

Paper 16 – Tax Management and Practice

Answer to MTP_Final_Syllabus 2012_Jun2017_Set 2

Paper 16 – Tax Management and Practice

Full Marks: 100

Time allowed: 3 hours

Answer Question No. 1 which is compulsory and any five from the rest

- 1.(a) Fill in the blanks: [5×1=5]
- (i) Normally, the purchasing dealer has to issue C Form to the selling dealer, once in _____ months under the CST Act.
 - (ii) Leasing of machinery with transfer of right to use _____ (is/is not) liable to service tax.
 - (iii) Service provided by an Indian company to another Indian company by way of undertaking repairs to machinery located in Singapore _____ (taxable /not taxable) for levy of service tax purposes.
 - (iv) Monetary limit of disposing of a case by a single member bench of ITAT is _____.
 - (v) An application referred to in section 270AA(1) shall be made within _____ from the end of the month in which the order referred to in section 270AA(1)(a) has been received and shall be made in such form and verified in such manner as may be prescribed.

Answer:

- (i) three
- (ii) is not
- (iii) taxable
- (iv) ₹ 50 Lakh
- (v) 1 month

- (b) Choose the most appropriate alternative: [5×1=5]
- (i) Service tax was levied by the Central Government by drawing power from:
 - (A) Entry 97 of the Union List.
 - (B) Entry 85 of the Union List.
 - (C) Entry 83 of the Union List.
 - (D) Entry 82 of the Union List.
 - (ii) The excise duty paid at the time of purchase of Lubricating oil – ₹ 2,000 and Pollution control equipment – ₹ 22,000 by a non-SSI unit. Total Cenvat credit admissible in the current year is:
 - (A) ₹ 2,000
 - (B) ₹ 22,000
 - (C) ₹ 13,000
 - (D) ₹ 11,000
 - (iii) Mr. A purchases the goods from a manufacturer for ₹ 1,000 plus VAT @4%. If he, sell the same by adding ₹ 200 profit, his net VAT payable will be:
 - (A) 48
 - (B) 8
 - (C) 40
 - (D) None of the above.
 - (iv) The provision of advance ruling is covered under section _____.
 - (A) 237 to 241
 - (B) 245A to 245L
 - (C) 245N to 245V
 - (D) 246 to 264
 - (v) Maximum qualifying limit for deduction u/s 80CCC is

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- (A) 50,000
- (B) 1,00,000
- (C) 1,50,000
- (D) None of the above.

Answer:

- (i) (A)
- (ii) (C)
- (iii) (B)
- (iv) (C)
- (v) (C)

(c) State true or false with reasons: [5×2=10]

- (i) Section 14A of Central Excise Act deals with CENVAT Credit Audit.
- (ii) Service provided by a private transport operator to a school in relation to transportation of students to and from a school is a taxable service.
- (iii) An area beyond 200 nautical miles from the base line is called High Seas.
- (iv) The valuation officer to estimate the fair market value of the property provisionally attached and submit a report of the estimate within 30 days if reference is made by A.O.
- (v) Is failure to record investments in the books of account falls under misreporting of income referred to in section 270A(8).

Answer:

- (i) False: Section 14A of Central Excise Act deals with Valuation Audit.
- (ii) False: Service provided by a private transport operator to a school in relation to transportation of students to and from a school is an exempted service by way of Mega Exemption.
- (iii) True: An area beyond 200 nautical miles from the base line is called High Seas. All countries have equal rights in this area.
- (iv) True: The valuation officer to estimate the fair market value of the property provisionally attached and submits a report of the estimate within 30 days if reference is made by A.O.
- (v) True: The failure to record investments in the books of account falls under misreporting of income referred to in section 270A(8).

2. M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1-4-2010. H, I and G were partners in their individual capacity. The deed of partnership provided for payment of salary amounting to ₹ 2,00,000 each to H and G who were the working partners. A new deed of partnership was executed on 1-10-2016 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1-4-2010 for the first time provided for payment of simple interest @ 12% p.a. on the balance standing to the credit of the Capital accounts of partners from 1-4-2016. The firm was dissolved on 31-3-2017 and the Capital assets of the firm were distributed amongst partners on 20-4-2017. The net profit of the firm for the year ending 31-3-2017 after payment salary to the working partners and debt /credit of the following items to the Profit and Loss Account was ₹ 1,50,000:

- (i) Interest amounting to ₹ 1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1-4-2016 to 31-3-2017.
- (ii) Interest amounting to ₹ 50,000 paid to the partners on the balance standing to the credit of their current accounts from 1-4-2016 to 31-3-2017.
- (iii) Interest amounting to ₹ 20,000 paid to the Hindu undivided family of partner H @ 18 p.a.
- (iv) Payment of ₹ 25,000 towards purchase of television sets made by crossed cheque on 1-11-2016.

