

Mock Test Paper - Series I: March, 2024

Date of Paper: 15 March, 2024

Time of Paper: 2 P.M. to 6 P.M.

FINAL COURSE: GROUP – II

PAPER – 6: INTEGRATED BUSINESS SOLUTIONS

SUGGESTED ANSWERS

ANSWERS TO THE CASE STUDY 1

I. Answers to the Multiple Choice Questions

1. (d) As per Section 8 of the CGST Act, 2017,
The tax liability on a composite or a mixed supply shall be determined in the following manner, namely:-
- (a) a composite supply comprising two or more supplies, one of which is a principal supply, shall be treated as a supply of such principal supply; and
 - (b) a mixed supply comprising of two or more supplies shall be treated as supply of that particular supply that attracts highest rate of tax

In order to determine whether the supplies are 'composite supply' or 'mixed supply', one needs to determine whether the supplies are naturally bundled or not naturally bundled in ordinary course of business. The concept of 'naturally bundled' supplies is emanating from the definition of 'composite supply'.

Accordingly, the supply which is not naturally bundled and not supplied in ordinary course of business is a mixed supply that attracts highest rate of tax.

Here, in the gift pack highest rate of tax is of Cournville Chocolate (50 mg) taxable @ 28% and the price of ₹ 600 is GST inclusive. Accordingly, GST payable would be $\text{₹ } 600 \times 28/128 = \text{₹ } 131$ (rounded off)

2. (d) The Council has passed a Resolution under Regulation 190A granting general permission (for private tutorship, and part-time tutorship under Coaching organization of the Institute) and specific permission (for parttime or full-time tutorship under any educational institution other than Coaching organization of the Institute). Such general and specific permission granted is subject to the condition that the direct teaching hours devoted to such activities taken together should not exceed 25 hours a week in order to be able to undertake attest functions.

3. (a) As per SA 610 “Using the Work of Internal Auditor”, the external auditor shall not use internal auditors to provide direct assistance to perform procedures that involve making significant judgments in the audit. Significant judgments, inter-alia, include the following:
 - Assessing the risks of material misstatement;
 - Evaluating significant accounting estimates;

Further, in accordance with SA 505, “External Confirmation” the external auditor is required to maintain control over external confirmation requests and evaluate the results of external confirmation procedures, it would not be appropriate to assign these responsibilities to internal auditors. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.

4. (a) Section 133A(2) of the Income Tax Act, 1961,
 The income-tax authority may enter any place of business or profession mentioned above only during the hours at which such place is open for the conduct of business or profession and in the case of any other place, only after sunrise and before sunset.
 Further, as per section 133A(3) of the Income Tax Act, 1961,
 An income-tax authority, inter-alia, may impound and retain in his custody for such period as he thinks fit any book of account or other documents inspected by him after recording reasons for doing so.

However, the income tax authority cannot retain in his custody such books of account etc. for a period exceeding 15 days (excluding holidays) without obtaining the approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or the Principal Commissioner or Commissioner or Principal Director or Director, as the case may be.

5. (c) Section 292C of the Income Tax Act, 1961, provides that where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search under section 132 or survey under section 133A, it may, in any proceeding under this Act, be presumed that –
- (i) such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person;
 - (ii) the contents of such books of account and other documents are true; and
 - (iii) the signature and every other part of such books of account and other documents which purport to be in the handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting;
 - (iv) In the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.

II. Answers to the Descriptive Questions

6. (i) On the basis of standard deviation project Dehradun Plant be chosen because it is less risky than Project Borsad Plant having higher standard deviation.

Decision on the basis of CV:

CV of project Dehradun Plant = $SD/ENPV = 1,80,00,000/2,44,00,000 = 0.738$

CV of project Borsad Plant = $2,40,00,000/4,50,00,000 = 0.533$

On the basis of Co-efficient of Variation (C.V.) Project Dehradun Plant appears to be riskier and hence, project Borsad Plant should be accepted.

(ii) Under conditions of inflation, the project cost estimates that are relevant for a future date will suffer escalation. Inflationary conditions will tend to initiate the measurement of future cash flows. Either of the following two approaches may be used while appraising projects under such conditions:

- (1) Adjust each year's cash flows to an inflation index, recognizing selling price increases and cost increases annually; or
- (2) Adjust the 'Acceptance Rate' (cut-off) suitably retaining cash flow projections at current price levels.

An example of approach (ii) above can be as follows:

Normal Acceptance Rate: 15.0%

Expected Annual Inflation: 5.0%

Adjusted Discount Rate: 15.0×1.05 or 15.75%

It must be noted that measurement of inflation has no standard approach nor is easy. This makes the job of appraisal a difficult one under such conditions.

7. (i) At 31st March, 2024, the average unused entitlement is two days per employee. The company on the basis of experience expects that 184 employees will take no more than five days of paid sick leaves in 2024-2025 and that the remaining sixteen employees will take an average of six and a half days each.

The company expects that it will pay an additional 24 days of sick pay as a result of the unused entitlement that has accumulated at 31st March, 2024 (one and a half days each, for sixteen employees).

Therefore, the company would recognize a liability equal to 24 days of sick pay.

- (ii) As per Ind AS 19, the benefit will be attributed till the period the employee service will lead to no material amount of benefits. And service in later years will lead to a materially higher level of benefit than in earlier years. Therefore, for

employees expected to leave after twenty or more years, the entity would attribute benefit on a straight-line basis. Service beyond twenty years will lead to no material amount of further benefits. Therefore, the benefit attributed to each of the first twenty years is 2% (i.e. 40% divided by 20) of the present value of the expected medical costs.

For employees expected to leave between ten and twenty years, the benefit attributed to each of the first ten years is 1.5% (15 % divided by 10) of the present value of the expected medical costs. For these employees, no benefit is attributed to service between the end of the tenth year and the estimated date of leaving.

