

**PRIME ACADEMY  
PROGRESS TEST – JANUARY 2008**

Time Allowed : 2 Hours

FINAL

Maximum Marks : 75

**COST MANAGEMENT ACCOUNTING QUANTITATIVE TECHNIQUES**

**SECTION – B**

**(45 Marks)**

**Answer All Questions**

1. Anova Industries is manufacturing several consumer durables which have good demand in the market. The firm has been established only very recently and currently it is in the first stage of production. It has ambitious plans to expand production after earning a name in the market. However, the company is having problems to get adequate power supply. Moreover most of its labourers are casual workers and labour-absenteeism is also affecting production. In view of these unstable conditions, the firm has adopted the practice of preparing quarterly flexible budgets.

For the quarter ended 30<sup>th</sup> September, 2007 flexible budgets for three possible levels of production were prepared as follows. The company wanted to achieve 90% capacity utilization as its products had good demand.

	Flexible Budgets		
	60%	80%	90%
	(in lakhs of rupees)		
Budgeted Sales	50.00	66.00	75.00
Budgeted Costs:			
Direct Materials	12.00	16.00	18.00
Direct labour	15.00	20.00	22.50
Production overheads	11.80	14.00	15.10
Administration overheads	2.00	2.00	2.00
Selling overheads	7.80	9.40	10.20

Soon after the decision to attain 90% capacity utilization, available power was reduced by the State Electricity Board and the reduced supply was sufficient to meet 50% capacity production. The position has been immediately reviewed and the firm is considering the following possible options to meet the situation:

- (a) Stop production for the quarter. As regular employees are only very few, lay-off compensation payable will be only Rs.1.20 lakhs. Further, overheads can be reduced by as much as 60%
- (b) Continue production at 50% level. Estimated sales income at this level will be Rs. 40 lakhs.
- (c) A private agency in the area has offered surplus captive power available with it. With this additional supply, production can be maintained at 90% level. However, the overall variable production overhead will increase by 40%
- (d) Subcontract the balance 40% which cannot be made by the firm to two small industrial units in the area, which have the necessary facilities, equally at a cost of Rs. 15 lakhs each.

Evaluate each of the above options and recommend the best plan. Indicate the other important points, if any, to be considered.

**(15 Marks)**

2. Delta Airlines is considering the feasibility of offering a special oneway fare of Rs. 4,000 per passenger on weekdays (i.e Monday to Friday) and Rs.2,100 per passenger on weekends (i.e., Saturday and Sunday) between two cities. This scheme is valid effectively for 4 weeks. The flight duration between the cities is estimated at 30 minutes. Delta airlines will lease two aircrafts each having a capacity of 100 persons. The lease rent will be Rs. 6,00,000 per aircraft per day. The ground service cost per day will be Rs. 1,60,000 for both the aircrafts. Lease rent and ground service are fixed for the week and are to be paid on the first day of each week. Apart from this the Airlines will be incurring a cost of Rs.28,000 per hour of flight for crew and administration charges. Fuel cost is estimated at Rs.40,000 per flight hour. The estimated variable cost per passenger is Rs.400. Food costing Rs.200 on an average per passenger will be served free to the persons traveling on weekdays. Airlines expects a capacity of 80% on weekdays and 100% on weekends.

Delta Airlines will operate 10 flights each way on weekdays and 15 flights each way on weekends

You are required to compute:

- (a) Profitability for one week
- (b) Break-even passengers for a week
- (c) Break-even flights for a week.

**(18 Marks)**

3. A city corporation has decided to carry out road repairs on four main arteries of the city. The government has agreed to make special grant of Rs.50Lakhstowards the cost with a condition that the repairs must be done at the lowest cost and quickest time. If conditions warrant then a supplementary token grant will also be considered favourably. The corporations have floated tenders and 5 contractors have sent their bids. In order to expedite work, one road will be awarded to only one contractor.

**Cost of repairs (Rs in Lakhs)**

Contractors	R1	R2	R3	R4
C1	9	14	19	15
C2	7	17	20	19
C3	9	18	21	18
C4	10	12	18	19
C5	10	15	21	16

- (i) Find the best way of assigning the repair work to the contractors and the costs.
- (ii) If it is necessary to seek supplementary grant, then what should be the amount sought?
- (iii) Which of the five contractors will be unsuccessful in his bid?

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COST MANAGEMENT**

**PART – B**

(50 Marks)

The variable and fixed costs at 50% and 90% capacities would be as follows:

	<b>50% Capacity</b>		<b>90% Capacity</b>	
	Variable (in lakhs of rupees)	Fixed	Variable (in lakhs of rupees)	Fixed
Direct Materials	10.00		18.00	
Direct Labour	12.50		22.50	
Production overheads	5.50	5.20	9.90	5.20
Administration overheads		2.00		2.00
Selling & Distribution overheads	4.00	3.00	7.20	3.00
<b>Total</b>	<b>32.00</b>	<b>10.20</b>	<b>57.60</b>	<b>10.20</b>
Total Cost		42.20		67.80
Sales		40.00		75.00
Anticipated Profit		-2.20		7.20

(a) Close operation:

Cost incurred will be: Lay off compensation	Rs.1.20 lakhs
Fixed overheads @ 40% of Rs.10.20 lakhs	<u>Rs.4.08 lakhs</u>
Loss	<u><u>Rs.5.28 lakhs</u></u>

(b) Continue production at 50% capacity:

Loss incurred will be Rs.2.20 lakhs (as shown above)

(c) Purchase power from external sources:

Production is now at 90% level

Profit at 90% level Rs.7.20 lakhs	=	Rs.7.20 lakhs
Less: Additional cost under production overheads (variable) @ 40%		<u>Rs. 3.96 lakhs</u>
Net Profit		<u><u>Rs. 3.24 lakhs</u></u>

