



**COST AUDIT – LEGAL ASPECTS (COMPANIES ACT, 2013)**



**Cost Audit**

**Section 148 of Companies Act, 2013**

- The conduct of Cost Audit is mandatory, if such an order is made by the Central Government.
- It is applicable to such class of companies for which Central Government has made an order for maintenance of Cost records; and
  - Which have –
    - Net worth of such amount as may be prescribed
    - Turnover of such amount as may be prescribed.
- Cost audit shall be conducted in the manner specified in the order made by the Central Government.

**Appointment of Cost Auditor by Board**

- Cost audit shall be conducted by a Cost Accountant in practice.
- Only a Cost Accountant in practice or a firm of Cost Accountants in practice can be appointed as a cost auditor
- The Cost Auditor shall be appointed by the Board
- The cost audit shall be in addition to the audit conducted under section 143.
- The auditor appointed under section 139 shall not be appointed as Cost Auditor



- 
- The remuneration of the Cost Auditor shall be determined by the members in such manner as may be prescribed.
  - The company shall give all assistance and facilities to the cost auditor as may be required.

### **Powers of Cost Auditor**

Section 148(5) of the Companies Act, 2013 gives the cost auditor same qualifications, disqualifications, rights, duties and obligations as the financial auditor has under Section 141 and 143.

- The auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place
- The auditor shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor
- The auditor shall make a report to the Board of Directors of the company on the cost accounts examined by him and on every financial statement which are required by or under this Act.
- Where any of the matters required to be included in the cost audit report is answered in the negative or with a qualification, the report shall state the reasons there for.
- Where a company has a branch office, the accounts of that office shall also be audited.
- Every auditor shall comply with the cost auditing standards.

### **Duties of Cost Auditor**

The auditor's report shall state—

- Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the cost statements;
- whether, in his opinion, proper books of cost account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
- whether the report on the cost accounts of any branch office of the company audited by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
- whether the company has complied with Cost accounting standards.
- any qualification, reservation or adverse remark relating to the maintenance of cost accounts and other matters connected therewith;



- whether the company has adequate internal cost controls system in place and the operating effectiveness of such controls;
- such other matters as may be prescribed.

#### **Qualifications of a Cost Auditor**

As per section 2(28) of Companies Act, 2013 "cost accountant" means a cost accountant as defined in the Cost and Works Accountants Act, 1959.

- A person shall be eligible for appointment as a cost auditor of a company only if he is a cost accountant.
- Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are cost accountants shall be authorised to act and sign on behalf of the firm.

#### **Disqualifications of a Cost Auditor**

The following persons shall not be eligible for appointment as a cost auditor of a company, namely:—

- (i) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
- (ii) an officer or employee of the company;
- (iii) a person who is a partner, or who is in the employment, of an officer or employee of the company;
- (iv) a person who, or his relative or partner—
  - is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company: Provided that the relative may hold security or interest in the company of face value not exceeding one lakh rupees or such sum as may be prescribed;
  - is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed (the sum prescribed is ₹5,00,000); or
  - has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed (the sum prescribed is ₹1,00,000);
- (v) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;
- (vi) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;



- (vii) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;
- (viii) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
- (ix) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as provided in section 144.

### Remuneration of a Cost Auditor

→ Where a company is **required** to constitute an audit committee

- The Board shall appoint the cost auditor on the recommendations of the Audit Committee
- The Audit Committee shall recommend the remuneration of the cost auditor.
- The remuneration of the cost auditor shall be considered and approved by the Board and ratified subsequently by the members.

→ Where a company is **not required** to constitute an audit committee

- The Board shall appoint the cost auditor
- The remuneration of the cost auditor shall be fixed by the Board and ratified subsequently by the members.

### Cost Audit Report

- The cost auditor shall submit his report to the Board of Directors
- Within 30 days of receipt of cost audit report, the company shall furnish to the Central Government-
  1. A copy of the cost audit report;
  2. Along with full information and explanation on every reservation or qualification contained in the cost audit report
- The Central Government may call for such further information and explanation as it may deem fit.
- The company shall furnish such further information and explanation within such time as may be specified by the Central Government.

### Punishment for contravention

Sec 148(8) of Companies Act, 2013 states that if any default is made in complying with the provisions of this section,—

- a. the company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;



b. the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

→ **Punishment for COMPANY**

- Minimum Fine** - ₹ 25,000
- Maximum Fine** - ₹ 5,00,000

→ **Punishment for EVERY OFFICER IN DEFAULT**

- Maximum Imprisonment** – 1 year
- Minimum Fine** - ₹ 10,000
- Maximum Fine** - ₹ 1,00,000

→ **Punishment for COST AUDITOR**

- Minimum Fine** - ₹ 25,000
- Maximum Fine** - ₹ 5,00,000

If a contravention is committed knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, then punishment shall be –

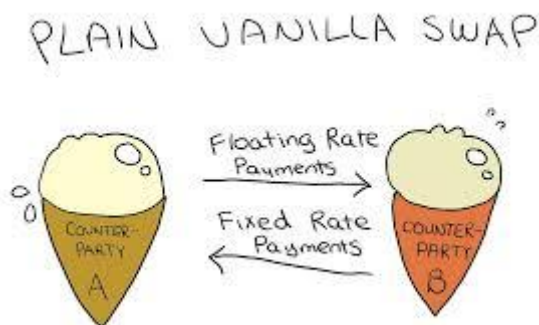
- Maximum Imprisonment** – 1 year
- Minimum Fine** - ₹ 1,00,000
- Maximum Fine** - ₹ 25,00,000

**Consequences of conviction of auditor for contravention**

- **Refund of Remuneration** – The auditor shall be liable to refund the company the remuneration received by him.
- **Payment of damages by the auditor** – The auditor shall be liable to pay damages to the company, statutory bodies or authorities, any other person for loss arising out of incorrect or misleading statements of particulars made in his cost audit report.

## INTEREST RATE SWAPS

An interest rate 'swap' is a contract which involves two counter parties to exchange over an agreed period, two streams of interest payments, each based on a different kind of interest rate, for a particular notional amount.



Interest rate swaps are generally used for swapping from a floating rate of interest into a fixed rate of interest, or vice-versa. Interest rate swaps are used to hedge interest rate risks as well as to take on interest rate risks. The most commonly traded and most liquid interest rate swaps are known as 'vanilla' swaps. Each participant in a vanilla swap transaction is known by its relation to the fixed rate stream of payments. The party that elects to receive a fixed rate and pay floating is the 'receiver' and the party that receives floating in exchange for fixed is the 'payer'. Both the receiver and the payer are known as 'counterparties' in the swap transaction.

Since there are no movements of principal, these are off balance sheet instruments and the capital requirements on these instruments are minimal.

Features can be briefed as follows:

- The principal amount is only notional.
- Opposing payments through the swap are normally netted.
- The frequency of payment reflects the tenor of the floating rate index.

The most important reference rate in swap and other financial transaction is the London Inter-bank Offered Rate (LIBOR).

Basic Characteristics of an Interest Rate Swaps

- Contractual agreement
- Exchange a series of cash flows
- Only net cash flows exchanged
- Over a period of time
- Not in itself either a borrowing or lending



- The size of the swap is referred to as the notional amount and is the basis for calculation
- Actual principal of the swap NOT exchanged
- It is an off-balance sheet transaction.

#### **Interest Rate Swap – Advantages**

- Asset-Liability mismatch correction
- Opens up diverse avenues of funding
- Hedging Floating Rate Risks
- Taking advantage of low floating rate borrowings
- Low Credit Risk
- Decouple funding & duration decisions
- Can be customized-flexibility in the management of interest rates
- Smoothing out Interest Rate Fluctuations



#### **Mechanism of Interest Rate Swap –without any bank as an intermediary**

**Example:** X and Y companies can borrow for a five-year term at the following rates:

	<b>Company X</b>	<b>Company Y</b>
Credit-rating	A	B
Fixed-rate borrowing cost	10.5%	12%
Floating rate borrowing cost	LIBOR	LIBOR +1%

- Calculate the quality spread differential.
- Develop an interest rate swap in which both X and Y have an equal cost savings in their borrowing costs. Assume X desires floating rate debt and Y desires fixed-rate debt. No swap bank is involved in this transaction.

#### **Solution:**

The quality spread differential = (12.0% - 10.5%) minus (LIBOR +1% - LIBOR)= 0.5%.

X needs to issue fixed-rate debt at 10.5% and Y needs to issue floating rate-debt at LIBOR +1%.



X needs to pay LIBOR to Y. Y needs to pay 10.75% to X.

If this is done ,X 's floating rate all in cost is :  $10.5\% + \text{LIBOR} - 10.75\% = \text{LIBOR} - 0.25\%$ . A 0.25% savings over issuing floating-rate debt on its own.

Y's fixed rate all in cost is  $\text{LIBOR} + 1\% + 10.75\% - \text{LIBOR} = 11.75\%$ . A 0.25% savings over issuing fixed rate debt.

**Mechanism of Interest Rate Swap –with bank as an intermediary**

Bank is involved in a swap deal as a financial intermediary who matches the two counter parties.

**Example:** From the following information given below, compute the gain to be shared between Right Ltd. and Wrong Ltd. in the Interest Swap arrangement

Company	Banker	Fixed rate	Floating rate
Right Ltd	Premier Bank	10%	MIBOR-1%
Wrong Ltd	Silver Finance	13%	MIBOR +1%

Middleman banks is the financial intermediary for a commission of 5 basis points. Net gain shared in the ratio of 3:2 between Right Ltd. and Wrong Ltd.

