

Remuneration of a managerial person as per Schedule V (Part II of Schedule V)



Part II of Schedule V governs the remuneration of a managerial person. These provisions are explained as follows:

1. Remuneration payable by companies having profits (Section I of Part II of Schedule V)

A company having profits in a financial year may pay remuneration to a managerial person(s) not exceeding the limits specified in section 197.

2. Remuneration payable by companies having no profit or inadequate profit without Central Government approval (Section II of Part II of Schedule V)

Where in any financial year, a company has no profits or its profits are inadequate, it may, without the approval of the Central Government, pay remuneration to its managerial person(s) not exceeding the higher of the limits under (A) and (B) given below:

(A) Remuneration based on the effective capital. The remuneration calculated as per the following scale:

Where the Effective Capital of company is -	Yearly remuneration payable to each managerial person shall not exceed (in ₹)
(i) negative or less than ₹ 5 crore	30 Lakhs
(ii) ₹ 5 crore or more but less than ₹ 100 crores	42 Lakhs
(iii) ₹ 100 crores or more but less than ₹ 250 crores	60 Lakhs
(iv) ₹ 250 crores or more	60 Lakhs plus 0.01% of the effective capital in excess of ₹ 250 crores

Note 1. If the resolution passed by the shareholders is a special resolution, the above limits shall be doubled.

Note 2. If a managerial person has been employed for a period less than 1 year, the above limits shall be pro-rated.



(B) Remuneration based on current relevant profit. The remuneration shall be 2.5% of the current relevant profit, in the case of a managerial person who was not security holder holding securities of the company of nominal value of ₹ 5 lakh or more or an employee or a director of the company or related to any director or promoter at any time during the 2 years prior to his appointment as a managerial person.

Note. If the resolution passed by the shareholders is a special resolution, the above limit shall be doubled, viz. 5% of the current relevant profit.

3. Conditions for payment of remuneration as per Section II of Part II of Schedule V

- (a) Payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under sub-section (1) of section 178 also by the Nomination and Remuneration Committee.
- (b) The company has not made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of 30 days in the preceding financial year before the date of appointment of such managerial person.
- (c) A special resolution has been passed at the general meeting of the company for payment of remuneration for a period not exceeding 3 years.
- (d) A statement shall be given to the shareholders along with the notice calling the general meeting. The statement shall contain the following information:
 - (i) General Information
 - (ii) Information about the appointee
 - (iii) Other information
 - (iv) Disclosures.

4. Remuneration payable by companies having no profit or inadequate profit without Central Government approval in certain special circumstances (Section III of Part II of Schedule V)

In the following circumstances a company may, without the Central Government approval, pay remuneration to a managerial person in excess of the amounts provided in Section II:

- (a) Where all the following conditions are satisfied:
 - (i) The remuneration in excess of the limits specified in Section I or II is paid by any company, other than the company of which the person is employed as a managerial person.
 - (ii) That other company is either a foreign company or has got the approval of its shareholders in general meeting to make such payment.
 - (iii) That other company treats such amount as managerial remuneration for the purpose of section 197.
 - (iv) The total managerial remuneration payable by such other company to its managerial persons including such amount is within permissible limits under section 197.
- (b) Where all the following conditions are satisfied:
 - (i) The company is a newly incorporated company.
 - (ii) The remuneration is upto twice the amount permissible under Section II.
 - (iii) The remuneration is paid for a period of 7 years from the date of incorporation of the company.



(c) Where all the following conditions are satisfied:

- (i) The company is a sick company.
- (ii) A scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction or National Company Law Tribunal for such company.
- (iii) The remuneration is upto twice the amount permissible under Section II.
- (iv) The remuneration is paid for a period of 5 years from the date of sanction of scheme of revival.

(d) Where all the following conditions are satisfied:

- (i) The remuneration of a managerial person exceeds the limits in Section II.
- (ii) The remuneration has been fixed by the Board for Industrial and Financial Reconstruction or the National Company Law Tribunal.

Compliance of conditions for payment of excess remuneration. For payment of excess remuneration in the special circumstances specified above in point (a), (b), (c) and (d) above, the company shall comply with all the conditions specified under Section II and the following additional conditions:

- (i) Except where the remuneration is paid by any other company (as per point (a) above), the managerial person is not receiving remuneration from any other company.
- (ii) The auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under section 196.
- (iii) The auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

5. Perquisites not included in managerial remuneration (Section IV of Part II of Schedule V)

(a) A managerial person shall be eligible for the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II and Section III:

- (i) Contribution to provident fund, superannuation fund or annuity fund
- (ii) Gratuity
- (iii) Encashment of leave at the end of the tenure.

(b) An expatriate managerial person (including a non-resident Indian) shall be eligible to the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II or Section III:

- (i) Children's education allowance
- (ii) Holiday passage for children studying outside India or family staying abroad
- (iii) Leave travel concession.

6. Meaning of certain terms (Section IV of Part II of Schedule V)

(a) 'Effective capital' means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share



premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expenses not written off.

- (b) Where the appointment of the managerial person is made in the year in which company has been incorporated, the effective capital shall be calculated as on the date of such appointment. In any other case the effective capital shall be calculated as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made.
- (c) The Nomination and Remuneration Committee while approving the remuneration under Section II or Section III, shall -
- (i) take into account, financial position of the company, trend in the industry, appointee's qualification, experience, past performance, past remuneration, etc.;
 - (ii) be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.
- (d) 'Negative effective capital means the effective capital which is calculated in accordance with the provisions contained in Schedule V, and is less than zero.
- (e) 'Current relevant profit' means the profit as calculated under section 198 but without deducting the excess of expenditure over income referred to in sub-section 4 (l) of section 198 in respect of those years during which the managerial person was not an employee, director or shareholder of the company or its holding or subsidiary companies.
- (f) 'Remuneration' means remuneration as defined in clause (78) of section 2 and includes reimbursement of any direct taxes to the managerial person.

7. Remuneration payable to a managerial person in two companies (Section V of Part II of Schedule V)

A managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from from any one of the companies of which he is a managerial person. The provisions of Section V of Part II of Schedule V are subject to the provisions of Sections I to IV of Part II of Schedule V.

As per Para (d) of Section III of Part II of Schedule V, a company in a Special Economic Zone (as notified by Department of Commerce from time to time) may pay remuneration to a managerial person in excess of the amounts provided in Section II, but not exceeding ₹ 2,40,00,000 per annum, without the approval of the Central Government, if –

- (a) it has not raised any money by public issue of shares or debentures in India; and
- (b) it has not made any default in India in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of 30 days in any financial year.



CAPITAL RATIONING



Firms generally set budgets for a year. Subsequently it attempts to select a combination of good projects within the limit aiming at maximum profitability. We know that NPV and IRR rules tell us that all good projects need to be accepted. However, a firm may not have enough resources to fund all these projects owing to internal or external constraints. This situation leads to capital rationing. It needs to “ration” (allocate) the available capital in such a way that shareholders wealth is maximized.

A firm having good positive NPV projects faces capital rationing because –

- It does not have capital on hand
- It does not have capacity to raise the capital needed to finance projects, because
 - ⌘ The firm's borrowing credibility is low
 - ⌘ The firm's stock is under-priced or the market is down
 - ⌘ The costs of external financing are high
 - ⌘ Upper management may impose limits on the funds available to the firm's divisions

A firm may face a “hard” or a “soft” capital rationing problem.

“**Hard**” capital rationing refers to restraints imposed “**Externally**”. For example, it occurs when the external markets will not lend the company money even when there are positive NPV projects.

“**Soft**” capital rationing occurs “**Internally**”. For example the firm itself limits the amount of money that will be available for projects. One reason for internally “rationing” the available funds is to limit the firm from spending money on frivolous projects.

Firms have capital rationing constraints, thereby limiting the funds available for investment.





Capital rationing may be tackled in capital budgeting by one of the following means:

- A firm may impose ceiling on acceptance of projects through budgets. Projects would be selected according to the approved budgets.
- Responsibility accounting may be followed by firms, wherein the concerned departments can take up projects only up to a certain limit beyond which these would be decided by their higher ups.
- A firm may resort to accepting several small projects so that the allotted budget is fully utilized. However, the firm may forego higher profits by rejecting bigger projects. Thus the firm may not optimize profits.
- A firm may use the PI method to rank the projects and select the best combination to optimize profits.



1. AD Ltd. has an investment budget of ₹25 lakhs for next year. It has under consideration three projects A, B and C (B and C are mutually exclusive) and all of them can be completed within a year. Further details are given below:

Project	Investment required	Net present value
A	14	5.6
B	12	7.2
C	10	5.0

Recommend the best policy to utilize the investment budget, supported by proper reasoning.