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- (v) ₹ 30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.
- (vi) Depreciation amounting to ₹ 15,000 on motor car bought and used exclusively in the name of business purposes, but not registered in the name of the firm,
- (vii) Depreciation under section 32(1)(ii) amounting to ₹ 37,500 of new machinery bought and installed for manufacture of pens on 1-11-2016 at a cost of ₹ 5,00,000. There was no increase in the installed capacity as a result of the installation of the new machinery.
- (viii) Interest amounting to ₹ 25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

- a) Closing stock-in-trade was valued at ₹ 60,000 as per the method of lower of cost or market rate consistently followed by it. The market value of the closing stock-in-trade was ₹ 65,000.
- b) Brought forward business loss relating to the assessment year 2016-17 was ₹ 50,000.
- c) The fair market value of the capital assets as on 31-3-2017 was ₹ 20,00,000 and the cost of their acquisition was ₹ 15,00,000.

Compute the total income of M/s. HIG for the assessment year 2017-18. You are required to furnish explanations for the treatment of the various items given above. [16]

Answer:

Computation of total Income of M/s HIG for the A.Y 2017-18

Particulars	Amount (₹)	Amount (₹)
1) Book profit as computed (See working note)	6,05,000	
Less: Remuneration allowed to working partners	4,00,000	
	2,05,000	
Less: Brought forward business loss	50,000	
Business income		1,55,000
Income from other sources: Interest on fixed deposits		25,000
Total Income		1,80,000
Computation of book profits		
Net profit as per profit and loss account		1,50,000
Add: (i) Interest to partners on capital accounts prior to the period of amended partnership deed i. e. from 1-4-2016 to 30-9-2016		50,000
(ii) Interest to partners on current accounts [See working note]		50,000
(iii) 100% of ₹ 25,000 paid towards purchase of television sets as payment made by a mode other than account payee cheque		25,000
(iv) Difference on account of valuation of closing stock-in-trade at market value		5,000
(v) Salary paid to working partners to be considered separately		4,00,000
		6,80,000
Less: Additional depreciation on new machinery @ 10% on ₹ 5,00,000		50,000

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Less: Interest received from bank on fixed deposits taxable under other sources		25,000
Book Profit		7,55,000
Less: Deduction allowable towards salary to working partner On First ₹ 3,00,000 boom profit @90% or ₹ 1,50,000 Whichever is more On balance ₹ 3,05,000 @ 60%		2,70,000 1,83,000
		4,53,000

Working notes:

(1) The Kerala High Court in *Novel Distributing Enterprises v DCIT and Another* (2001) 251 ITR 704 (Ker), held that interest paid to the partners on their current account balances is not allowable unless it is mentioned in the partnership deed.

(2) Interest paid to the Hindu Undivided Family of partner H is not disallowed under section 40(b).

(3) As per section 40A(3) if expenditure, in respect of which payment exceeding ₹ 20,000 has been made by the assessee otherwise than by an account payee cheque/account payee bank draft, 100% of such amount paid shall be disallowed. Since the firm has made payment of ₹ 25,000 towards purchase of television sets which forms part of its stock -in trade, 100% of such expenditure would be disallowed.

(4) Gift of Gold Jewellery of ₹ 30,000 received from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.

(5) Depreciation on motor car bought and used exclusively for the purposes of business allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd v CIT* (1999) 239 ITR 775.

(6) In respect of the new machinery installed for manufacture of pens an additional depreciation of 20% is allowable. However, the new machinery has been put to use is less than 180 days during the relevant previous year, the additional depreciation is thus restricted to 50% of the prescribed rate of 20% i.e. 10%.

(7) For computing book profits, interest on fixed deposit has not been taken into account interest received on fixed deposits made out of surplus funds is taxable under the head 'Income from other sources'.

(8) The Supreme Court has, in *A.L.A. Firm v CIT* (1991) 189 ITR 285, held that the closing stock has to be valued at market rate in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the market rate.