**Solution:**

**Computation of gain to be shared**

Particulars	Value
Fixed rate for wrong ltd	13.00%
Less: Fixed rate for right Ltd	10.00%
Spread in fixed rate [A]	3.00%
Floating rate for wrong Ltd.	MIBOR +1%
Floating rate for right ltd	MIBOR-1%
Spread in Floating rate [B]	2.00%
Gain [A-B]	1.00%
Less: Commission to Middleman Ltd	(0.05%)
Net Gain	0.95%
Share of Right Ltd [0.95% x 3/5]	0.57%
Share of Wrong Ltd [0.95% x 2/5]	0.38%

**Example:** Company A has outstanding debt on which it currently pays fixed rate of interest at 9.5%. The company intends to refinance the debt with a floating rate interest. The best floating rate it can obtain is LIBOR +2%. However, it does not want to pay more than LIBOR. Another Company B is looking for a loan at a fixed rate of interest to finance its exports. The best rate it can obtain 13.5%, but it cannot afford to pay more than 12%. However one bank has agreed to offer finance at a floating rate of LIBOR +2%. Citibank is in the process of arranging an interest rate swap between these two companies.

- Show how the swap deal can be structured.
- What are the interest savings by each company?
- How much would Citibank receive?





**Solution:**

First let us tabulate the details to find the quality spread differential:

		Cost of Funds to Company A and B	
	Objective	Fixed rate	Floating rate
Company A	Floating	9.50% p.a.	LIBOR +200bp
Company B	Fixed	13.50% p.a.	LIBOR +200bp
Differential		400bps	0bps

The differential between the two markets = 400 bps – 0 = 400 bps. A total of 400 bps needs to be shared between A, B and Citibank. Since A cannot afford to pay more than LIBOR, it needs 200 bps benefits out of the total 400 bps (LIBOR +2% - LIBOR). Similarly B cannot pay more than 12% as against the existing available fixed rate funding of 13.5%, it requires 150 bps benefits out of 400 bps. The balance 50 bps would be shared/charged by the Citibank. The swap can therefore be structured as follows:

Firm	Paid to Bank	Received from Bank	Paid to market	Net Cost	Savings
A	LIBOR	9.5%	9.5%	LIBOR	(LIBOR + 2%) - (LIBOR) = 200bps
B	10%	LIBOR	LIBOR +200bps	12%	(13.5-12.0) = 150bps

Company A gets floating rate funds at LIBOR as against LIBOR + 2%, thereby getting an advantage of 200 bps, Company B gets fixed rate funds at 12% as against 13.5%, thereby getting an advantage of 150bps and finally Citibank gets 50 bps commission.





### TARGET COSTING

**Target costing** is a pricing method used by firms. It is defined as "a cost management tool for reducing the overall cost of a product over its entire life-cycle with the help of production, engineering, research and design".

A target cost is the maximum amount of cost that can be incurred on a product and with it the firm can still earn the required profit margin from that product at a particular selling price.

In the traditional cost-plus pricing method, materials, labor and overhead costs are measured and a desired profit is added to determine the selling price.

#### **Advantages:**

- Proactive approach to cost management
- Orients organizations towards customers
- Breaks down barriers between departments
- Implementation enhances employee awareness and empowerment
- Foster partnerships with suppliers
- Minimize non value-added activities
- Encourages selection of lowest value added activities
- Reduced time to market

#### **Disadvantages:**

- Effective implementation and use requires the development of detailed cost data
- Its implementation requires willingness to cooperate
- Requires many meetings for coordination
- Many reduce the quality of products due to the use of cheap components which may be of inferior quality

#### **How to Set a Target Cost**

Traditionally it has been the cost of producing an item that has driven the selling price: the first step was to estimate the production cost and then to decide on a selling price. However, this approach ignored the effect of the selling price on the demand for the product, and also gave no direct incentive to reduce costs. Target costing is a market driven approach used in the design phase and consists of the following steps:

- From research of the market determine a selling price at which the company expects to achieve the desired, the target selling price.
- Decide on the profit required (eg. a required profit margin, or a required return on investment)
- Calculate the maximum cost per unit in order to achieve the required profit: this is the target cost
- Estimate the actual cost of production and compare with the target cost.

**In summary, there are essentially two ways of looking at a target cost:**

Target cost = selling price – desired profit

Selling price = target cost + desired profit

#### **Example:**

A company has the capacity of production of 80,000 units and presently sells 20,000 units at ₹100 each. The demand is sensitive to selling price and it has been observed that with every reduction of ₹10 in selling price the demand is doubled. What should be the target cost at full capacity if profit margin on sale is taken as 25%



Demand	Price (₹)
20,000	100
40,000	90
80,000	80

Target Cost = ₹80 – (25% of 80) = 80 – 20 = ₹60

**The Motivation for Target Costing**

In target costing, the market sets prices, therefore, the anticipated market price is taken as a given in target costing. Once a product has been designed and has gone into production, not much can be done to significantly reduce its cost. This means that most of the opportunities to reduce costs come from designing the product so that it is as simple as possible to make, uses the least inexpensive parts possible yet is still robust and reliable.

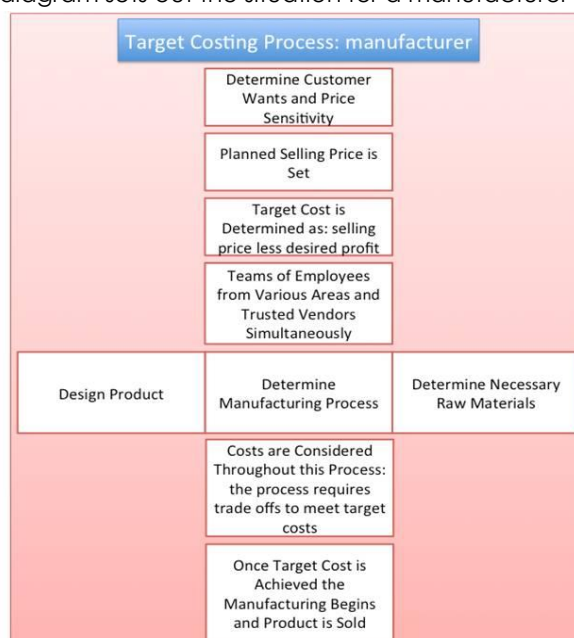
In a target costing driven organization this is where the effort is concentrated: in designing and developing the product. The difference between target costing and other approaches to product development is profound. Instead of designing the product and then finding out how much it costs, the target cost is set first and then the product is designed so that the target cost is attained

Consider the following list as a more comprehensive set of motivations for why we might use target costing:

- Reduction in cost
- Planning & designing high quality products
- Meeting customers' needs
- Using value engineering to target cost
- Attain target cost using standard cost
- Keeping track of external market forces

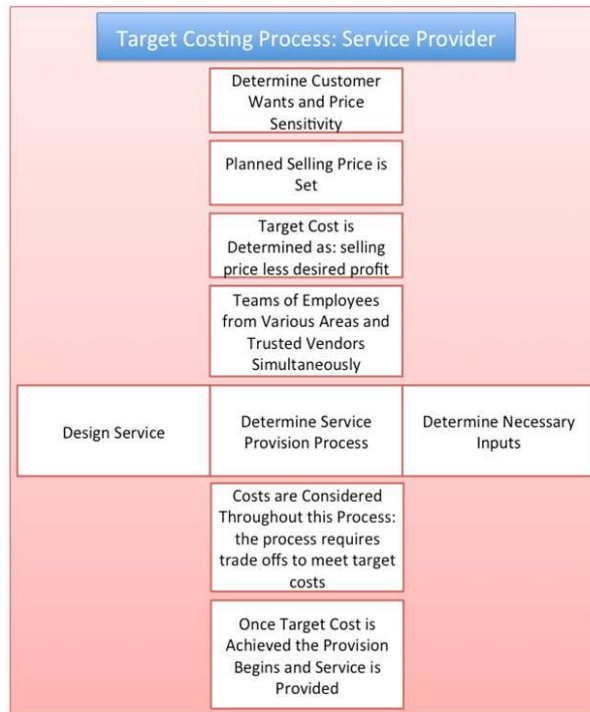
**Target Costing Process**

The following diagram sets out the situation for a manufacturer's approach to target costing.





The following diagram shows how the target costing process might work in the business of a service provider, in outline.



With the help of an example it can be understood more clearly:

**Example:**

Medical Instruments uses a manufacturing costing system with one direct-cost category (direct materials) and three indirect-cost categories:

- a. Setup, production order, and materials-handling costs that vary with the number of batches
- b. Manufacturing operations costs that vary with machine-hours
- c. Costs of engineering changes that vary with the number of engineering changes made

In response to competitive pressures at the end of 2013, Medical Instruments employed value engineering techniques to reduce manufacturing costs. Actual information for 2013 and 2014 are:

	2013	2014
Setup, production-order, and materials-handling cost per batch	₹8,000	₹7,500
Total manufacturing operating cost per machine-hour	55	50
Cost per engineering change	12,000	10,000

The management of Medical Instruments wants to evaluate whether value engineering has succeeded in reducing the target manufacturing cost per unit of one of its products, HJ6, by 10%. Actual results for 2013 and 2014 for HJ6 are

	Actual Result for 2013	Actual Result for 2014
Units of HJ6 produced	3,500	4,000



## CMA Students Newsletter (For Final Students)

Vol.8C: April 30, 2015

Direct material cost per unit of HJ6	₹1,200	₹1,100
Total number of batches required to produce H J6	70	80
Total machine- hours required to produce HJ6	21,000	22,000
Number of engineering changes made	14	10

### Required:

1. Calculate the manufacturing cost per unit of HJ6 in 2013.
2. Calculate the manufacturing cost per unit of HJ6 in 2014.
3. Did Medical Instruments achieve the target manufacturing cost per unit for HJ6 in 2014 Explain?
4. Explain how Medical Instruments reduced the manufacturing cost per unit of HJ6 in 2014.