Investment Allocation Strategy under Capital Rationing Situation



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Choices	Projects	Investment required (₹ lakhs)	NPV	Comment
1	A&B	26	12.8	Funds available are only ₹25 lakhs and this proposal is not possible to implement.
2	B&C	22	12.2	Since B & C are mutually exclusive, it is not possible to take up B&C simultaneously.
3	A&C	24	10.6	The possible option is only to take up A & C, even though NPV is lowest.

2. The total available budget for a company is ₹20 crores. The projects listed below have been ranked in order of profitability index. The firm has already accepted Project X whose cost is assumed to be ₹13 crores and it has the profitability index of 1.40.

Project	Cost	Profitability Index (₹ in crores)
A	6	1.50
B	5	1.25
C	7	1.20
D	2	1.15
E	5	1.10
	25	

Which projects, including X should be acquired by the company?



Since the funds available with the firm are limited to ₹20 crores only, and the firm has already decided to take up the project X, the decision regarding other projects to be taken up, may be analyzed as follows.

Calculation of Net Present Value of different projects				
Project	Cost (₹ in crores)	PI	PV of Inflows (Cost × PI)	NPV (₹ in crores)
X	13	1.40	18.20	5.20
A	6	1.50	9.00	3.00
B	5	1.25	6.25	1.25
C	7	1.20	8.40	1.40
D	2	1.15	2.30	0.30
E	5	1.10	5.50	0.50

It may be noted that in each set Project X must be included. The firm will then decide on the basis of maximum NPV.

Project	Cost of Project (₹ in crores)	NPV of the Projects (₹ in crores)
X and A	13+6= 19	5.20 +3.00 = 8.20
X and B	13+5=18	5.20 +1.25= 6.45



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X and C	13+7=20	5.20 +1.40=6.60
X, B and D	13+5+2=20	5.20 +1.25 +0.30=6.75
X, D and E	13+2+5=20	5.20 +0.30 +0.50=6.00

Since, X and A , taken together have highest NPV of ₹8.20 crores, the same combination should be accepted.

3. M Industries has a limit of ₹10,00,000 available for investment in the current year. The cost of capital of the firm is 10%. There is no capital rationing in the future. The company has the following indivisible projects for evaluation:

Project	Initial Cost (₹)	NPV @ 10% (₹)
I	3,50,000	1,75,000
II	4,00,000	2,25,000
III	6,50,000	3,80,000
IV	4,80,000	3,15,000
V	2,30,000	90,000

Suggest an optimum investment plan if, there is no alternative investment for surplus funds.



In case, there is no alternative investment opportunity for surplus funds, the investment plan can be selected as follows:

Set	Outlay (₹)	Surplus (₹)	NPV (₹)
I,III	10,00,000	---	5,55,000
I,II,V	9,80,000	20,000	4,90,000
I,IV	8,30,000	1,70,000	4,90,000
II,IV	8,80,000	1,20,000	5,40,000
II,V	6,30,000	3,70,000	3,15,000
III, V	8,80,000	1,20,000	4,70,000
IV,V	7,10,000	2,90,000	4,05,000

The above table shows that the best investment plan is the combination of Projects I and III. It will consume the total funds available and would give the highest NPV of ₹5,55,000.



ASSESSMENT PROCEDURE

1. OBLIGATION TO FILE RETURN (PERSON U/S 140)

- (a) Every Company and Firm should Return of Income or Loss.
- (b) Individual/HUF/AOP/BOI/AJP to file Return if Total Income before 10AA/10BA, Chapter VIA is > Basic Exemption Limit.
- (c) R&OR who is not covered above, has any asset outside India or signing authority in any account located outside India.
- (d) Trust or Institution where Total Income before exemption u/s 11 or 12 exceeds basic exemption limit [Sec.139(4A)]
- (e) Political parties where Total Income before Sec.13A Exemption exceeds Basic Exemption [Sec.139(4B)]
- (f) Specified Persons [Sec.139(4C)] if Total Income before Sec.10 Exemption exceeds max amount not chargeable to tax
- Scientific Research Association claiming exemption u/s 10(21).
 - New Agency claiming exemption u/s 10(22B).
 - Professional Association or Institution claiming exemption u/s 10(23A).
 - Khadi & Village Industries Development Institution whose income is exempt u/s 10(23B).
 - Approved Education Institution or Hospital claiming exemption u/s 10(23C).
 - Trade Union claiming exemption u/s 10(24)
 - Specified Income of Body or Authority or Board or Trust or Commission u/s 10(46).
 - Notified Infrastructure Debt Fund u/s 10(47).
 - Mutual Fund referred to in Sec.10(23D)
 - Securitization Trust referred to in Sec.10(23DA)
 - Venture Capital Company (or) Venture Capital Fund referred to in Sec.10(23FB).
- (g) Every University, College or Other Institution u/s 35(1)(ii)/(iii), who are not required to file Return of Income or Loss under any other provision of Sec.139 [Sec.139(4D)].
- (h) Business Trust, which is not required to file Return of Income or Loss under any other provision of Sec.139. Business Trust is required to file its Return of Income or Loss in every previous year. [Sec.139(4E)]

2. LIMITATION OF TIME

Section	Situation	Time Limit
139(1)	Voluntary / Regular Return of Income (a) Company	30 th September of Relevant Assessment Year (RAY)
	(b) Any person other than Company <ul style="list-style-type: none">• Subject to audit under IT / any other law + Working Partner of Firm.	30 th September of RAY



	<ul style="list-style-type: none"> • Not subject to Audit (c) Assessee who is required to furnish a Report u/s 92E	31 st July of RAY 30 th November of RAY
139(3)	Loss Return- to c/fd loss u/s 72, 73, 74, 74A	Due Date u/s 139(1)
139(4)	Belated Return of Income	Before completion of assessment or within 1 year from end of RAY, whichever falls earlier.
139(5)	Revised Return of Income	Before completion of assessment or within 1 year from end of RAY, whichever falls earlier.
139(9)	Defective Return rectification	Within 15 days of receipt of notice from AO, or such time as extended by him.

3. DIFFERENT TYPES OF RETURN

Sec.	Nature	Situation	Points to Remember
139(1)	Voluntary Return	Obligation to file Return, as per Point 1 above.	Refer Due Dates for filing Return under Point 2 above.
139(3)	Loss Return	Assessee has incurred loss and wants to carry forward u/s 72, 73, 74 and 74A	This Return mandatory only for c/fd of current year loss, and not for prior year losses. Not applicable for carry forward of losses u/s 71B, 32(2), 35(4), 36(1)(ix).
139(4)	Belated Return	Assessee fails to furnish or file the return within time limit u/s 139(1) or time limit given in the notice u/s 142(1)	<ul style="list-style-type: none"> • Loss cannot be c/fd. • It cannot be revised. • Liable for interest u/s 234A. • Return filed after end of RAY, liable for 271F penalty ₹5,000.
139(5)	Revised Return	Filed Return within the date u/s 139(1) or u/s 142(1), and in that return any error omission/ wrong statement	<ul style="list-style-type: none"> • Loss Return can be revised. • Belated Return cannot be revised. • Return can be Revised, after receipt of intimation u/s 143(1) or notice u/s 143(2), but within time limit.



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139(9)	Defective Return	<ol style="list-style-type: none"> 1. All Annexure / Statements / Columns not filled in. 2. Self-Assessment Tax along with Interest not paid on or before the date of furnishing return. 3. General / Specific / Other details not enclosed. 	<ul style="list-style-type: none"> • AO shall intimate to the Assessee, the defect in the Return, and give him an opportunity to rectify the defect. • If not rectified, the Return is to be treated as Invalid Return. • If Rectification is done before completion of assessment, AO can condone the delay.
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Note:

General Details	Specific Details		Other Details	
	Books of A/c Maintained	No books of Accounts	All Assesseees	Business Assesseees
<ul style="list-style-type: none"> • Computation Statement • Audit Report u/s 44AB • Proof of Tax Payment • Proof of Deposit • Audited Financial Statement • Other Audit Report 	<ul style="list-style-type: none"> • Financial Statements • Capital Accounts and Personal Accounts of Owner /Partner / Member 	<ul style="list-style-type: none"> • Statement of Turnover & Income • Statement of Current Assets and Liabilities 	<ul style="list-style-type: none"> • Exempt Incomes, • Assets belonging to the Assessee, of prescribed nature and value, • Bank Accounts, • Credit Cards, • Expenditure incurred by the Assessee under prescribed heads above prescribed limits, • Such other outgoings as may be prescribed. 	<ul style="list-style-type: none"> • Audit Report u/s 44AB, if applicable. • Copy of Report and Proof of furnishing the Report, if furnished earlier to filing Return. • Location and Style of the Principal Place of Business and Branches. • Names and Addresses of the Partners / Members in case of Firm / AOP / BOI, and • Extent of Share of all such Partners / Members in the PGBP.