(d) Sub-contract part of production

Cost of production at 50% level	Rs.42.20 lakhs
Payment to subcontract firms towards production cost	Rs.30.00 lakhs
40% (Rs. 7.20 lakhs less Rs.4 lakhs) selling OH's	<u>Rs. 3.20 lakhs</u>
	Rs.75.40 lakhs
Sales	<u>Rs.75.00 lakhs</u>
Net Loss	<u><u>Rs. 0.40 lakhs</u></u>

### Comments:

The firm is a growing firm which is trying to expand its production as sales. Currently it is affected mainly by shortage of power which acts as a limiting factor. As its long term objective is to expand its activities, options (a) and (b) are not acceptable. Regarding option (d), apart from the loss, entrusting production to another unit may mean parting with technology and method of manufacture and creating ground for further competition. Hence, this is also not acceptable, even if it had been more profitable. The best course for the firm at present is to follow option (c) and build up its own captive power supply, so that future production would in no way be affected.

<b>(a) Profitability (Weekly)</b>	<b>Weekdays</b>	<b>Weekends</b>
<b>No.of Flights</b>	100	60
No.of Passengers per flight	80	100
Contribution per passenger	(Rs.4000-600)	(Rs.2100-400)
	Rs.3400	Rs.1700
Total Contribution (Rs. in Thousand)	Rs.27200	Rs.10200
	<hr/>	
	<u>Rs.37400</u>	
Less: Fixed Cost (crew / Administrative)		
(160*30/60*68000)	5440	
Lease Rent & Ground Service		
((2*600000)+160000)	9520	
	<hr/>	
	<u>14960</u>	
	<hr/>	
Net Profit	<u>22440</u>	

### **(B) Break even Passengers**

No of Flights	100	60
No of passengers	0.8x	x
(x is the capacity & Ratio)		
Contribution per passenger	Rs.3400	Rs.1700
Total Contribution	272000x	102000x
	374000x	
Total fixed cost	14960000	
Break even passengers	40	
Week Days 80%	= 32 passengers	
Week Ends 100%	= 40 Passengers	

### **c) BREAKEVEN FLIGHTS**

The total fixed cost is only Rs. 9520000 service the crew & fuel cost are variable per flight. Further during the weekdays the flights earn a contribution sufficient to cover these fixed costs. Hence the flights will be restricted to weekday flights.

No.of Passengers	80
Gross contribution per passenger	Rs. 3400
	<hr/>
Total	<u>272000</u>
Less: Fuel Cost	
(30/60 * 68000)	34000
Contribution per flight	238000
Fixed Cost	9520000

Since this is an assignment problem with 5 contractors and 4 roads, a dummy road, 'R5' with zero cost of repairing for each contractor is introduced to make the problem balanced.

**Step 1:**

Road Contractors	R1	R2	R3	R4	R5
C1	9	14	19	15	0
C2	7	17	20	19	0
C3	9	18	21	18	0
C4	10	12	18	19	0
C5	10	15	21	16	0

**Step 2:** Draw minimum 'straight lines to cover all zeros

2	2	1	0	0
0	5	2	4	0
2	6	3	3	0
3	0	0	4	0
3	3	3	1	0

**Step 3:**Smallest uncovered number is then subtracted from uncovered numbers added to numbers at intersection of two lines

2	2	1	0	1
0	5	2	4	1
1	5	2	2	0
3	0	0	4	1
2	2	2	0	0

**Step 4:**Return to step 2. Cover all zeros, since the number of lines is 4, the optimality criteria is not satisfied.

1	1	0	0	1
0	5	2	5	2
0	4	1	2	0
3	0	0	5	2
1	1	1	0	0

**Step 5:**Return to step 3. All rows and columns have single allocation and hence optimality criteria is satisfied.

1	1	<b>0</b>	<del>0</del>	1
<b>0</b>	5	2	5	2
<del>0</del>	4	1	2	<b>0</b>
3	<b>0</b>	<del>0</del>	5	2
1	1	1	<b>0</b>	<del>0</del>

Thus allotments are as follows:

(i) R1 → C2, R2 → C4, R3 → C1, R4 → C5, R5 → C3, Total Cost = Rs.54 Lacs

(ii) Since cost exceeds 50 lacs, the excess amount of Rs.4 (54-50) lacs is to be sought as supplementary grant.

(iii) Contractor C3 who has been assigned the dummy row (Road R5) loses out in the bid.

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**MANAGEMENT INFORMATION AND CONTROL SYSTEMS**

**PART B**

**( 50 Marks )**

**Question No.1 is compulsory. Answer any two from the remaining Four questions**

- 1(a)** Describe in detail the various feasibility studies carried out as part of preliminary investigation. ? **(10 Marks)**
- 1(b)** Explain stage 2 of SDLC? **(6 Marks)**
- 
- 2(a)** What are the factors to be considered while designing system inputs ? **(10 Marks)**
- 2(b)** Discuss the advantages of using pre-written application packages **(7 Marks)**
- 
- 3(a)** Explain briefly the meaning, advantages and disadvantages of various conversion strategies. **(10 Marks)**
- 3(b)** Briefly explain the meaning and contents of a Systems Manual **(7 Marks)**
- 
- 4(a)** Why is personnel training important for the successful implementation of information system ?  
What type of training should be imparted to i. Systems operator and (ii) end users **( 10 Marks)**
- 4(b)** What is Program Debugging? **( 5 Marks)**
- 4(c)** What are the two broad types of Maintenance **( 2 Marks)**
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- 5.** Write Short Notes on :
- a.** Windowing Capability **( 6 Marks)**
  - b.** Public Evaluation Reports **( 6 Marks)**
  - c.** Data Dictionary **( 5 Marks)**

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MANAGEMENT INFORMATION AND CONTROL SYSTEMS**

**PART B**

**(50 Marks)**

**1(a) Testing project's feasibility (Technical, Operational, Economical etc.)**

**Purpose:** To determine whether the proposed project would be beneficial to the organisation.

**How is it done ?** By testing the project for technical, operational and economical feasibility

First technical feasibility studied → then impact on social systems/employees (operational feasibility) → if both are found to be ok, then economical feasibility study done.