(9) The Madras High Court in case of *CIT v Vijaylaxmi Metal Industries* (2002) 256 ITR 540 held that section 45(4) will be applicable in the year in which transfer takes place and not in the year dissolution. Though the dissolution of the firm took place on 31-3-2016, there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20-4-2017. The capital gains will be assessable in the assessment year 2018-19.

3.(a) 'X' Ltd., transferred its fertilizer business to a new company 'Y' Ltd., by way of demerger with effect from appointed date of 1.4.2016 after satisfying the conditions of demerger. Further information given:

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- (a) WDV of the entire block of plant and machinery held by 'X' Ltd. as on 1.4.2016 is ₹ 100 crores;
(b) Out of the above, WDV of block of plant and machinery of fertilizer division is ₹ 70 crores;
(c) 'X' Ltd. has unabsorbed depreciation of ₹ 50 lakhs as at 31.3.2016;

On the above facts:

- (i) You are required to explain the provisions of the income-tax as to the allowability of depreciation, post-merger, in the hands of 'X' Ltd. and 'Y' Ltd. as at 31.3.2017 duly calculating the depreciation.
(ii) State how the unabsorbed depreciation has to be dealt with for the assessment year 2017-18. [8]

Answer:

- (i) As the conditions laid down in section 2(19AA), have been satisfied the depreciation claim is subject to the following provisions:

- Where there is a demerger of a company the resulting company will be entitled to depreciation on the written down value of the block of assets transferred to it, which will be the written down value of the transferred assets of the demerged company immediately before the demerger [Explanation 2B to section 43(6)].
- Where there is a demerger of a company the written down value of the block of assets in the hands of the demerged company shall be the written down value of the block of assets of the demerged company for the immediately preceding previous year as reduced by the written down value of the assets transferred to the resulting company pursuant to the demerger. [Explanation 2A to section 43(6)].
- Depreciation on plant and machinery in the hands of 'X' Ltd. and 'Y' Ltd. will be computed as under:

WDV of plant and machinery	'X' Ltd. Amt. in crores	Y Ltd. Amt. in crores
As at 1-4-2016	30.00	70.00
Less: Depreciation@ 15%	4.50	10.50
WDV as at 31-3-2017	25.50	59.50

- (ii) Set-off of unabsorbed depreciation:

- (i) In case of demerger section 72A(4) provides as under:

- the unabsorbed depreciation directly relatable to the undertakings transferred to the resulting company is allowed to be carried forward and set off in the hands of the resulting company.
- where such unabsorbed depreciation is not directly relatable to the undertaking transferred to the resulting company, it has to be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company.
- the demerged company and the resulting company would be allowed to carry forward and set-off their respective portion of unabsorbed depreciation, as calculated above, for indefinite period as per section 32(2). However, brought forward business loss can be carried forward for the unexpired period of 8 years.

- (b) ABC Limited was amalgamated with XYZ Limited on 01-04-2016. All the conditions of section 2(1B) were satisfied, ABC Limited has the following carried forward losses as assessed till the Assessment Year 2016-17:**

(i) Speculative Loss

₹ 4 lakhs

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(ii) Unabsorbed Depreciation	₹ 18 lakhs
(iii) Unabsorbed expenditure of capital nature on scientific research	₹ 2 lakhs
(iv) Business Loss	₹ 120 lakhs

XYZ Limited has computed a profit of ₹ 140 lakhs for the financial year 2016-17 before setting off the eligible losses of ABC Limited but after providing depreciation at 15% per annum on ₹150 lakhs, being the consideration at which plant and machinery were transferred to XYZ limited, The written down value as per income-tax record of ABC Limited as on 31.3.2016 was ₹ 400 lakhs.

The above profit of XYZ Limited includes speculative profit of ₹ 10 lakhs. Compute the total income of XYZ Limited for Assessment Year 2017-18 and indicate the losses /other allowances to be carried forward by it. [8]

Answer:

Computation of total income of XYZ Ltd for the A.Y 2017-18 (Fig in Lakhs)

Particulars	Amount (₹)	Amount (₹)
Business Income before setting off of brought forward losses of ABC Ltd.	140	
Add: Excess depreciation claimed in the scheme of amalgamation of ABC Ltd with XYZ Ltd	22.50	
Depreciation claimed 15% of ₹ 150 Lakhs		
Depreciation allowable 15% of 100 lakhs (WDV in the books of ABC Ltd)	15.00	7.50
		147.50
Less: Brought forward business loss and unabsorbed depreciation	120	
Brought forward business loss of ABC Ltd set off (See Note 2 & 4)	18	
Unabsorbed depreciation set off as per section 72A (See Note 2 & 4)	12	140
Unabsorbed capital expenditure set off		
Business Income		7.50