For employees expected to leave within ten years, no benefit is attributed.

8. The action of the Commissioner in issuing the second notice is not justified. The term “record” has been defined in clause (b) of Explanation 1 to section 263(1). According to this definition “record” shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at the same time, in view of the express provisions contained in clause (b) of the Explanation 1 to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner. Issuance of a notice under section 263 succeeds the examination of record by Commissioner.

In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was issued could not be said to be “record” available at the time of examination as emphasized in Explanation 1(b) to section 263(1).

9. (i) The supply between Khwab Pharma Ltd. (Pune) and Rajratna Medicines (Rampur) is a bill to ship to supply where the goods are delivered by the supplier [Khwab Pharma Ltd.] to a recipient [Saras Med Pvt. Ltd. (Udupi)] or any other person on the direction of a third person [Rajratna Medicines]. The place of supply in case of domestic bill to ship to supply of goods is determined in terms of section 10(1)(b) of the IGST Act, 2017.

As per section 10(1)(b) of the IGST Act, 2017, where the goods are delivered by the supplier to a recipient or any other person on the direction of a third person, whether acting as an agent or otherwise, before or during movement of goods, either by way of transfer of documents of title to the goods or otherwise, it shall be deemed that the said third person has received the goods and the place of supply of such goods shall be the principal place of business of such person.

Thus, in the given case, it is deemed that the Rajratna Medicines has received the goods and the place of supply of such goods is the principal place of business of Rajratna Medicines. Accordingly, the place of supply between Khwab Pharma Ltd. (Pune) and Rajratna Medicines (Rampur) will be Rampur, Uttar Pradesh.

This situation involves another supply between Rajratna Medicines (Rampur) and Saras Med Pvt. Ltd. (Udupi). The place of supply in this case will be determined in terms of section 10(1)(a) of the IGST Act, 2017.

Section 10(1)(a) stipulates that where the supply involves movement of goods, whether by the supplier or the recipient or by any other person, the place of supply of such goods shall be the location of the goods at the time at which the movement of goods terminates for delivery to the recipient.

Thus, the place of supply in second case is the location of the goods at the time when the movement of goods terminates for delivery to the recipient (Saras Med Pvt. Ltd.), i.e. Udupi, Karnataka.

- (ii) As per provisions of section 49(10) read with rule 87(13) of CGST Rules, 2017, "A registered person may, on the common portal, transfer any amount of tax, interest, penalty, fee or any other amount available in the electronic cash ledger under the

Act to the electronic cash ledger for integrated tax, central tax, State tax or Union territory tax or cess in FORM GST PMT-09”.

It is important to note that only amounts available under Electronic Cash Ledger can be transferred to the respective heads using Form GST PMT-09 and not otherwise.

Accordingly, contention of Mr. Arvind by asking the accountant to use Form GST PMT-09 is not valid for transfer of ₹ 84,500 from head IGST to respective CGST & SGST in Electronic Credit Ledger.

ANSWERS TO THE CASE STUDY 2

I. Answers to the Multiple Choice Questions

1. (d) Guidelines for Advertisement pursuant to decision of Council at its 388th Meeting:
Disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India.
2. (c) As per Clause (8) of the Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice cannot accept position as auditor previously held by another chartered accountant without first communicating with him/her in writing.
3. (a) Notice for detailed scrutiny i.e. regular assessment, under section 143(2) of the Income Tax Act, 1961, cannot be served after the expiry of 3 months from the end of the financial year in which the return of income is furnished.
Here, Adarsh Tech Ltd. filed its return of income for A.Y. 2024-25 on 30th September, 2024, so, 3 months would expire on 30.06.2025.
4. (d) Section 143(1)(a) of the Income Tax Act, 1961, provides for computation of the total income of an assessee after making the following adjustments to the returned income:-
(a) any arithmetical error in the return;

- (b) an incorrect claim, if such incorrect claim is apparent from any information in the return;
 - (c) Disallowance of loss claimed, if return of the previous year for which set-off is claimed was filed beyond due date u/s 139(1);
 - (d) Disallowance of expenditure or increase in income indicated in the audit report but not taken into account in computing the total income in the return;
 - (e) Disallowance of deduction claimed under section 10AA or under any of the provisions of Chapter VI-A under the heading "C.—Deductions in respect of certain incomes", if return is filed beyond due date u/s 139(1)
5. (a) Entry 3A of the Exemption **Notification No. 12/2017 Central Tax (Rate) dated 28.06.2017**: provides exemption to composite supply of goods and services in which the value of supply of goods constitutes not more than 25% of the value of the said composite supply provided to the Central Government, State Government or Union territory or local authority by way of any activity:
- in relation to any function entrusted to a Panchayat under article 243G of the Constitution or
- in relation to any function entrusted to a Municipality under article 243W of the Constitution.
- Thus, GST is exempt on supply of services of development of online cloud system to JMC, in the given case, for quoting the best price.

II. Answers to the Descriptive Questions

6. (i)

Shares	No. of shares	Price	Amount (₹)
Nepathya Ltd.	25,000	20.00	5,00,000
D-Con Ltd.	35,000	300.00	1,05,00,000
Sarpan Ltd.	29,000	380.00	1,10,20,000

Care Health Ltd.	40,000	500.00	2,00,00,000
			4,20,20,000
Less: Accrued Expenses			1,50,000
Other Liabilities			3,00,000
Total Value			4,15,70,000
No. of Units			12,00,000
NAV per Unit (4,15,70,000/12,00,000)			34.64

(ii) **ADVANTAGES OF MUTUAL FUND**

- (a) **Professional Management:** The funds are managed by skilled and professionally experienced managers backed by a team of Research Analysts.
- (b) **Diversification:** Mutual Funds invest into many securities and offer diversification which reduces the concentration risk.
- (c) **Convenient Administration:** There are no administrative risks of share transfer, as many of the Mutual Funds offer services in a demat form which saves investor's time and prevents delay.
- (d) **Higher Returns:** Over a medium to long-term investment horizon, investors get higher returns in Mutual Funds as compared to other avenues of investment. However, investors are cautioned that such very high returns during the exceptional bull phase of the market like IT boom or Infrastructure boom should not be considered as regular returns and therefore one should look at the average returns provided by the Mutual Funds particularly in the equity schemes over a long period of time.
- (e) **Low Cost of Management:** SEBI has prescribed maximum limit of charging 2.50% for Equity Mutual Funds. No Mutual Fund can increase the cost beyond prescribed limits of 2.5% maximum and any extra cost of management is to be borne by the AMC.