### Solution:

1. and 2. Manufacturing costs of HJ6 in 2013 and 2014 are as follows:

	2013		2014	
	Total	Per Unit	Total	Per unit
	(1)	(2) = (1) ÷ 3,500	(3)	(4) = (3) ÷ 4,000
Direct materials, ₹1,200 × 3,500; ₹1,100 × 4,000	₹42,00,000	₹1,200	₹44,00,000	₹1,100
Batch – level costs, ₹8,000 × 70; ₹7,500 × 80	5,60,000	160	6,00,000	150
Manufacturing operations costs, ₹55 × 21,000; ₹50 × 22,000	11,55,000	330	11,00,000	275
Engineering change costs, ₹12,000 × 14; ₹10,000 × 10	1,68,000	48	1,00,000	25
Total	₹60,83,000	₹1,738	₹62,00,000	₹1,550

3. Target manufacturing cost per unit of HJ6 in 2014 = Manufacturing costs per unit in 2013 × 90% = ₹ 1,738 × 0.90 = ₹ 1,564.20  
Actual manufacturing cost per unit of HJ6 in 2014 was ₹1,550. Hence, Medical Instruments did achieve its target manufacturing cost per unit of ₹ 1,564.20

To reduce the manufacturing cost per unit in 2014, Medical Instruments reduces the cost per unit of activity in each of the four cost categories—direct materials costs, batch-level costs, manufacturing operations costs, and engineering change costs. It also reduced machine-hours and number of engineering changes made—the quantities of the cost drivers. In 2013, Medical Instruments used 6 machine-hours per unit of HJ6 (21,000 machine-hours ÷ 3,500 units). In 2014, Medical Instruments used 5.5 machine-hours per unit of HJ6 (22,000 machine-hours ÷ 4,000 units). Medical Instruments reduced engineering changes from 14 in 2013 to 10 in 2014. Medical Instruments achieved these gains through value engineering activities that retained only those product features that customers wanted while eliminating activities and their costs.



## **FAQ ON SECTION 194C [PAYMENT TO CONTRACTORS AND SUB-CONTRACTORS]**

### **Question 1: What would be the scope of an advertising contract for purpose of section 194C of the Act?**

**Answer:** The term 'advertising' has not been defined in the Act. During the course of the consideration of the Finance Bill, 1995, the Finance Minister clarified on the floor of the House that the amended provisions of tax deduction at source would apply when a client makes payment to an advertising agency and not when advertising agency makes payment to the media, which includes both print and electronic media. The deduction is required to be made at the rate of 1 per cent. It was further clarified that when an advertising agency makes payments to their models, artists, photographers, etc., the tax shall be deducted at the rate of 5 per cent as applicable to fees for professional and technical services under section 194J of the Act.

### **Question 2: Whether the advertising agency would deduct tax at source out of payments made to the media?**

**Answer:** No. The position has been clarified in the answer to question No. 1 above.

### **Question 3: At what rate is tax to be deducted if the advertising agencies give a consolidated bill including charges for art work and other related jobs as well as payments made by them to media?**

**Answer:** The deduction will have to be made under section 194C at the rate of 1 per cent. The advertising agencies shall have to deduct tax at source at the rate of 5 per cent under section 194J while making payments to artists, actors, models, etc. If payments are made for production of programmes for the purpose of broadcasting and telecasting, these payments will be subjected to TDS @ 2 per cent. Even if the production of such programmes is for the purpose of preparing advertisement material, not for immediate advertising, the payment will be subjected to TDS at the rate of 2 per cent.

### **Question 4: Whether the tax is required to be deducted at source on payments made directly to the print media/Doordarshan for release of advertisements?**

**Answer:** The payments made directly to print and electronic media would be covered under section 194C as these are in the nature of payments for purposes of advertising. Deduction will have to be made at the rate of 1 per cent. It may, however, be clarified that the payments made directly to Doordarshan may not be subjected to TDS as Doordarshan, being a Government agency, is not liable to income-tax.

### **Question 5: Whether a contract for putting up a hoarding would be covered under section 194C or 194-I of the Act?**

**Answer:** The contract for putting up a hoarding is in the nature of advertising contract and provisions of section 194C would be applicable. It may, however, be clarified that if a person has taken a particular space on rent and thereafter sub-lets the same fully or in part for putting up a hoarding, he would be liable to TDS under section 194-I and not 194C of the Act.



**Question 6: Whether payment under a contract for carriage of goods or passengers by any mode of transport would include payment made to a travel agent for purchase of a ticket or payment made to a clearing and forwarding agent for carriage of goods?**

**Answer:** The payments made to a travel agent or an airline for purchase of a ticket for travel would not be subjected to tax deduction at source as the privity of the contract is between the individual passenger and the airline/travel agent, notwithstanding the fact that the payment is made by an entity mentioned in section 194C(1). The provision of section 194C shall, however, apply when a plane or a bus or any other mode of transport is chartered by one of the entities mentioned in section 194C of the Act. As regards payments made to clearing and forwarding agents for carriage of goods, the same shall be subjected to tax deduction at source under section 194C of the Act.

**Question 7: Whether a travel agent/clearing and forwarding agent would be required to deduct tax at source from the sum payable by the agent to an airline or other carrier of goods or passengers?**

**Answer:** The travel agent, issuing tickets on behalf of the airlines for travel of individual passengers, would not be required to deduct tax at source as he acts on behalf of the airlines. The position of clearing and forwarding agents is different. They act as independent contractors. Any payment made to them would, hence, be liable for deduction of tax at source. They would also be liable to deduct tax at source while making payments to a carrier of goods.

**Question 8: Whether section 194C would be attracted in respect of payments made to couriers for carrying documents, letters, etc.?**

**Answer:** The carriage of documents, letters, etc. is in the nature of carriage of goods and, therefore, provisions of section 194C would be attracted in respect of payments made to the Couriers.

**Question 9: In case of payments to transports, can each GR be said to be a separate contract, even though payments for several GRs are made under one bill?**

**Answer:** Normally, each GR can be said to be a separate contract, if the goods are transported at one time. But if the goods are transported continuously in pursuance of a contract for a specific period or quantity, each GR will not be a separate contract and all GRs relating to that period or quantity will be aggregated for the purpose of the TDS.

**Question 10: Whether there is any obligation to deduct tax at source out of payment of freight when the goods are received on "freight to pay" basis?**

**Answer:** Yes. The provisions of tax deduction at source are applicable irrespective of the actual payment.

**Question 11: Whether a contract for catering would include serving food in a restaurant/sale of eatables?**

**Answer:** TDS is not required to be made when payment is made for serving food in a restaurant in the normal course of running of the restaurant/cafe.



**Question 12: Whether payment to a recruitment agency can be covered by section 194C?**

**Answer:** Provisions of section 194C apply to a contract for carrying out any work including supply of labour for carrying out any work. Payments to recruitment agencies are in the nature of payments for services rendered. Accordingly, provisions of section 194C shall not apply. The payment will, however, be subject to TDS under section 194J of the Act.

**Question 13: Whether section 194C would cover payments made by a company to a share registrar?**

**Answer:** In view of answer to the earlier question, such payments will not be liable for tax deduction at source under section 194C. But these will be liable to tax deduction at source under section 194J.

**Question 14: Whether FD commission and brokerage can be covered under section 194C?**

**Answer:** No.

**Question 15: Whether section 194C would apply in respect of supply of printed material as per prescribed specifications?**

**Answer:** Yes.

**Question 16: Whether tax is required to be deducted at source under section 194C or 194J on payment of commission to external parties for procuring orders for the company's product?**

**Answer:** Rendering of services for procurement of orders is not covered under the provisions of section 194C. However, rendering of such services may involve payment of fees for professional or technical services, in which case tax may be deductible under the provisions of section 194J.

**Question 17: Whether advertisement contracts are covered under section 194C only to the extent of payment of commission to the person who arranges release of advertisement, etc. or whether deduction is to be made on the gross amount including bill of media?**

**Answer:** Tax is to be deducted at the rate of 1 per cent of the gross amount of the bill.

**Question 18: Whether deduction of tax is required to be made under section 194C for sponsorship of debates, seminars and other functions held in colleges, schools and associations with a view to earn publicity through display of banners, etc. put up by the organisers?**

**Answer:** The agreement of sponsorship is in essence, an agreement for carrying out a work of advertisement. Therefore, provisions of section 194C shall apply.

**Question 19: Whether deduction of tax is required to be made on payments for cost of advertisements issued in the souvenirs brought out by various organisations?**

**Answer:** Yes.

**Question 20: Whether payments made to a hotel for rooms hired during the year would be of the nature of rent?**





**Answer:** Payments made by persons other than individual and HUFs for hotel accommodation taken on regular basis will be in the nature of rent subject to TDS under section 194-I.