Notes:

1. The question does not state that conditions mentioned in section 72A are satisfied. It is assumed all the conditions of section 72A are satisfied.
2. As per section 72A, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year. Therefore, business loss (other than speculation loss) and unabsorbed depreciation are allowed to be carried forward and set off by the amalgamated company for a period of 8 years and indefinitely, respectively.
3. As per section 72(2) business loss shall have to be set off first.

4.(a) State the benefits available to EOU/ EHTP/ STP/ BTP in the context of foreign trade policy 2015-20. [8]

Answer:

Benefits available to EOU/ EHTP/ STP/ BTP:

- (i) Reimbursement of Central Sales Tax (CST) paid on procurement of goods. Interest @ 6% p.a. will be payable on delay refund of CST, if the case is not settled within 30 days of receipt of complete application.
- (ii) Exemption from payment of Central Excise Duty on goods procured from DTA on goods manufactured in India.
- (iii) Reimbursement of duty paid on fuel procured from domestic oil companies.
- (iv) CENVAT credit on service tax paid.

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- (v) Exemption from industrial licensing for manufacture of items reserved for SSI sector.
- (vi) Export proceeds will be realized within 9 months.
- (vii) Units will be allowed to retain 100% of its export earnings in the EEFC account.
- (viii) Unit will not be required to furnish bank guarantee at the time of import or going for job work in DTA, subject to fulfillment of required conditions.
- (ix) 100% FDI investment permitted through automatic route similar to SEZ units.

(b) Assessment of Bhajan Ltd. was completed u/s 143(3) with an addition of ₹ 15 lakhs to the returned income. The assessee-company preferred appeal before the Commissioner (Appeals) which is pending now.

In this backdrop, answer the following:

- (i) Can the assessee-company seek revision u/s 264 in respect of matters other than those preferred in appeal?**
- (ii) Can the Commissioner make a revision u/s 263 both in respect of matters covered in appeal and other matters?** **[8]**

Answer:

(i) As per section 264(4)(d), the Principal Commissioner or Commissioner shall not revise any order under this clause where the order has been made the subject of an appeal to the Commissioner (Appeals) i.e. where an appeal has been filed to CIT (Appeal) on any issue relating to such order.

Hence, in this case, the Commissioner cannot revise an order which is pending before the Commissioner (Appeals), even if the revision pertains to a matter, other than the matter(s) covered in the appeal.

(ii) As per clause (c) of Explanation to section 263, where an order passed by the Assessing Officer has been subject matter of any appeal, it cannot be revised by the Commissioner. However, in respect of such matters which have not been considered and decided in appeal, the Commissioner has powers under section 263 for revision.

The Supreme Court in the case of Jaykumar B. Patil held that CIT has jurisdiction and power to initiate proceedings under section 263 in respect of issues which are not touched by the Commissioner of Income Tax (Appeals) in his appellate order.

5.(a) M/s. Kalaji Manufacturers & Exporters Pvt. Ltd. furnishes following information and requests you to compute the maximum refund eligible under Rule 5 of CENVAT Credit Rules for the relevant period (amounts in ₹) :

(i)	Total CENVAT Credit taken on inputs	2,50,000
(ii)	Amount of CENVAT credit reversed under Rule 3(5C)	50,000
(iii)	Total CENVAT Credit taken on input services	80,000
(iv)	Total CENVAT Credit taken on capital goods	2,00,000
(v)	Value of final products exported without payment of duty	6,00,000
(vi)	Value of goods cleared for home consumption	20,00,000
(vii)	Amounts received towards services exported (includes ₹ 50,000 of advance towards services to be provided/exported after the current relevant period)	2,50,000
(viii)	Value of other services provided	2,00,000
(ix)	Value of inputs removed as such under Rule 3(5)	30,000

[8]

Answer:

Computation of maximum refund eligible u/s 5 of the CENVAT Credit Rules, 2004:

		₹
(i)	NET CENVAT Credit taken = CENVAT credit on inputs and input services - Credit reversed under Rule 3(5C)	2,80,000

