CASE STUDY 8

LWS & Co., a chartered accountant firm has been into practice since 2006 in Delhi. CA Suresh Shah and CA Harvinder Kaur started their firm after practicing individually for almost 4 years and now firm has grown into big firm of 5 partners. The partners of firm have contributed various articles on subjects of Direct tax and allied Laws in professional journals and magazines. The clientele encompasses various segments i.e. software, education, NGOs, Government Bodies, real estate, construction, jewellery and a host of others. Over the years, the firm has evolved into renowned professional firm that has worked on various assignments ranging from statutory audits, management audits, income tax planning, FEMA consultancy, GST consultancy, establishment of overseas ventures and other related matters.

The firm has unique way of training its articles by involving them with its experienced partners on crucial projects so that they are able to learn and understand the practical issues arising in different industries. Currently, Subhash, Ashish and Manoj being articles of the firm are working with CA Harsh Bhatia, CA Nikhil Grover and CA Sakshi Ahuja, respectively for prestigious clients of the firm.

(1) Subhash assisting CA Harsh Bhatia

Currently, CA Harsh Bhatia is working on the applicability of Ind AS for various clients. The firm has a prestigious client, Shivalik Construction Private Limited, a construction company. On 1st January 2024, the company contracts to renovate a building including installation of new elevators. The company estimates following with respect to the contract:

Particulars			**Amount (₹)**
Transaction price			60,00,000
Expected costs:			
(a)	Elevators	10,00,000	
(b)	Other costs	35,00,000	45,00,000

The company purchased elevators and they are delivered to the site six months before they will be installed. The Company uses an input method based on cost to measure progress towards completion. The Company has incurred actual other costs of ₹ 7,00,000 by 31st March, 2024. The accounts team of the Company is facing difficulty in recognising revenue in respect of above contract. So, they have approached CA Harsh Bhatia with the abovementioned facts. CA Harsh

Bhatia delegated the said work to Subhash to start initial working and then revert to him with his opinion.

(2) Ashish assisting CA Nikhil Grover

CA Nikhil Grover handles tax department of the firm. The final calculation of income tax and tax planning is being headed by CA Nikhil Grover. He is nowadays being assisted by Ashish. One of the oldest clients of the firm is MVS Private Ltd. The accountant of the company approached CA Nikhil Grover for calculation of final tax liability of the company. CA Nikhil assigned the work to Ashish. The accountant showed financials of the company to Ashish as below:-

The Profit & Loss Account of MVS private Limited for the year ended 31st March, 2024 shows a profit of ₹ 75 lakhs after debiting the following items:

(i) ₹ 2 Lakhs contributed to Employee's Welfare Trust (not required as per any law for the time being in force).

(ii) ₹ 7,80,000 paid towards course fee and hostel expenses for MBA course of a close relative of a director. The relative is not in employment with the company.

(iii) ₹ 3.50 lakhs being expenses incurred on installation of a traffic signal, so as to facilitate its employees coming to office to overcome traffic jam and save office time.

(iv) ₹ 3 lakhs spent on gift items distributed to various dealers under the company's sales incentive scheme.

(v) ₹ 6 lakhs being expenses incurred on the travelling of the wife of MD, who accompanied him on tour to Singapore on invitation of Trade and Commerce chamber, Singapore.

(vi) ₹ 3 lakhs being amount paid in March 2024 consequent upon change in currency rate due to exchange fluctuation in excess of the amount due to the supplier of machinery. Such second hand machinery was acquired and put to use on 10th September 2023.

(vii) ₹ 18,000 and ₹ 9,000 paid in cash on 25th August, 2023 by two separate vouchers to a contractor who carried out certain repair work in the office premises.

(viii) Interest of ₹ 2 lakhs was paid in September, 2023 to a company on a loan taken form it. Tax deducted at source, during P.Y. 2023-24, from such interest was deposited in April 2024.