**Question 21: Whether the limit of ₹ 1,80,000 per annum would apply separately for each co-owner of a property?**

**Answer:** Under section 194-I, the tax is deductible from payment by way of rent, if such payment to the payee during the year is likely to be ₹ 1,80,000 or more. If there are a number of payees, each having definite and ascertainable share in the property, the limit of ₹ 1,80,000 will apply to each of the payee/co-owner separately. The payers and payees are, however, advised not to enter into sham agreements to avoid TDS provisions.

**Question 22: Whether the rent paid should be enhanced for notional income in respect of deposit given to the landlord?**

**Answer:** The tax is to be deducted from actual payment and there is no need of computing notional income in respect of a deposit given to the landlord. If the deposit is adjustable against future rent, the deposit is in the nature of advance rent subject to TDS.

**Question 23: Whether payments made by company taking premises on rent but styling the agreement as a business centre agreement would attract the provisions of section 194-I?**

**Answer.** The tax is to be deducted from rent paid, by whatever name called, for hire of a property. The incidence of deduction of tax at source does not depend upon the nomenclature, but on the content of the agreement as mentioned in clause (i) of Explanation to section 194-I.

**Question 24: Whether in a case of composite arrangement for user of premises and provision of manpower for which consideration is paid as a specified percentage of turnover, section 194-I of the Act would be attracted?**

**Answer:** If the composite agreement is in essence the agreement for taking premises on rent, the tax will be deducted under section 194-I from payments thereof.

**Question 25: Whether the receipts prior to 1-7-1995 are to be aggregated to determine limit of ₹ 20,000 for each financial year?**

**Answer.** Clause (B) of proviso to section 194J(1) makes it clear that tax shall be deducted at source if the aggregate sums credited or paid or likely to be credited or paid during the financial year are likely to exceed ₹ 20,000. Therefore, in regard to financial year 1995-96, the limit of ₹ 20,000 will have to be worked out taking into account all the payments from 1-4-1995 to 31-3-1996. But the deduction of tax at source would be made at the specified rate only from the payment made on or after 1-7-1995.

**Question 26: Whether commission received by the advertising agency from the media would require deduction of tax at source under section 194J of the Act?**

**Answer. Yes.**



**Question 27: Whether the services of a regular electrician on contract basis will fall in the ambit of technical services to attract the provisions of section 194J of the Act? In case the services of the electrician is provided by a contractor, whether the provision of section 194C or 194J would be applicable?**

**Answer.** The payments made to an electrician or to a contractor who provides the service of an electrician will be in the nature of payment made in pursuance of a contract for carrying out any work. Accordingly, provisions of section 194C will apply in such cases.

**Question 28: Whether a maintenance contract including supply of spares would be covered under section 194C or 194J of the Act?**

**Answer.** Routine, normal maintenance contracts which include supply of spares will be covered under section 194C. However, where technical services are rendered, the provision of section 194J will apply in regard to tax deduction at source.

**Question 29: Whether the deduction of tax at source under sections 194C and 194J has to be made out of the gross amount of the bill including reimbursements or excluding reimbursement for actual expenses?**

**Answer:** Sections 194C and 194J refer to any sum paid. Obviously, reimbursements cannot be deducted out of the bill amount for the purpose of tax deduction at source.

**Question 30: Whether TDS from income in respect of units is applicable to dividend or is it applicable to capital appreciation distributed at the time of re-purchase/redemption of the units?**

**Answer:** The provisions of section 194K regarding deduction of tax at source from income in respect of units are applicable to periodical distribution of income, which is in the nature of dividend. These provisions do not apply to capital gains arising at the time of re-purchase or redemption of the units.

**Question 31: Whether TDS on reinvestment term deposit should be made on accrual basis, which is quarterly, or once in a financial year?**

**Answer:** Tax has to be deducted at source at the time of credit of interest to the account of the payee or at the time of payment thereof, whichever is earlier. If credit is given to the account of the payee or payment is made to him annually, the tax may be deducted annually. It may be clarified that a credit to interest payable account or suspense account, etc. is also taken as credit to the account of the payee, even though this credit is not reflected separately in the payee's account.

**Question 32: Whether variable deposit schemes are liable to deduction of tax at source from interest?**

**Answer.** Under section 194A, tax is to be deducted from interest from banks on time deposits. As variable deposits are in the nature of time deposits, tax is deductible at source from interest on such deposits.

**Question 33: Whether tax has to be deducted from principal on renewal of deposits made after 1-7-1995 but which matured on or before 30-6-1995 when the renewal is made retrospectively?**



**Answer.** Tax has to be deducted from interest credited or paid, whichever is earlier, on time deposits with a bank made on or after 1-7-1995. When a time deposit is renewed retrospectively, the relevant date for deciding the applicability of section 194A would be that date of renewal. Thus, if the time deposit is renewed after 1-7-1995, the tax deduction at source will have to be made from interest paid or credited in respect of such a time deposit. [Circular No. 715, dated 8-8-1995]

### **NOTIONAL ACTUAL COST [EXPLANATIONS TO SECTION 43(1)]**

#### **Summarised Table of Notional Actual Cost [Section 43(1)]**

<b>Sl. No.</b>	<b>Situation</b>	<b>Notional Actual Cost</b>	<b>Relevant Explanation to section 43(1)</b>
<b>1.</b>	Asset used in business after it ceases to be used for Scientific Research	Actual cost of the asset minus the amount of deduction allowed u/s 35 i.e. it will be 'Nil'.	Explanation 1
<b>2.</b>	Asset acquired by way of gift or inheritance	Actual cost to the previous owner minus the depreciation actually allowed prior to assessment year 1988-89 and depreciation allowable on that asset for assessment year 1988-89 and onwards assuming it is the only asset in the block.	Explanation 2
<b>3.</b>	Depreciable asset transferred to reduce tax liability by claiming depreciation at enhanced cost	Actual cost as determined by Assessing Officer with approval of Joint Commissioner. Genuine cases not covered.	Explanation 3



4.	Depreciable assets earlier transferred reacquired by the assessee	(a) original actual cost minus the depreciation actually allowed to him prior to assessment year 1988-89 and amount of depreciation allowable to him for assessment year 1988-89 and onwards, or  (b) actual price for which reacquired, whichever is less.	Explanation 4
<b>Sl No.</b>	<b>Situation</b>	<b>Notional Actual Cost</b>	<b>Relevant Explanation to Section 42(1)</b>
5.	Asset previously used by any person and on which depreciation allowed to him, acquired by another person but leased back to the seller	Actual cost in the hands of the person who has leased back the asset shall be same as the W.D.V. of the said asset to the seller at the time of transfer thereof.	Explanation 4A
6.	Buildings brought into use for business purpose subsequent to its acquisition	Depreciation that would have been Actual cost of the building minus all allowable had the building been used for business since its acquisition.	Explanation 5
7.	Assets transferred by holding company to 100% subsidiary or vice versa where transferee company is an Indian company	Actual cost to the transferee company shall be same as would have been to transferor company, if it continued to hold it.	Explanation 6
8.	Assets transferred under a scheme of amalgamation	Actual cost to the amalgamated company shall be same as would have been to the amalgamating company, if it continued to hold it.	Explanation 7
9.	Asset transferred to the resulting company in case of demerger	Same as would have been to demerged company, if it continued to hold the asset.	Explanation 7A



10.	Interest pertaining to post acquisition period	Interest on money borrowed for the purpose of acquiring a capital asset, pertaining to the period after the asset is put to use is to be claimed as a revenue expenditure u/s 36(1)(iii).	Explanation 8
11.	Actual cost of Cenvatable asset	Actual cost minus duty of excise/ customs for which credit of Cenvat has been taken.	Explanation 9
12.	Asset acquired where portion of cost met by some other person	Actual cost minus cost met by some other person.	Explanation 10
13.	Asset acquired by non-resident outside India but brought by him to India for the purpose of business and profession	Actual cost minus depreciation that would have been allowable in India since the date of its acquisition.	Explanation 11
<b>Sl No.</b>	<b>Situation</b>	<b>Notional Actual Cost</b>	<b>Relevant Explanation to</b>
14.	Assets acquired by a company under a scheme for corporatisation of a recognised stock	Actual cost to the company shall be the amount which would have been regarded as actual cost had there been no such corporatisation.	Explanation 12
15.	Capital asset on which 100% deduction has been allowed or is allowable to the assessee under section 35AD	'Nil'— (a) in the case of such assessee; and (b) in any other case if the capital asset is acquired or received,— (i) by way of gift or will or an irrevocable trust; (ii) on any distribution on liquidation of the company; and (iii) by such mode of transfer as is referred to in clauses (i) (iv), (v), (vi), (vib), (xiii), (xiiib)	Explanation 13



## VALUATION UNDER CENTRAL EXCISE

### Practical illustration on Methods of Valuation under different circumstances

#### (1) The effect of price escalation subsequent to the removal of goods, on the assessable value

The amount realized under an escalation clause would form part of the assessable value and would attract Central Excise duty. The same is payable once the enhanced rate is fixed and finalized. In addition to the duties of excise, interest at appropriate rate is also payable. In *Petrofab v CCE 2008 (223) ELT 656 (CESTAT)* where the buyer did not agree to additional payment and did not pay the amount as there was no price variation clause in agreement. Held that the demand was not sustainable.

