [DDT + Surcharge]	13,545	22,050
Add: SHEC @ 1% on [DDT + Surcharge]	6,773	11,025
Total Dividend Distribution Tax Payable	**6,97,568**	**11,35,575**
Dividend Distribution Tax (rounded off)	**6,97,570**	**11,35,580**

Notes:

1. Dividend u/s 115-O includes all dividend except dividend u/s 2(22)(e). Hence, interim dividend is also covered u/s 115-O.
2. Case (I) – refers to dividend received by a domestic company which is a holding company of another company and is not a subsidiary of any other company. Benefit of set off of dividend received during previous year 2011-12 available as all the conditions are satisfied.
3. Case (II) and Case (III): Domestic company is a subsidiary of another company:
   (a) Case (II)- P Ltd is a subsidiary of K Ltd. an Indian Company. Benefit of set-off of dividend received not available as all the conditions are not satisfied [Refer Point No.(b) of the Principle]
   (b) Case (III) – P Ltd. is a subsidiary of K Ltd. a Foreign Company. Benefit of set-off of dividend received not available as all the conditions are not satisfied as the Holding company should not be a subsidiary of "any other company". *Refer Point no (b) of principle]. U/s 2(17), Company includes a Foreign company.

Question no. 13(d)

Explain briefly the consequences of opting for tonnage tax scheme.

Answer: The following are the consequences:

(i) All deductions u/s 30 to 43B shall be deemed to be allowed

(ii) Depreciation shall be deemed to be allowed. No question of unabsorbed depreciation of operating qualifying ship

(iii) No benefit of Sections 70,71,72,72A,73 relates to the loss of operating qualifying ship

(iv) No chapter VI deduction available on the tonnage income

(v) Book profit or loss of the tonnage tax company shall be excluded in computation of book profit u/s 115JB.

(vi) In case relevant shipping income is a loss, it shall be ignored while computing tonnage income.

Question no. 14(a)

Write short notes on the scheme of submission of returns through tax return preparers [Section 139B]

Answer:

The Tax Return Preparer shall assist the persons furnishing the return in a manner that will be specified in the Scheme, and shall also affix his signature on such return. The "specified class or classes of persons" for this purpose means any person other than a company or a person whose accounts are required to be audited under section 44AB (tax audit) or under any other existing law, who is required to furnish a return of income under the Act.

Question no. 14(b)

Write short notes on Tax Return Preparer.

Answer: A Tax Return Preparer can be an individual, other than

(i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings.

(ii) any legal practitioner who is entitled to practice in any civil court in India.

(iii) a chartered accountant.

(iv) an employee of the 'specified class or classes of persons'.

(3) The Scheme notified under the said section may provide for the following —

(i) the manner in which and the period for which the Tax Return Preparers shall be authorised,

(ii) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer,

(iii) the code of conduct for the Tax Return Preparers,

(iv) the duties and obligations of the Tax Return Preparers,

(v) the circumstances under which the authorisation given to a Tax Return Preparer may be withdrawn, and

(vi) any other relevant matter as may be specified by the Scheme.

Question no. 14(c)

Write short notes on Permanent Account Number (PAN) [Sec. 139A]

Answer: Permanent Account Number (PAN) is a 10-character alpha-numeric number, allotted to an assessee by the Income Tax Department.

(1) Where any person in th the following category has not been allotted a permanent account number (PAN), he should apply to the Assessing Officer within the prescribed time for allotment of a PAN -

(i) Every person whose total income or the total income of any other person in respect of which he is assessable under this Act during any previous year exceeded the basic exemption limit; or

(ii) Every person carrying on any business or profession whose total sales, turnover or gross receipts exceeds or is likely to exceed ₹5 lakhs in any previous year; or

(iii) Every person who is required to furnish a return of income under section 139(4A); or

(iv) Every person, being an employer, who is required to furnish a return of fringe benefits under section 115WD [Sub-section (1)].

(2) The CBDT had introduced a new scheme of allotment of computerized 10 digit PAN. Such PAN comprises of 10 alphanumeric characters and is issued in the form of a laminated card.

(3) All persons who were allotted PAN (Old PAN) earlier and all those persons who were not so allotted but were required to apply for PAN, shall apply to the Assessing Officer for a new series PAN within specified time.

(4) Once the new series PAN is allotted to any person, the old PAN shall cease to have effect. No person who has obtained the new series PAN shall apply, obtain or process another PAN.

(5) On receipt of allotment of PAN it must be mentioned on all tax payment challans, returns, correspondence.

(6) Where TDS or TCS is made, the person from whom it is made must communicate his PAN to the person deducting or collecting tax.

(7) Every person receiving any document relating to a transaction prescribed under clause (c) of sub-section (5) shall ensure that the permanent account number or the General Index Register Number has been duly quoted in the document.

Question no. 14(d)

(i) What is the due date of filling of return of income in case of a non-working partner of a firm whose accounts are not liable to be audited?

Answer : Due date of furnishing return of income in case of non-working partner shall be 31st July of the assessment year whether the accounts of the firm are required to be audited or not. A working partner for the above purpose shall mean an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner and is drawing remuneration from the firm.

(ii) Can unabsorbed depreciation be carried forward even if the return is filed after due date?

Answer : Unabsorbed depreciation can be carried forward even if the return of loss is submitted after the due date, as it is not covered under Chapter VI of set off or carry forward of losses but covered u/s 32(2).[East Asiatic Co.(India) Pvt. Ltd. vs.CIT (1986) 161 ITR 135(Mad.)]

(iii) Can a belated return of income filed u/s 139(4) be revised?

Answer: There was a difference of opinion among various courts regarding filling of revised return in respect of belated returns. However, it has been held that a belated return filed u/s 139(4) cannot be revised as section 139(5) provides that only return filed u/s 139(1) or in pursuance to a notice u/s 142(1) can be revised [Kumar Jagdish Chandra Sinha vs.CIT(1996) 220 ITR 67(SC)].

(iv) Can a revised return be further revised?

Answer: If the assessee discovers any omission or any wrong statement in a revised return, it is possible to revise such a revised return provided it is revised within the same prescribed time [Niranjan Lal Ram Chandra Vs.CIT (1982) 134 ITR 352 (All.)]

(v) Can an Assessing Officer himself allot permanent account number to an assessee?

Answer: The Assessing Officer having regard to the nature of the transactions as may be prescribed may also allot a permanent account number to any other person(whether any tax is payable by him or not) in the manner and in accordance with the procedure as may be prescribed.

Question no. 15(a)

(i) Joseph engaged in profession filed his return of income for assessment year 2011-12 on 15th November, 2011. He disclosed an income of ₹4,00,000 in the return. In February, 2012 he discovered that he did not claim certain expenses and filed a revised return on 3rd February, 2012 showing an income of ₹1,80,000 and claiming those expenses. Is the revised return filed by Joseph acceptable?

Answer: Joseph is engaged in profession. The due date for filing income tax return for assessment year 2011-12 as per section 139(1) of the Income-tax Act is 30th September, 2011 if his accounts are required to be audited under any law. The due date is 31st July, 2011 if the accounts are not required to be audited under any law.

The return was filed beyond the due date prescribed in section 139(1). The return so filed is covered by section 139(4) and the time limit is one year from the end of the relevant assessment year. The Apex court in *Kumar Jagadish Chandra Sinha v. CIT 220 ITR 67 (SC)* has held that a return filed under section 139(4) is not eligible for revision and hence a revised return cannot be filed.

Hence, the return filed by Joseph is not valid as the original return was not filed before the due date mentioned in section 139(1).

(ii) An assessee filed a return of income on 31.8.2011 in respect of Assessment year 2011-12 disclosing an income of ₹5 lakhs from business. It was not accompanied by proof of payment of tax due on self-assessment. Discuss the validity of such a return.