- (f) **Liquidity:** In all the open ended funds, liquidity is provided by direct sales / repurchase by the Mutual Fund and in case of close ended funds, the liquidity is provided by listing the units on the Stock Exchange.
- (g) **Transparency:** The SEBI Regulations now compel all the Mutual Funds to disclose their portfolios on a half-yearly basis. However, many Mutual Funds disclose their Scheme Portfolio on a quarterly or monthly basis to their investors. The NAVs are calculated on a daily basis in case of open ended funds and are published through AMFI in the newspapers.
- (h) **Other Benefits:** Mutual Funds provide systematic withdrawal and systematic investment plans according to the need of the investors. The investors can also switch from one scheme to another without any restrictions except in case of Tax Savings Fund which restricts switch out for first 3 years of its investments.
- (i) **Highly Regulated:** Mutual Funds all over the world are highly regulated and in India all Mutual Funds are registered with SEBI and are strictly regulated as per the Mutual Fund Regulations which provide high level of investor protection.
- (j) **Economies of scale:** The way mutual funds are structured gives it a natural advantage. The “pooled” money from numerous investors ensures that mutual funds enjoy economies of scale; it is cheaper compared to investing directly in the capital markets which involves higher charges. This also allows retail investors access to participation in the Capital Market which otherwise is difficult for them to go directly.
- (k) **Flexibility:** One of the biggest advantages of a Mutual Fund Scheme is its flexibility. An investor can opt for Systematic Investment Plan (SIP), Systematic Withdrawal Plan etc. to plan his cash flow requirements as per his convenience. The wide range of schemes being launched in India by different mutual funds also provides an added flexibility to the investor to plan his portfolio accordingly.

- (l) **Convenience:** It is very convenient & easy to invest & disinvest from Mutual Fund Schemes specially through digital transaction portals

Note: Any three points need to be mentioned.

DRAWBACKS OF MUTUAL FUND

- (a) No guarantee of Return – There are three issues involved:
 - (i) All Mutual Funds cannot be winners. There may be some Schemes who may underperform against the benchmark index. However, the Fund Manager will endeavour to give better return than the underlying benchmark Index in the long run.
 - (ii) A mutual fund may perform better than the stock market but this does not necessarily lead to a similar gain for every investor. This is because of the different entry & exit points for each investor.
 - (iii) In case of a massive fall in the value of the stocks held in the Portfolio, the investor may lose principal in the short-term e.g., during Global Financial Crisis in 2008 or during outbreak of Covid 19 pandemic in 2020 etc. But if the investment is held for a longer term, the chances of losing principal are very remote & negligible.
- (b) **Diversification** – A mutual fund helps to create a diversified portfolio. Though diversification minimizes risk, it does not ensure maximizing returns. The returns that mutual funds offer is at times lesser than what an investor can earn from a single stock. For example, if a single security held by a mutual fund double in value, the mutual fund itself would not double in value because that security is only one small part of the fund's holdings. By holding a large number of different investments, mutual funds tend to do neither exceptionally well nor exceptionally poor.
- (c) **Selection of Proper Fund** – It may be easy for someone to select the right share rather than the right mutual fund scheme. For stocks, one can rely his selection on the

parameters of economic, industry and company analysis. In case of mutual funds, past performance is the one of the most important criteria to fall back upon but the past performance cannot predict the future.

- (d) Cost Factor** – Every Mutual Fund Scheme charges some fund management fees as a part of Annual Recurring Expenses. Although there are no charges/load on entry, but at times an exit may get charged if withdrawn before a stipulated period, known as “Exit Load”. Amount withdrawn after the stipulated period of holding, if withdrawn, doesn’t attract any Exit Load. The fees paid to the Asset Management Company is in no way related to performance.

Note: Any three points need to be mentioned.

7. Following are the illustrative steps for performing audit of above said block chain:
- (a) Obtain a comprehensive understanding of the blockchain-based pilot program, including its objectives, scope, and key processes involved.
 - (b) Review the partnership agreements, contracts, and legal documentation governing the relationship between the Indian bank and Bouyanc Bank.
 - (c) Identify the specific blockchain technology used, its functionalities, and the underlying smart contracts.
 - (d) Assess Internal Controls:

Review policies and procedures related to the on-chain Nostro accounts, settlement processes, and money transfer mechanisms.

Assess the governance framework, risk management practices, and compliance procedures established by the Indian bank and Bouyanc Bank.
 - (e) Review Security Measures:

Assess encryption methods, cryptographic key management, and secure transmission protocols used for data protection.

Review measures taken to prevent unauthorized access, cyber threats, and potential vulnerabilities in the blockchain network.

(f) Test Transaction Validity and Accuracy:

Validate that transactions are recorded and settled accurately on the blockchain, ensuring adherence to relevant regulations and contractual obligations.

Perform reconciliations between on-chain Nostro accounts and the corresponding accounts held at Bouyanc Bank to confirm the accuracy of balances and transactions.