Additional Information:

(a) Audit fee of ₹ 6 lakhs was credited during previous year 2022-23 without deducting tax at source. Such fee was paid to the auditors in September, 2023 after deducting tax under section 194J and the tax so deducted was deposited on 7th December, 2023. 30% of audit fee was disallowed while computing income for financial year 2022-23.

(b) During financial year under consideration, the company purchased 10,000 shares of AB Private Limited out of its total 2 lakh shares at ₹ 40 per share. The fair market value of such shares on the date of transaction was ₹ 60 per share.

(3) Manoj assisting CA Sakshi Ahuja

Mr Amit, the director of SSI Pvt. Ltd. visited CA Sakshi Ahuja who is handling all customs related works of clients for past 7 years. The company imported machinery from USA by air for which the details are given under. FC signifies foreign currency in appended table.

Purchase cost of Machinery	FC 7,000
Accessories worth US $ 2,000 compulsorily supplied with machine, price of which is included in price of machine	
Air Freight	FC 2,000
Insurance	FC 100
Local Agent Commission (not buying commission)	₹ 4,500
Exchange Rate with respect to INR	1 FC = 70
Custom Duty on Machine	10% ad valorem
Custom duty on Accessory	20% ad valorem
Integrated Tax	12%
GST Compensation cess	Nil
SWS (Social Welfare Surcharge)	10%

I. Multiple Choice Questions

1. With reference to the Information given in point (3), compute the FOB value of machinery purchased by SSI Pvt. Ltd. as per Customs Act, 1962.

   (a) ₹ 4,90,000

   (b) ₹ 4,94,500

(c) ₹ 6,30,000

(d) ₹ 6,37,000

2. With reference to the Information given in point (3), compute assessable value of machinery purchased by SSI Pvt. Ltd. as per Customs Act, 1962.

(a) ₹ 6,00,400

(b) ₹ 6,37,000

(c) ₹ 6,41,500

(d) ₹ 7,81,500

3. With reference to the Information given in point (3), compute the total customs duty and integrated tax payable as per Customs Act, 1962 by SSI Pvt. Ltd. in respect of imported machine.

(a) ₹ 1,54,918

(b) ₹ 1,46,017

(c) ₹ 1,56,013

(d) ₹ 1,90,060

4. With reference to the Information given in point (2), compute the Income of MVS Private Limited taxable under the head "Income from other sources".

(a) ₹ 4,00,000

(b) ₹ 1,50,000

(c) ₹ 2,00,000

(d) Nil

5. Existence of which of the conditions would make it appropriate for Shivalik Construction Private Limited to recognise revenue only to the extent of costs incurred?

(i) The goods do not represent a distinct performance obligation

(ii) The goods represent a distinct performance obligation

(iii) Customer is expected to obtain control of the goods significantly before receiving the services

(iv) Cost of such goods is significant relative to the total expected costs to complete the performance obligation and

(v) The entity procures the goods from a third party and does not significantly involve in designing / manufacturing the goods (even if the entity is a principal in the arrangement between the entity and end customer).

In the above context, which of the following is correct combination:

(a) (i), (ii), (iii), (iv), (v)

(b) (i), (iii), (iv), (v)

(c) (ii), (iii), (iv), (v)

(d) (i), (ii), (iii), (iv)

II. Descriptive Questions

6. Compute total income of MVS Private Limited for Assessment Year 2024-25 and tax liability under Income Tax Act on such income indicating reasons for treatment of each item. Ignore provisions relating to minimum alternate tax. Assume that company does not opt for provisions of section 115BAA (Turnover of company for previous year 2021-22 was ₹ 250 crore)

7. How will Shivalik Construction Private Limited recognize revenue as per the relevant Ind AS, if performance obligation is met over a period of time?