Answer :As per Explanation to sub-section (9) of section 139 a return is regarded as defective unless it is accompanied by proof of tax deducted at source, advance tax and tax on self-assessment, if any, claimed to have been paid. Therefore, the return is prima facie defective. It is not invalid at that stage. On receipt of the return, the Assessing Officer has to intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation or within such further period which, on application by the assessee, he may, in his discretion allow. If the defect is not rectified within the said period, the return will be treated as an invalid return and the provisions of the Income-tax Act shall apply, as if the assessee has failed to furnish the return.

Also, it may noted that section 140A(3) says that if an assessee fails to pay tax or interest on self assessment he shall be deemed to be an assessee in default in respect of the tax or interest or both remaining un paid and all the provisions of the Act shall apply accordingly.

(iii) If an assessment is remanded back to Assessing Officer, can he introduce new sources of income for assessment?

Answer: Where the assessment is set aside by the Tribunal and the matter remanded to the Assessing Officer, it is not open to him to introduce into the assessment new sources of income so as to enhance the assessment. Any power to enhance is confined to the old sources of income which were the subject matter of appeal [Kartar Singh vs.CIT (1978) 111 ITR 184 (P &H)].

(iv) Can Department make fresh computation, once the assessment is made final?

Answer: It is now a well settled principle that an assessment once made is final and that it is not open to the department to go on making fresh computation and issuing fresh notices of demand to the end of all time. [ITO vs.Habibullah (S.K.) (1962) 44 ITR 809 (SC)]

(v) Can an Assessing Officer make an assessment for a year other than the assessment year for which the return is filed?

Answer: It is not open to the Assessing Officer to make assessment in respect of a year other than the Assessment Year for which the return is filed. Thus, in respect of a return filed for assessment year 2010-11, assessment cannot be made for the assessment year 2011-12. [CIT vs. Amaimugan Transports Pvt.Ltd.(1995) 215 ITR 553 (Mad.)]

(vi) Can an Assessing Officer assess the income below the returned income or assess the loss higher than the returned loss?

Answer: The Assessing Officer cannot assess income under section 144 for an assessment below the returned income or cannot assess the loss higher than the returned loss.

(vii) Can incomplete, unsigned or unverified return lead to best judgement assessment?

Answer: Incomplete, unsigned or unverified return may lead to best judgement assessment. A best judgement assessment can be made when the return is filed woefully incomplete or not signed and verified. [Behari Lal Chatterji vs.CIT (1934) 2 ITR 377 (All.)

(viii) Can assessee follow different method of accounting for different businesses?

Answer: If an assessee is carrying on more than one business, he can follow cash system of accounting for one business and mercantile system (accrual system) of accounting for other business. Similarly, if he had more than one sources of income under the head income from other sources, he can follow accrual system for one source of income under the head income from other sources, he can follow accrual system for one and cash system for other sources of income.

<u>**Question no. 15(b)**</u>

Anand and Aniket are equal members in AA & Associates. The profit and loss account of the AOP for the year ending 31st March 2012 is as follows:

Particulars	₹	Particulars	₹
Selling and administrative		**Gross Profit**	**20,00,000**
Expenses	**8,00,000**	**Income from house property**	**3,60,000**
Interest to Anand @ 15%	**60,000**		
Remuneration:			

Anand	**1,50,000**	
Aniket	**1,50,000**	
Net profit:		
Anand	**6,00,000**	
Aniket	**6,00,000**	
	23,60,000	**23,60,000**

Other information:

1. **Selling and administrative expenses include ₹ 60,000 paid to a consultant in cash.**
2. **The other income/investment details of the members are given as below:**

Members	Income	Source of income	Investments
Anand	**90,000**	**Interest on fixed deposit from bank**	**Purchase of NSC VIII ₹ 30,000**
Aniket	**1,00,000**	**Interest on govt. securities**	**Contribution to PPF ₹ 50,000**

Compute the tax liability of the AOP and it members

Answer: Computation of Total ncome of AOP: Previous Year 2011-2012

Particulars	₹
Net profit	12,00,000
Add: Inadmissible payments.	
1. Fees paid to consultants in cash Sec. 40A (3)	60,000
2. Interest paid to members [Sec. 40(ba)]:	60,000
3. Remuneration paid to members Sec. 40(ba)	3,00,000
	16,20,000
Less: Income from house property	3,60,000
Business profits	12,60,000
Add: Income from house property	3,60,000
Total income	16,20,000
Tax liability of AOP on total income	
Tax on slabs rates	3,90,000
Add:	
Education cess 2%	7,800
SHEC @ 1%	3,900
Tax payable	**4,01,700**

Allocation of income amongst the members:

Particulars	Anand ₹	Aniket ₹	Total ₹
Interest	60,000	—	60,000
Remuneration	1,50,000	1,50,000	3,00,000
Share of divisible profit (12,60,000-60,000-3,00,000)	4,50,000	4,50,000	9,00,000
Share of profit	6,60,000	6,00,000	12,60,000
Share of income from house property	1,80,000	1,80,000	3,60,000
	8,40,000	**7,80,000**	**16,20,000**

Computation of Total Income of members:

Particulars	Anand ₹	Aniket ₹
Share income from AOP	8,40,000	7,80,000
Income from other sources:		
Interest on bank deposits	90,000	—
Interest on government securities	—	1,00,000
Gross Total Income	**9,30,000**	**8,80,000**
Less: Deduction under Sec. 80C	30,000	50,000
Total Income	**9,00,000**	**8,30,000**
Tax liability of members: Tax on slab rates	1,74,000	1,53,000
Add: Education Cess @ 2% on income tax	3,480	3,060
Add: SHEC @ 1%	1,740	1,530
	1,79,220	**1,57,590**
Less: Rebate on share of profit at the average: (See Note below)	**1,67,272**	**1,48,097**
Tax payable	11,948	9,493
Tax payable rounded off to the nearest multiple of ₹ 10 (See. 288B)	11,950	9,490
Note: Anand = ₹1,79,220 x 8,40,000/9,00,000	15,050	
Aniket = ₹1,57,590 x 7,80,000/8,30,000		12,290

Question no. 15(c)

Devdas Charitable Trust submits the particulars of its receipts and outgoing during the previous year 2011-2012.

as below :

		₹
(i)	**Income from property held under trust for charitable purposes**	**20,00,000**
(ii)	**Voluntary contribution (out of which ₹ 5,00,000 will form part of the corpus)**	**15,00,000**
(iii)	**Donations paid to blind charitable school**	**6,00,000**
(iv)	**Scholarship paid to poor students**	**4,00,000**
(v)	**Amount spent on holding free eye camps in urban slums**	**3,00,000**
(vi)	**Amount set apart for setting up an old age home by March 2014**	**10,00,000**

Compute the total income of the trust for the previous years 2010-2011 and 2015-2016 if it spends ₹ 5,00,000 during the previous year 2014-2015 and ₹ 3,00,000 during the previous year 2015-2016 in setting up the old age home.

Solution: (a) Computation of the Taxable Income of the trust for previous year 2011-2012/AY 2012-2013.