(g) Evaluate Compliance and Regulatory Requirements:

Review documentation and procedures related to customer due diligence, transaction monitoring, and reporting obligations.

Ensure that the pilot program adheres to industry-specific standards and best practices.

(h) Assess Business Continuity and Disaster Recovery:

Evaluate the adequacy of backup and recovery procedures, redundancy measures, and failover mechanisms to ensure uninterrupted operations.

Test the effectiveness of these plans by conducting simulations or examining historical incidents and response procedures.

(i) Report Findings and Recommendations:

Provide recommendations for improving internal controls, security measures, compliance procedures, and overall efficiency and effectiveness of the pilot program.

Communicate the audit results to the relevant stakeholders, highlighting areas of concern and suggesting remedial actions.

8. Statement showing computation of inventory cost

Particulars	Amount (₹)	Remarks
Costs of purchase	6,00,000	Purchase price of raw material [purchase price (6,50,000) less refundable purchase taxes (50,000)]
Loan-raising fee	–	Included in the measurement of the liability
Costs of purchase	55,000	Purchase price of consumable stores
Costs of conversion	65,000	Direct costs—labour
Production overheads	15,000	Fixed costs—depreciation
Production overheads	10,000	Product design costs and labour cost for specific customer
Other costs	37,000	Refer working note
Borrowing costs	–	Recognized as an expense in profit or loss
Total cost of inventories	7,82,000	

Working Note:

Costs of testing product designed for specific customer:

= ₹ 21,000 material (i.e. net of the ₹ 3,000 recovered from the sale of the scrapped output) + ₹ 11,000 labour + ₹ 5,000 depreciation.

= ₹ 37,000

ANSWERS TO THE CASE STUDY 3

I. Answers to the Multiple Choice Questions

1. (c) Processing of transactions is inaccurate.

Reason:

Possible potential misstatements - Indicators	
Completeness	• Transactions not identified. • Source documents not prepared. • Source documents not captured. • Rejected source documents not represented
Existence	• Fictitious or unauthorised transactions entered on source documents. • Source documents overstated. • Transactions duplicated on source documents. • Capture of source documents duplicated. • Invalid source documents captured on subsidiary ledgers.
Recording	• Source documents captured inaccurately. • Processing of transactions is inaccurate. • Inaccurate adjustments made in subsidiary ledgers.
Cut-Off Procedures	• Transactions that occur in one period are recorded in another period.

2. (b) Incorrect, as ITC is available for utilisation as per GST Law.

Reason: ITC on such goods and/or services is allowed in the case of sub- contracting, i.e. when such goods and/or services are used by the taxpayer who is in the same line of business, e.g. outdoor catering service availed by another outdoor caterer.

3. (d) Purchases & Account Payables

Reason: Assertions relating to validity of Purchases is being checked.

4. (a) ₹ 1000

Reason: In terms of rule 32(6) relating to valuation, the value of a coupon is the money value of the goods redeemable against it. Therefore, though the coupon is sold for ₹ 900, its value is ₹ 1000.

5. (c) Statement 1 is Incorrect while Statement 2 is Correct.

Reason: STATEMENT 1 :- As per para B15 of Ind AS 103, in a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree. Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including the relative voting rights in the combined entity after the business combination. The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In above mentioned para, acquirer shall be the either of the combining entities (i.e. Naman Hotels Limited or Anupama Hotels Limited) whose owners as a Group retain or receive the largest portion of the voting rights in the combined entity. Hence in the above scenario Naman Hotels Limited shareholder gets 67% Share $[(100/150) \times 100]$ and Anupama Hotels Limited shareholder gets 33% share in the Namupama Villas Limited. Hence Naman Limited is acquirer as per the principles of Ind AS 103.

STATEMENT 2 :- In this case, as the control over financial and operating policies are acquired through obtaining board representation on 1st July, it is this date that is considered as the acquisition date. It may be noted that the appointed date as per the agreement is not considered as the acquisition date, as Naman Hotels Ltd. did not have control over Anupama Hotels Ltd. as at that date.

II. Answers to the Descriptive Questions

6. The amount of Anupama Hotels Ltd. identifiable net assets [₹ 400, calculated as ₹ 500 - ₹ 100) exceeds the fair value of the consideration transferred plus the fair value of the non controlling interest in Anupama Hotels Ltd. [₹ 384 calculated as 300 + 84]. Kavya Hotels Ltd. measures the gain on its purchase of the 80 per cent interest as follows:

		₹ in lakh
Amount of the identifiable net assets acquired (₹ 600 - ₹ 200)		400
Less: Fair value of the consideration transferred for Kavya Hotels Ltd. 80 per cent interest in Anupama Hotels Ltd.	300	
Add: Fair value of non controlling interest in Anupama Hotels Ltd.	84	(384)
Gain on bargain purchase of 80 per cent interest		16

Journal Entry

	₹ in lakhs	₹ in lakhs
Identifiable assets acquired Dr.	600	
To Cash		300
To Liabilities assumed		200
To OCI/Equity-Gain on the bargain purchase		16
To Equity-non controlling interest in Anupama Hotels Ltd.		84

Alternatively if the acquirer chooses to measure the non-controlling interest in Anupama Hotels Ltd. on the basis of its proportionate interest in the identifiable net assets of the acquiree, the recognized amount of the non-controlling interest would be ₹ 80 Lakhs (₹ 400 x 0.20). The gain on the bargain purchase then would be ₹ 20 lakhs (₹ 400 - (₹ 300 + ₹ 80))

7. (a) Auditors are required to assess the risks of material misstatement at two levels :-

- ♦ The first is at the overall financial statement level, which refers to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
- ♦ The second relates to risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. This means that for each account balance, class of transactions and disclosure, an assessment of risk (such as high, moderate, or low) should be made for each individual assertion being addressed.