#### (2) The effect of reduction in price subsequent to the removal of excisable goods

After the goods are cleared on payment of duty, subsequent reduction of price for any reason, including Govt. interference, discount etc would not create a claim for refund of Central Excise duty paid on the quantum of price reduced. It was held in *Traco Cable Co. v. CCE 2004(172) ELT 33(CESTAT)* that where assessee gave a price reduction after the clearance from factory, refund not eligible.

#### (3) Whether interest payable after the expiry of credit period would form part of transaction value -Such interest would not form part of transaction value.

**Illustration** - Assessee charges ₹ 200 per unit for his goods and payment under the contract is required to be made within 45 days from the date of clearance. ₹ 200 per unit would include the interest component pertaining to the general credit period of 45 days. Even if the payment is made at the time of delivery, ₹ 200 would be the assessable value, irrespective of the possible inclusion of interest element in the price. If the assessee charges ₹ 204 per unit after 45 days and ₹ 4 per unit being relatable to time lag in payment and not relating to the manufactured goods, this amount of ₹ 4 per unit would not form part of the value.

#### (4) Role of notional interest on the advances/deposits accepted by the manufacturer

Interest on advance/deposits received against future sale of goods is includible in the assessable value only when there is a nexus between the advance/deposit and the sale price. The ratio decided in the *Metal Box case 1995 (75) ELT 449 (SC)* requires establishment of the facts that the interest free advance reflected favour or special treatment and that advances had the effect of pegging down the price. If the assessee charges the same price from those who provide advances and those who do not, the question of including notional interest on advances does not arise - *VST Industries Ltd v CCE 1998 (97) ELT 395 (SC)*.



**(5) The value of trade mark and assessable value**

Where a manufacturer is the owner of the brand name, the price including the value of the brand name, at which he sells the goods in the course of wholesale trade, would constitute the normal price. But where the goods are manufactured by other manufacturer and then sold to a dealer who owns the brand name, the value of the brand name cannot be considered for computing the assessable value, as the brand name owner cannot be construed as manufacturer and the price at which the brand name owner sells the goods cannot be taken as assessable value.

**(6) Consultancy/technical services and assessable value**

The costs towards drawing, designing and technical specifications are clearly elements of machinery costs and are to be included in the assessable value. However, the cost towards project report, plant layout, civil works and training which are in the nature of services are not includible in the assessable value.

**(7) Inspection charges and testing charges**

Where the manufacturer bears the cost towards inspection and testing of goods prior to their clearance, such costs are includible in the assessable value. The inspection and testing charges incurred *subsequent* to the clearance of the goods should ideally suffer service tax as such services are taxable services under the provisions of service tax.

**(8) Excess amounts charged to the customer**

Amount charged and recovered from customers by providing separate bills would be considered as gross receipts or cum duty price and duty is to be paid after computing the assessable value from the gross receipts.

**(9) Handling cost and assessable value**

Handling cost incurred before the clearance of the goods from the place of removal is includible in the assessable value.

**(10) The cost of accessories supplied by the buyer**

There is a distinction between the component and the accessory. A thing is a part or a component of the other, only if the other is incomplete without it. A thing is an accessory of the other if the thing is not essential for the other, but only adds to its convenience or effectiveness.

The cost of accessory supplied by the buyer as a package of sale of the manufactured goods would be includible in the value and Cenvat credit benefit is also available on the accessories.



---

**(11) The cost of transportation**

Cost of transportation and insurance can be excluded for the purpose of determining the assessable value of goods. In cases where the vehicles are owned by the manufacturers, then the cost of transportation can be calculated through the accepted principles of costing. A cost certificate from a Cost Accountant/ Chartered Accountant/Company Secretary may be accepted. The cost of transportation should, however, be separately shown on the invoice.

It is clarified vide Circular No. 827/4/2006-CX, dated 12-4-2006, that as per Rule 5 of the Valuation Rules the actual cost of transportation from the place of removal up to the place of delivery is only to be excluded. If the assessee is recovering an amount from the buyer towards the cost of return fare of the empty vehicle from the place of delivery, this amount would not be available as a deduction. Therefore, unless it is specifically mentioned on the invoice that the transportation charges indicated therein do not include cost of transportation for the return journey of the empty truck/vehicle, the deduction of the said transportation charges would not be admissible.

However vide Circular No. 923/13/2010-CX dated 19.5.2010 it was clarified that if the manufacturer/transporter charges for transportation cost for outward journey upto point of delivery and return there from, cost of transportation of return journey of empty truck/vehicle would also be allowed as a deduction.

**(12) Valuation in cases where the manufacturer is supplying some of the parts free of cost**

It is clarified vide Circular No. 725/41/2003-CX., dated 30-6-2003 that since the assessable value shall take the entire intrinsic value of the article sought to be assessed, irrespective of the fact that manufacturer or processor of the article does not pay for the cost of some of its components, the value of caps fitted with the tubes should be included while determining assessable value of the tubes. However where the components are received under Rule 4(5)(a) for job work, only the cost of goods supplied by the job worker needs to be included as per the decision of the Supreme Court in the case of *International Auto Ltd.* 2005 (183) ELT 239 (SC). This is as per the logic that the manufacturer would again be discharging the duty of excise on the finished components and would have availed of the duty on the components sent for job work.





**JUDICIAL DECISIONS ON VALUATION**

<b>Particulars</b>	<b>Citation</b>
The transaction value concept is quite different from the classic concept of price of goods and is based on the GATT protocol and WTO agreement introduced through the Customs Valuation rules 1988.	Associated Cement Companies v CC, 2001 (128) ELT 21 (SC)
Expenses on advertisement and after sales service during guarantee period provided under an agreement at arms length, and the manufacturer shared half of the advertisement and after sales charges, which benefited both the dealers and the manufacturer, not to be added to the value.	Philips India Ltd. v CCE 1997 (91) ELT 540 (SC)
Sales organisation expenses upto the stage of delivery of goods, such as handling charges, interest on inventories, transportation to such place of sale, marketing expenses are all includible in the assessable value.	UOI v Bombay Tyres 1983 (14) ELT 1896 (SC)
Warranty charges for the first twelve months collected from customers are includible in assessable value. If repair charges are collected during warranty period being labour charges from customers, the same held to be different from services. Provision for free repair during warranty period by manufacturer through the dealer for the customers' benefit includible in the value.	V. B. Office Systems v CCE, 2001 (128) ELT 162 (Tri-Chennai)
Commission paid to wholesale buyer in the form of credit notes is a permissible deduction. Commission paid to a selling agent is not deductible.	Ballarpur Industries Ltd v UOI 1987 (30) ELT 267 (Bom- HC)
Service charges paid to selling agent for services rendered by an organisation for procuring orders and payments from various government departments, are includible in value of goods. So also inspection charges.	Siddhartha Tubes Ltd v CCE 2006 (193) ELT 3 (SC)



## CMA Students Newsletter (For Final Students)

Vol.8C: April 30, 2015

<b>Particulars</b>	<b>Citation</b>
The PDI (pre-delivery inspection charges for vehicles and after sale service charges are to be includible in the assessable value even if paid to dealer, as these are in connection with sale.	Maruti Suzuki India v CCE 2010 (257) ELT 226 (Tri-LB). Note: Earlier in a plethora of cases it was held that predelivery inspection and after-sale-service recovered by dealers from buyers would not be included in the assessable value. The aforesaid decision of the Larger Bench of the Tribunal takes a contrary view to the earlier judgements.
Cost of additional testing of goods conducted at the request of and borne by the customer, was not includible in the assessable value.	CCE v Bhaskar Ispat Pvt. Ltd. 2004 (167) ELT (189) (T-LB)
Development and artwork charges recovered by debit notes for making printed flexible packaging laminates are to be included for the purpose of section 4.	Paper Products Ltd. v CCE, 2005 (189) ELT 248 (SC). This was appealed to the Supreme Court, appeal was disposed off in 2004 (214) ELT 161 (SC).
Head Office expenses for maintenance and upkeep of factory, where the manufacture takes place, raw material is procured, R&D takes place, are includible in the assessable value.	Colour Chem Ltd. v CCE, 2004 (177) ELT 1080 (T-Mum)
The cost of printing or labeling of customer's logo on the goods sold by the manufacturer in the case of aluminum extruded tubes includible in the assessable value.  Printing is not a process of manufacture, but if manufactured bottles were printed and decorated inside the same factory, the cost of printing is includible.	UOI v Metal Box Co. of India Ltd. 1996 (87) ELT 327 (SC)  UOI v J G Glass Industries Ltd. 1998 (97) ELT 5 (SC)
Erection, installation and commissioning charges of goods at the site of customer, whether movable or which eventually turn out to be immovable property after erection is not includible.  Maintenance charges and site charges for installation of air conditioners and water coolers were not includible in the assessable value.	Thermax Ltd. v CCE 1998 (99) ELT 481 (SC).  Voltas Ltd. v UOI 1991 (56) ELT 329 (HC-Bom.)