	Particulars		₹
(i)	Income from property held under charitable trust		20,00,000
(ii)	Income from voluntary contributions (₹ 15,00,000- ₹ 5,00,000)		10,00,000
	Total		30,00,000
	Less : 15% set apart for future application		4,50,000
	Balance		25,50,000
	Less: Income applied for charitable purposes:		
(i)	Donations to blind charitable school	6,00,000	
(ii)	Scholarship to poor students	4,00,000	
(iii)	Free eye camps in urban slums	3,00,000	

Total	13,00,000	
Amount set apart for old age home	10,00,000	23,00,000
Taxable Income		**2,50,000**

(b)Previous year 2015-2016 /AY 2016-2017:

Amount set apart for old age home	10,00,000
Less: 1. Amount spent during 2014-2015	3,00,000
2. Amount spent during 2015-2016	5,00,000
Taxable Income	**2,00,000**

Question no. 15(d)

Happy Home Cooperative Society Ltd. furnishes the following particulars of its income for the previous year ending on 31st March 2012:

(i)	**Interest on government securities**	**40,000**
(ii)	**Profits from banking business**	**3,50,000**
(iii)	**Income from purchase and sale of agricultural implement and seeds to its members**	**2,50,000**
(iv)	**Income from marketing of agricultural produce of its members**	**4,00,000**
(v)	**Profits and gains of business**	**2,20,000**
(vi)	**Income from cottage industry**	**3,50,000**
(vii)	**Interest and dividends (gross) from other cooperative societies**	**30,000**

Compute Total Income of the society and calculate the tax payable by it for the assessment year 2012-2013.

Solution: **Happy Home Cooperative Society Ltd.**

Computation of income of the for the previous year 2011-2012, Assessment Year 2012-2013

Particulars	₹	₹
1. Profits and gains of business or profession:		
a) Banking business	3,50,000	
b) Income from purchase and sale of agricultural implements and seeds to its members	2,50,000	
c) Income from marketing of agricultural produce of its members	4,00,000	
d) Profits and gains of business	2,20,000	
e) Income from cottage industry	3,50,000	15,70,000
2. Income from other sources:		
a) Interest on government securities	40,000	
b) Interest and dividends from other cooperatives	30,000	70,000
Gross Total Income		**16,40,000**
Less: Deduction allowable from gross total income under Sec. 80P		
1. Banking business	3,50,000	
2. Income from purchase and sale of agricultural implement and seeds to its members	2,50,000	

3.	Income from marketing of agricultural produce of its members	4,00,000	
4.	Income from cottage industry	3,50,000	
5.	Interest on government securities(not eligible for deduction)	Nil	
6.	Interest and dividends from other cooperative societies	30,000	13,80,000
Total Income			**2,60,000**

Computation of Tax Liability:

Particulars	Rate	₹
On first ₹ 10,000	10%	1,000
On next ₹ 10,000	20%	2,000
On balance ₹ 2,40,000	30%	72,000
Income tax payable		75,000
Add: Education cess @ 2%		1,500
Add: SHEC @ 1%		750
Tax payable		**77,250**

Question no. 16(a)

The following details have been supplied by the Karta, of an HUF aged 62 years. You are required to compute its total income and tax liability for the assessment year 2012-2013.

Particulars	₹
(i) Profits from business (after charging ₹ 1,00,000 salary to Karta for managing the business).	15,00,000
(ii) Salary received by the member of a family.	60,000
(iii) Director's fee received by Karta from B Ltd where HUF holds 20% shares but he became director because of his qualifications,	40,000
(iv) Rental income from house property (after deduction of municipal taxes ₹ 2,000).	78,000
(v) Dividends (gross) from Indian companies	15,000
(vi) Long-term capital gain	80,000
(vii) Short-term capital gain	30,000
(viii) Donation to a school, which is an approved institution,	1,00,000
(ix) Deposits in Public Provident Fund	20,000
(x) NSC-VIII issues purchased	40,000

Solution: Computation of Total Income for the A.Y. 2012-13

Particulars	₹	₹
(i) Income from house property:		
Gross annual value (₹ 78,000 + ₹ 12,000)	90,000	
Less: Municipal taxes paid	12,000	
Annual value	78,000	
Less: Statutory deduction: 30% ×78,000	23,400	54,600
(ii) Profits and gains from business		15,00,000
(iii) Capital gains (a) long-term + (b) short-term		1,10,000
(iv) Income from other sources—gross dividends from Indian		Nil

companies: Exempt [Sec. 10(34)]		
Gross Total Income		**16,64,600**
Less:		
1. Contribution to approved savings (Sec. 80C)		
(i) Deposits in Public Provident Fund	20,000	
(ii) NSC-VIII Issue	<u>40,000</u>	
	60,000	
2. Donation to recognised school:		
(a) Actual donation: ₹ 1,00,000 or		
(b) 10% of adjusted total income = (Gross Total Income – Long Term Capital Gains – All deductions under Chapter VIA excluding Sec. 80G) of ₹ 15,24,600 (16,64,600 - 80,000 - 60000) whichever is less, is qualifying amount.		
Amount of deduction: : 50% of ₹ 1,00,000	<u>50,000</u>	<u>1,10,000</u>
Total Income		**<u>15,54,600</u>**

Computation of Tax Liability:

Particulars of total income	₹	Rate of income tax ₹	₹
(a) Long-term capital gain	80,000	20%	16,000
(b) Balance of total income: ₹ 14,74,600			
(i) First	2,50,000	Nil	—
(ii) Between 2,50,000 – 5,00,000	2,50,000	10%	25,000
(iii) Between 5,00,000 – 8,00,000	3,00,000	20%	60,000
(iv) Between 8,00,000 – 14,74,600	6,74,600	30%	<u>2,02,380</u>
Gross Tax			3,03,380
Add: Education cess @ 2% on income tax			6,068
SHEC @ 1% on income tax			<u>3,034</u>
Tax payable			<u>3,12,482</u>
Rounded off u/s 288B			3,12,480

<u>Question no. 16(b)</u>

Fashion Ltd., a well-diversified group, gives below its profit and loss account for the previous year 2011-2012:

Particulars	₹	Particulars	₹
Manufacturing expenses	9,00,000	Sale of manufactured goods	10,00,000
Salaries/wages	5,50,000	Sale of agriculture produce	15,00,000
Cultivation expenses	4,00,000	Receipt from generation/distribution of power	
	15,00,000		
Power generation/distribution expenses	4,00,000	Receipt from water supply/ irrigation projects	
Irrigation expenses	6,00,000	Receipt from I.U. set up in backward district	
Expenses of I.U., located in backward district	5,00,000	in July 2004	10,00,000
Expenses of I.U., located in free trade		Transfer from Reserve & Provision a/c,	
zone(Sec. 10A)	1,50,000	debited to profit and loss account in 2005-06	
	9,50,000		
Expenses of I.U. (Sec. 10B)	1,00,000	on account of free service under	
Expenses of I.U. (Sec. 10C)	50,000	warranty period	2,00,000
Provision for losses of subsidiary	4,00,000	Sale of goods of I.U. (Sec. 10B)	2,00,000
Sundry expenses	10,000	Sale of goods of I.U, located in free trade	

Provision for bad and doubtful debts	2,00,000	zone (Sec. 10A)	1,00,000
Provision for bills under discount	50,000	Sale of goods of I.U. located in Northern Eastern Region (NER) (Sec. 10C)	50,000
Provision for sales tax, wealth tax against demand notice	3,30,000	Income from UTI	5,00,000
Income tax provision against demand notice	3,00,000		
Dividend paid on preference shares	2,00,000	Long term capital gain on sale of equity shares, transaction chargeable to Securities Transaction Tax	35,00,000
Proposed dividend on equity shares	4,00,000		
Transfer to general reserve	1,00,000		
Dividend Equalisation reserve	2,00,000		
Penalties under direct tax laws	60,000		
Goodwill written off	50,000		
Depreciation	3,00,000		
Amortisation of patent rights	30,000		
Expenses on transfer of equity shares	20,000		
Net profit	42,00,000		
	1,05,00,000		**1,05,00,000**

The following additional information is provided as below:

1. Depreciation includes, a sum of ₹ 1,00,000 on account of revaluation of building and plant and machinery.
2. Past year losses, before depreciation, are given below:

	Loss (₹)	Depreciation (₹)
2007-2008	(-) 5,00,000	(-) 6,00,000
2008-2009	Nil	(-) 5,00,000
2009-2010	(-) 7,00,000	(-) 4,00,000
2010-2011	(-) 5,00,000	Nil

Compute book-profits for the previous year 2011-2012/AY 2012-2013 for MAT under Sec. 115 JB.