(b) Audit Procedures: The following procedures by Komal may address the validity of the account balance:-

- ♦ Make a selection of the purchases, review correspondence with the vendors, purchase requisitions (internal document) and reconciliations of their accounts.
- ♦ Review Vendor listing along with the ageing details. Follow up the material amounts paid before the normal credit period and analyse the reasons for exceptions.
- ♦ Meet with the company's Purchase officer and obtain responses to our inquiries regarding the purchases made without purchase orders.
- ♦ Discuss the summary of such issues with the client.

8. Computation of Profits and Gains of Business or Profession of Kavya Hotels Ltd. for the A.Y. 2024-25

Particulars	Amount (₹)	
Profit as per Statement of profit and loss		1,50,00,000
Add: Items debited but to be considered separately or to be disallowed		
(a) Payment to middleman for purchase of vegetables, etc. in an amount exceeding ₹ 10,000	30,000	

[Under section 40A(3), disallowance is attracted in respect of expenditure for which cash payment exceeding ₹ 10,000 is made on a day to a person. Payment of ₹ 35,000 to farmer for purchase of vegetables is covered by exception under Rule 6DD. However, payment of ₹ 30,000 to confectionery wholesaler is not covered under the exception - CBDT Circular 27/2017 dated 3/11/2017].		
(b) Contribution towards employees' pension scheme in excess of 10% of salary disallowed under section 40A(9) [Contribution to the extent of 10% of salary (basic salary + dearness allowance, if it forms part of pay for retirement benefits) is allowable as deduction under section 36(1)(iva)]	50,000	
(c) Payment to transport contractor without deduction of tax at source [Since the contractor declares profit under presumptive taxation scheme under section 44AE and furnished a declaration to this effect, tax is not required to be deducted at source under section 194C in respect of payment to transport contractor].	-	
(e) Contribution to IIT for scientific research [Contribution to IIT for scientific	-	

	research programme approved by the prescribed authority qualifies for deduction @100% under section 35(2AA). Since the amount of contribution has already been debited to the statement of profit and loss, there is no further adjustment required]		
(f)	Expenses on foreign travel of two directors for a collaboration agreement which failed to materialize [Where expenditure is incurred for a project not related to the existing business and the project was abandoned without creating a new asset, the expenses are capital in nature as per <i>Mc Gaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.)</i> . Brewery project is not related to the existing business of running hotels]	5,00,000	
(g)	Fees paid to directors without deducting tax at source [30% of ₹ 1 lakh] [Disallowance @ 30% would be attracted under section 40(a)(ia) for non-deduction of tax at source from director's remuneration on which tax is deductible under section 194J]	30,000	6,10,000
	Less: Items credited but to be considered separately/ Expenditure to be allowed		1,56,10,000
(d)	Profit on sale of plot of land to 100% subsidiary	12,00,000	

	[Short-term capital gains arise on sale of plot of land held for less than 24 months. However, in this case, since the transfer is to a 100% subsidiary company and the subsidiary company is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv). Since this amount has been credited to the statement of profit and loss, the same has to be deducted for computing business income].		
(h)	Depreciation [Depreciation allowable under the Income-tax Act, 1961 is ₹ 15 lakhs whereas the depreciation as per books of account debited to the statement of profit and loss is ₹ 10 lakhs. Hence, the additional amount of ₹ 5 lakhs has to be deducted while computing business income]	5,00,000	
(i)	Interest paid during the year [Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since ₹ 2 lakhs has been paid in the P.Y. 2023-24, the same is allowable as deduction]	2,00,000	
(iii)	Purchases omitted to be recorded in the books [Since the purchase is made in March,	3,00,000	22,00,000

2024 (i.e., P.Y.2023-24), in respect of which bill of ₹ 3 lakhs received on 31.3.2024 has been omitted to be recorded in the books in that year, it has to be deducted to compute the business income [<i>Kedarnath Jute Manufacturing Company Ltd. v. CIT (1971) 82 ITR 363 (SC)</i>]. It is logical to assume that the company is following mercantile system of accounting.]	
Income under the head “Profits and Gains of Business or Profession”	1,34,10,000

ANSWERS TO THE CASE STUDY 4

I. Answers to the Multiple Choice Questions

1. (d) Ross: Central Government: Chandler: Prohibited Transaction

Reason: Under section 5 of the Foreign Exchange Management Act, 1999, and Rules relating thereto, some current account transactions require prior approval of the Central Government, some others require the prior approval of the Reserve Bank of India, some are freely permitted transactions and some others are prohibited transactions. Accordingly,

- (i) It is a current account transaction, where Amit is required to take approval of the Central Government for drawal of foreign exchange for remittance of hire charges of transponders.
- (ii) Withdrawal of foreign exchange for payment related to call back services of telephone is a prohibited transaction. Hence, Amit cannot obtain US \$ 20,000 for the said purpose.

2. (c) Both are persons resident in India.

Reason: Medico Inc. being a UK based company would be person resident outside India [(Section 2(w)]. Section 2 (u) defines 'person' under clause (viii) thereof, as person would include any agency, office or branch owned or controlled by such person. The term such person appears to refer to a person who is included in clause (i) to (vi). Accordingly, the Headquarters in New Delhi, being a branch of a company would be a 'person'. Section 2(v) defines a person resident in India. Under clause (iii) thereof person resident in India would include an office, branch or agency in India owned or controlled by a person resident outside India. Headquarters Unit in New Delhi is owned or controlled by a person resident outside India, and hence it, would be a 'person resident in India.' However, Dubai Branch though not owned is controlled by the Headquarters in New Delhi which is a person resident in India. Hence, the Dubai Branch is also a person resident in India.