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(ii)	Export Turnover of goods (only goods cleared without payment of duty)		6,00,000
(iii)	Export turnover of services (advance received towards services to be provided/ exported after the current relevant period shall not be included, hence : ₹ 2,50,000- ₹ 50,000)		2,00,000
(iv)	Total Turnover:		
	Total of all excisable goods (exports + exempted + dutiable)	26,00,000	
	Export turnover of services (as computed above) + Value of other services	4,00,000	
	Value of inputs removed as such under Rule 3(5)	30,000	30,30,000
(v)	Maximum refund = [(Item (ii) + Item (iii)) + Item (iv)] × Item (i)		73,927

(b) Compute the assessable value and total customs duty payable under the Customs Act, 1962 for an imported machine, based on the following information:

	US \$
(i) Cost of the machine at the factory of the exporter	20,000
(ii) Transport charges from the factory of exporter to the port for shipment	800
(iii) Handling charges paid for loading the machine in the ship	50
(iv) Buying commission paid by the importer	100
(v) Lighterage charges paid by the importer	200
(vi) Freight incurred from port of entry to Inland Container depot	1,000
(vii) Ship demurrage charges	400
(viii) Freight charges from exporting country to India	5,000
Date of bill of entry	20.01.2016 (Rate BCD 20%;
Exchange rate as notified by CBEC	₹ 60 per US \$)
Date of entry inward	25.03.2016 (Rate of BCD 12%;
Exchange rate as notified by CBEC	₹ 65 per US \$)
Additional duty payable under section 3(1) of the Customs Tariff Act, 1975	12.5%
Additional duty payable under section 3(5) of the Customs Tariff Act, 1975	4%

[8]

Answer:

Statement showing Assessable and customs duty:

Particulars	US \$	Remarks
Cost of the machine	20,000	
Add: transport charges from factory of exporter to the port for shipment	800	
Add: handling charges	50	
FOB	20,850	
Add: buying commission	Nil	Not addable
Add: Insurance	234.5625	20,850 x 1.125%
Add: Freight	5,000	
Add: Lighterage charges	200	
Add: Ship demurrage	400	
CIF Value	26,684.5625	
Add: 1% unloading charges	266.8456	26,684.5625 x 1%
Value of import	26,951.4081	

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	₹	
Assessable Value	16,17,084	26,951.4081 USD x ₹60
Add: BCD 12%	1,94,050	₹ 16,17,084 x 12%
Balance	18,11,134	
Add: CVD 12.5%	2,26,392	₹ 18,11,134 x 12.5%
Balance	20,37,526	
Add: 3% Cess	12,613	(₹ 1,94,050 + ₹ 2,26,392) x 3%
Balance	20,50,139	
Add: 4% Spl. CVD	82,006	₹ 20,50,139 x 4%
Landed value of imported goods	21,32,145	
Total customs duty	5,15,061	

6.(a) Rana Pvt. Ltd. is engaged in providing the taxable services. Compute the value of taxable service and the service tax payable by it in the month of June 2016 from the information furnished below:

Receipts	₹
Free Services provided to friend of director (Similar services are rendered for consideration of ₹1,00,000).	Nil
Subsidy received from Government for making investment in backward area	1,00,000
Interest received from client who has not made timely payment of service	2,00,000
For free service rendered to customers, amount reimbursed by the manufacture of such product	50,000
Other taxable services provided during the month	15,00,000

Note: Rana Pvt. Ltd. is eligible for small service providers' exemption under Notification No. 33/2012-ST, dated 20-06-2012.

All the above amounts are exclusive of service tax.

[8]

Answer:

Statement showing service tax liability of Rana Pvt. Ltd.:

Particulars	₹
Free Services provided to friend of director	Nil
Subsidy received from Government for making investment in backward area	Nil
Interest received from client who has not made timely payment of service	Nil
For free service rendered to customers, amount reimbursed by the manufacture of such product	50,000
Other taxable services provided during the month	15,00,000
Total value of taxable services	15,50,000
Less: Small Service Providers' Exemption	-10,00,000
Taxable Services	5,50,000
Service Tax @14% on ₹ 5,50,000	77,000
Swachh Bharat Cess @0.5% on ₹ 5,50,000	2,750
Krishi Kalyan Cess @0.5% on ₹ 5,50,000	2,750

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(b) Mrs. Vasudha, a registered dealer in Chennai, furnishes the following information relating to Inter-state sales made by her during the year ended 31.3.2016:

	₹
Sales turnover as per books	36,72,000
Above includes	
(i) Excise duty	3,20,000
(ii) Freight (of this ₹ 30,000 alone is shown separately in sales invoices)	1,10,000
(iii) Deposit for returnable containers	2,40,000
(iv) Transfer to branch (covered by Form F)	12,15,000
(v) Packing charges	35,000

Further, in ascertaining the sales turnover above which includes CST also, the dealer has deducted the following:

1. Turnover relating to goods worth ₹ 10,000 (exclusive of tax) covered by invoice dated 2.4.2015, which were returned on 1.10.2015.
2. Goods worth ₹ 12,400 (including tax) covered by invoice dated 13.4.2015 were rejected by the customer and the dealer received back the goods on 14.10.2015.

Vasudha deals only in one type of commodity which is chargeable to VAT at 2% in Tamil Nadu.

You are required to compute the total turnover, CST and taxable turnover for the financial year 2015-16. Treatment of each item above should be shown distinctly. [8]

Answer:

Statement showing taxable turnover, CST and total sales for the year 2015-16:

Particulars	Taxable Turnover ₹	Workings
Total sales	36,72,000	
Less: Freight shown separately	30,000	
Less: Deposit of returnable containers	2,40,000	
Less: Transfer to Branch	12,15,000	No CST against Form F
Less: sales returns within 6 months from the date of sales	—	Deductible, already deducted
Less: Goods rejected	—	Allowed to deduct irrespective of time, already deducted
Total sales	21,87,000	
Less: Central Sales Tax	42,882	₹ 21,87,000 x 2/102
Taxable Turnover	21,44,118	

7.(a) Sanvitha Medicos Pvt. Ltd., proposes to manufacture a skin ointment, which will be available in all stores and super markets, across the counter, without a prescription of a doctor or medical practitioner. The company wishes to know whether the product will be classified as a cosmetic or medicament, for central excise purposes, merely on this ground. Advise the company suitably. [10]

Answer:

Availability of a skin ointment in stores or super market without the prescription of a doctor or medical practitioner is not the relevant criterion to classify it as a cosmetic/toilet preparation; what is relevant is the function of the ointment i.e., whether the same is used for "care" or "cure".

The Supreme Court in the case of CCE vs. Ciens Laboratories 2013 (295) ELT 3 (SC) has laid down certain broad guidelines relating to classification of such goods.

As per the decision, the following significant guiding principles to determine as to whether a product will be classified as a medicament or a cosmetic/toilet preparation:

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- (i) When a product contains pharmaceutical ingredients that have therapeutic or prophylactic or curative properties, the proportion of such ingredients is not invariably the decisive factor in classification. The relevant factor is the curative attributes of such ingredients that render the product a medicament and not a cosmetic.
- (ii) Though a product is sold without the prescription of a medical practitioner, it does not lead to the immediate conclusion that all products that are sold over / across the counter are cosmetics. There are several products that are sold over-the-counter and are yet, medicaments.
- (iii) Prior to adjudicating upon whether a product is a medicament or not, it ought to be seen as to how do the people who actually use the product, understand it to be. If a product's primary function is "care" and not "cure", it is not a medicament. Medicinal products are used to treat or cure some medical condition whereas cosmetic products are used in enhancing or improving a person's appearance or beauty.
- (iv) A product that is used mainly in curing or treating ailments or diseases and contains curative ingredients, even in small quantities, is to be treated as a medicament. Based upon the above observations, the Supreme Court held that presence of pharmaceutical ingredients in the cream (in the instant case the impugned cream had pharmaceutical content) showed that it was used for prophylactic and therapeutic purposes namely, for curing dry skin conditions of the human skin and was not primarily intended to protect the skin; therefore, the same was classifiable as a medicament.

Advice should be tendered on the above lines to the company.