Solution: **Computation of Book Profit for the AY 2011-2012**

Particulars	₹	₹
Net profit as per profit and loss account		42,00,000
Add:		
(i) Cultivation expenses	4,00,000	
(ii) Expenses of I.U. located in Free Trade Zone (Sec. 10A)	1,50,000	
(iii) Expenses of I.U. under Sec. 10B	1,00,000	
(iv) Provision of loss of subsidiary	4,00,000	
(v) Provision for bad and doubtful debts— an unascertained liability	2,00,000	
(vi) Provision for bills under discount— an unascertained liability	50,000	
(vii) Provision for wealth-tax, sales- tax, against demand notice— an ascertained liability	—	
(viii) Income-tax provision— an ascertained liability to be added back	3,00,000	
(ix) Dividend paid on preference shares	2,00,000	
(x) Proposed dividend on equity shares	4,00,000	
(xi) Transfer to general reserve	1,00,000	
(xii) Dividend Equalisation reserve	2,00,000	
(xiii) Depreciation [Sec. 115JB(2)(g) w.e.f. AY 2011-2012]	3,00,000	28,00,000
Adjusted profits		70,00,000

Less:

(i)	Sales of agriculture produce [Sec. 10(1)]	10,00,000	
(ii)	Receipt from I.U. in Free Trade Zone [Sec. 10A]	2,00,000	
(iii)	Receipt from I.U. Sec. 10B	2,00,000	
(iv)	Depreciation, excluding depreciation on account of revaluation of assets	2,00,000	
(v)	Brought forward loss or depreciation, whichever is less.	9,00,000	
(vi)	Withdrawals from Reserve & Provision for free sale service, under warranty scheme	9,50,000	
(vii)	Long-term capital gain on transfer of equity shares {Sec. 10(38)] — see Note below	Nil	
(viii)	Receipts from UTI [Sec. 10(35)]	50,000	35,00,000
	Book-profits		35,00,000

Note: 1. Calculation of brought forward losses or depreciation:

2007-2008	Loss	5,00,000
2008-2009	Loss/depreciation	Nil
2009-2010	Depreciation	4,00,000
2010-2011	Loss/depreciation	Nil

1. Transfer from provision for after sale service, free of cost, made during the year 2005-2006, debited to profit and loss a/c and now credited to profit and loss a/c and now credited to profit and loss a/c is an allowable deduction [Sec. 115-JB(2)].

2. Long-term capital gain from the transfer of equity shares in a company is exempt is chargeable to securities trans action tax (STT). However, for the purposes of computing book-profits, it is not to be deducted [Sec. 10(38)]. Accordingly, the expenditure incurred for the transfer of equity shares has not been added back in computing book profits.

Question no. 16(c)

Classic Exporters Ltd, runs a new industrial undertaking set up in 2006-2007 which satisfies the conditions of Sec. 80-IB. Given below is the profit and loss account for the previous year 2011-2012 :

Particulars	₹	Particulars	₹
Stock	4,00,000	Domestic sales	24,00,000
Purchases	23,00,000	Export sales	43,00,000
Salaries and wages	9,70,000	Export incentives Sec. 28(iiia)/(iiic)	50,000
Entertainment expenses	1,30,000	Profit of foreign branch	2,50,000
Freights and insurance attributable to exports	3,00,000	Brokerage/commission/interest/ rent, etc	50,000
Travelling expenses	2,20,000	Transfer from contingency reserve	10,00,000
Depreciation	1,50,000	Stock	3,50,000
Selling expenses	1,20,000		
Income tax paid	90,000		
Income-tax penalty	20,000		
Wealth tax paid	10,000		
Custom duty payable against demand notice	30,000		

Provision for unascertained liabilities	20,000		
Provision for ascertained liabilities	50,000		
Proposed dividend	3,00,000		
Loss of subsidiary company	50,000		
Net profit	32,40,000		
	84,00,000		**84,00,000**

You are further informed:

(i) Excise duty for 2010-2011, amounting ₹ 1,20,000 was paid on 15 December 2011.

(ii) Depreciation under Sec. 32 is ₹ 2,20,000.

(iii) During the year 2008-2009, contingency reserve, amounting ₹ 10,00,000, debited to profit and loss a/c, was added back to the extent of ₹ 4,00,000 in the computation of book-profits. The company has transferred the said reserve to the profit and loss a/c during the year.

(iv) Brought forward business loss/depreciation:

PY	Accounting purposes		Tax purposes	
	Loss	Depreciation	Loss	Depreciation
2007-2008	(-) 10,00,000	(-) 1,00,000	(-) 5,00,000	(-) 2,50,000
2008-2009	(-) 2,00,000	(-) 3,00,000	(-) 1,00,000	(-) 2,00,000

Compute the following: (a) Total income, (b) Book-profits and (c) Tax liability.

Solution: **Computation of Total Income for the Assessment Year 2012-2013**

Particulars	₹	₹
Net profit as per Profit & Loss A/c		32,40,000
Add : Expenses debited to P/L A/c – disallowed		
(i) Income tax	90,000	
(ii) Wealth tax	10,000	
(iii) Custom duty payable	30,000	
(iv) Provision for unascertained liability	20,000	
(v) Proposed dividend	3,00,000	
(vi) Loss of subsidiary company	50,000	
(vii) Income-tax penalty	20,000	5,20,000
		37,60,000
Less : Allowable Expenses and wrong credits in P/L A/c		
(i) Withdrawals from contingency reserve	10,00,000	
(ii) Excise duty	1,20,000	
(iii) Depreciation	70,000	
(iv) Brokerage, commission, interest and rent, etc.	50,000	12,40,000
Business profits		**25,20,000**
Add: Income from other sources: Brokerage/ commission, etc.		50,000
Aggregate Income		**25,70,000**
Less: (i) Brought forward losses (Sec. 72)	6,00,000	
(ii) Brought forward depreciation [Sec. 32(2)]	4,50,000	10,50,000
Gross Total Income		**15,20,000**
Less: Profit from industrial undertaking Sec. 80IB: 30% of ₹ 15,20,000 as included in GTI		4,56,000
Total Income		**10,64,000**

(b) Computation of Book Profits for the Assessment Year 2012-2013

Particulars	₹	₹
Net profits as per Profit & Loss A/c		32,40,000
Add : Expenses disallowed		
(i) Income tax	90,000	
(ii) Provision for unascertained liability	20,000	
(iii) Proposed dividend	3,00,000	
(iv) Loss of subsidiary	50,000	4,60,000
		37,00,000
Less : Allowable expenses and wrong credit in P/L A/c		
(i) Withdrawals from contingency reserve	4,00,000	
(ii) Brought forward business loss or depreciation whichever is less		
2007-2008 Depreciation	1,00,000	
2008-2009 Loss	2,00,000	7,00,000
Book-Profits		**30,00,000**

(c) Computation of tax liability for the Assessment Year 2012-2013

Particulars	₹
(a) Tax on Total Income (including Education Cess and SHEC)	
= 30.9% of 10,64,000	3,28,776
(b) Tax on Book Profits (including Education Cess and SHEC)	
= 19.055% on 30,00,000	5,71,650
Tax payable	**5,71,650**

Notes:

(i) No adjustment is required for depreciation debited to profit and loss a/c because it is not on account of revaluation of any asset.