3. (d) Euro 10,000 should not be recognized as impairment loss

Reason: The carrying value of the foreign currency asset will be determined based on the recoverable amount of the asset converted into functional currency at the exchange rate on valuation date which is ₹ 54 lakhs. Therefore, the impairment loss of Euro 10,000 in foreign currency should not to be recognised.

4. (c) Yes, the Perpetual Debt can be considered as a monetary item and the related exchange gains and losses should be recorded in equity at the consolidated level.

Reason: Yes, as per Ind AS 21, net investment in a foreign operation is the amount of the reporting entity's interest in the net assets of that operation. As per para 15 of Ind AS 21, an entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables. In accordance with para 15 of Ind AS 21, the foreign exchange gains and losses should be recorded in

equity at the consolidated level because settlement of that perpetual debt is neither planned nor likely to occur.

5. (a) She should leave India on or before 28th September, 2023 and get her salary credited to a Bank account in Germany only, to be remitted, later on, to her Joint account in India

Reason: In this case, since Parminder is an Indian citizen and leaving India during P.Y. 2023-24 for the purpose of employment outside India, she will be treated as resident only if the period of her stay during the previous year amounts to 182 days or more. Therefore, Parminder should leave India on or before 28th September, 2023, in which case, her stay in India during the previous year would be less than 182 days and she would become non-resident for the purpose of taxability in India. In such a case, only the income which accrues or arises in India or which is deemed to accrue or arise in India or received or deemed to be received in India shall be taxable. The income earned by her in Germany would not be chargeable to tax in India for A.Y. 2024-25, if she leaves India on or before 28th September, 2023. If any part of Parminder's salary will be credited directly to her bank account in Jalandhar, then, that part of her salary would be considered as income received in India during the previous year under section 5 and would be chargeable to tax under Income-tax Act, 1961, even if she is a non-resident. Therefore, Parminder should receive her entire salary in Germany and then remit the required amount to her bank account in Jalandhar in which case, the salary earned by her in Germany would not be subject to tax in India.

II. Answers to the Descriptive Questions

6. As per Master Direction No. 17 on Import of Goods and Services issued by the RBI, the general Guidelines for Imports are as follows:-

- (i) **Mode of payment:** A person resident in India may make payment for import of goods in foreign exchange through-
- an international card held by him/in rupees from international credit card/ debit card through the credit/debit card servicing bank in India against the

charge slip signed by the importer, or

- as prescribed by Reserve Bank from time to time, provided that the transaction is in conformity with the extant provisions and the import is in conformity with the Foreign Trade Policy in force. In essence, payment has to be made through banking channels.

Any person resident in India may also make payment as under:

- (a) In rupees towards meeting expenses on account of boarding, lodging and services related thereto or travel to and from and within India of a person resident outside India who is on a visit to India;
- (b) By means of a crossed cheque or a draft as consideration for purchase of gold or silver in any form imported by such person in accordance with the terms and conditions imposed under any order issued by the Central Government under the Foreign Trade (Development and Regulations) Act, 1992 or under any other law, rules or regulations for the time being in force;
- (c) A company or resident in India may make payment in rupees to its non- whole time director who is resident outside India and is on a visit to India for the company's work and is entitled to payment of sitting fees or commission or remuneration, and travel expenses to and from and within India, in accordance with the provisions contained in the company's Memorandum of Association or Articles of Association or in any agreement entered into it or in any resolution passed by the company in general meeting or by its Board of Directors, provided the requirement of any law, rules, regulations, directions applicable for making such payments are duly complied with.

(ii) Time Limit for Settlement of Import Payments:

- (i) *Time limit for Normal Imports:*
 - In terms of the extant regulations, remittances against imports should be completed not later than

six months from the date of shipment, except in cases where amounts are withheld towards guarantee of performance, etc.

- AD may permit settlement of import dues delayed due to disputes, financial difficulties, etc. However, interest if any, on such delayed payments, usance bills (a bill of exchange which allows the drawee to have period of credit or term) or overdue interest is payable only for a period of up to three years from the date of shipment at the rate prescribed for trade credit from time to time.

(ii) Time Limit for Deferred Payment Arrangements:

- Any deferred payment arrangements (including suppliers' and buyers' credit) entered into, for up to three years in case of import of capital goods and up to one year or the operating cycle whichever is less, in case of import of non-capital goods, shall be treated as trade credits for which the procedural guidelines as laid down in the Master Direction on External Commercial Borrowings, Trade Credits and Structured Obligations (updated from time to time) may be followed.

(iii) Extension of Time:

- (i) limit of extension:** AD Category – I banks can consider granting extension of time for settlement of import dues up to a period of six months at a time (maximum up to the period of three years) irrespective of the invoice value for delays on account of disputes about quantity or quality or non-fulfilment of terms of contract; financial difficulties and cases where importer has filed suit against the seller. In cases where sector specific guidelines have been issued by Reserve Bank of India for extension of time (i.e. rough, cut and polished diamonds), the same will be applicable.
- (ii) Circumstances:** While granting extension of time, AD must ensure that:

- a. The import transactions covered by the invoices are not under investigation by Directorate of Enforcement / Central Bureau of Investigation or other investigating agencies;
 - b. While considering extension beyond one year from the date of remittance, the total outstanding of the importer does not exceed USD one million or 10 per cent of the average import remittances during the preceding two financial years, whichever is lower; and
 - c. Where extension of time has been granted by the AD, the date up to which extension has been granted may be indicated in the 'Remarks' column.
- (iii) Cases not covered by the above instructions / beyond the above limits, may be referred to the concerned Regional Office of Reserve Bank of India.
- (iv) The above shall be reported in IDPMS as per message "Bill of Entry Extension" and the date up to which extension is granted will be indicated in "Extension Date" column.

7. No, SIMCO cannot presume INR to be its functional currency on the basis of its location. It needs to consider various factors listed in Ind AS 21 for determination of functional currency.