**Technical feasibility study**

**Meaning:** To study the impact of the proposed system on the hardware and software- both existing and expected (compatibility, interoperability).

**What questions are posed to judge technical feasibility?**

Can user requirements be met by the existing technology and can the organisation acquire the technology?

**Ex:** A university may want to put all the results in the internet. It has to see whether there is any software to securely put it on the web and whether it can buy it .

Has the proposed system the technical capability to hold the data required by the new system?

**Ex:** The organisation decides to centralise its corporate mail facility. The server proposed should have the capability to handle such high volumes of data.

Will the system provide adequate response to inquires for multiple users from multiple location?

This is a case of a number of users trying to access the same system from various locations.

**Ex:** A bank with a centralised server should have the capability to respond to various internet banking users who access their accounts from various locations.

Will the system have facility for expansion?

This pertains to scalability of the system to meet future needs of business.

Are there technical guarantees of accuracy, reliability, ease of access and data security?

**Economical feasibility**

**Meaning:** Involves judging the incremental costs /benefits (cost saving or increased revenue) on account of implementing a new system.

**What are the questions that need to be answered?**

Cost of conducting a full systems investigation

Cost of new hardware and software for the proposed system

Benefits in terms of reduced operating costs or lesser costly errors.

**Ex :**Cost of introducing a billing software to ensure that no items are omitted to be billed.

Cost of maintaining status-quo- that is if we continue with the existing system what would be cost or opportunity that we would be missing.

### **Operational feasibility**

**Meaning:** Ascertaining the views of employees, managers and suppliers. about the system

**Importance:** The support or lack of support given by the employees is very critical to the success of the system. A system feasible in all other aspects but not supported by employees is likely to create HR problems and will fail.

**Ex:** An ERP package may be technically advanced and economically feasible, but if users are not comfortable with the usage, the system might fail.

### **What are the questions to be answered?**

Do the management and staff support the system

Are the current systems well used and users satisfied that they may resist change to a new system?

Do users find some problem with the current systems- in which case they may support a new system?

Has there been user participation in the planning and development of new system- if so acceptance is likely to be high with little or no resistance and projects would be successful.

Will the proposed system

- Cause harm /loss of control in any area

- Produce poorer results

- Reduce/hinder accessibility of information

- Affect adversely individual performance

- Slow down performance of any department.

### **Some other feasibility studies to be undertaken**

#### **Schedule feasibility**

**Meaning:** Involves the estimation by the design team of the time involved for making the new system functional/operational and communicating this to the steering committee.

**Purpose of schedule feasibility:** This is a tool by which the management can decide whether to go-ahead with the development of the project or look for alternates like buying a off-the shelf product.

**Ex:** A bank decides that it needs to implement a centralised banking software.

The design team estimates that it would take at least 3 years to develop and implement the system. This is communicated to the steering committee.



The steering committee may decide that it would be better to buy an off-the shelf centralised-banking solution and customise it since it would take lesser time than development.

**Legal feasibility**

**Meaning:** The proposed system should not conflict with the legal/statutory obligations of the organisation. It should help the organisation conform with the state and central legislations.

**Ex:** A hospital wants to buy/develop a hospital management system to store the patient records in the system. Since the hospital is bound legally to maintain confidentiality about patient information, the software should support this through access controls and encryption.

**1(b) When does this stage begin? :** When management after feasibility stage decides to go-ahead with a particular project development, this phase is carried out.

**What is the focus of this stage?**

- 1. If traditional method of systems development is followed-** focus is on understanding user needs, in-depth study of the application area, strength and weakness of the current system and reporting results to management.
- 2. If prototyping approach is used -** in this methodology, the requirement analysis and design phase run parallel. As the user is testing with the initial prototype, the analyst observes and incorporates the requirements- which form the basis for next level of prototype.

**How thoroughly is the existing system studied ?**

The depth of study of the new system depends on :

<i><b>Situation</b></i>	<i><b>Action to be taken</b></i>
1. If old system to be used with only slight modifications	Study the system in-depth to make the necessary corrections/ modifications
2. If the old system is to be completely overhauled by a new system	Analyst should concentrate on finding out the requirements of the new system rather than wasting his time on the study of the existing system.

***What are the various methods through which information can be gathered about the requirements?***

**1. Documents**

**Ex:** Manuals, input forms, output forms, procedure manuals organisational charts showing the organisational structure.

Very good source of information about user needs and current systems

Provide objective information and are easy to collect. However the analyst should ensure that they are current, up-to-date and authentic.

## 2. Questionnaires

- Users and managers are required to fill in questionnaires. These can be given to multiple users and information collected quickly.
- Properly drafted questionnaires provide basis for analysis using computers

## 3. Interviews

- Users and managers interviewed by analysts. They provide a complete picture of the problems and opportunities.
- An analyst notes the user reaction and probes for further information.

**Ex:** Analyst interviews a pay-roll officer on requirement of new pay-roll software. Based on the reaction, may get the information that problem lies in H.R Dept. conveying information to pay-roll and would probe further.

## 4. Observations

**If prototyping approach adopted:** Observation is an absolute must. Only by observing how users react to the new system, modifications / improvements can be made

**If traditional approach adopted:** Observation is not mandatory but is recommended to gauge reactions.

### **How is observation carried out?**

- Visit the user in his work area and watch the activities carried out by them.

### **Advantages of observation**

- Surprise visit provides analyst a clear picture of the work environment and to determine why the request for a new system has originated.

What the analyst reads from documents or hears during interviews may be different from what he observes in the live situation

## 2(a) Meaning of input design

Consists of developing specifications and procedures for basic data preparation and entry into the computer system.