(ii) MAT credit available ₹ (5,71,650 – 3,28,776) = ₹ 2,42,874

Question no. 17(a)

A firm made the following payments of advance tax during the Financial Year 2011-12:

	Figures in ₹ Lakhs
15.09.2011	9.30
15.12.2011	9.0
15.03.2012	14.5
	32.80

The income returned by the firm is ₹ 100 Lakhs under the head "Business" and ₹ 10 Lakhs by way of Long-term Capital Gains on sale of a property effected on 1.3.2012. What is the interest payable by the assessee u/s 234B and 234C of the Income Tax Act for Assessment Year 2012-2013? Assume that the return of income was filed on 31.07.2012 and tax was fully made upon self-assessment.

Solution:

Assessee: Firm **Previous Year : 2011-2012** **Assessment Year : 2012-2013**

(a) Interest u/s 234B = Nil [since more than 90% of Tax Payable has been paid before the end of the previous year]

(b) Interest u/s 234C

Due Date	Advance Tax payable	Advance Tax paid	Cumulative Advance tax paid before due date	Shortfall in payment of advance tax	Surplus	Months	Interest @ 1% pm
	₹	₹	₹	₹	₹		₹
15.09.2011	30% of 30,90,000 =9,27,000	9,30,000	9,30,000	Nil	3,000	3	
15.12.2011	60% of 30,90,000 =18,54,000	9,00,000	18,30,000	24,000	----	3	720
15.03.2012	100% of 32,96,000 = 32,96,000	14,50,000	32,80,000	16,000	----	1	160
Total							880

Note: Tax on LTCG has been considered only for the 3rd instalment as such gain had arisen only on 1.3.2011.

Computation of Actual Tax Payable by the Firm:

Particulars	₹	₹
Profits and Gains of Business or Profession		1,00,00,000
Capital Gains — Long Term Capital Gain		10,00,000
Total Income		1,10,00,000
Tax on Total Income including Surcharge and Cess		
On Long Term Gain of ₹ 10 lakhs @ 20%+ EC @ 2%+ SHEC @ 1%	2,06,000	
On Business Income @ of ₹ 100 lakhs @ 30%+ EC @ 2%+ SHEC @ 1%	30,90,000	
Net Tax Payable	**32,96,000**	

Note : Tax on Business income alone considered for computation of 1st and 2nd instalment.

Question No. 17(b):

A firm made the following payments of advance tax during the previous year 2011-12 :

	₹ in lakh
September 15, 2011	7.00
December 15, 2011	7.75
March 15, 2012	11.80
	26.75

The return of income is filed on 31.7.2012 showing —

Bonus income	₹ 80 lakh
Long term capital gain taxable @ 20% (as on 1.12.2011)	₹ 20 lakh

Short term capital loss arised on 10th November, ₹9 lacs.

Compute interest payable u/s 234C.

Solution: **Computation of tax liability for the A.Y. 2012-13.**

₹ in lakh

Particulars	Business Income	Long term capital gain
Income	80.00	20.00
Less: Set-off of short term capital loss	----	(9.00)
Net Income	**80.00**	**11.00**
Tax rate	30%	20%
Tax liability before surcharge	24.00	2.20
Add: Education Cess & SHEC	0.72	0.067
Tax liability including cess	24.72	2.267

Total Tax Liability = (24.72 + 2.267) lakhs = ₹ 26.987 lakhs.

Computation of interest payable u/s 234C

Due Date	Advance Tax payable	Advance Tax paid	Cumulative Advance tax paid before due date	Shortfall in payment of advance tax	Surplus	Months	Interest @ 1% pm
	₹	₹	₹	₹	₹		₹
15.09.2011	30% of 24,72,000 = 7,41,600	7,00,000	7,00,000	41,600	Nil	3	1,248
15.12.2011	60% of 24,72,000 (+) 60% of 2,26,700 = 16,19,220	7,75,000	14,75,000	2,55,400	Nil	3	7,662
15.03.2012	100% of 26,98,700 = 26,98,700	11,80,000	26,75,000	23,700	Nil	1	237
Total							9,147

Question No. 17(c):

During the previous year 2011-12, Mrs. X (aged 46 years) pays the following instalments of advance tax:

	₹
On September 15, 2011	6,000
On December 15, 2011	22,000
On March 15, 2012	16,000
On March 16, 2012	18,000

Mrs.X files return of ₹ 7,01,000. Assessment is also completed on the basis of income returned by Mrs. X after making addition of ₹ 25,000 (date of assessment order : January 20, 2013). Mrs. X is entitled to tax credit of ₹ 12,510 on account of tax deducted at source. Compute interest under sections 234B and 234C.

Solution:

Interest liability under section 234B

	₹
Income (7,01,000 + 25,000) =	7,26,000
Tax on ₹ 7,26,000	76,200
Less : Tax deducted at source	12,510
Assessed tax	63,690
90% of assessed tax	57,321

Advance tax paid during 2011-12 (i.e., ₹ 6,000 + 14,000 + 16,000 + 18,000) = ₹ 54,000.

Since advance tax during the previous year 2011-12 is less than 90% of assessed tax, Mrs. X is liable to pay interest under section 234B, i.e., on the shortfall of ₹ 9,690 (being ₹ 63,690 – 54,000) for 10 months (₹ 9,690 × 1/100 × 10) which comes to ₹ 969.

Interest liability under section 234C

Tax on ₹ 7,01,000 = ₹ 71,200

Due Date	Advance Tax payable	Advance Tax paid	Cumulative Advance tax paid before due date	Shortfall in payment of advance tax	Surplus	Months	Interest @ 1% pm
	₹	₹	₹	₹	₹	₹	₹
15.09.2011	30% of 71,200 = 21,360	6,000	6,000	15,360	Nil	3	461
15.12.2011	60% of 71,200 =42,720	22,000	28,000	14,720	Nil	3	442
15.03.2012	100% of 71,200 = 71,200	34,000	62,000	9,200	Nil	1	92
Total							995

Question No.18 (a)

Compute the Advance Tax payable by R from the following estimated income submitted for the previous year 2011-12.

		₹
(1)	Income from Salary	3,64,000
(2)	Rent from house property (per annum)	1,80,000
(3)	Interest on Government securities	5,000
(4)	Interest on bank deposits	3,000
(5)	Receipt from horse race (net)	14,000
(6)	Agricultural Income	90,000
(7)	Contribution towards PPF	10,000

Tax deducted at source by the employer on salary is ₹ 9,680.

Solution:

Computation of Estimated Total Income for the Previous Year 2011-12

	₹	₹
Income from Salary :		
Gross salary	3,64,000	
Less : Deduction	Nil	3,64,000
Income from House Property :		
Rent received	1,80,000	
Less : (Statutory deduction u/s 24(a) @ 30%)	54,000	1,26,000
Income from Other Sources :		
Interest on Government securities	5,000	
Interest on Bank Deposit	3,000	
Horse Races (Gross)	20,000	28,000
Estimated Gross Total Income		**5,18,000**
Less : Deduction under section 80C		10,000
Total Income		**5,08,000**

Estimated Tax :

Step-1 : Aggregate of Agricultural income + Non-Agricultural income
(90,000 + 5,08,000) = 5,98,000

Tax on : Income from Horse Race of ₹ 20,000 @ 30%	6,000
Balance income of ₹ 5,78,000	47,600
	53,600

Step-2 : Aggregate of Basic exemption limit of agricultural income
(1,80,000 + 90,000) = 2,70,000

Tax on ₹ 2,70,000	9,000

Step-3 : Tax on non-agricultural income

Tax under step-1 - Tax under step-2 (53,600 – 9,000) = 44,900

Estimated tax payable	**44,900**

Add : Education cess @ 2%		898
Add : SHEC @ 1%		449
		46,247
Less : Estimated TDS		
on salary	9,680	
on horse races	6,000	15,680
Advance tax payable (rounded off)		**30,567**
First installment payable by 15.9.2011 (30%)		9,170
Second installment payable by 15.12.2011 (30%)		9,170
Third installment payable by 15.3.2012 (balance 40%)		12,227

Working notes :

Computation of gross winnings from horse races :	₹
Net Amount	14,000
Grossing up	20,000
Tax deducted at source (Gross amount ₹ 20,000 – Amount received ₹ 14,000)	6,000

Question No.18 (b)

X Ltd. estimates its income for the previous year 2010-11 at ₹ 1,20,000. Besides this income, it has also earned long-term capital gain of ₹ 80,000 on transfer of gold on 1.12.2011. Compute the advance tax payable by the company in various instalments.