4. RETURN FORMS

1. Individuals - Salary, Interest, Family Pension and no other Income	Form ITR-1 (SAHAJ)
2. Individuals & HUFs - Any Income except Business income	Form ITR-2
3. Individuals & HUFs - Partners except proprietary & Presumptive Business	Form ITR-3
4. Individuals & HUFs - Income from Presumptive Business [u/s 44AD / 44AE]	Form ITR-4S (SUGAM)
5. Individuals & HUFs - Proprietary Business	Form ITR-4
6. Firms / AOP / BOI	Form ITR-5
7. Companies (other than Company claiming exemption u/s 11)	Form ITR-6
8. Persons required to file Return u/s 139(4A), 139(4B), 139(4C) & 139(4D)	Form ITR-7
9. Acknowledgement for Filing Income Tax Return	Form ITR V



5. PERSONS EXEMPTED FROM FILING RETURN OF INCOME [SEC.139(1C)]

Individual whose Total Income does not exceed ₹5 Lakhs, and consists of only Income under the head - (a) "Salaries", and (b) "Income from Other Sources", by way of interest from a Savings Account in a bank, not exceeding ₹10,000.

Conditions:

- Reported PAN to Employer,
- Reported Interest Income to Employer and Employer has deducted the tax thereon,
- Received TDS Certificate in Form 16 from the Employer,
- Discharge the total tax liability for the assessment year through TDS and deposit to the Central Government,
- No claim of refund** of taxes due to him for the income of the assessment year, and
- Received Salary from only one employer for the assessment year.

6. CONSEQUENCES OF NON- FILING RETURN

- 234A Interest,
- No Carry forward of losses,
- No Right to revise,
- Penalty u/s 271F,
- Best Judgement Assessment,
- Prosecution u/s 276CC,
- Withdrawal of exemption for specified assesses.

7. TAX RETURN PREPARES (TRP) [SEC. 139B]

Definitions: (a) **TRP** refers to any Individual authorized u/s 139B, excludes CA's, Legal Practitioners, Officers of the Assessee Banker or Employees of Specified Class(es) of Persons, (b) **Specified Class(es) of Persons** refers to Persons required to furnish ROI, excludes Companies, & persons whose accounts are audited u/s 44AB or under any other law.

Duty of TRP: Every TRP shall assist the persons furnishing ROI as specified in the scheme and affix his signature on return.

Structure of TRP Scheme: (a) Manner and period of authorising TRPs, (b) Educational and other qualifications required, training and other conditions to act as TRP, (c) Code of Conduct for TRPs, (d) Duties & Obligations of TRPs, (e) Withdrawal of authorization, (f) Any other matter which is required to be, specified by the Scheme for the purposes of S.139B.



**8. STATEMENT OF FINANCIAL TRANSACTION OR REPORTABLE ACCOUNT - SEC.285BA
(W.E.F. 01.04.2015)**

Person required to file [Sec.285BA (1)]	
(a) an Assessee, or (b) Prescribed Person in the case of an Office of Government, or (c) Local Authority or other Public Body or Association, or (d) Registrar or Sub-Registrar appointed u/s 6 of the Registration Act, 1908, or (e) Registering Authority empowered to Register Motor Vehicles under Chapter IV of the Motor Vehicles Act, 1988, or (f) Post Master General as referred in Sec.2(j) of the Indian Post Office Act, 1898, or	(g) Collector referred to in Sec.3(g) of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013, or (h) Recognised Stock Exchange referred to in Sec.2(f) of the Securities Contracts (Regulation) Act, 1956, or (i) Officer of RBI, constituted u/s 3 of the RBI Act, 1934, or (j) Depository referred to in Sec.2(l)(e) of the Depositories Act, 1996, or (k) a Prescribed Reporting Financial Institution.
Responsibility: The above persons are responsible for -	
(a) registering, or, maintaining Books of Account or other document containing a record of any Specified Financial Transaction or any Reportable Account as prescribed, (b) furnishing a Statement in respect of that Financial Transaction or Reportable Account.	
Specified Financial Transaction [Sec.285BA(3)]	
(a) transaction of purchase, sale or exchange of goods or property or right or interest in a property, or (b) transaction for rendering any service, or (c) transaction under a works contract, or (d) transaction by way of an investment made or an expenditure incurred, or (e) transaction for taking or accepting any loan or deposit, which may be prescribed	

9. POWERS OF IT AUTHORITIES/DEPT

1. Powers of Discovery, Production of Evidence, etc. [Sec.131]
2. Powers to call for information [Sec. 133]
3. Powers of Survey [Sec. 133A]
4. Powers to collect certain information [Sec.133B]
5. Power to Verify information. [Sec.133C]
6. Powers to inspect Registers of Companies [Sec. 134]
7. Powers to disclose information [Sec. 138]
8. Powers of Inquiry before Assessment [Sec. 142(1)]
9. Powers to direct Audit of Accounts [Sec. 142(2A)]
10. Powers of Reference to Valuation Officer [Sec.142A]



Important case Decisions

- Cash in Bank** is conceptually different from Cash on Hand, and it was not permissible for the Department to convert assets to cash and thereafter impound it. KCC Software Ltd vs. DIT 298 ITR 1 (SC)
- Survey by TDS Authorities:** TDS Authorities are empowered to conduct survey to matters relevant to TDS only. [Reckitt & Coleman India Ltd 251 ITR 306 (SC)]
- Power u/s 133A:** Sec.133A does not empower any ITO to examine any person on oath, so statement recorded u/s 133A has no evidentiary value and any admission made based on such statement cannot be made as a basis for addition. CIT vs S. Khader Khan Son (SC) 25 Taxmann.com 413
- Seizure contrary to provisions:** Even though the Department seized the books and documents during the survey operations in contrary to provisions of the law, the Department would be entitled to use such books and documents. However SC directed the photocopies of such records to be provided to Assessee for his purposes. [ITO vs. U K Mahapatra & Co and Ors (SC) 308 ITR 133]
- Special Audit:** Principles of natural justice are to be adopted while issuing a direction for Special Audit u/s 142(2A). Sahara India (Firm) vs CIT 300 ITR 403 (SC)
- Special Audit:** A direction issued u/s 142(2A) of the IT Act, 1961 for Special Audit of accounts of the Assessee is not administrative in nature, it is quasi—judicial. So, the Assessee shall be given reasonable opportunity of being heard before an order for such audit. Rajesh Kumar & Others 287 ITR 91 (SC)
- Special Audit:** If the Assessee was heard, it could have explained to the Assessing Authority that there was no complexity in its accounts and therefore separate audit was not necessary. Therefore, before passing an order u/s 142(2A), the Assessee was entitled to be heard. Muthoottu Mini Kuries 266 ITR 213 (Ker)
- Special Audit:** The complexity of accounts of the Assessee is to be determined not only by the books of accounts, but even by other documents which are available during the course of an assessment and at any stage subsequent thereto may become available to the Assessing Officer. Rajesh Kumar Prop. Surya Trading 275 ITR 641 (Del.)
- Special Audit:** Direction for Special Audit on the basis of the nature and complexity of accounts is valid u/s 142(2A). Living Media Ltd 255 ITR 268
- Special Audit Refused by CA:** Refusal by a Chartered Accountant to conduct audit u/s 142(2A) cannot lead to Best Judgment Assessment. Swadeshi Polytex Ltd 144 ITR 171 (SC)
- Information found in return need not be disclosed under RTI Act unless in public interest:** Information contained in the Return of Income are personal information, the disclosure of which has no relationship to any public activity or public interest. Disclosure of such details would amount to unwarranted invasion of privacy of that individual.[In Girish Ramchandra Deshpande (2013) 351 ITR 472 (SC)]
- Information u/s 133(6) from Banks:** With the prior approval of DIT / CIT, the A.O. may collect information from Banking Company or any other Department, even if no assessment is pending. [Kathiroor Service Cooperative Bank Ltd. vs. CIT (CIB) 2013 (SC)], [Ketchery Service Co-op. Bank Ltd 263 ITR 161 (Ker.)]
- Existence of PE :**Where in course of survey carried out at premises of Indian subsidiary of assessee, a non-resident company, Assessing Officer found that said subsidiary formed assessee's PE in India, Assessing Officer was justified in initiating reassessment proceedings in case of assessee [LG Electronics Inc. vs ADIT [2014] 48 taxmann.com 130 (Alla) HC].
- Where the accounts including the documents, records and other material before the AO did make the issues for his decision complex requiring a special audit, contention of the assessee that the books of



account were not called for and examined by the AO could not be accepted [AT & T Communication Services India (P) Ltd. vs. CIT-I(2014)(DEL)]