## CMA Students Newsletter (For Final Students)

Vol.8C: April 30, 2015

<b>Particulars</b>	<b>Citation</b>
The demand on advertising, marketing and sales promotion expenses not sustainable.	Pinakini Beverages (P) Ltd v CCE Guntur ((2007) TIOL 639 CESTAT Bangalore)
Expenditure incurred by dealers on sales promotion not includible in assessable value.	Ford India (P) Ltd v CCE Chennai ((2007) TIOL 1055 CESTAT Chennai)
Bonus to dealer deductible from assessable value but freight and transportation charges and commission to agents not deductible.	CCE Bhopal v Raymond Ltd ((2007) TIOL 956 CESTAT Mumbai)
When independent factory sale price is available, that should be the basis for determining the value of captively consumed goods; The assessable value of the captively consumed grey yarn would be on the basis of the price at which the grey yarn was sold by the assessee to unrelated buyers in wholesale at the factory.	CCE v Scan Synthetics 2008-TIOL-34
It has been finally confirmed that free samples of medicines of physician's are to be valued on pro-rata basis on basis of price of regular pack (and not based on Cost of Production plus 10%).	Medley Pharmaceuticals v CCE (2011 (263) ELT 641 (SC).
Even if the parties are related, if it has not influenced the price at which goods are sold; transaction value has to be accepted.	CCE v Bharti Telecom Ltd 2008-TIOL-124
The sale of the goods by the respondents to M/s. DIS was one of a 'dealer', which transaction was on principal-to-principal basis, and, therefore, the payment of duty made by the respondents on the assessable value of the goods determined on the basis of the discounted price is in order.	CCE v Mag Torqpowder Clutches P Ltd 2009-TIOL-92
Cost of design and drawings to be included in Assessable Value by the component vendors who were supplying components on the basis of the drawings and designs.	CCE v Tata Motors 2009-TIOL-241



## CMA Students Newsletter (For Final Students)

Vol.8C: April 30, 2015

<b>Particulars</b>	<b>Citation</b>
<p><b>Where onward freight was not includible in the assessable value, there was no question of return freight being included:</b> It defies all logic that for Central Excise purposes, the freight for carrying the empty container back is held to be part of the assessable value of the manufactured goods, whereas the outward freight for carrying goods is not considered to be part of the assessable value. Considering the fact that it is a legal requirement to use specially designed containers for carrying the goods which is notified as an explosive and consequently, the return of the empty containers that carry the impugned goods namely, Butadiene becomes a necessity and considering the fact that transaction value exclusive of the freight element, is available for sale at the factory gate, such transaction value has to be taken as the assessable value under section 4(1)(a) of the Central Excise Act. 1944.</p>	Haldia Petrochemicals Ltd v CCE 2009-TIOL-360
<p>Freight charges shown on invoice were an approximation vis-a-vis that actually collected from buyer, deduction of freight cannot be denied in its entirety by contending that only the actual, if shown on invoice, is allowable.</p>	Indo Rama Synthetics (I) Ltd v CCE 2009-TIOL-310
<p>Even if there is no flow back of any money, the fact that the price is not the sole consideration is sufficient for rejecting the transaction value.</p>	CCE v Sun Pharmaceuticals 2009-TIOL-572
<p>Installation charges collected from the buyers are not includable in the transaction value. Installation charges are not collected for the reason of, or in connection with, sale of computers. Transaction value is the total consideration received by the assessee in exchange for the excisable goods at the time of sale, or later. Installation of computers is not after sales service of the computers sold. Excise duty and service tax cannot be levied on the same activity.</p>	HCL Infosystems Ltd v CCE 2009-TIOL-535
<p>Cost of transportation from one place of removal (factory) to another place of removal (depot) is not deductible from the assessable value.</p>	Industrial chemicals and Monomers Ltd v CCE 2009-TIOL-534



## CMA Students Newsletter (For Final Students)

Vol.8C: April 30, 2015

<b>Particulars</b>	<b>Citation</b>
The cost of transportation from place of removal upto place of delivery is excluded when delivery is at a place other than place of removal. If freight is not shown separately in invoice, burden of proof is on assessee claiming such a deduction.	Wearwell Tyres v CCE (2010 (257)ELT 126 (CESTAT)
Assessee had rate contract with DGS&D. Goods were dispatched at consignor risk on freight paid basis. Held that transport of property in goods was when the goods were handed over at buyer's premises. Hence outward freight includible in assessable value.	CCE v Punjab Tractors (2010 (259) ELT 123 (CESTAT).
Issue of 0% interest fully convertible debentures by the holding company to subsidiary company cannot be held to be interest free loan. In the absence of allegation of mutuality of interest on any other ground, the sale price adopted by the appellant is acceptable.	SV Sugar Mills Ltd v CCE 2009-TIOL-622
Torches cleared for free supply by manufacturers as advertisement propaganda to be assessed in terms of Section 4 of the CEA'44.	Vineetha Polymers P Ltd v CCE 2008-TIOL-70
Interest on receivables not to be included in the assessable value of the goods manufactured and cleared by the assessee.  Any compensation for damage or breakage of goods after its removal from the factory not deductible from the assessable value.	CCE v Raptakos Brett & Co 2008-TIO1-28
Agreement with the buyer of the goods to purchase minimum quantity failing which the buyer has to pay "Minimum Take or Pay". Such payments are in the nature of liquidated damages for breach of contract and are not includible in the assessable value.	CCE v Praxair India Ltd 2008-TIOL-160.
Once the sale was effected at the factory gate on the basis of purchase order, the additional responsibility of arranging transport and physical delivery at a different place cannot make any difference.	Blue Star Ltd v CCE 2008-TIOL-272



## CMA Students Newsletter (For Final Students)

Vol.8C: April 30, 2015

Particulars	Citation
MRP Assessment cannot be denied on the ground that footwear was not sold in a package bearing MRP when the foot wears themselves bore MRP on them.	Pond's Exports Ltd v CCE 2008-TIOL-349
The discount granted to buyer of excisable goods described by whatever name was not to be included in the assessable value provided that the discount was known at or prior to removal of the goods on sale.	CCE v Texmo Industries 2008-TIOL-623
Held that discount can be passed on later by way of a credit note. If buyers were aware of discount structure deduction of discount is admissible even if it is not shown in invoice.	Gujarat Borosil v CCE (2010 (253) ELT 610 (CESTAT) Maintained in 2012 (284) ELT A163 (Supreme Court)
Assessee was supplying specialised tankers for transport of his final product and was charging rental for the same from the transporters. It was held that the rental charges was not includible in assessable value.	Sree Rayalseema Hi-Strength Hypo v CCE (2010 (252) ELT 87 (CESTAT)
Freight charges from the depot to the place of delivery are not includable.	CCE & CC v Birla Tyres 2008-TIOL-1238
<b>Stock-transfer of goods from factory to depot with duty liability discharged at rate at which goods were sold from depot, at time of their removal from factory. Goods so cleared to depot prior to price reduction sold at reduced price - HELD :</b> Assessee's plea that excise duty recovered by them from customers was less than what they paid at factory, rejected as duty was paid according to Rule 7 of Central Excise (Valuation) Rules, 2000.	Finolex Cables Ltd. v Commissioner of Central Excise, Pune-I (2011 (270) ELT 81 (Tri. - Mumbai)
Expenses incurred by the dealers on account of sale promotion of vehicles is not includable in the assessable value.	TVS Motor Company Ltd v CCE 2008-TIOL-1405
There was a reciprocal arrangement between Oil marketing Companies to supply petroleum products at a price which was much lower than the price charged to independent dealers. Held that such price cannot be accepted for valuation. In such case, the valuation to be done under Rule 4 at the basis of price to independent dealers.	Bharat Petroleum Corporation Ltd v CCE (2009 (242) ELT 358 (CESTAT).
Merely because a holding company is related to its subsidiary company, it is not sufficient to invoke valuation rules. Revenue has to establish that the relationship had influenced the price.	CCE v Beacon Neyrpic Ltd 2008-TIOL-1717



## CMA Students Newsletter (For Final Students)

Vol.8C: April 30, 2015

<b>Particulars</b>	<b>Citation</b>
Held that mere common directors, employees or premises are not sufficient to lift corporate veil. Financial flowback and mutuality of interest is to be shown and proved.	Motorol Speciality Oils v CCE (2009 (243) ELT 449 (CESTAT).
Merely giving an interest free advance as a matter of commercial expediency and as a trade practice it is not sufficient to say that the buyer and seller are related persons.	CCE v Kwalitiy Ice Cream (2010-TIOL-100-SC-CX)
Cost of transportation, laying, jointing, testing and commissioning, by any stretch of reasoning, cannot be considered to be the elements of price of goods at the factory gate.	CCE v Koya & Company Constructions P Ltd 2008-TIOL-2044
Different MRPs are acceptable for different packages. It is the prerogative of the manufacturer to affix the MRP on the goods and if different MRPs are affixed keeping in view the market condition, different MRP so fixed would be the retail sale price in respect of that packet.	CCE v Bell Granito Ceramics Ltd 2008-TIOL-2030
Held that the fans sold to various Government Departments by way of DGS & D rate contract were to be assessed under MRP based valuation under Section 4A of Central Excise Act, 1944.	[Commissioner v Jay Engineering Works Ltd. - 2011 (263) ELT A 16 (SC)]
Performance bonus received from customers not includible in assessable value.	MPR Refractories Ltd v CCE 2008-TIOL-2176
Cost of gift articles viz. gold/silver coins put inside the containers of the lubricating oil or sunglasses and watches given as gifts with lubricating oil containers is required to be included in the Assessable value of Lubricating oil.	CCE v Nandan Petrochem Ltd 2008-TIOL-2124
Though know-how was received free of cost and its cost was includible in assessable value of medicine manufactured by assessee, in absence of a proper mechanism to quantify its value to medicines cleared, its value could not be included in assessable value of medicine manufactured using it - Section 4 of Central Excise Act, 1944.	Commissioner of C. Ex., Bangalore-III v Wintac Limited 2011 (263) ELT 273 (Tri. - Bang.)
Assessable value of goods shall be the transaction value excluding the actual cost of transportation charges incurred from the factory gate to the premises of Consignment agents.	Bhuwalka Alloys P Ltd v CCE 2008-TIOL-2483