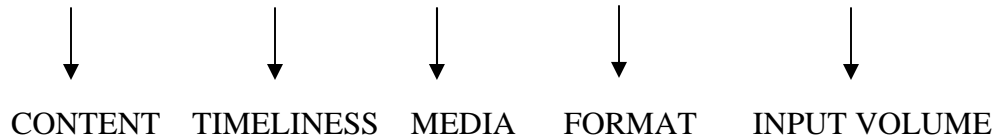
*Where to begin?*

Review the information collected at the requirement analysis phase to understand as to **what** data are entered, **who** enters them, **where** are they captured/entered, **when** are they captured in the current system.

The above process helps to identify the weakness in the present systems which need to be addressed by the new system.

**Important factors to be considered in design of input**

Six important factors to be given importance while designing user inputs :



**1. Content**

- Analyst has to decide on the types of data that need to be collected to get the desired output
- New systems require new information from new data source and hence use new documents for collecting information.

**2. Timeliness**

- Timely outputs require timely inputs
- Plan of action need to be drawn as to when various inputs will enter the system. This is critical when people giving the inputs and people requiring the outputs are different.

**3. Media**

- An important consideration is the choice of the input media and the devices used to input data. (Ex: magnetic tapes, key-boards, OCR/OMR etc.)
- Medium selection should be based on the application to be computerised.

**4. Format**

- Refers to specifying record formats like length of data fields, special characters to be used etc.
- Formats can be generated using application generators and sometimes may require the assistance of professional programmers/ DBAs

**5. Input volume**

- Refers to the amount of data to be entered in the computer system at one time.
- In real-time systems input volume is less (since each entry is posted immediately) while in batch processing systems the inputs are accumulated and then entered and hence input volume is heavy.

**2(b) ADVANTAGE OF BUYING THE APPLICATION SOFTWARE FROM THE VENDOR (“OFF-THE-SHELF” PRODUCT)**

<b>S.No.</b>	<b>Points for consideration</b>	<b>Advantage if we buy the software</b>	<b>Disadvantage if it is developed in-house</b>
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1.	<b>Implementation</b>	Rapid implementation	May take months or years to implement
2.	<b>Risk</b>	Low risk- product already available- organisation aware of the features it is going to get at what price.	Long development time- leads to uncertainty as regards quality and cost of development.
3.	<b>Quality</b>	Vendors dealing in application software- retain specialists who have lot of experience. Hence product quality good.	In-house programmers have to work on a wide range of applications and may not have expertise.
4.	<b>Cost</b>	Software vendors sell products to various customers and hence cost per customer may be low.	There may be some hidden costs.

Further vendors may provide complete set of documentation and user training along with the software which is an added advantage.

**3(a)** Various conversion strategies, their meaning, advantages and disadvantages

<i>Conversion method</i>	<i>Meaning</i>	<i>Advantages</i>	<i>Disadvantages</i>
1. Direct change over method (also called Plunge Method)	On a specified date old system is dropped and new system is put to use  Can be adopted only if extensive testing done beforehand	Users straight away use the new system- adaptation easy.	1. Risky 2. Long delays if errors occur since this the only system available to do the processing 3. Users resent/resist since unfamiliar system 4. Cannot compare results with the old system(since old system has been discarded)
2. Parallel conversion	Running the old system and the new system in parallel at the same time	1. Since data available from both old and new systems, any	1. Cost of running both systems (old and new) is very high.

	Results of the new system compared with that of the old system and if reliable over a period of time, old system is stopped and new system put to use.	<p>errors in new system can be corrected.</p> <p>2. Users feel secure as they are not faced with abrupt change</p>	<p>2. Employees work load increases during conversion.</p> <p>3. Unless new system is replacing old manual system, output comparison difficult.</p> <p>4. If new system is an improvement over existing system, outputs would differ and hence difficult to compare.</p> <p>5. Users familiar with old system and will continue to use only that.</p>
3. Gradual conversion	<p>Attempts to combine the good features of parallel and direct changeover method.</p> <p>Volume of transaction gradually increased → new system is phased in.</p>	Users can use the new system gradually and there is a possibility of detecting and correcting errors without much system downtime.	<p>1. Time consuming as it may take a long time to put the new system in use.</p> <p>2. Not the best method for small, simple systems.</p>
4. Modular prototype conversion	<p>Involves building of modular, operational prototypes to change from old to new system.</p> <p>Each module is modified, accepted and put to use gradually.</p>	<p>1. Thorough testing of modules before being put to use.</p> <p>2. User familiarity before model put to use.</p>	<p>1. Too many prototypes and hence may not be feasible.</p> <p>2. Interfacing of the various modules (so that they work as a system) may be a problem.</p>
5. Distributed conversion (Also called as PILOT run)	Involves full implementation of the system in one branch of the organization (say a bank branch) using any of the above four methods. If successful then	Problems if any can be identified and controlled in one location rather than affecting all locations.	Each branch/site may have its own problem that needs to be handled separately. Hence success in one site does not necessarily mean success in other

	carried out at other branches.		sites.
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**3(b)** The deliverable of the Design phase is a document containing description of the activities to be carried out with diagrammatic representations like flowcharts. This document is called as systems manual/job specification manual.

### **Contents of a Systems Manual**

- An overview of the existing system in place
- Information and process flows of the existing system
- The outputs and the intended recipients of the existing system
- A description of the proposed system
- Data and process flows of the proposed system
- Outputs and departments for which they are intended
- Input layout and departments responsible for various inputs
- Description of the various files to be maintained- temporary files, permanent files etc. and the contents of each file
- A program listing which would constitute the new system
- Estimates as regards the probable time involved in development (expressed in terms of computer hours, man days etc.)
- Proposed controls and audit trails to be enabled in the new system

### **4(a) Importance of training**

- A system can succeed or fail depending on how it is operated or used. Hence quality of training received by various personnel (systems operators and other users ) decides the success or failure of the implementation effort.