10. VARIOUS TYPES OF ASSESSMENT

Particulars	Summary Assessment or Intimation	Regular / Scrutiny Assessment	Best Judgment Assessment	Income Escaping Assessment	Protective Assessment	Search Assessment
Section	143(1)	143(3)	144	147	143(3) or 144 as per Court Order	153A
Return of Income filed under Section	139 or 142(1)	139 or 142 (1)	<ul style="list-style-type: none"> No return filed u/s 139 or 142(1), or Not complied with notice u/s 142(1) / 143(2) / 142(2A), or Situation u/s 145(3) 	Return filed for notice u/s 148.	139 or 142(1)	139 or 142(1) 153A
Issue of Notice	No Notice.	Notice to be issued u/s 142(2)	Show Cause Notice u/s 144	Notice u/s 148	u/s 143(2) or 144	u/s 153 only
Time Limit for Issue of Notice	Not applicable	Notice shall be served within 12 Months from the end of the month, in which return of income is filed.	Within reasonable time before completion of assessment.	Notice to be issued within specified years from end of RAY. <ul style="list-style-type: none"> 4 years, for any Income escaped assessment. 6 years, if the Income escaped assessment > Rs. 1,00,000 16 years, if Income escaped in relation to any Asset located outside India. 	Within reasonable time before assessment	Within reasonable time before assessment.
Time Limit for completion of assessment	One year from the end of the FY in which return of income is filed.	24 months from the end of the Relevant AY.	24 months from the end of the relevant AY.	12 months from the end of FY in which notice u/s 148 served.	Within time limit u/s 143(3)	24 months from the end of FY in which last search has made, or books received u/s 132A.

Common Points for all the above types of assessment:

- Mistakes in AO Order:** Rectification possible u/s 154 within 4 years from the end of the financial year in which the above order was passed.
- Remedy to Dept. for Concealment of Income:** u/s 147 or Revision Order by Commissioner u/s 263.
- Remedy to Assessee:** Appeal u/s 246A or Revision u/s 264.



Important case Decisions
Summary Assessment / Scrutiny Assessment / Best Judgment Assessment

- 1. Intimation u/s 143(1)** is not an order, and hence Assessee can file revised return within the prescribed time, even after such intimation. [S R Koshti 276 ITR 165 (Guj)]
- Assessing Officer need not record reasons for taking up the case for scrutiny while issuing notice u/s 143(2). However, the selection of case must be in accordance with CBDT directions. [Shyam Sundar Gupta 276 ITR 592 (MP)]
- 3. Sec 143(2):** It is not open to the Department to issue intimation u/s 143(l)(a) after notice of Regular Assessment is issued u/s 143(2). [Gujarat Electricity Board 260 ITR 84 (SC)]
- 4. Best Judgment:** In cases of Best Judgment Assessment, the action of the AO may involve a certain amount of guesswork. For this action of the AO, the Assessee himself is to be blamed, as he did not submit proper books of accounts. [Kachawala Gems, Jaipur vs. JCIT 206 CTR 585 (SC)]
- 5. Best Judgment not vitiated by error of law:** In spite of service of notice by AO, neither any return was submitted nor any cause shown, the best judgment assessment of the AO cannot be said to be vitiated by any error of law. [Alok Todi vs. CIT (Cal.)]
- 6. Substance of transaction to be taken into account:** In the absence of any material to pronounce on genuineness of transaction, mere fact that what had been purchased had been leased out to Vendor or that Vendor had undertaken to pay Hire Charges on behalf of Assessee, per se, cannot lead to a conclusion that transaction is a sham one. [CIT vs High Energy Batteries (India) Ltd (Mad.)]
- 7. Method of Accounting:** An Assessee is free to arrange his affairs and choose a method of accounting as per his choice and the Revenue cannot insist on changing the same method until it arrives at findings that such a method distorts profits in a particular year. [Bilahari Investment (P) Ltd 299 ITR 1 (SC)]
- 8. Valuation of Closing Stock:** Closing Stock is to be valued of the lower of Cost or Market Price. Goods can be written down below cost only if there is an anticipated or actual loss. If the fall in price will reduce merely prospective profit, the Stock should not be valued below cost. [CIT vs Hindustan Zinc Ltd 291 ITR (SC) 391]
- 9. Rejection of Stock Valuation by AO:** Rejection of accounts maintained by the Assessee for wrong valuation of Closing Stock by Assessing Officer is legally valid. [Sanjeev Woollen Mills 279 ITR 434 (SC)]
- It is not permissible for the AO to adopt different methods of valuation of Excise Duty Paid Raw Material when purchased and the Unconsumed Raw Material on hand at the end of the year. Therefore, he could not adopt the 'Gross Method' at the time of purchase of Duty Paid Raw Material and the 'Net Method' of valuation at the time of valuation of stock on hand. [Indo Nippon Chemicals Co Ltd 182 CTR 291 (SC)]
- 11. Sec.80—IA Workings by AO:** Where Assessee had not maintained a separate account for manufacturing as a part of Industrial Undertaking, AO is justified in working out Manufacturing Account giving a bifurcation for the purpose of Sec.80-IA. [Arisudana Spinning Mills Ltd vs CIT (SC)]
- 12. Non Production of Evidence:** Where Assessee had not disclosed names of persons to whom jewellery had been sold and also no evidence had been furnished by Assessee to establish that cash deposited in its Bank Account was in lieu of sales made of Jewellery, addition made to Assessee's Income on account of unverifiable sales is justified. [Zaveri Diamonds vs. CIT 25 Taxmann.com 552 (SC)]
- 13. Valid transaction should not be doubted:** Where there was an agreement in form of Offer & Acceptance for sale of Assets, and existence of such assets could not be doubted, the said Sale & its Lease back should not be rejected for the purpose allowing depreciation. [The First Leasing Co of India Ltd [2013] 356 ITR 128]



(Mad)].

14. **Prosecution u/s 276CC:** For Sec.276CC to get attracted, there should be a willful delay in filing of Return and not merely of the failure to file Return in time. [Union of India vs. Bhavecha Machinery and Others 320 ITR 263 (MP)]
15. **Invalidation of Assessment proceedings:** Technical pleas of mistakes / defects / omissions in notices / summons do not invalidate Assessment Proceedings when no confusion or prejudice is caused by mistakes / defects / omissions. [CIT vs Jagat Novel Exhibitors 18 Taxmann 138 (Del.)]
16. **Interest:** Where amount retained u/s 132 exceeds amounts required to meet liability u/s 132B(l)(i), the Department is liable to pay Simple Interest on expiry of 6 months from date of Order passed u/s 132(5) to date of regular assessment or re-assessment. [Chironjilal Sharma (HUF) vs. Union of India (2014) 41 taxmann.com 274 (SC)]

Important case Decisions Income Escaping Assessment

17. **Sec.147:** There should be failure on the part of the assessee to disclose material facts in the return filed by him. In the absence of any failure on the part of the Assessee to disclose fully and truly all material facts, the re-opening of assessments beyond the period of four years is not sustainable. [Grindwell Norton Ltd 276 ITR 673 (Bom.)]
18. **Sec.147:** In case assessment u/s 143(3) is already made and there is no failure on the part of the assessee to file the returns or disclose fully or truly all the material facts, Sec.147 cannot be invoked after 4 Assessment Years. [Haryana Acrylic Manufacturing Co. vs. CIT (Del) 308 ITR 38]
19. **Recording of Reasons:** At the stage of issuing notice, it is not necessary to have established facts of escapement of income, but what is necessary is that there is relevant material on which a reasonable person could have formed requisite belief. Conclusive Proof was not germane at this stage, but formation of belief must be on the base or foundation or platform of prudence which a reasonable person is required to apply. [Sarthak Securities Co. Pvt. Ltd vs. ITO (2010) (Del.)]
20. **Objection of Assessee should be considered first:** The AO is first required to decide the objection of the Assessee filed u/s 148 and serve a copy of the order to the Assessee, and after giving some reasonable time to the assessee for challenging his order, it is open to him to pass an Assessment Order. When the above is not followed, the order of objection and assessment order passed under the Act shall be quashed. [General Motors India Pvt Ltd vs. CIT]
21. Notice for re-assessment on the basis that conditions for allowance for Bad Debts claimed by the Assessee were not fulfilled is valid. [ACIT vs Rajesh Javeri Stock Brokers (P) Ltd 291 ITR (SC) 500]
22. **Failure to disclose material facts:** Failure to disclose material facts necessary for assessment - re-assessment justified. [Central India Electric Supply Co. 247 ITR 54 (SC)]
23. Assessment Order against deceased person without giving notice to Legal Representative is invalid. [Smt. Sudha Prasad [2003] TIOL 114 (Ranchi)]
24. **Notice u/s 148 to be issued for each AY separately:** Each assessment year is to be taken as an independent unit of assessment and the provisions of the Act would apply separately. [Mohd. Ayub (2012) 346 ITR 30 (All)]
25. Service of notice is a pre-condition for making an order of assessment. [R K Upadhya vs Shana Bhai P Patel 166 ITR 163]