## CMA Students Newsletter (For Final Students)

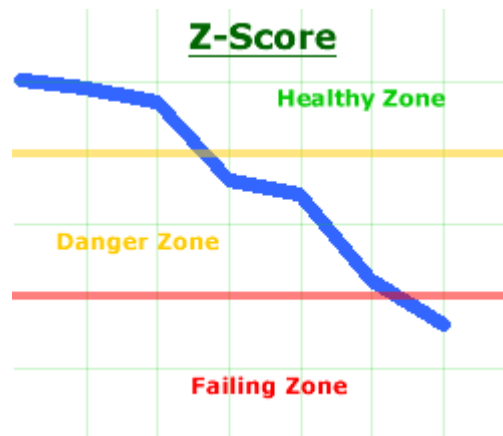
Vol.8C: April 30, 2015

<b>Particulars</b>	<b>Citation</b>
Once the product is covered under MRP provisions, quantity discount or free supply is not applicable. The transaction value is not relevant. If sale is through related party it is immaterial. Trade discount is not relevant.	Indica Laboratories v CCE (2007 (213) ELT 20
Constitutional validity of section 3(2) was upheld.	Century Manufacturing Company Ltd 1992 (60) ELT 3 (SC)
Assessee involved in manufacture and sale of cars. Cars sold below COP continuously for 5 years. Held that the goods are sold below costs to penetrate the market. Therefore such a sale is not done in ordinary course of sale or trade. The price based on costing to be assessable value.	Commissioner of Central Excise, Mumbai v M/s Fiat India Pvt Ltd & Anr (2012 (283) E.L.T. 161 (S.C.)





### ALTMAN MODEL: Z – SCORE



Altman developed a multivariate model to predict corporate failure using multiple discriminant analysis. Altman's sample consisted of 33 failed and 33 non-failed firms elected by paired sample design. In his model, failure firms were those firms which were legal] bankrupt. Twenty-two accounting and non-accounting variables were considered in various combinations as predictors of failure.

The following discriminant function did the best overall job in determining the bankruptcy status of the firms :

$$Z = 0.012X_1 + 0.014X_2 + 0.033X_3 + 0.006X_4 + 0.999X_5$$

Where

$X_1$  = Working Capital/Total Assets [a liquidity measure]

$X_2$  = Retained Earnings/Total Assets [a measure of reinvested earnings]

$X_3$  = Earnings before interest and tax/Total Assets [a profitability measure]

$X_4$  = Market value of Equity/Book value of total debt [a measure of leverage]

$X_5$  = Sales/Total Assets [a measure for the sales-generating ability of the firm's assets]

#### Findings of Altman's Study

- (1) Out of 22 tested ratios, only 5 ratios could give the best performance to measure the corporate sickness.
- (2) All firms that had a Z score greater than 2.99 fell into non-bankrupt class, while all firms that had a Z score smaller than 1.81 score were bankrupt. The group of firms falling between 1.81 and 2.99, referred to as Grey area or zone, consisted of both bankrupt and non-bankrupt firms. Therefore, firms whose Z scores fall in the



Grey area obviously require further investigation to determine their solvency status.

- (3) On examining the predictive ability of this model, Altman observed that prediction of bankruptcy could be correctly made with 95% success in the first year before the year of bankruptcy. The percentage of correct classification decreased sharply to 72% in the second year. 48% in the third year. 26% in the fourth year and 19% in the fifth year prior to bankruptcy.
- (4) Out of the three liquidity ratios evaluated by Altman, working capital to total assets ratio, appeared to be the best predictor. The other two widely used liquidity ratios namely, current ratio and quick ratio were found to be very poor indicators of corporate sickness.
- (5) According to Altman, retained earnings to total assets ratio which gives a measure of cumulative profitability, is a very good indicator of sickness. A high retained earning to total assets reveals the growth characteristic of the firm.
- (6) Earnings before Interest and Taxes (EBIT) to Total Assets ratio, which is a measure of true productivity of the firm's assets was found to be very relevant for predicting corporate failure.**
- (7) Altman found that Market Value of Equity to Book Value of Total Debt ratio was a more effective predictor than the more commonly used ratio Net Worth to Book Debt ratio.**
- (8) Altman observed that a firm with a very high asset turnover ratio never fell sick. Accordingly, this ratio appeared to be the best indicator of sickness.**

#### Limitations of Altman's Model

Although Altman's model is considered a landmark in the financial statement analysis, it is not free from some limitations. These are:

- (1) Altman's model could not accurately discriminate between failed and non-failed firms when the prediction horizon was more than two years before bankruptcy.
- (2) The variables considered in this model were firm oriented variables like profitability and coverage ratios. The macro economic variables like change in interest rate, government policy, political condition etc. which have a strong correlation with failure rates in the economy were ignored in Altman's model.
- (3) The variables were chosen for their impact on the efficiency of the discriminant function, rather than from any underlying theory. There was no assurance that all significant variables were included in the analysis, nor were they weighted in appropriate ways.
- (4) The prior probabilities of failure and survival are assumed to be equal for failed and surviving firms. Also the different costs of type 1 and type 2 error were not considered while assessing the performance of the model.

Despite the above limitations, the innovative approach introduced by Altman in predicting corporate sickness was imitated widely, and has led to a series of empirical work. Although having detractors, it has led to further developments in the sickness prediction.



**Example**

Calculate Altman's Z score using multivariate analysis and assign the firm as failed or non-failed firm.

	₹
<b>Sales</b>	10,00,000
<b>Operating expenses</b>	8,00,000
<b>Interest</b>	6,000
<b>Depreciation</b>	50,000
<b>Tax</b>	15,000

**Balance sheet**

Equity & Liabilities	₹	Assets	₹
<b>Shareholders' Fund:</b>		<b>Non Current Assets:</b>	
Share Capital at ₹ 10 each	1,00,000	Fixed Assets	1,50,000
Reserve and surplus from retained earnings	50,000	<b>Current Assets:</b>	
<b>Non Current Liabilities:</b>		Inventory	2,00,000
6% long term loan	1,00,000	Sundry debtors	1,10,000
<b>Current Liabilities:</b>		Loans and Advances	40,000
Sundry creditors	2,00,000	Cash at Bank	50,000
Provision for tax	1,00,000		
	<b>5,50,000</b>		<b>5,50,000</b>

Market value per share is ₹ 8.

**Answer:**

The equation of Z Score as developed by Altman is,

$$Z = 0.012X_1 + 0.014X_2 + 0.033X_3 + 0.006X_4 + 0.999X_5$$

$$X_1 = \frac{\text{Working Capital}}{\text{Total Assets}}$$

**Working Capital = Current Assets – Current Liabilities**

Current Assets	₹	Current Liabilities	₹
Inventory	2,00,000	Sundry creditors	2,00,000
Sundry Debtors	1,10,000	Provision for tax	1,00,000
Loans & Advances	40,000		
Cash at Bank	50,000		
	<b>4,00,000</b>		<b>3,00,000</b>



Hence, Working Capital = ₹ (4,00,000 – 3,00,000) = ₹ 1,00,000.

Total Assets = Fixed Assets + Current Assets = ₹ (1,50,000 + 4,00,000) = ₹ 5,50,000

$$X_1 = \frac{₹1,00,000}{₹5,50,000} = 0.18 \times 100 = 18\%.$$

$$X_2 = \frac{\text{Retained Earnings}}{\text{Total Assets}} = \frac{₹50,000}{₹5,50,000} = 0.09 \times 100 = 9\%.$$

$$X_3 = \frac{\text{Earnings before Interest and Tax}}{\text{Total Assets}} = \frac{\text{Sales} - \text{Operating Expenses}}{\text{Total Assets}}$$
$$= \frac{₹(1,00,000 - 8,00,000)}{₹5,50,000} = \frac{₹2,00,000}{₹5,00,000} = 0.36 = 36\%.$$

$$X_4 = \frac{\text{Market Value of Equity}}{\text{Book Value of Total Debts}} = \frac{10,000 \text{ Shares} \times ₹8}{₹1,00,000 + 3,00,000} = \frac{₹80,000}{₹4,00,000} = 0.20 = 20\%.$$

$$X_5 = \frac{\text{Sales}}{\text{Total Assets}} = \frac{₹10,00,000}{₹5,50,000} = 1.82 \text{ times.}$$

$$Z = (0.012 \times 18) + (0.014 \times 9) + (0.033 \times 36) + (0.006 \times 20) + (0.999 + 1.82) = 3.468$$

**Note:** It is assumed that depreciation remains included in operating expenses.

Altman observed in his study that all sample firms considered by him with Z score above 2.99 were non-bankrupt. Accordingly, the firm in question with Z score 3.468 may be predicted as non-sick.

**Note:** It should be noted that the values of the variables i.e.,  $X_1$ ,  $X_2$ ,  $X_3$ , and  $X_4$  to be multiplied with their respective discriminate coefficients will be in absolute number and not in percent.



### ITEMS TO BE CONSIDERED IN COMPUTATION OF MINORITY INTEREST

In case of a holding company problem if the holding company does not hold all the shares, then it is a partly owned subsidiary. The interest of shareholders outside the group is called "Minority Interest".

#### Minority interest –

- Should be calculated and shown in the consolidated financial statements separately in separate head.
- Minority interest means the portion of net assets of subsidiary on the date of consolidation not controlled by the parent itself or through its subsidiary.