(Ex: An ERP package's success depends on how well the end users are trained in its usage and maintenance)

**How is training imparted? :** Training is imparted through classes and through hands-on learning techniques for both hardware and software.

**Who are the people to be trained ?:** Training should be imparted to :



SYSTEMS OPERATORS



END USERS

### Training of systems operators

- System operators are responsible for keeping equipment running + providing support services.
- Training should cover all types of operations ; both routine and extra-ordinary.
- Areas of training should include :
  - How to switch on a new equipment
  - What are the normal operations of the new system
  - What are the common malfunctioning/problems that might arise, how to recognise them and what action is to be taken (**trouble shooting**).
  - Who are the contact persons in case of unusual problems, how to get in touch with them (**Ex:** Vendor help desk number etc.)

### Training of users

- It may involve **use of equipment** i.e. how to operate the system.
- They may be trained in **trouble-shooting**. This involves identification as to whether a problem is caused due to software or is it a hardware problem.
- They are also trained in **data handling**. This includes data editing, data coding, designing queries and deleting records.
- Users are trained in **system maintenance activities** like preparing disks, loading papers in printers and changing printer cartridges/ribbons.

**4(b) Meaning :**Correcting the syntax errors in programming language and also the diagnostic errors.

**Purpose:** It is carried out so that the program compiles without any problem (called as “clean compile”) and can be successfully converted from source code into machine code.

Debugging consists of the following steps :

Inputting the source program into the compiler



Compiler finds out the errors in programming



Correct the errors thrown out



Re-submit the source program to the compiler

4(c)

<i>Category</i>	<i>Meaning</i>	<i>Example</i>
Schedule maintenance	Maintenance efforts which can be anticipated and which are planned for	Implementation of new tax rates in payroll software after every budget
Rescue maintenance	Not anticipated – require immediate attention – may be some previously unnoticed errors/bugs	A particular screen in the billing module may not work. The system may stop processing and hence may require immediate attention.

5. a. **Windowing Capability**

- i. Some software allows the windows to be repositioned on the display screen.
- ii. They may allow changing the window size/ hiding a window when not required.
- iii. **Overlapping:** This means that multiple screens/windows are open at the same time.

This allows users to move information from back-ground to foreground as and when needed. Such capabilities should be supported by O/S.

***When should windowing capability be considered ?***

- a. It is required to display different data or reports simultaneously  
**Ex:** We may open two different Word documents containing sales reports for two different regions simultaneously.
- b. Switch between different programs, alternatively displaying the output from each  
**Ex:** We may open a Word document containing some reports and tables and also open the Calculator tool and alternate between both.
- c. Move information from one window to the other (either among same programs or between different programs)

Allowing individual users to align/reposition the information on a display screen to suit their specific needs.



## b. Public evaluation reports:

Some consultancy agencies compare and contrast performance of various software and hardware and publish these reports. These reports are used by companies wanting to invest in new software/hardware and especially useful when company staff donot have much systems knowledge.

## c. Data Dictionary

- It contains **data about data** (called as “meta data”)
- Contains descriptive information about data items in the files of the information system.

**Ex:** Date field is a data field. Data dictionary contains information like date field accepts data only in “dd/mm/yyyy” format. It is describing the characteristic of the data field.

### Some information contained in the data dictionary

- Codes describing data length , data type (numeric, alphabetic etc.)
- Information about the source document used to create the data item.
- Names of the computer files storing data items.

As new data fields are added to the record structure      —————>      data dictionary is updated.

**Example:** If roll number field is added to a screen, the data dictionary is updated to state that this field will contain a maximum of 8 characters, the first two places will be alphabets, and the next 6 will be reserved for numbers. Like **AB2455**.

As a data field is deleted      —>      corresponding entries are deleted in the data dictionary.

If new computer programs are created to access the existing data items in the files —> data dictionary is updated about the data items these programs access.

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**PRIME ACADEMY  
PROGRESS TEST – JANUARY 2008**

**Time Allowed : 2 Hours**

**FINAL**

**Maximum Marks : 75**

**DIRECT TAX**

**PART B**

**65 MARKS**

**Answer all questions**

**(5\*10 = 50)**

**I)**

1. a) What is a zero coupon bond? State briefly the treatment of zero coupon bonds in the hands of the issuer and the investor under the Income-tax Act, 1961.  
b) S, an individual, purchased a site on 21.4.2001 for Rs.2, 00,000. He completed Construction of a building thereon on 14.2.2005 at a cost of Rs.10, 00,000. He Sold the property consisting of site and building on 7.12.2007 for Rs.20,00,000. S seeks your opinion on the nature of capital gain arising to him from the sale of the property for the assessment year 2008-09. Computation of capital gain is not necessary
2. a) Explain what is business connection  
b) What is diversion of income?
3. Briefly Discuss various exemption's under Capital Gains topic.
4. a) X purchased land measuring 30 acres in April 1998 for Rs.60 lakhs near Ahmedabad. In 2003-04 he commenced real estate business and introduced this land as capital. Value recorded in the books is Rs. 14 lakhs whereas FMV as on date of introduction was Rs. 125 lakhs. He incurs expenses for development of land & approval of housing plots in the land to the extent of Rs. 14 lakhs. The entire plots of land in the 10 acres is sold during 2006-07 & 2007-08 in the Proportion of 40% & 60% respectively for a consideration of Rs. 210 lakhs. Compute the capital gains and business income indicating relevant assessment years.  
b) Mr. Dilip, an individual purchased unlisted shares in Indian companies as investments on 10.5.2002 for Rs. 30 lacs. On June 1, 2005 he started a business as a dealer in shares and transferred 50% of such shareholding to the business. The fair market value of the entire shares as on that date was Rs. 60 lacs. The shares held in business were sold by Dilip for Rs. 34 lacs on October 20, 2007. Compute the taxable income of Mr.Dilip under the relevant heads of income indicating the relevant assessment year

5. The general principle as per “section 4 “is that the income of a previous year is charged to income tax during the assessment year, at the rates applicable to the relevant assessment year. State whether any exemptions are there is so, explain them

**(II)**

**(5\*3 = 15 marks)**

- 1) State any three exemptions available under the head “Capital Gains”
- 2) Define, What is income?
- 3) State the cases where the benefit of indexation of costs is not available for determination of capital gains.
- 4) How to calculate the residential status of a HUF.
- 5) Pandu was the owner of two residential houses. On 2nd April, 2007 he transferred one of the houses and utilised the entire sale proceeds to construct first floor on his second house which he completed by 15th March, 2008. He seeks your advice as to the taxability of transaction to capital gains under the provisions of Income-tax Act, 1961.