ANSWERS TO THE CASE STUDY 8

I. Answers to the Multiple Choice Questions

1. (b) ₹ 4,94,500

Reason:

Particulars	Amount
Cost of machinery inclusive of accessory (FOB) (See note)	7,000
Total (in Indian ₹) FC 7000 * ₹ 70 (being Exchange Rate)	₹ 4,90,000
Add: Local Agency Commission	₹ 4,500
FOB Value as per Customs	**₹ 4,94,500**

Note:

1) As per Accessories (Conditions) Rules, 1963, accessories and spare parts compulsorily supplied with main implements are chargeable at the same rate applicable to main machine. Therefore, such accessories shall also be chargeable with duty at the rate applicable to the machinery i.e. 10% ad valorem

2) Agency Commission, which is incurred in India, is not regarded as Buying Commission and therefore will be added to determine customs FOB Value.

2. **(a)** ₹ 6,00,400

Reason:

Particulars	**Amount**
Cost of machinery inclusive of accessory (FOB) (See note)	7,000
Total (in Indian ₹) FC 7,000* ₹ 70 (being Exchange Rate)	₹ 4,90,000
Add: Agency Commission	₹ 4,500
FOB Value as per Customs	**₹ 4,94,500**
Add: Cost of insurance (FC 100 * ₹ 70)	₹ 7,000
Add: Air freight restricted to 20% of FOB Value as per customs	₹ 98,900
CIF Value/Assessable Value	**₹ 6,00,400**

Note: Actual Air freight is FC 2,000, it is limited to 20% of Custom FOB value of Goods as per Rule 10(2) of Custom Valuation Rules

3. **(b)** ₹ 1,46,017

Reason:

Particulars		**Amount (₹)**
Assessable Value	(A)	6,00,400
Add: Basic Custom Duty (10%)	(B)	60,040
Add: SWS @10% on BCD	(C)	6,004
Total for Integrated Tax u/s 3(7) CTA,1975	(D)	6,66,444
Integrated Tax @ 12% of ₹ 6,66,444 (rounded off)	(E)	79,973

Total Custom Duty Payable = (B) + (C) + (E) i.e. ₹ 1,46,017

4. **(c)** ₹ 2,00,000

Reason: Income from other sources- Difference between the aggregate fair market value of shares of a closely held company and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company under section 56(2)(x). Since the difference exceeds ₹ 50,000, the entire sum is taxable.

10,000 shares * (60 - 40) = ₹ 2,00,000

5. **(b)** (i), (iii), (iv), (v)

Reason: While applying input method, a careful consideration should be given for events that do not depict a direct relationship between entity's inputs and transfer of control of goods or services. For example, when cost-based input method is used, an adjustment may be required when cost incurred is not proportionate to entity's progress in satisfying its performance obligation. In such cases, the best reflection is to adjust the input method to recognise revenue only to the extent of costs incurred. Such recognition of revenue to the extent of costs incurred is appropriate, if at contract inception, all the following conditions exist:

(i) The goods do not represent a distinct performance obligation;

(iii) Customer is expected to obtain control of the goods significantly before receiving the services;

(iv) Cost of such goods is significant relative to the total expected costs to complete the performance obligation; and

(v) The entity procures the goods from a third party and does not significantly involve in designing / manufacturing the goods (even if the entity is a principal in the arrangement between the entity and end customer).

II. Answers to the Descriptive Questions

6. **Computation of total income of MVS Private Ltd. for A.Y. 2024-25**

Particulars	**Amount (₹)**
Profits and gains of business or profession	
Net profit for the year as per profit and loss account	75,00,000
Add: Expenses debited to profit and loss account but not allowable	