(b) Kalyani Hotels (P) Ltd. is of the opinion that the value of service provided in restaurants and those provided in outdoor catering should be the same and therefore valuing them differently at 40% and 60% of the total amount respectively is incorrect. Discuss with an appropriate case law. [6]

Answer:

Restaurant services and Outdoor catering services are altogether different. The Supreme Court had occasion to consider this difference in the judgment in Tamil Nadu Kalyana Mandapam Assn. v. Union of India — 2006 (3) S.T.R. 260 (S.C.) (applied in Hotel East Park v. Union of India 2014 (35) S.T.R. 433 (Chhattisgarh)). The Supreme Court opined that the services rendered by outdoor caterers is clearly distinguishable from the service rendered in a restaurant or hotel in as much as —

- (i) Choice of food: In the case of outdoor catering service, the food/eatables/drinks are the choice of the person who partakes the services. He is free to choose the kind, quantum and manner in which the food is to be served. But in the case of restaurant, the customer's choice of foods is limited to the menu card.
- (ii) Choice of time and place: Again in the case of outdoor catering, customer is at liberty to choose the time and place where the food is to be served.
- (iii) Negotiation: In the case of an outdoor caterer, the customer negotiates each element of the catering service, including the price to be paid to the caterer.
- (iv) More personalized: Outdoor catering has an element of personalized service provided to the customer. Clearly the service element is more weighty, visible and predominant in the case of outdoor catering.

Since the two services viz. 'restaurant services' and 'outdoor catering services' are different and outdoor catering services has more service element, hence, valuation of restaurant service at 40% and outdoor catering service at 60% (differently) is justified. The assessee's contention is therefore, incorrect.

8.(a) A Ltd is an Indian Company which is a 100% Subsidiary of B Ltd, a Foreign Company. B Ltd sells its products to A Ltd at \$15 per unit. At the same time, it sells its products to an Unrelated Party at \$20 per unit. How will the ALP be determined in this transaction?

Answer to MTP_Final_Syllabus 2012_Jun2017_Set 2

In the above example, if A Ltd is the Sole Selling Agent of the products of B Ltd, and A Ltd resold the goods at \$ 20, how will the Arm's Length Price be determined in this transaction? [8]

Answer:

1. Principle: U/s 92A, where an enterprise holds, directly or indirectly, shares carrying not less than 26% of voting power in the other enterprise, then the two enterprises are called Associated Enterprises. In view of the above, A Ltd and B Ltd are Associated Enterprises.
2. Analysis: Based on the details given, the appropriate method to determine Arm's Length Price is Comparable Uncontrolled Price Method. Applying the above method, the Arm's Length Price of the product is \$20 per unit.
3. If A Ltd is the Sole Selling Agent of the products of B Ltd, the most appropriate method shall be Resale Price Method if the goods are re-sold by the Agent Company without any value additions. Applying the above method, the Arm's Length Price is \$20 per unit.

(b) Boulevard Inc. a French Company, holds 40% of Equity in the Indian Company Vista Technologies Ltd (VTL). VTL is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes Boulevard Inc.

During the year, VTL had spent 2,000 Man Hours for developing and maintaining software for Boulevard Inc, with each hour being billed at ₹ 1,250. Costs incurred by VTL for executing work for Boulevard Inc. amount to ₹ 18,00,000.

VTL had also undertaken developing software for Bal Industries Ltd for which VTL had billed at ₹ 2,700 per Man Hour. The persons working for Bal Industries Ltd and Boulevard were part of the same team and were of matching credentials and caliber. VTL had made a Gross Profit of 50% on the Bal Industries work.

VTL's transactions with Boulevard Inc. is comparable to transactions with Bal Industries, subject to following differences –

- (a) Boulevard gives technical knowhow support to VTL which can be valued at 8% of the Normal Gross Profit. Bal Industries does not provide any such support.**
- (b) Since the work for Boulevard involved huge number of man hours, a quantity discount of 14% of Normal Gross Profits was given.**
- (c) VTL had offered 90 Days credit to Boulevard the cost of which is measured at 2% of the Normal Billing Rate. No such discount was offered to Bal Industries Ltd.**

Compute ALP and the amount of increase in Total Income of Vista Technologies Ltd. [8]

Answer:

Computation of Arm's Length Gross Profit Mark up

Particulars	%	%
Normal GP Mark up		50
Less: Adjustment for differences		
(a) Technical Support from Boulevard 8% of Normal GP (8% of 50%)	4	
(b) Quantity Discount 14% of Normal GP (14% of 50%)	7	(11)
		39
Add: Cost of credit to Boulevard 2% Normal Bill (2% x 50%)	1	1
Arm's Length Price		40

Computation of Increase in Total Income of VTL

Particulars	
	₹

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Cost of Services provided to VTL	18,00,000
Arm's Length Billed Value Cost/ 100-Arm's Length Mark up =1800000/100%-40%	3,00,000
Less: Actual Billing to Boulevard (2000 Hours x ₹1,250)	2,50,000
Therefore increase in Total Income	5,00,000