Solution:

	₹
Tax on ₹ 1,20,000 @ 30%	36,000
LTCG of ₹ 80,000 @ 20%	16,000
	52,000
Add : Education cess @ 2%	1,040
SHEC @ 1%	520
	53,560

Amount payable on 1st and 2nd instalment. For the first two instalments tax on LTCG will not be taken into account as this accrued on 1.12.2011 *i.e.* after the due date of the first 2 instalments.

₹

Tax including Education Cess and SHEC payable without Long-term Capital Gain (₹ 36,000 + 720 +360) =₹37,080

Advance Tax Payable

Due Date	Tax Liability as on due date	Amount of Instalment Payable (₹)
15.6.2011	15% of 37,080 = 5,562	₹ 5,562
15.9.2011	45% of 37,080 = 16,680	= 16,680 – 5,560 = 11,118
15.12.2011	75% of 53,560 = 40,170	= 40,170 – 5,562 – 11,118 = 23,490
15.3.2012	100% of 53,560 = 53,560	= 53,560 – 5,562 – 11,118 – 23,490 = 13,390

Question No.18(c):

Find out the amount of advance tax payable by ABC Ltd. on specified dates for the previous year 2011-12 :

Business income	₹ 1,75,000
Long term capital gain on 31-7-2011	₹ 3,50,000
Bank interest	₹ 10,000
TDS on business income	₹ 19,995

Solution :

Computation of Total Income of ABC Ltd. for the previous Year 2010-11

Particulars	Amount ₹
Profits and gains of business or profession	1,75,000
Capital gains: Long term capital gains	3,50,000
Income from other sources: Bank Interest	10,000
Total Income	**5,35,000**

Computation of tax liability of ABC Ltd. for the previous year 2011-12

Particulars	Long term capital gain ₹	Other income ₹
Income	3,50,000	1,85,000
Tax rate	20%	30%
Tax on above	70,000	55,500
Add : Education cess & SHEC	2,100	1,665
Tax and cess payable	72,100	57,165
Less : TDS	—	19,995
Advance tax payable	72,100	37,170

Advance tax to be paid on specified dates

	Advance tax on LTCG		Advance tax on income other than LTCG		
Date	Workings	Amount (a) ₹	Workings	Amount (b) ₹	Total (a+b) ₹
15.06.2011	As LTCG occurred on 31.7.11	Nil	15% of ₹ 37,170	5,576	5,576
15.09.2011	45% of ₹ 72,100	32,445	30% of ₹ 37,170	11,151	43,596
15.12.2011	30% of ₹ 72,100	21,630	30% of ₹ 37,170	11,151	32,781
15.03.2012	25% of ₹ 72,100	18,025	25% of ₹ 37,170	9,292	27,317
Total		**72,100**		**37,170**	**1,09,270**

Question No. 19(a)

R a resident Indian, has derived the following income for the previous year relevant to the assessment year 2012-2013.

	Particulars	₹
(1)	Income from profession	4,00,000
(2)	Share income from a partnership in country X (tax paid in country Y for this income in equivalent Indian rupees ₹ 25,000)	2,00,000
(3)	Commission income from a concern in country Y (tax paid in country Y at 20%) converted in Indian rupee.	40,000
(4)	Interest from schedule banks.	20,000

R wishes to know whether he is eligible to any double taxation relief, if so, its quantum. India does not have any Double Taxation Avoidance Agreement with countries X and Y.

Solution: (a) Computation of Total Income

	Particulars	₹	₹
(a)	Income from business:		
	(i) Income from profession	4,00,000	
	(ii) Share income in partnership firm in country X	2,00,000	6,00,000
(b)	Income from other sources:		
	(i) Interest from schedule bank	20,000	
	(ii) Commission earned in country Y, assumed from other sources	40,000	60,000
Total Income			**6,60,000**
(b)	Computation of tax liability :		
	Tax on total income of ₹ 6,60,000		64,000
	Add : Education cess @ 2%		1,280
	Add : SHEC @		640
			65,920
	Less : Double taxation relief : (2,00,000 + 40,000) = 2,40,000 × 9.99%		23,976
Tax payable			41,944
Tax payable to be rounded off to the nearest multiple of ₹ 10 (Sec. 288B)			41,940

Note: (i) Average rate of tax in the foreign country 20%.

(ii) Average rate of tax in India: [₹65,920 x100/6,60,000] =9.99%

Whichever is less, is applicable

Question No. 19(b)

SIPRA Constructions Ltd. is engaged in the construction of residential flats. For the valuation date 31.3.2012, furnishes the following data and requests you to compute the taxable wealth:

(a) Land in urban area (construction is not permitted as per Municipal laws in force) ₹ 50 lakhs
(b) Motor-cars (in the use of company) ₹10lakhs
(c) Jewellery (Investment) ₹10 lakhs
(d) Cash balance (As per books) ₹ 3 lakhs
(e) Bank Balance (As per books) ₹ 6 lakhs
(f) Guest House (Situated in rural area) ₹ 8 lakhs
(g) Residential flat occupied by Managing Director (Annual remuneration of whom is ₹8 Lakhs excluding perquisites) ₹ 10 lakhs
(h) Residential house let-out for 100 days in the financial year ₹ 5 lakhs
(i) Loan obtained for:

- Purchase of Motor Car ₹ 3 lakhs
- Purchase of Jewellery ₹ 2 lakhs

Solution:

Assessee: SIPRA Constructions Ltd. Valuation Date: 31.3.2012 Assessment Year: 2012-13

Nature of Asset	Amount taxable (₹ Lakhs)	Reasons
Land in Urban Area	NIL	Land in which construction is not permitted as per municipal laws is not an asset u/s 2(ea)
Motor-cars	10	Motor-car other than those used in the business of hire or held as stock-in-trade is an asset u/s 2(ea)
Jewellery	10	Not held as stock-in-trade - asset u/s 2(ea)
Cash Balance	NIL	Cash as per books - not an asset u/s 2(ea)
Bank Balance	NIL	Not an asset u/s 2(ea)
Guest House	8	Asset u/s 2(ea)
Residential Flat Occupied by MD	10	Asset u/s 2(ea)-since Gross Annual Salary of Managing Director is greater than ₹ 5 Lakhs
Let-out Residential House Property	5	Asset u/s 2(ea) – since not let-out for a period exceeding 300 days
TOTAL ASSETS	**43**	
Less: Debt incurred in relation to Assets		
1. Purchase of Motor-car	(3)	
2. Purchase of Jewellery	(2)	
NET WEALTH	**38**	
Less: Basic Exemption	30	
Taxable Net Wealth	**8**	
Tax Payable @ 1%	8,000	

Question No.19 (c)

Abhishek, a person of Indian origin was working in Austria since 1991. He returned to India for permanent settlement in May 2011 when he remitted money into India. For the valuation date 31.3.2012, the following particulars were furnished. You are required to compute the taxable wealth. The reason for inclusion or exclusion should be stated –

- Building owned and let-out for 270 days for residence. Net maintainable rent (₹1,00,000) and the Market Value (Excess of Unbuilt Area over Specified Area is 20% of the Aggregate Area) ₹ 30 lakhs
- Jewellery **:** (a) Purchased in April 2011 out of money remitted to India from Austria ₹ 12,00,000

  (b) Purchased in May 2011 out of sale proceeds of motor-car brought from abroad and sold for ₹ 40 lakhs.