Contribution to Employees' Welfare Trust disallowed under section 40A(9) Note: Alternatively, contribution to Employees Welfare Trust can be regarded as labour welfare expenditure and hence, can be allowed as deduction under section 37 as the payments were made on the ground of assessee's business exigencies [CIT v. Cheran Transport Corp. Ltd. (Mad.)]	2,00,000
Expenses on course fee and hostel expenses for MBA course of a close relative of a director, who is not in employment of MVS Private Ltd., is not deductible under section 37 [Enkay (India) Rubber Co. Ltd. V CIT] Such expenditure is not incurred wholly and exclusively for the purposes of business. Hence, it should be added back to compute business income.	7,80,000
Expenses on installation of traffic signal, to facilitate its employees to overcome traffic jam and be on time, is in the interest of the business so that the work gets completed on time, and is hence, an allowable expense under section 37(1) [Infosys Technologies Ltd. v. CIT (Bangalore)]	
Expenses on distribution of gift items to dealers under sales incentive scheme would promote goodwill and is made in the interest of business. Such gifts are prompted by commercial expediency and hence, the expenditure is allowable under section 37(1) [CIT v. Avery Cycle Industries Ltd. (Punjab & Haryana)]	
Expenses on travelling to Singapore of the wife of Managing Director on the invitation of Trade and Commerce Chamber, Singapore, is an allowable expense on the grounds of commercial expediency and business considerations. [Hero Honda Motors Ltd. v. CIT (Delhi)]	
Increase in liability due to change in currency rate and paid to the suppliers of machinery is to be added to cost of the asset as per section 43A. Hence, it should be added back to compute business income.	3,00,000
Payments to a contractor for repair work in a day by two separate vouchers in cash, is not an allowable expense as per section 40A(3), since the aggregate payments in a day exceeds the limit of ₹ 10,000	27,000
Interest of ₹ 2 lakhs paid in September, 2023, on which tax deducted at source was remitted to the government before the due date of filling of income tax return, is allowable as per section 40(a)(ia).	
Total	88,07,000
Less: Expenditure allowable as deduction but not debited to profit and loss account	

Disallowed audit fees paid for the year ended 31.3.2023 for which tax was not deducted in the F.Y. 2022-23 but was deducted and paid in F.Y 2023-24, is allowable as deduction in the A.Y. 2024-25, as per the proviso to section 40(a)(ia)	1,80,000
Depreciation on the amount of ₹ 3 lakhs added in cost of Machinery was put to use for more than 180 days	45,000
Income under the head Profits & Gains of Business or Profession	**85,82,000**
Income from other sources Difference between the aggregate fair market value of shares of a closely held company and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company other section 56(2)(x). Since the difference exceeds ₹ 50,000, the entire sum is taxable.	2,00,000
Total Income	**87,82,000**

Computation of tax liability of MVS Private Ltd. For the A.Y. 2024-25

Particulars	Amount (₹)
Tax on ₹ 87,82,000 @ 25%	21,95,500
Add: Health & Education cess @ 4%	87,820
Total tax payable	**22,83,320**

7. **Costs to be incurred comprise two major components – elevators and cost of construction service**

(a) The elevators are part of the overall construction project and are not a distinct performance obligation.

(b) The cost of elevators is substantial to the overall project and are incurred well in advance.

(c) Upon delivery at site, customer acquires control of such elevators.

(d) And there is no modification done to the elevators, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on input method as provided under Ind AS 115, 'Revenue from Contracts with Customers' –

- The measure of progress should be made based on percentage of costs incurred relative to the total budgeted costs.
- The cost of elevators should be excluded when measuring such progress and revenue for such elevators should be recognized to the extent of costs incurred.

The revenue to be recognized is measured as follows:

Particulars	**Amount (₹)**
Transaction price	60,00,000
Costs incurred:	
(a) Cost of elevators	10,00,000
(b) Other costs	7,00,000
Measure of progress:	7,00,000/35,00,000 = 20%

Revenue to be recognised:	
(a) For costs incurred (other than elevators)	Total attributable revenue = 50,00,000 % of work completed = 20% Revenue to be recognised = 10,00,000
(b) Revenue for elevators	10,00,000 (equal to costs incurred)
Total revenue to be recognised	10,00,000 + 10,00,000 = 20,00,000

Therefore, for the year ended 31st March, 2024, the company shall recognize revenue of ₹ 20,00,000 on the project.