- 26. Vague Notice:** Second Notice issued u/s 148 on the basis of a vague notice u/s 154 is not maintainable. [ACIT vs Shreyas Gramin Bank 25 Taxmann.com 282 (SC)]
- 27. Assessee is entitled to seek reason for notice u/s 148 :** The Assessee is entitled to seek the reason for issue of notice u/s 148 and the Assessing Officer is bound to furnish such reasons. The Assessee is entitled to file objection to the Assessing Officer and the Assessing Officer is bound to dispose-off the same, by passing an order in writing. [GKN Driveshafts (India) Ltd & Others 259 ITR 19 (SC)], [Samsung India Electronics 362 ITR 460]
- 28. Issue of Notice - When Complete?:** Merely signing notices cannot be equated with issuance of notice as contemplated u/s 149. Date of Issue would be date on which same is handed over for service to Proper Officer. [Kaubhai M Patel (HUF) vs. Hiren Bhatt & His Successors to Office (2011) (Guj.)]
- On plain reading of Sec.149, it is apparent that the maximum time limit for issuance of notice u/s 148 is 6 years from the end of the Relevant Assessment Year. In the instant case, notice was dated 31.03.2010 and the said notice were sent for booking to the Speed Post Centre on 07.04.2010. Hence the date of issuance of the said notice would be 07.04.2010 and not 31.03.2010. Thus, the notice is barred by limitation.
- 29. S.148 - Limitation applies for every notice u/s 148:** Writ Petition against notice on grounds that no reason had been recorded or disclosed u/s 148, and that Assessee had already received a notice earlier and submitted a Return in response to it and that second notice was barred by time - Dismissal of Writ Petition by High Court was not valid. [Communicator of Chicalim 247 ITR 271 (SC)]
- 30. No Notice if other proceedings are pending:** Notice u/s 148 cannot be issued till the assessment proceedings pending on the basis of Return already filed are not terminated. [Trustees of H.E.H The Nizams Supplemental Family Trust 242 ITR 381 (SC)]
- 31. Scope of Sec.147:** The purpose or objective of re-opening an assessment is only to bring to tax income escaping assessment and not to give further relief to the Assessee. Therefore u/s 147, the original total income should not be allowed to come down. [Sun Engg. Works P Ltd 198 ITR 297 Chettinad Corpn. Pvt Ltd 200 ITR 320]
- 32.** Re-opening of assessment based on conjenctures is in gross abuse of law, and same is liable to be quashed. [German Remedies Ltd]
- 33.** The opinion of the audit party on a particular statutory provision is not a valid information for initiating re-assessment proceedings. [Juhi Metal Works 263 ITR 287 (All.)]
- 34. Opinions of District Valuation Officer:** Opinions of District Valuation Officer cannot be basis for re-opening assessment. [ACIT vs. Dhariya Construction Company 328 ITR 515 (SC)]
- 35.** Mere Change in Opinion will not entitle the AO to initiate re-assessment proceedings. Re-assessment notice cannot be issued after years where there is no failure on the part of the Assessee to disclose fully and truly all facts necessary for assessment. [Foramer France 264 ITR 566 (SC)]
- 36. Change in Opinion:** Return of Income is processed without any scrutiny u/s 143(1), there can be no change of opinion and re-assessment proceedings can be validly initiated. In case an issue or query is raised and answered by the Assessee in original assessment proceedings but thereafter the A.O does not make any addition in the Assessment Order, such cases will be hit by principle of change of opinion and re-assessment proceedings will be invalid. [Usha International Ltd 348 ITR 485 (2012) (Del)], [Innovative Foods Ltd 37 Taxmann 463 (2013) (Ker)]
- 37. Change in Opinion:** Where Assessing Officer in Assessment order failed to express any opinion accepting genuineness of donations received by Assessee, Reassessment Notice issued u/s 148 on basis of prima facie enquiry that donation given by Donor to Assessee was in nature of accommodation entries and



fictitious as donor had no financial capacity to give such donation, it would not be said that said notice was given on basis of change of opinion. [Fateh Chand Charitable Trust (All) 36 Taxmann 67(2013)]

- 38. Enquiry on Concluded Matters:** The power of AO to reconsider the material and evidence at the time of re-assessment cannot be untrammelled but should be laced with reasonable restrictions. The Assessing Officer cannot make fishing inquiry on concluded matters. [Amrinder Singh Dhiman 269 ITR 378 (P&H)]
- 39. Second Thought on Same Material:** Assessee-Company claimed deduction u/s 80-IA which was allowed by AO after considering Assessee's reply to detailed questionnaire. However, later on AO issued notice u/s 147 on ground that Assessee was a Contractor or Supplier of Irrigation Products, and could not be called a Developer of any new infrastructural facility so as to be eligible for deduction u/s 80-IA. This is a case of second thought on same material, hence notice is not valid. [ACIT vs Parixit Industries (P) Ltd 25 Taxmann.com 301 (SC)]
- 40. Change in Decision:** Subsequent reversal of legal position by judgment of Supreme Court does not authorise Department to re-open assessment, which stood closed on basis of law as it stood at relevant time. [DCIT vs Simplex Concrete Piles (India) Ltd 25 Taxmann.com 283 (SC)]
- 41. Retrospective Amendment:** Where a Company was assessed u/s 143(3), Sec.147 cannot be invoked merely by reason of a retrospective amendment to Sec. 115JB. Sun Investment (P.) Ltd vs ACIT 18 Taxmann 218 (2012)(Del.)
- 42. Report along with Return:** U/s 148, while disposing of objections of Assessee, AO stated that Assessee had filed only sketchy details in its Return filed in Electronic Form. This is not a valid reason as relevant provisions u/s 139C and 139D expressly make it clear that no document or report can be filed with Return of Income in Electronic Form. Filing of Document or Report is possible only if a notice is issued u/s 143(2), which was not done in instant case. [Indivest Pte Ltd, Singapore vs ADIT (2012) (Bom) 19 Taxmann 216]
- 43. Applicability of Explan 3 to Sec.147:** Explan. 3 to Sec.147 is applicable only in the event that the opinion formed in the notice has been found correct and the proceeding in the respect of the said income was not dropped u/s 152(2). [ACIT vs Major Deepak Mehta (Chh.)
- Explan. 3 to Sec.147:** The AO may assess or re-assess the income in respect of any issue which has escaped assessment which has come to his notice subsequently in the course of the proceedings u/s 147, even if reasons for such issue have not been included in the reasons recorded u/s 148(2).
- 44. Change in Opinion:** Where in the Return, Assessee had fully disclosed details of Stock and Shares, but later on revenue reopened assessment on the ground that loss incurred was a Speculative Loss, the same being change of opinion, hence re-opening was not proper. [ACIT vs ICICI Securities Primary Dealership Ltd (SC)]
- 45. Sec.156 Notice Demand:** Service of Notice of Demand u/s 156 is mandatory before initiating recovery proceedings and constitutes the foundation of subsequent recovery proceedings. [Sri Mohan Wahi 248 ITR 799 (SC)]
- 46.** In absence of reasons recorded to suggest that Income that escaped assessment is ₹ 1,00,000 or more, reassessment notice given after 4 Years from the end of Assessment Order is not valid. [Mahesh Kumar Gupta vs. CIT (2013) (ALL)]

Important case Decisions Search Assessment

- 47. Block Assessment:** Provisions of Sec. 127 apply to Block Assessment cases also. [Mohammed Salim vs CIT



300 ITR 302 (SC)]

48. Search pre—requisite for Block Assessment: A valid search is pre-requisite for invoking the provisions relating to Block Assessment. Mere intimation by the CBI did not constitute information. [UOI vs Ajit Jain (SC) 260 ITR 80]