Primary indicators:

1. The currency that mainly influences:
 - (a) sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
 - (b) labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.

2. Other factors that may provide supporting evidence to determine an entity's functional currency are **(Secondary indicators):**
 - (a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and
 - (b) the currency in which receipts from operating activities are usually retained.
3. **If an entity is a foreign operation**, additional factors set out in Ind AS 21 should be considered to determine whether its functional currency is the same as that of the reporting entity of which it is a subsidiary, branch, associate or joint venture:
 - a. Whether the activities of foreign operations are carried out as an extension of that reporting entity, rather than being carried out with a significant degree of autonomy;
 - b. Whether the transactions with the reporting entity are a high or a low proportion of the foreign operation's activities;
 - c. Whether cash flows from the activities of the foreign operations directly affect the cash flows of the reporting entity and are readily available for remittance to it.
 - d. Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligation without funds being made available by the reporting entity.

On the basis of additional factors mentioned in point 3 above, SIMCO cannot be said to have functional currency same as that of Simran Constructions GmbH.

Hence, primary and secondary indicators should be used for the determination of its functional currency giving priority to primary indicators. The analysis is given below:

- ◆ Its significant revenues and competitive forces are in USD.
- ◆ Its significant portion of cost is incurred in INR. Only 20% costs are in USD.
- ◆ 78% of its finances have been raised in USD.

- ♦ It retains its operating cash flows partially in USD and partially in INR.

Keeping these factors in view, USD should be considered as the functional currency of Sim Contractors Pvt. Ltd.

- 8. The residential status of a foreign company is determined on the basis of place of effective management (POEM) of the company.** For determining the POEM of a foreign company, the important criteria is whether the company is engaged in active business outside India or not.

A company shall be said to be engaged in “Active Business Outside India” (ABOI) for POEM, if

- the passive income is not more than 50% of its total income; and
- less than 50% of its total assets are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Raj Pharma AG shall be regarded as a company engaged in active business outside India for P.Y. 2023-24 for POEM purpose only if it satisfies all the four conditions cumulatively:-

Condition 1: The passive income of Raj Pharma AG should not be more than 50% of its total income

Total income of Raj Pharma AG during the P.Y. 2023-24 is ₹ 175 crores [(₹ 50 crores + ₹ 75 crores) + (₹ 30 crores + ₹ 20 crores)]

Passive income is the aggregate of, -

- (i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and
- (ii) income by way of royalty, dividend, capital gains, interest or rental income;

Passive Income of Raj Pharma AG is ₹ 65 crores, being sum total of:

- (i) ₹ 15 crores, income from transactions where both purchases and sales are from/to associated enterprises (₹ 5 crores in India and ₹ 10 crores in Germany)
- (ii) ₹ 50 crores, being interest and dividend from investment (₹ 30 crores in India and ₹ 20 crores in Germany)

Percentage of passive income to total income = ₹ 65 crore/ ₹ 175 crore x 100 = 37.14%

Since passive income of Raj Pharma AG is 37.14%, which is not more than 50% of its total income, the first condition is satisfied.

Condition 2: Raj Pharma AG should have less than 50% of its total assets situated in India

- Value of total assets of Raj Pharma AG during the P.Y. 2023-24 is ₹ 470 crores [₹ 190 crores, in India + ₹ 280 crores, in Germany]
- Value of total assets of Raj Pharma AG in India during the P.Y. 2023-24 is ₹ 190 crores
- Percentage of assets situated in India to total assets = ₹ 190 crores/₹ 470 crores x 100 = 40.43%.

Since the value of assets of Raj Pharma AG situated in India is less than 50% of its total assets, the second condition for ABOI test is satisfied.

Condition 3: Less than 50% of the total number of employees of Raj Pharma AG should be situated in India or should be resident in India

- Number of employees situated in India or are resident in India is 60 Total Number of employees of Raj Pharma AG is 150 [60 + 90]
- Percentage of employees situated in India or are resident in India to total number of employees is 60/150 x 100 = 40%

Since employees situated in India or are residents in India of Raj Pharma AG are less than 50% of its total employees, the third condition for ABOI test is satisfied.

Condition 4: The payroll expenses incurred on employees situated in India or resident in India should be less than 50% of its total payroll expenditure

- Payroll expenses on employees employed in and resident of India = ₹ 10 crores.
- Total payroll expenses = ₹ 25 crores (₹ 10 crores + ₹ 15 crores)
- Percentage of payroll expenses of employees situated in India or are resident in India to the total payroll expenses = $10 \times 100/25 = 40\%$

Since the payroll expenses incurred on employees situated in India or resident in India is less than 50% of its total payroll expenditure, the fourth condition for ABOI test is also satisfied.

Thus, since Raj Pharma AG has satisfied all the four conditions, the company would be said to be engaged in “active business outside India” during the P.Y. 2023-24.

POEM of a company engaged in active business outside India shall be presumed to be outside India, if the majority of the board meetings are held outside India.

Since Raj Pharma AG is engaged in active business outside India in the P.Y. 2023-24 and majority of its board meetings i.e., 5 out of 8, were held outside India, POEM of Raj Pharma AG would be outside India.

Therefore, Raj Pharma AG would be non-resident in India for the P.Y. 2023-24.

ANSWERS TO THE CASE STUDY 5

I. Answers to the Multiple Choice Questions

1. The correct answer is (a) Recognize a loss of ₹ 5 crores in its books. As per Ind AS 28, Investment in Associates and Joint Ventures, the sale of aircraft by PGL to TAPL will be a downstream transaction where the investor sells the asset to the joint venture. There has been an impairment loss of ₹ 5 crores in the value of the aircraft since the fair value is less than the carrying value of the asset. As per para 29 of Ind AS 28, in case of downstream transactions where there has been an impairment in the net realizable value of the asset, the loss should be recognized in full by the investor.