- Value of interest in urban land held by a firm in which he is a partner ₹10 lakhs
- Bonds held in companies ₹10 lakhs
- Motor car used for own business ₹ 25 lakhs
- Vacant house plot of 480 sq. mts. (purchased in December 2003) market value of ₹ 20,00,000
- Cash in hand ₹ 45,000
- Urban land purchased in the year 2008 out of withdrawals of NRE Account ₹ 15,00,000

Solution :

Assessee : Abhishek Valuation Date : 31.3.2012 Assessment Year : 2012-13

Computation of Net Wealth

Nature of the Asset	₹	₹	Reasons
Value of the House		**18,50,000**	Asset u/s 2(ea). Working Note 1
Jewellery: Purchased in April 2011	12,00,000		Asset u/s 2(ea).
Less: Exempt u/s 5(v) Jewellery	(12,00,000)	**Nil**	Purchased out of money brought into India
Jewellery: Purchased in May 2011	40,00,000		Asset u/s 2(ea).
Less: Exempt u/s 5(v)	(40,00,000)	**Nil**	Purchased out of sale proceeds of assets brought into India
Interest in Urban Land held by firm		**10,00,000**	Deemed Asset u/s 4(1)(b)
Bonds held in companies	—	**Nil**	Not an asset u/s 2(ea)
Motor car		**25,00,000**	Asset u/s 2(ea). Not held as stock-in-trade
Vacant House Plot (480 sq. mts.)	20,00,000		Asset u/s 2 (ea)
Less: Exempt u/s 5(vi)	(20,00,000)	**Nil**	House/part of house/plot less than 500 sq.mts.
Cash in hand		**Nil**	Since not exceeding ₹50,000
Urban Land Purchased	15,00,000		Purchased out of money
Less: Exempt u/s 5(v)	(15,00,000)	**Nil**	brought into India
NET WEALTH		**53,50,000**	
Less : Basic Exemption		**30,00,000**	
Net Taxable Wealth		**23,50,000**	
Tax Payable @ 1%		**23,500**	

(1) Working Notes: Valuation of Building:

Net Maintainable Rent(NMR)	= ₹1,00,000
Capitalized Value of NMR=NMR×12.5 (Owner of the land) = ₹ 1,00,000 × 12.5	= ₹12,50,000
Add : Premium for excess of unbuilt area (20%) over specified area = 40% of CNMR	= ₹ 5,00,000
VALUE OF THE HOUSE	**₹18,50,000**

Question No. 19(d)

From the following dated furnished by Mr. Soumitra, determine the value of house property built on leasehold land as at the valuation date 31.3.2012:

Particulars	₹
Annual Value as per Municipal valuation	1,40,000
Rent received from tenant (Property vacant for 3 months during the year)	1,08,000
Municipal tax paid by tenant	10,000
Repairs on property borne by tenant	8,000
Refundable deposit collected from tenant as security deposit which does not carry any interest	50,000

The difference between unbuilt area and specified area over aggregate area is 10.5%.

Solution:

Assessee: Mr. Soumitra Valuation Date: 31.3.2011 Assessment Year: 2012-13

Computation of Value of House Property

Step I: Computation of Gross Maintainable Rent(GMR)

Particulars	₹	₹
Actual Annual Rent- ₹ 1,08,000 x 12 Months/9 Months		1,44,000
Add: Municipal tax paid by the Tenant10,000		
I/9th of Actual Rent Receivable as repair expenses are borne by the tenant - ₹ 1,44,000/9	16,000	
Interest on Refundable Security Deposit- ₹ 50,000 x 15% x 9/12	6,000	32,000
GROSS MAINTAINABLE RENT (GMR)	**1,76,000**	

Step II: Computation of Net Maintainable Rent (NMR)

Particulars	₹	₹
Gross Maintainable Rent (GMR)		1,76,000
Less: Municipal Taxes levied by the local authority	10,000	
15% of Gross Maintainable Rent - ₹1,76,000 x 15%	26,400	(36,400)
NET MAINTAINABLE RENT (NMR)		**1,39,600**

Step III: Capitalisation of the Net Maintainable Rent (CNMR) (Assumed that unexpired lease period is more than 50 Years)

NMR × Multiple Factor for an Unexpired Lease Period - ₹ 1,39,600 × 10 = ₹ 13,96,000

Step IV: Addition of Premium to SNMR in case of excess inbuilt area:

Particulars	₹
Add: Capitalisation of the Net Maintainable Asset	13,96,000
Premium for excess of 10.5% unbuilt area over specified area-30% of CNMR	4,18,800
Value of House Property as per Wealth Tax Act	**18,14,800**

Question No.19 (e)

Property Company Ltd. has let-out a premise with effect from 1.10.2011 on monthly rent of ₹ 1.5 lakh. The lease is valid for 10 years and the tenant has made a deposit equivalent to 3 months rent. The tenant has undertaken to pay the municipal taxes of the premises amounting to ₹ 2 lakhs. What will be the value of the property under Schedule III of the Wealth Tax Act for assessment to wealth tax?

Solution :

Assessee: Property Company Ltd. Valuation Date: 31.3.2012 Assessment Year : 2012-13

Computation of Value of Let-out Property

Actual Annual Rent Receivable - ₹ 1,50,000 × 12 Months	18,00,000
Add: Municipal Taxes borne by the Tenant	2,00,000
GROSS MAINTAINABLE RENT	20,00,000
Less: Municipal Taxes levied by the Municipal Authority	2,00,000
Less: 15% of Gross Maintainable Rent (₹ 20,00,000 × 15%)	3,00,000
NET MAINTAINABLE RENT	15,00,000

Value of the Property = Capitalized Value of NMR

NMR × 8 (unexpired period of lease is less than 50 years) = ₹ 15,00,000×8 = ₹ **1,20,00,000**

Question No.19(f)

Net wealth of firm consisting of three partners Bidyut, Kingshuk and Deepak in 2:2:1 and a capital contribution of ₹ 17 Lakhs, ₹13 Lakhs, and ₹12 Lakhs respectively is as under -

(a)	Value of assets located outside India	₹ 30,00,000
(b)	Value of assets located in India	₹ 80,00,000
(c)	Debts incurred in relation to assets in India	₹ 40,00,000

Determine the value of interest of the partners in the firm under the Wealth Tax Act, 1957.

Solution :

Assesses: Bidyut, Kingshuk & Deepak Valuation Date: 31.3.2012
Assessment Year: 2012-13

Computation of net wealth of the Firm

Particulars	₹	₹
Value of Assets located in India	80,00,000	
Less: Liability in relation to assets in India	40,00,000	40,00,000
Value of Assets located outside India		30,00,000
Net Wealth of the Firm		**70,00,000**

Solution :

Computation of Interest of the Partner in the net wealth of the Firm (Amount in ₹)

Particulars	**Bidyut**	**Kingshuk**	**Deepak**
To the extent of Capital Contribution	17,00,000	13,00,000	12,00,000
Balance (Net Wealth-Capital Contribution) in Profit sharing ratio since dissolution ratio is not given	11,20,000	11,20,000	5,60,000
Interest of the Partner in the Net Wealth of the Firm	**28,20,000**	**24,20,000**	**17,60,000**

Computation of the Interest of the Partner in the net wealth of the Firm on the basis of location of assets:
(Interest of the Partner in the Firm **apportioned** in the ratio of **4:3)**

Particulars	Balu	Kausik	Deepu
Assets Located Inside India	16,11,429	13,82,857	10,05,714
Assets Located Outside India	12,08,571	10,37,143	7,54,286
Interest of the Partner in the Net Wealth of the Firm	28,20,000	24,20,000	17,60,000

Question No.20 (a)

A company has started a new industrial undertaking in an old building purchased by it for ₹30,00,000 and has installed both new and second hand machinery from time to time to cope with the increase in production. The details of the machinery installed (old and new) are furnished below. It wants to know whether it is eligible to any deduction u/s 80IB, if so, for how many years?