Contrary View: There is no requirement under provisions of the Act that, Block Assessment proceedings u/s 158BD can be initiated only in pursuance of legal and valid Search proceedings u/s 132 [Gunjan Girishbhai Mehta vs. DIT (Investigation) [2014] 49 taxmann 69 (Guj) HC]

49. S. 132(I) not based on pretence: The words "has reason to believe" in Sec. 132(1) postulate belief and existence of reasons for that belief. The belief must be held in good faith, it cannot be merely pretence. [Dr Pratap Singh vs Director of Enforcement 155 ITR 166 (SC), Lakhmani Mewal Das 103 ITR 437 (SC)]

50. S.132 pre-requisites: If the conditions for exercise of the power u/s 132 are not satisfied, the proceeding is liable to be quashed. [Seth Bros and others 74 ITR 836 (SC)]

51. Impounding of Assets after conversion: Cash in Bank is conceptually different from Cash on Hand, and it was not permissible for the Department to convert assets to cash and thereafter impound it. [KCC Software Ltd vs DIT 298 ITR 1 (SC)]

52. Proceedings which had become final cannot be abated: Regular assessment proceedings which had become final cannot be abated and restored to AO in case of Block Assessment u/s 153A. [CIT vs Smt. Shaila Agarwal (All.)]

53. Invalid Search: Subsequent event cannot make good the deficiency found at the time of initiation of search. Incriminating documents found during search cannot validate an Invalid Search. When search is illegal, seized assets shall be returned. [Dr. Mrs Anita Sahai 266 ITR 597 (All.)]

54. No Power to Arrest: U/s 132, no power has been conferred on the Authorised Officer to arrest the person who is found or suspected to be in possession of any document or money, etc. that represents partly or wholly income or property not disclosed. [K Choyi vs Syed Abdulla Bafakky Thangal & Others 123 ITR 435 (SC)]

55. Condition for retention of books

The following two conditions must be fulfilled before extended retention of books become permissible in law.

Reasons in writing must be recorded by the Authorised Officer or the concerned ITO seeking the CIT's approval, and Obtaining of the CIT's approval for such extended retention. [Oriental Rubber Works 145 ITR 477 (SC)]

56. 3 conditions for initiating proceedings u/s 153C

(a) Satisfaction must be recorded by the AO that any Undisclosed Income belongs to any person, other than the person with respect to whom search was made u/s 132,

(b) The books of account or other documents or assets seized or requisitioned had been handed over to the Assessing Officer having jurisdiction over such other person,

(c) The Assessing Officer has proceeded u/s 153A against such other person. [Manish Maheswari vs ACIT 289 ITR 341 (SC)]

57. Undisclosed income of any other person: Assessing Officer can record his satisfaction for issuing notice u/s 158BD in case of person other than searched person even after completion of Block Assessment in case of searched person, [CIT vs. Calcutta Knitwears(2014)43 taxmann.com 446 (SC)]

Protective Assessment

58. Protective Assessment is valid to protect the interest of the revenue. [Lalji Haridas 43 ITR 387 (SC)]

59. Protective Assessment does not invalidate other assessment. [Bachulal Kapoor 60 ITR 74 (SC)]



EFFECT ON CENVAT CREDIT: REMOVAL OF INPUTS & CAPITAL GOODS AS SUCH

- **100% credit to be paid:** As per provisions of Rule 3(5) of CENVAT Credit Rules, 2004, when inputs or capital goods, on which CENVAT credit has been taken, are removed as such from the factory or premises of the provider of output service, the manufacturer of the final products or provider of output service, as the case may be, shall pay an amount equal to the credit availed in respect of such inputs or capital goods.
- **Payment of Cenvat not required when inputs/capital goods removed for provision of output service:** Payment of amount equal to Cenvat shall not be required to be made where any inputs or capital goods are removed outside the premises of the provider of output service for providing the output service.
- **Payment of Cenvat not required when inputs removed for providing free warranty:** Payment of amount equal to Cenvat shall not be required to be made where any inputs are removed outside the factory for providing free warranty for final products.

- **Payment of Cenvat not required for Job Work:**

Purpose	Input Goods (as such or partially processed) are sent to a Job Worker for further processing, testing, repair, re-conditioning, etc.
Condition	<ol style="list-style-type: none">1. Receipt within 180 Days: Goods should be received back within 180 days from the day on which they were sent to the job worker. The period can be extended for a further period of 180 days by permission from Jurisdictional Deputy Commissioner or Assistant Commissioner in case of capital goods. No time limit for bringing back the capital goods, when Capital Goods are removed for provision of services.2. Consequence of Non-Receipt: If input goods/ capital goods are not received within 180 days, the Service Provider should pay an amount equal to the CENVAT Credit claimed.3. CENVAT Credit: The amount so paid can be availed back on receipt of the goods.

- **Payment of Cenvat not required for Removal of Consumables:** If Jigs, Fixtures, Moulds and dies are sent by the manufacturer of final products (a) to another manufacturer for further production or (b) to a job worker for the production of goods according to his specifications, CENVAT Credit on them need not be reversed as they are in the nature of consumables. Hence, such goods need be returned back within 180 days.
- **Eligibility as Cenvat credit of the Amount:** As per Rule 3(6), the amount paid as aforesaid shall be eligible as Cenvat credit in the hands of the buyer of such inputs/capital goods, as if it was a duty paid by the person who removed such goods.
- **Monthly payment:** The amount payable under Rule 3(5) shall be paid by the manufacturer of goods or the provider of output service by debiting the CENVAT credit or otherwise on or before the 5th of the following month except for the month of March, where such payment shall be made on or before the 31st March.
- **Recovery:** If the manufacturer of goods or the provider of output service fails to pay the amount payable under Rule 3(5) it shall be recovered, in the manner as provided in Rule 14, for recovery of CENVAT credit wrongly taken and utilised.



Illustration 1: ABC Ltd., Kolkata purchased plastic granules valued ₹ 1,12,360 (inclusive of central excise ₹ 12,360) for manufacture of plastic moulded chairs. It availed CENVAT credit of excise duty of ₹ 12,360 paid on the said inputs. It subsequently cleared the said inputs as such from the factory in the following manner

(a) Sales to A Ltd. (purchase price: ₹ 15,000)	₹ 30,000
(b) Sales to B Ltd. (purchase price: ₹ 12,000)	₹ 12,000
(c) Clearance to ABC Ltd.'s own factory at Mumbai (purchase price: ₹ 60,000)	Free of cost

ABC Ltd. wants to calculate the excise duty payable by it on the above clearances.

Solution: Rule 3(5) of the CENVAT Credit Rules, 2004, when inputs are removed as such from the factory, the amount of duty payable shall be equivalent to the credit availed in respect of such inputs. The sale price has no bearing on the duty payable if the inputs are cleared as such from the factory.

Computation of excise duty payable by ABC Ltd.:

(a) Excise duty payable on sales to A Ltd. [₹ 15,000 x ₹ 12,360 ÷ ₹ 1,00,000]	₹ 1,854
(b) Excise duty payable on sales to B Ltd. [₹ 12,000 x ₹ 12,360 ÷ ₹ 1,00,000]	₹ 1,483
(c) Excise duty payable on clearance to own factory at Mumbai [₹ 60,000 x ₹ 12,360 ÷ ₹ 1,00,000]	₹ 7,416

Case Study: Inputs used in the waste or the by-product generated, even if such by-product is excisable and duty is payable on it, will not be considered as removal of inputs as such and credit on such inputs would not be reversed by applying provision of Rule 3(5) of Cenvat Credit Rules, 2004. It is of no relevance that assessee obtains remission of duty under rule 21 of Central Excise Rules, 2002. **[Commissioner v. Gelfec Ltd. [2014] 304 ELT A85 (SC)]**

- **Removal of Capital Goods after usage:** When Capital Goods are cleared after use, the CENVAT Credit availed on such goods as reduced by the prescribed percentage per quarter shall be reversed. The prescribed % is as follows:

a) For Computer and Computer Peripherals: [Notification No.12/2013 dt. 27.09.2013]:

Year	1	2	3	4
% per Quarter	10%	8%	5%	1%

b) For other Capital Goods: 2.5% per quarter per year —

Amount of Credit to be reversed	CENVAT availed at the time of receipt of Capital Goods. Less: % of CENVAT Credit per quarter (or part thereof) from the date of taking credit (as above)
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Note:

- (a) If the amount of duty calculated on Transaction Value is more than the amount as calculated as above, then the duty calculated on the Transaction Value shall be reversed.
- (b) Hence the amount to be reversed = Amount calculated as per above points or Transaction Value x ED rate whichever is higher. (Note: EC and SHEC shall not apply as this is a levy under CENVAT Rules and not under Central Excise Act.)