Therefore, the entire loss has to be recognized by PGL, who is the investor in TAPL.

2. The correct answer is (b) Evolutionary product. Premium economy are an upgraded version of economy seats which currently form 95% of the seating capacity within the domestic aviation market. Premium economy offers few upgraded services and facilities as compared to the economy seats for a slightly higher charge. Hence, they have evolved out the economy seat concept, with few additional features. At the same time premium economy are not as niche in terms of their service as full premium seats.
3. The correct answer is (d) Ensuring synergy between the work cultures of executives of PGL and AAI deputed at TAPL by arranging team building exercises would be soft accountability for Human Resources department. Team building exercises to build synergy is human input in the system that cannot be objectively measured and is essentially intangible in nature. Hence from a performance management perspective, it is a soft measure.

The other measures are either financial or quantitative information which can be measured.

4. The answer is (a) since reduction in the number of complaints will be definitively indicative of achievement of on time performance
Reduction in time taken to attend customer complaints, record of on time performance or increased staff training do not necessarily indicate the achievement of the best on time performance within the industry.

5. The answer is (a) According to Section 14 of the Insolvency and Bankruptcy Code, 2016, the institution of suits and continuation of pending proceedings against a Corporate Debtor in any court is not allowed during the period of moratorium. However, the DGCA had not instituted any suit to reallocate the right; hence, they did not breach the Insolvency and Bankruptcy Code.

Furthermore, Section 14 explicitly states that a license, permit, registration, or similar grant or right issued by the Central

Government, State Government, local authority, or sectoral regulator shall not be suspended or terminated on the grounds of insolvency, provided there is no default in the payment of current dues arising from the use of such license or grant during the moratorium.

The DGCA has right to reallocate the rights to use due to default of the current dues by Trujet. However, DGCA did not breach the Insolvency and Bankruptcy Code, 2016 during the hearing of TAPL's petition.

II. Answers to the Descriptive Questions

6. The internal audit can play an important role in joint venture in assessing key governance risks. Such risks in a joint venture may include: -

- Establishing joint venture strategy and its monitoring
- Issues in capital planning
- Controls governing investments in joint venture
- Division of governance functions and consequent delegation of authority
- Agreement between both the stakeholders on key governance matters

The purpose of a joint venture is sharing risks and rewards in developing new market for “premium economy” segment in India. A joint venture involves joint control of a business with contribution of resources by investors to run it.

Internal audit provides independent assurance on effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives. In fact, internal audit can help an organisation in achieving its objective without compromising upon its independence. It includes review of operational activities, underlying internal controls and compliance with applicable laws and regulations.

Therefore, internal audit function can play a critical role in joint venture like TAPL.

7. AAI and PGL will benefit from the McKinsey 7s framework as it is undergoing substantial change in its operations by entering the Indian aviation sector. There are 3 hard elements – Strategy, Structure and Systems and 4 soft elements – Shared values, Style, Staff and Skills. Each of these elements represent a constellation of systems, which when integrated well assist in effective implementation of strategies, efficient use of resources and ultimately enables the organization to create value. The hard elements can be easily quantified, defined, and influenced by the management while the soft elements are those that are influenced by culture within an organization, making them intangible in nature and therefore relatively difficult for the management to influence. It is important for TAPL to have properly integrated systems in place in order to execute its strategies well in the highly competitive aviation industry. It is a Joint Venture between two globally established, reputed organizations and therefore this framework will help the organization identify any blind spots at the inception stage itself.

Strategy

- TAPL strategically positions itself in the "premium economy" segment to capture a unique market niche, leveraging Avian Airlines' premium services and PGL's extensive market presence.
- It differentiates by offering superior service at slightly higher rates than economy, aiming to attract business travellers and price-sensitive premium customers.
- The partnership with AAI enhances global connectivity, a key differentiator in the competitive Indian aviation market.

Structure

- The joint venture's structure, with PGL's majority and AAI's strategic stake, balances expertise and control, optimizing the organizational workflow.

- Initially centralized under COO Mr. Tan for coherent early decision-making, with a view to evolve towards flexibility and scalability as TAPL grows.
- Functional departmentalization harnesses AAI's aviation expertise and PGL's market insight, fostering efficiency and market responsiveness.

Systems

- Digitalization and technology adoption streamline operations and improve customer satisfaction, positioning TAPL for operational excellence.
- Strategic implementation of advanced reservation and CRM systems underpins competitive advantage through enhanced efficiency and service personalization.
- Clear goals and performance measurement for each department ensure aligned and efficient operational execution.

Style

- Leadership style integrates AAI and PGL's diverse cultures, promoting innovation, agility, and a unified approach towards strategic goals.
- Emphasizes a corporate culture of creativity, motivation, and customer-centricity, crucial for navigating the dynamic aviation sector.
- Cross-functional teams foster collaboration and a shared vision, enhancing TAPL's strategic and operational agility.

Staff

- TAPL's strategic talent management focuses on diversity, competitive remuneration, and professional growth to mitigate industry-high attrition rates.
- A supportive work environment and opportunities for development aim to attract and retain a motivated workforce.
- Recognizes staff as crucial for delivering the high service standards expected in the premium economy segment.

Skills

- Collaborative training and continuous learning initiatives ensure the workforce is equipped with necessary technical and soft skills.
- Balanced focus on operational safety and customer service excellence supports TAPL's differentiation strategy.
- Continuous investment in staff development ensures alignment with TAPL's premium service ethos and brand promise.

Shared Values

- TAPL's core values of honesty, work ethic, transparency, accountability, and trust underpin its operations and customer interactions. These values are central to building a strong, customer-focused brand identity and fostering loyalty in the competitive aviation sector.
- Aligning strategic and operational practices with these shared values ensures TAPL's market positioning and brand strength.