**PRIME ACADEMY  
PROGRESS TEST – JANUARY 2008  
FINAL  
DIRECT TAX**

**PART – B**

**(65 Marks)**

**I**

**(5 x 10 = 50)**

**1(a) Taxability of Zero Coupon Bonds (ZCBs)**

- i) According to Sec. 2(48) “Zero coupon bond”, means a bond -
  - a) issued by any infrastructure capital company or infrastructure capital fund or public sector company on or after the 1<sup>st</sup> day of June, 2005;
  - b) in respect of which no payment and benefit is received or receivable before maturity or redemption from infrastructure capital company or infrastructure capital fund or public sector company; and
  - c) which the Central Government may, by notification in the Official Gazette, specify in this behalf.
- ii) Any maturity or redemption of ZCBs shall be treated as transfer as per section 2(47) and accordingly subject to tax under the head “Capital Gains”. However, in case such bonds are held as stock-in-trade of the business, it shall be chargeable to tax under the head “Profits and Gains of Business or Profession”.

- iii) Any long term capital gain arising from the transfer of “ZCBs” shall be entitled to a concessional tax rate of 10% without the benefit of indexation or at the rate of 20% after availing the benefit of indexation.
- iv) In case ZCBs are held for equal to or less than 12 months, it shall be considered as short term capital asset u/s.2(42A). However, concessional rate of 10% tax provided for short-term capital gains on transfer of listed shares u/s.111A is not applicable to ZCBs. Therefore, short-term capital gains on transfer of “ZCBs” shall be subject to tax as per normal rates of tax.

**1(b)** In this case, assessee has purchased the site in the financial year 2001-02 and completed the construction of the building in the financial year 2004-05. The building was sold on 07-12-2007 for a total consideration of Rs.20 lakhs. The land, which was held from April 2001, is a long term capital asset and the gain arising on transfer is taxable as long term capital gains. Since, the building is owned for less than 36 months preceding the date of transfer, the gain arising there from is chargeable as short term capital gains.

S is advised to make a sale deed mentioning therein the sale consideration separately towards land and building out of the total consideration of Rs.20 lakhs. This would enable the assessee to compute capital gain independently for land and building. This bifurcation of sale consideration towards land and building is endorsed by various courts in cases such as CIT vs.Smt.Lakshmi B.Menon and Another (2003) 264 ITR 76 (Ker); CIT vs. Citibank N.A. (2003) 261 ITR 570 (Bom); CIT vs. Estate of Omprakash Jhunjhunwala (2001) 254 ITR 152 (Cal); CIT vs. T.C. Itty Ipe (2001) 249 ITR 591 (Mad); CIT vs. Vimal Chand Golecha (1993) 201 ITR 442 (Raj); CIT vs. Dr.D.L.Ramachandra Rao (1999) 236 ITR 51(Mad) and CIT vs. C.R.Subramanian (1999) 242 ITR 342 (Karn).

**2(a) Business Connection – Sec. 9(1)(i)**

“Business connection” shall include any business activity carried out through a person who, acting on behalf of the non-resident –

- a) has an authority to conclude contracts and habitually exercises such authority in India; or
- b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or
- c) habitually secures orders in India mainly or wholly for the non-resident or for that non-resident along with other non-residents who are subjected to the same common control as that non-resident.

Where a person has authority from a non-resident and exercises the same in India only for activities limited to the purchase of goods or merchandise for the non-resident, it would not amount to “Business connection”.

**2(b) Diversion of Income**

Diversion of income could be on account of any reason. If diversion of income is at source by overriding title then such income cannot be taxed in the assessee’s hands. For instance, where a property is inherited by Mr.X subject to the right of residence in favour of his mother any amount paid out of sale consideration of such property to the mother for relinquishment of her right to reside should be considered as diverted at source by overriding title. In this case,

Mr.X has got title over the property and his mother has right of residence. For effective sale of the property, both should transfer their rights in the property. The portion of sale consideration attributable to the surrendering of right of residence by the mother gets diverted from the assessee Mr.X in view of her title over that portion of the sale consideration, which overrides his title. Therefore, Mr.X cannot be held liable to tax in respect of that portion of the sale consideration diverted at source by the overriding title in favour of his mother. This concept is also recognised by various judicial pronouncements.