Computation of Minority Interest	
Particulars	Amount
Face Value of equity shares of the subsidiary company held by the outsiders	XXXX
Proportion of Bonus Shares held by the outsiders	XXXX
Proportionate share of outsiders in Capital Profit	XXXX
Proportionate share of outsiders in Revenue Profit	XXXX
Minority Interest	XXXX

#### Example 1:

On 31.03.2013, R Ltd. acquired 1,05,000 Shares of S Ltd. for ₹ 12,00,000. The Balance Sheet of S Ltd. on that date was as under -

(₹ 000's)			
Liabilities	₹	Assets	₹
1,50,000 Equity Shares of ₹ 10 each fully paid	1,500	Fixed Assets (Tangible)	1,050
Pre-Incorporation Profits	30	Current Assets	615
Profit & Loss Account	60		
Creditors	75		
Total	1,665	Total	1,665



## CMA Students Newsletter (For Final Students)

Vol.8C: April 30, 2015

On 31.03.2014, the Balance Sheets of the two Companies were as follows -

(₹ 000's)

Liabilities	R	S	Assets	R	S
Equity Shares of ₹ 10 each fully paid (before Bonus Issue)	4,500	1,500	Fixed Assets (Tangible)	7,920	2,310
			1,05,000 Equity Shares in	1,200	-
Securities Premium	900	-	S Ltd. at Cost		
Pre-Incorporation Profits	-	30	Current Assets	4,410	1,755
General Reserve	6,000	1,905			
Profit and Loss Account	1,575	420			
Creditors	555	210			
<b>Total</b>	<b>13,530</b>	<b>4,065</b>	<b>Total</b>	<b>13,530</b>	<b>4,065</b>

Directors of S Ltd. made a bonus issue on 31.03.2014 in the ratio of one Equity Share of ₹ 10 each fully paid for every two Equity Shares held on that date.

Calculate as on 31.3.2014 Minority Interest; (in each of the following cases: (1) Before issue of Bonus Shares; (2) Immediately after the issue of Bonus Shares.

It may be assumed that Bonus Shares were issued out of Post-Acquisition Profits by using General Reserve.

**Answer:**

### 1. Basic Information

Company Status	= R Ltd.	Dates	= S Ltd.	Holding Status
Holding Company	= R Ltd.	Acquisition:	31.03.2013	Holding Company = 70%
Subsidiary	= S Ltd.	Consolidation:	31.03.2014	Minority Interest = 30%

### 2. Analysis of Reserves and Surplus of S Ltd.

(a) Pre-Incorporation Profits = ₹ 30,000 – Capital Profit



**(b) General Reserve**

Before Bonus Issue		After Bonus Issue	
As on 31.3.2014	19,05,000	As on 31.3.2014	19,05,000
		Less: Bonus Issue	7,50,000 (15 Lacs x 1/2)
		Corrected Bal	11,55,000
↓	↓	↓	↓
As on 01.04.13	Tfr between 01.04.13 & 31.3.2014	01.04.2013	Tfr between 1.4.13 & 31.3.14
<b>NIL</b>	<b>19,05,000</b>	<b>NIL</b>	<b>11,55,000</b>
<b>Capital</b>	<b>Revenue</b>	<b>Capital</b>	<b>Revenue</b>

**(c) Profit & Loss Account**

As on 31.03.2014 ₹ 4,20,000			
As on 01.04.2013	60,000	Profits between 01.04.2013 & 31.03.2014	<b>3,60,000</b>
	<b>Capital</b>		<b>Revenue</b>

**3. Analysis of Net Worth of S Ltd.**

Particulars	Before Bonus Issue			After Bonus Issue		
	Total	R	Minority	Total	R	Minority
	100%	70%	30%	100%	70%	30%
(a) Share Capital <b>Add:</b> Bonus Issue	15,00,000 –			15,00,000 7,50,000		
	<b>15,00,000</b>	10,50,000	4,50,000	<b>22,50,000</b>	15,75,000	6,75,000
(b) Capital Profits Pre Incorporation Profits General Reserve Profit and Loss Account	30,000 NIL 60,000			30,000 NIL 60,000		
	<b>90,000</b>	63,000	27,000	<b>90,000</b>	63,000	27,000
(c) <b>Revenue Reserve:</b> Gen. Reserve	<b>19,05,000</b>	13,33,500	5,71,500	<b>11,55,000</b>	8,08,500	3,46,500
(d) <b>Revenue Profits:</b> P & L A/c	<b>3,60,000</b>	2,52,000	1,08,000	<b>3,60,000</b>	2,52,000	1,08,000
<b>Minority Interest</b>			<b>11,56,500</b>			<b>11,56,500</b>



**Example 2:**

Following are the Balance Sheets of Mumbai Limited, Delhi Limited, Amritsar Limited and Kanpur Limited as at 31st December, 2014:

Liabilities	Mumbai Ltd.	Delhi Ltd.	Amritsar Ltd.	Kanpur Ltd.
Share Capital (₹ 100 face value)	1,00,00,000	80,00,000	40,00,000	1,20,00,000
General Reserve	40,00,000	8,00,000	5,00,000	20,00,000
Profit & Loss Account	20,00,000	8,00,000	5,00,000	6,40,000
Sundry Creditors	6,00,000	2,00,000	1,00,000	1,60,000
	1,76,00,000	98,00,000	51,00,000	1,48,00,000
<b>Assets</b>				
<b>Investments :</b>				
60,000 shares in Delhi Ltd.	70,00,000	—	—	—
20,000 shares in Amritsar Ltd	22,00,000	—	—	—
10,000 shares in Amritsar Ltd.	—	10,00,000	—	—
Shares in Kanpur Ltd. @ ₹ 120	72,00,000	36,00,000	12,00,000	—
Fixed Assets	—	40,00,000	30,00,000	1,40,00,000
Current Assets	2,00,000	12,00,000	9,00,000	8,00,000
	1,76,00,000	98,00,000	51,00,000	1,48,00,000

Balance in General Reserve Account and Profit & Loss Account, when shares were purchased in different companies were:

	Mumbai Ltd.	Delhi Ltd.	Amritsar Ltd.	Kanpur Ltd.
General Reserve Account	20,00,000	4,00,000	2,00,000	12,00,000
Profit & Loss Account	12,00,000	4,00,000	1,00,000	1,20,000

Compute the Minority Interest.





**Answer:**

**Analysis of profit —**

**Analysis of profits of Kanpur Ltd.**

	<b>Capital Profit</b>	<b>Revenue Reserve</b>	<b>Revenue Profit</b>
	₹	₹	₹
General Reserve on the date of purchase of shares	12,00,000		
Profit and Loss A/c on the date of purchase of shares	1,20,000		
Increase in General Reserve		8,00,000	
Increase in profit			5,20,000
	13,20,000	8,00,000	5,20,000
Less : Minority Interest (1/6)	2,20,000	1,33,333	86,667
	11,00,000	6,66,667	4,33,333
Share of Mumbai Ltd. (1/2)	6,60,000	4,00,000	2,60,000
Share of Delhi Ltd. (1/4)	3,30,000	2,00,000	1,30,000
Share of Amritsar Ltd. (1/12)	1,10,000	66,667	43,333

**Analysis of profits of Amritsar Ltd.**

	<b>Capital Profit</b>	<b>Revenue Reserve</b>	<b>Revenue Profit</b>
	₹	₹	₹
General Reserve on the date of purchase of shares	2,00,000		
Profit and Loss A/c on the date of purchase of shares	1,00,000		
Increase in General Reserve		3,00,000	
Increase in Profit and Loss A/c			4,00,000
Share in Kanpur Ltd.		66,667	43,333
	3,00,000	3,66,667	4,43,333
Less : Minority Interest (1/4)	75,000	91,667	1,10,833
	2,25,000	2,75,000	3,32,500
Share of Mumbai Ltd. (1/2)	1,50,000	1,83,333	2,21,667
Share of Delhi Ltd. (1/4)	75,000	91,667	1,10,833



**Analysis of profits of Delhi Ltd.**

	<b>Capital Profit</b>	<b>Revenue Reserve</b>	<b>Revenue Profit</b>
	₹	₹	₹
General Reserve on the date of purchase of shares	4,00,000		
Profit and Loss A/c on the date of purchase of shares	4,00,000		
Increase in General Reserve		4,00,000	
Increase in Profit and Loss A/c			4,00,000
Share in Kanpur Ltd.		2,00,000	1,30,000
Share in Amritsar Ltd.		91,667	1,10,833
	<u>80,00,000</u>	<u>6,91,667</u>	<u>6,40,833</u>
Less : Minority Interest (1/4)	<u>2,00,000</u>	<u>1,72,917</u>	<u>1,60,208</u>
Share of Mumbai Ltd. (3/4)	<u>6,00,000</u>	<u>5,18,750</u>	<u>4,80,625</u>

**Minority interest**

	₹	₹
Share Capital:		
Delhi Ltd. (1/4)	20,00,000	
Amritsar Ltd. (1/4)	10,00,000	
Kanpur Ltd (1/6)	<u>20,00,000</u>	50,00,000
Share in profits & reserves (Pre and Post-Acquisitions)		
Delhi Ltd.	5,33,125	
Amritsar Ltd.	2,77,500	
Kanpur Ltd.	<u>4,40,000</u>	<u>12,50,625</u>
		<u>62,50,625</u>