Illustration 2: A Ltd. purchased capital goods for ₹ 20,00,000 plus excise duty @ 12.36% on 1-4-2014. Cenvat credit was taken in accordance with Cenvat Credit Rules, 2004. The said capital goods are removed after use on 12-04-2015 at a transaction value of ₹ 18,00,000. Compute the amount of Cenvat credit to be reversed.

Solution: In the above case the provisions of Rule 3(5A) of Cenvat Credit Rules, 2004 shall be applicable. The manufacturer shall be required to pay higher of the following amounts:

- (a) Amount of Cenvat credit taken (-) 2.5% per quarter or part thereof of use i.e. ₹ 2,47,200 - 2.5% x 5 quarters of ₹ 2,47,200 = ₹ 2,16,300; or
 - (b) Excise duty payable on transaction value i.e. 12.36% of ₹ 18,00,000 = ₹ 2,22,480.
- Thus, the company will be required to pay ₹ 2,22,480.

- **Removal of capital goods as waste and scrap [Rule 3(5A)(b)]:** If the capital goods are cleared as waste and scrap, the manufacturer shall pay an amount equal to the duty leviable on transaction value.
 - (a) As per Rule 3(6), the amount paid above shall be eligible as Cenvat credit in the hands of the buyer of such capital goods, as if it was a duty paid by the person who removed such goods.
 - (b) The amount payable under Rule 3(5A) shall be paid by the manufacturer of goods or the provider of output service by debiting the CENVAT credit or otherwise on or before the 5th of the following month except for the month of March, where such payment shall be made on or before the 31st March.
 - (c) If the manufacturer of goods or the provider of output service fails to pay the amount payable under Rule 3(5A) it shall be recovered, in the manner as provided in Rule 14, for recovery of CENVAT credit wrongly taken and utilised.

Illustration 3: A Ltd. purchased capital goods for ₹ 20,00,000 plus excise duty @ 12.36% on 1-4-2014. Cenvat credit was taken in accordance with Cenvat Credit Rules, 2004. The said capital goods are removed as waste and scrap at a transaction value of ₹ 50,000 on 12-4-2020. Compute the amount of Cenvat credit to be reversed.

Solution: The manufacturer shall be required to pay an excise duty payable on transaction value i.e. ₹ 50,000 x 12.36% = ₹ 6,180.

Case Study: Rule 3(5A) of Cenvat Credit Rules, 2004 for levy of duty on capital goods cleared as waste was inserted w.e.f. 16-5-2005. Therefore, it is not applicable to period before that date.

Scrap and waste arising out of worn out parts of capital goods used in production of goods and not arising out of manufacture are not excisable. [CCEX. v. CESTAT [2013] 297 ELT 498 (Mad.)]



BASEL I - WHAT IS A 'BANK' FOR THE PURPOSE OF BASEL ACCORD

INTRODUCTION

As on date the provisions of Basel Accord of 1988 has undergone a number of changes made year after year. Though Basel II accord has become operational some of the covenants of Basel I (1988) are still relevant. Under the 1988 accord, Banks and security firms have been given different treatment. In the ensuing paragraphs we will focus on these developments.

THE BASEL ACCORD (BASEL I)

In 1988, the Basel Committee published a set of minimal capital requirements for banks. These became law in G-10 countries in 1992; with Japanese banks being permitted an extended transition period. The requirements have come to be known as the 1988 Basel Accord.

What is a 'Bank' for the purpose of Basel accord: To understand the scope of the 1988 accord, we need to clarify what we mean by 'bank.' This is because, some jurisdictions distinguished between banks and securities firms, and the Basel accord (Basel I) applied only to the former.

Commercial Banks and Universal Banks - Glass Steagal Act, USA (1933-1999)

Under its Glass-Steagal Act, the United States had quite some time back made a distinction between commercial banks and securities firms (investment banks or broker-dealers). Following World War II, Japan adopted a similar legal distinction. The United Kingdom also distinguished between banks and securities firms, although this was more a matter of custom than law. By comparison, Germany had a tradition of universal banking, which made no distinction between banks and securities firms. Under German law, securities firms were banks and a single regulatory authority oversaw banks. France and the Scandinavian countries had similar regimes. The USA revoked the Glass Steagal Act in 1999.

Exclusive Focus on Credit Risk During 1988-1998

The 1988 Basel Accord -Basel I- primarily addressed banking in the sense of deposit taking and lending (commercial banking under US law), so its focus was credit risk. Under this dispensation, bank assets were assigned 'risk weights.' Generally, G-10 government debt was weighted 0 per cent, G-10 bank debt was weighted 20 per cent, and other debt was weighted 100 per cent. Following this the Government of India Securities were assigned zero risk weight. Having assigned and aggregated the risk, Banks were required to hold capital equal to 8 per cent of the risk weighted value of assets. Additional rules applied to contingent obligations, such as letters of credit or derivatives.

MARKET RISK - RECOGNITION OF THE NEED FOR CAPITAL – AMENDMENT OF BASEL I IN 1996

With banks increasingly taking market risks, in the early 1990s, the Basel Committee decided to update the 1988 accord to include bank capital requirements for market risk. This would have implications for non-bank securities firms. Any capital requirements the Basel Committee adopted for banks' market risk were to be incorporated into future updates of Europe's Capital Adequacy Directive (CAD) and thereby apply to Britain's non-bank securities firms. If the same framework were extended to non-bank securities firms outside Europe, then market risk capital requirements for banks, and, securities firms could be harmonized globally. In 1991, the Basel Committee entered discussions with the International Organization of Securities Commissions (IOSCO) to jointly develop such a framework. The two organizations formed a technical committee, and work commenced in January 1992.

COMMERCIAL BANKS & SECURITIES FIRMS - UNIVERSAL BANKS

Glass Steagal Act revocation in 1999 by USA: Historically, capital requirements for banks and securities firms had served different purposes.



Banks

Banks were primarily exposed to credit risk. They, often held illiquid portfolios of loans supported by deposits. Such loans could be liquidated rapidly only at 'fire sale' prices. This placed banks at risk of 'runs.' If depositors feared that a bank might fail, they would withdraw their deposits. Forced to liquidate its loan portfolio, the bank would succumb to staggering losses on those sales.

Though Deposit insurance and lender-of-last-resort provisions implemented eliminated the risk of bank runs, they introduced a new problem. Depositors no longer had an incentive to consider a bank's financial viability before depositing funds. Without such marketplace discipline, regulators were forced to intervene often at huge cost to the exchequer. One solution was to impose minimum capital requirements on banks. Because of the high cost of liquidating a bank, such requirements were generally based upon the value of a bank as a going concern.

Securities Firms

The primary objective behind stipulation of capital requirements for securities firms was to protect clients who might have funds or securities on deposit with a firm. Securities firms were primarily exposed to market risk. They held liquid portfolios of marketable securities supported by secured financing such as repos. A troubled firm's portfolio could be unwound quickly at market prices. For this reason, capital requirements were based upon the liquidation value of a firm.

Capital for Banks & Securities Firms

In a nutshell, banks entailed systemic risk. It was thought then that Securities firms did not. Regulators would strive to keep a troubled bank afloat but would gladly unwind a troubled securities firm. Banks needed long-term capital in the form of equity or long-term subordinated debt. Securities firms could operate with more transient capital, including short-term subordinated debt.

SEGREGATION OF BANKING BOOK & TRADING BOOK FOR HOLDING CAPITAL

In April 1993, the Basel Committee released a package of proposed amendments to the 1988 accord.

This included a document proposing minimum capital requirements for banks' market risk.

Banks would be required to identify a trading book and hold capital for market risk under trading book and organization-wide foreign exchange exposures.

- Capital charges for the trading book would be based upon a crude value-at-risk (VaR) measure broadly consistent with a 10-day 95 per cent VaR metric. Similar to a VaR measure used by Europe's CAD, this partially recognized hedging effects but ignored diversification effects.
- Later VaR measure was changed modestly from the 1993 proposal, still reflecting a 10-day 95 per cent VaR metric. Market risk capital requirements were set equal to the greater of either the previous day's VaR, or the average VaR over the previous six days, multiplied by 3.