### 3 Exemptions available in computation of capital gains

Sec.	Assessee	Conditions	Quantum of Exemption
54	Individual, HUF	<ol style="list-style-type: none"> <li>1) Residential house to be transferred.</li> <li>2) It must be a long term capital asset.</li> <li>3) The income from such asset is chargeable under the head 'Income from house property'</li> <li>4) Within one year before or 2 years after the date of transfer, a residential house is purchased or within a period of 3 years after the date of transfer, a residential house is constructed.</li> </ol>	If the cost of the new residential house is greater than capital gain then the whole of the capital gain. Otherwise to the extent of the cost of the new residential house.
54B	Individual	<ol style="list-style-type: none"> <li>1) Agricultural land to be transferred</li> <li>2) It must have been used in the 2 years immediately preceding the date of transfer for agricultural purposes either by the assessee or his parent.</li> <li>3) Within 2 years from the date of transfer another agricultural land is purchased.</li> </ol>	If the cost of the agricultural land is greater than the capital gain, then the entire capital gain. Otherwise capital gain to the extent of the cost of the new agricultural land.
54D	Any assessee	<ol style="list-style-type: none"> <li>1) There must be compulsory acquisition.</li> <li>2) The property acquired is land and building forming part of an industrial undertaking.</li> <li>3) The asset must have been used in the 2 years immediately preceding the date of transfer of the assessee for the purpose of the business.</li> <li>4) Within a period of 3 years after the date of transfer any other land or building is purchased or constructed for the industrial undertaking existing or newly set up.</li> </ol>	If the cost of the new asset is not less than the capital gain then the whole of the capital gain. Otherwise capital gain to the extent of the cost of new asset
54EC	Any Assessee	<ol style="list-style-type: none"> <li>1) The asset transferred is a long</li> </ol>	Amount of investment in

		<p>term capital asset.</p> <p>2) Within a period of 6 months from the date of transfer, the amount of capital gains should have been invested in the specified bonds issued by Rural Electrification Corporation (REC) Limited or National Highways Authority of India (NHAI).</p> <p>3) Assessee shall not transfer; or convert; or avail loan or advance on the security of the above bonds within a period of 3 years from the date of its acquisition.</p> <p>4) <i>The maximum amount of investment shall not exceed Rs.50 lakhs during any financial year.</i></p>	<p>the specified bonds or the capital gains, whichever is lower.</p>
54F	Individual, HUF	<p>1) The asset transferred is a long term capital asset, not being a residential house.</p> <p>2) Within a period of 1 year before or 2 years after the date of transfer, a residential house is purchased or within a period of 3 years after the date of transfer a residential house is constructed.</p> <p>3) The assessee does not own more than one residential house on the date of transfer.</p> <p>4) The assessee does not within a period of 1 year after the date of transfer purchase or does not within a period of 3 years after the date of transfer construct any residential house other than the new asset.</p>	<p>If the cost of the new residential house is not less than the net consideration then the whole of the capital gain. Other wise the capital gain in the same proportion as the cost of the new residential house bears to the net consideration.</p>
54G	Any assessee	<p>Machinery, plant, building, or land used for the business of an Industrial undertaking situated in an urban area is transferred.</p> <p>Transfer is due to shifting to any area other than an urban area.</p> <p>Within a period of 1 year before or 3 years after the date of transfer purchased machinery, plant or acquired building or land or constructed building and completed shifting to the new area.</p>	<p>If the cost of the new assets and expenses incurred for shifting are greater than the capital gain, the whole of such capital gain. Otherwise capital gain to the extent of the cost of the new asset.</p>
54GA	Any assessee	<p>1) Machinery, plant, building, land or any rights in building or land used for the purpose of industrial undertaking</p>	<p>Amount of capital gains derived on account of transfer of capital assets</p>

	<p>situated in an urban area is transferred to any SEZ.</p> <p>2) Transfer is due to shifting of undertaking to any SEZ.</p> <p>3) Within a period of one year before or three years after the date on which such transfer took place, the assessee—</p> <p>a. shall purchase machinery or plant for the purposes of business of industrial undertaking in the Special economic zone to which the said undertaking is shifted;</p> <p>b. shall acquire building or land or construct building for the purposes of his business in the SEZ;</p> <p>c. shall shift the original assets and transferred the establishment of such undertaking to the SEZ; and</p> <p>d. incurred expenses on such other purposes as may be specified in a scheme framed by the Central Government for the purposes of this section.</p>	<p>or the amount of cost and expenses incurred in relation to all or any of the purposes, whichever is lower.</p>
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#### 4(a) Conversion of capital asset into stock-in-trade

Conversion of capital asset into stock-in-trade attracts capital gain tax. But it is chargeable in the previous year in which stock is sold.

#### Computation of Capital Gain and Business Income

A.Y. 2007-08

	Rs. in lakhs	Rs. in lakhs
<b>Long term Capital Gain</b>		
Sale consideration (FMV) (125 x 1/3 x 40%)	16.67	
Less : Indexed cost of Acquisition of 10 acres (60 x 1/3 x 40%) x (463 / 351)	<u>10.55</u>	6.12
<b>Business Income</b>		
Sales (210 x 40%)	84.00	
Less : i) Land Acquisition cost	16.67	
ii) Development Expenses (14x1/3 x40%)	<u>1.87</u>	
<b>Total Income</b>		<u><b>71.58</b></u>

**A.Y.2008-09**

<b>Long term Capital Gain</b>		
Consideration (FMV) (125 x 1/3 x 60%)	25.00	
Less : Indexed cost of Acquisition (60 x 1/3 x 60%) x (463 / 351)	<u>15.83</u>	9.17
<b>Business Income</b>		
Sales (210 x 60%)	126.00	
Less : Land Acquisition cost 25.00		
Cost of development (14 x 1/3 x 60%) <u>2.80</u>	<u>27.80</u>	<u>98.20</u>
<b>Total Income</b>		<b><u>107.37</u></b>

**4(b) Conversion of capital asset into stock-in-trade**

Conversion of capital asset into stock-in-trade attracts capital gain tax. But it is chargeable in the previous year in which stock is sold.