Machinery	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011
		Additions	Additions	Additions	Additions
New	2,50,000	2,50,000	2,00,000	2,50,000	1,00,000
Second hand	1,50,000	Nil	Nil	Nil	1,50,000

Answer: For claiming deduction u/s 80IB, one of the conditions is that second hand machinery used should not exceed 20% of total value of machinery and plant used in the business [Explanation 2 to Sec.80IB(2)(iii)].

Financial Years	New Machinery (Rs)	Old Machinery (₹)	Total value (₹)	% of old in Total (₹)
2006-07	2,50,000	1,50,000	4,00,000	1,50,000/4,00,000 x 100 = 37.5%
2007-08	5,00,000	1,50,000	6,50,000	1,50,000/6,50,000 x 100 =23.1%
2008-09	7,00,000	1,50,000	8,50,000	1,50,000 / 8,50,000 x 100 = 17.6%
2009-10	9,50,000	1,50,000	11,00,000	1,50,000/11,00,000 x 100 = 13.6%
2010-11	10,50,000	3,00,000	13,50,000	3,00,000/13,50,000 x 100 = 22.2%

From the above analysis, it is revealed that cost of second hand machinery used in business has exceeded the limit of 20% in the financial years 2006-07,2007-08 and 2010-11. Hence, deductions shall be allowed only for the previous years 2008-09 and 2009-10.

Question No.20 (b)

Entertainment Arts of Mumbai engaged in distribution of cinematography films. It started construction of multiplex theatre and convention hall in Navi Mumbai in May 2002 and completed in January 2005. The profits for the year ended 31.3.2012 of all activities are:

(i) Distribution of cinematography films ₹10 lakhs

(ii) Convention theatre ₹12 lakhs

(iii) Multiplex theatre ₹5 lakhs

Compute taxable income for the assessment year 2012-13 with reasons.

Answer:

Assessee: Entertainment Arts **Previous Year : 2011-2012** **Assessment Year: 2012-2013**

Computation of Total Income

Particulars	**Amount (₹)**	**Amount (₹)**
Profits and gains from business or profession	10,00,000	
Convention centre at Navi Mumbai	12,00,000	
Multiplex theatre at Navi Mumbai	5,00,000	27,00,000
Gross Total Income		27,00,000
Less: Deduction under chapter VI-A		
80-IB(7B) – Convention Centre – 50% of ₹12,00,000		6,00,000
Total Income		**21,00,000**

Note: Though the multiplex was constructed between 1.4.2002 to 31.3.2005, deduction u/s 80-IB will not be available to a Multiplex Theatre located at a place within the municipal jurisdiction of Metros (whether known as a Municipality, Municipal Corporation, Notified Area Committee or a Cantonment Board or by any other name), i.e. Kolkata, Chennai, Delhi or Mumbai.

It may be noted that there is no space/ area restriction for a Convention Centre.

Question No.20(c)

Define "Manufacture" in the context of Sec. 80-IB.

Answer: With retrospective effect from Assessment Year 2009-10, "Manufacture" means change in non-living physical object/article/thing :-

- Resulting in a transformation of the object or article or thing into a new and distinct object or article or thing, having a different name, character and use, or
- Bringing into existence a new and distinct object or article or thing, with different chemical composition or integral structure.

According to Sec.80-IB, the Assessee company must be engaged in the business of manufacture or production of any article or thing [Hotel & Allied Trade Pvt. Ltd 245 ITR 538, Indian Hotels Co. Ltd and others 245 ITR 538 (SC)]

Question No. 20(d)

In Uttaranchal, an undertaking commenced business of manufacturing an article(other than those specified in Schedule III) and had undergone substantial expansion during the specified period. The commercial production had started on 15th April, 2003 and during the current previous year 2011-12, made a profit of ₹5 lakhs. Discuss exemption available, if any.

Answer: The assessee is eligible to claim an exemption u/s 80-IC, based on the location of its establishment. In the given case, the undertaking is located in Uttaranchal and the commencement is on or after 7th January, 2003 (specified date) and between 1st April,2012 (last date). Deduction is available @ 100% for the first 5 years and for the next 5 years @ 30% for companies and @25% for othe₹

Since this undertaking is presently in 9th year of its operations, it would be eligible to claim 30% (assuming this undertaking to be a company) on the profits earned u/s 80-IC.

Computation:

Profit as per profit & loss account	₹5,00,000
Less: Deduction u/s 80-IC @ 30% of ₹5,00,000	₹1,50,000
Total Income	**₹3,50,000**

Question No. 20(e)

Happy Times Entertainment Ltd. is also engaged in the business of hotel, one of which is located in a specified district having a World Heritage Site. Discuss taxability of profits.

Answer: U/s 80-ID, a undertaking engaged in the business of hotels located in specified district having a world heritage site (w.e.f. assessment year 2009-10), would be eligible for deduction @100% of profits for the first 5 years, provided, the date of commencement is on or after 1st April, 2008 but upto 31st March,2013.

Hotel means a hotel of two-star, three-star or four-star category as classified by the Central Government. Specified area means the National Capital Territory of Delhi and the districts of Faridabad, Gurgaon, Gautam Budh Nagar and Ghaziabad.

Question No. 20(f)

Discuss the provisions relating to deduction u/s 80-IE, for undertakings located in North-Eastern States.

Answer: U/s 80-IE, any undertaking which commences its operation during the period beginning on 1st April, 2007 and ending before 1st April,2017 in any of the North-Eastern States to:

(i) Manufacture or produce any eligible article or thing;

(ii) Undertake substantial expansion to manufacture or produce any eligible article or thing;

(iii) Carry on any eligible business.

Deduction is available @ 100% of the profits and gains derived from the business from 10 consecutive assessment years commencing from the previous years of manufacture, production or substantial expansion.

Question No.20 (g)

A foreign enterprise enters into a contract for the fabrication and supply of components for machinery with X & Co., a firm in India. X & Co. in turn subcontracts the work to Y & Co (a Partnership firm) and pays it ₹23 lakhs during the previous year 2011-12. Discuss the liability for tax deduction at source.

Answer: U/s 194C, payments to contractors (including sub-contractors) for contracts shall be subject to TDS @ 1% if the payee is a resident individual/HUF and 2% in case of other resident payees.

Since the payment is made to a firm, ₹23 lakhs shall be subject to TDS @ 2% i.e. ₹46,000

Therefore, X & Co. should deduct ₹46,000 from the amount payable to Y & Co and pay the balance of ₹22,54,000. Further, the foreign enterprise is also liable to deduct TDS on its payment to main contractor @ 2%.

Question No. 20(h)

X Ltd. has taken a 5,000 sq.ft. flat on rent from B Ltd to set up its Branch office. The rent payable to B Ltd for the flat is ₹ 90,000 per month plus applicable service tax. X Ltd. wishes to know whether tax is required to be deducted at source u/s 194-I, from gross amount of rent including service tax. Advice.

Answer:

Service tax paid by tenant is not in the nature of "income' for the landlord. Hence, TDS u/s 194-I would be required to be made on the amount of rent paid/payable without including service tax. [Circular No.4/2008 dated 28.4.2008]

Since the amount of rent payable exceeds ₹ 1,80,000, TDS is to be deducted @ 10% during the previous year 2011-12 is as follows:

= ₹ 90,000 x 12 months x 10% = ₹ 1,08,000.