BANKS TO HAVE INDEPENDENT RISK MANAGEMENT FUNCTION AND SATISFY THE REGULATOR REGARDING ITS RISK MANAGEMENT PRACTICES

The Basel Committee's new proposal was adopted in 1996 as an amendment to the 1988 accord. It is known as the 1996 amendment. **It went into effect in 1998.**



HOW TO VALUE INVENTORIES? (AS - 2)



Inventory:

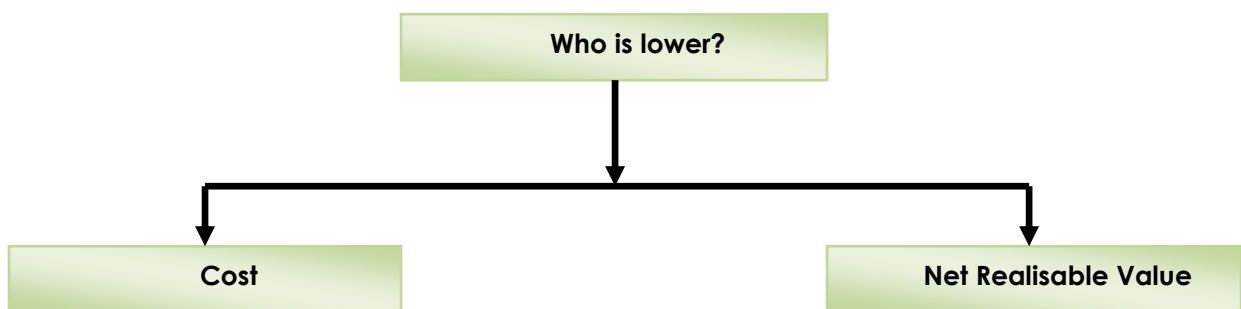
- It is held for sale in the ordinary course of business
- It is used in the process of production of such sale
- It can be in the form of materials or supplies that are to be consumed in production or in rendering of services.
- It does not include machinery.
- It includes spares which can be used only in connection with an item of fixed assets and whose use is irregular, such machinery spares are accounted for in accordance with AS -10 (Accounting for Fixed Assets).
- Machinery spares, that are not specific to a particular item of fixed asset but can be used generally for various items of fixed assets, should be treated as inventories for the purpose of AS-2 and should be charged to the statement of profit and loss as and when issued for consumption.
- However, the machinery spares of the following types should be capitalised being of the nature of capital spares/insurance spares—
 - ✓ Machinery spares which are specific to a particular item of fixed asset and
 - ✓ Their use is expected to be irregular.
- The total cost of such capital spares/ insurance spares should be allocated on a systematic basis over a period not exceeding the useful life of the principal item, i.e., the fixed asset to which they relate. When the related fixed asset is either discarded or sold, the written down value less disposal value, if any, of the capital spares/insurance spares should be written off.
- Any stand-by equipment is a separate fixed asset in its own right and should be depreciated like any other fixed asset.



AS – 2 is not applicable in the following cases:

- W-I-P arising under construction contract including directly related to service contract
- W-I-P arising in ordinary course of business for service providers
- Financial instruments held as stock-in-trade
- Producer's inventories like livestock, agricultural and forest products, mineral oil

How to compute the value of Inventories?



Inventories should be valued at lower of cost and net realisable value.

Steps in valuation of inventories

- Determination of **cost** of inventories.
- Determination of **net realisable value** of inventories.
- **Comparison** between the cost and net realisable value.

Cost of Inventories

Cost includes —

- A. Cost of purchase
- B. Cost of conversion
- C. Other costs (incurred in bringing the inventories to their present location and condition)

A. Cost of Purchase —

- ✓ Purchase price
- ✓ Duties and Taxes
- ✓ Freight inward
- ✓ Other expenditures directly attributable to the acquisition.

Less:

- ✓ Duties and taxes recoverable by enterprises from taxing authorities



- ✓ Trade discount
- ✓ Rebate
- ✓ Duty drawback
- ✓ Other similar items.

B. Cost of conversion —

It consists —

- ✓ Cost directly related to the units (ie. Direct Labour, Direct Material, Direct Expenses)
- ✓ **Plus** Systematic Allocation of fixed and variable production overheads that are incurred in converting material into finished goods.

Some Important points

- ✓ Allocation of fixed production overhead is done on the basis of normal capacity.
- ✓ In the periods of abnormally high production, the amount of fixed production overheads allocated to each unit of production is decreased so that inventories are not measured above cost.
- ✓ Allocation of variable production overhead is done on the basis of actual production.
- ✓ **In case of joint-products**, When the cost of conversion of each product is not separately identifiable, total cost of conversion is allocated between the products on the rational and consistent basis .
- ✓ **In case of by-product**, if by-products, scrap or waste materials are not of material value, they are measured at net realisable value, then net realisable value is deducted from cost of conversion. Net cost of conversion is distributed among the main products.

Example:

XYZ Ltd. manufacture computers, during the year ended 31 st March, 2015 the company manufactured 1,100 computers, it has the policy of valuing finished stock of goods at a standard cost of ₹1.8 lakhs per computer.

The details of the cost are as under :

	(₹ in Lakhs)
Raw material consumed	800
Direct Labour	500
Variable production overheads	300
Fixed production overheads (Including interest of ₹ 200)	580

Compute the value of cost per computer for the purpose of closing stock.

Answer:

As per AS-2 finished stock of goods should be valued on the basis of absorption costing. While absorbing fixed production overheads the normal production capacity is considered.

	(₹ in lakhs)
Materials	800
Direct Labour	500



Variable production overheads		300
Fixed production overheads	580	
Less: Interest	<u>200</u>	<u>380</u>
Total Cost		<u>1,980</u>
Number of computers produced 1,100 (Assumed to be normal production)		
Cost per computer 1,980/1,100		= ₹ 1.80 lakhs

Other costs are the costs which are incurred in bringing the inventories to their present location and condition.

Cost of Inventories does not include —

- Abnormal amounts of wasted materials, labour, other production costs
- Storage cost
- Administrative overhead
- Selling and distribution cost
- Interest and borrowing cost. However, if AS-16 allows such cost to be included it, can form part of the cost.

Example:

In a production process, normal waste is 5% of input. 10,000 MT of input were put in process resulting in a wastage of 600 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at the year end. If waste has Nil realisable value. How to treat abnormal loss at the time of valuation of inventories?

Answer:

As AS-2, abnormal amounts of waste materials, labour or other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. In this case, normal waste is 500MT and abnormal waste is 100MT. The cost of 500MT will be included in determining the cost of inventories (finished goods) at the year-end.

Net Realisable Value:

- ✓ Estimated selling price in ordinary course of business, **less**
- ✓ Estimated cost of completion and estimated cost necessary to make the sale.

Net realisable value is estimated on the basis of most reliable evidence at the time of valuation. It also takes into account the purpose for which the inventory is held.

Example:

The company deals in three products A,B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year ended 2014-15 the historical cost and net realizable values of the items of closing stock are determined as below:

Items	Historical Cost (₹ in lakhs)	Net Realisable Value (₹ in lakhs)
A	40	28
B	32	32
C	16	24
	88	84



What will be the value of closing stock?

Answer:

Value of closing stock is as follows —

Items	(₹ in lakhs)
A	28
B	32
C	16
	76

TREATMENT OF REVALUATION OF FIXED ASSETS (AS – 10)



- When the fixed assets are revalued, the assets are shown at revalued price.
- A competent valuer does the revaluation through appraisal.
- Revaluations may be done using price index appropriate to the concerned fixed assets.
- At the time of revaluation entire class of assets should be revalued or the selection of assets for revaluation should be made on a systematic basis.

Presentation of revalued asset in financial statement —

- ✓ By re-stating the gross book value and accumulated depreciation.
- ✓ By re-stating net book value adding there in the net increase on account of revaluation.
- Revaluation of fixed assets should be restricted to the net recoverable amount of fixed asset.

Treatment under different situations —

- First time revaluation (upward)
— Increase in net book value is credited to 'Revaluation Reserve'
- First time revaluation (Downward)



- Decrease in net book value is charged to the Profit & Loss Account.
- First revaluation (downward) subsequent revaluation (upward)
 - Decrease in net book value is charged to the Profit & Loss Account in the year in which downward revaluation was done.
 - Amount of revaluation that can be credited to Profit & Loss Account is restricted to the amount of devaluation earlier written off. Balance amount of revaluation should be credited to Revaluation Reserve.
- First revaluation (upward) subsequent revaluation (downward)
 - Increase in the net book value is credited to owner's interest under the head 'Revaluation Reserve'.
 - Amount of devaluation can be charged to revaluation reserve to the extent the revaluation reserve earlier credited is unutilized, the balance amount of devaluation is charged to profit and loss account.