**Taxable income for the assessment year 2008-09.**

<b>Capital gains</b>	<b>Rs.</b>
Sale consideration on the date of conversion (FMV)	30,00,000
Less : Indexed cost of acquisition (15,00,000 x 497 / 447)	<u>16,67,785</u>
<b>Long term capital gains</b>	<b><u>13,32,215</u></b>
<b>Business Income:</b>	
Sale consideration of stock-in-trade	34,00,000
Less: Fair market value on the date of conversion	<u>30,00,000</u>
<b>Taxable Business Income</b>	<b><u>4,00,000</u></b>

**5 Exceptions to the income of a previous year chargeable to relevant assessment year**

The general principle enunciated under section 4 is that the income of a previous year is charged to income tax at the rates applicable to the relevant assessment year. There are certain circumstances under which the income of a previous year is chargeable to tax in the same year and those exceptional situations are as follows:

**i) Shipping business of a non-resident - Sec.172:**

Where a ship belonging to or chartered by a non-resident carrying passengers, livestock, mail or goods shipped at a port of India, the ship is allowed to leave the port only if the tax due thereon has been paid or satisfactory arrangements have been made for payment thereof. 7.5% of the freight paid or payable (including demurrage, handling charges or any other amount) to the owner or the charterer or to any person on his behalf whether in India or



outside India on account of such carriage is deemed to be his income which is charged to tax in the same year in which it is earned. [Also refer Sec.44B]

**ii) Persons leaving India - Sec.174 :**

When it appears to the Assessing Officer that any individual may leave India during an assessment year or shortly after its expiry and he has no present intention of returning to India, the total income of such individual for the period from the expiry of the previous year for that assessment year up to the probable date of his departure from India is chargeable to tax in that assessment year, in accordance with the provisions of Sec. 174.

**iii) Assessment of AOP / BOI or artificial juridical person formed for a particular event or purpose – Sec. 174A:**

Where it appears to the Assessing officer that any association of person or body of individuals or an artificial juridical person formed for a particular event or purpose is likely to be dissolved in the assessment year in which such AOP/BOI was formed or immediately after such assessment year, the total income of such person for the period from the expiry of the previous year for that assessment year upto the date of its dissolution shall be chargeable to tax in that assessment year itself.

**iv) Persons likely to transfer property to avoid tax–Sec.175:**

During any current assessment year if it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose off or part with any of his assets to avoid payment of any liability under the Act the total income of such person for the period from the expiry of the previous year for that assessment year to the date when the Assessing Officer commences proceeding under this section is chargeable to tax in that assessment year.

**v) Discontinued business or profession – Sec.176(3A):**

Where any business is discontinued in any year, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt. By virtue of sec.176(4), where any profession is discontinued in any year on account of the cessation of the profession or by the retirement or death of the person carrying on the profession, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax in the year of receipt.

II

(5 x 3 = 15)

1 Exemptions available in computation of capital gains

Sec.	Assessee	Conditions	Quantum of Exemption
54	Individual, HUF	<ol style="list-style-type: none"> <li>1) Residential house to be transferred.</li> <li>2) It must be a long term capital asset.</li> <li>3) The income from such asset is chargeable under the head 'Income from house property'</li> <li>4) Within one year before or 2 years after the date of transfer, a residential house is purchased or within a period of 3 years after the date of transfer, a residential house is constructed.</li> </ol>	If the cost of the new residential house is greater than capital gain then the whole of the capital gain. Otherwise to the extent of the cost of the new residential house.
54B	Individual	<ol style="list-style-type: none"> <li>1) Agricultural land to be transferred</li> <li>2) It must have been used in the 2 years immediately preceding the date of transfer for agricultural purposes either by the assessee or his parent.</li> <li>3) Within 2 years from the date of transfer another agricultural land is purchased.</li> </ol>	If the cost of the agricultural land is greater than the capital gain, then the entire capital gain to the extent of the cost of the new agricultural land.
54D	Any assessee	<ol style="list-style-type: none"> <li>1) There must be compulsory acquisition.</li> <li>2) The property acquired is land and building forming part of an industrial undertaking.</li> <li>3) The asset must have been used in the 2 years immediately preceding the date of transfer of the assessee for the purpose of the business.</li> <li>4) Within a period of 3 years after the date of transfer any other land or building is purchased or constructed for the industrial undertaking existing or newly set</li> </ol>	If the cost of the new asset is not less than the capital gain then the whole of the capital gain. Otherwise capital gain to the extent of the cost of new asset

		up.	
54EC	Any Assessee	<ol style="list-style-type: none"> <li>1) The asset transferred is a long term capital asset.</li> <li>2) Within a period of 6 months from the date of transfer, the amount of capital gains should have been invested in the specified bonds issued by Rural Electrification Corporation (REC) Limited or National Highways Authority of India (NHAI).</li> <li>3) Assessee shall not transfer; or convert; or avail loan or advance on the security of the above bonds within a period of 3 years from the date of its acquisition.</li> <li>4) <i>The maximum amount of investment shall not exceed Rs.50 lakhs during any financial year.</i></li> </ol>	Amount of investment in the specified bonds or the capital gains, whichever is lower.
54F	Individual, HUF	<ol style="list-style-type: none"> <li>1) The asset transferred is a long term capital asset, not being a residential house.</li> <li>2) Within a period of 1 year before or 2 years after the date of transfer, a residential house is purchased or within a period of 3 years after the date of transfer a residential house is constructed.</li> <li>3) The assessee does not own more than one residential house on the date of transfer.</li> <li>4) The assessee does not within a period of 1 year after the date of transfer purchase or does not within a period of 3 years after the date of transfer construct any residential house other than the new asset.</li> </ol>	If the cost of the new residential house is not less than the net consideration then the whole of the capital gain. Other wise the capital gain in the same proportion as the cost of the new residential house bears to the net consideration.
54G	Any assessee	<p>Machinery, plant, building, or land used for the business of an Industrial undertaking situated in an urban area is transferred.</p> <p>Transfer is due to shifting to any area other than an urban area.</p> <p>Within a period of 1 year before or 3 years after the date of transfer purchased machinery, plant or acquired building or land or constructed building and completed shifting to the new area.</p>	If the cost of the new assets and expenses incurred for shifting are greater than the capital gain, the whole of such capital gain. Otherwise capital gain to the extent of the cost of the new asset.

54GA	Any assessee	<p>1) Machinery, plant, building, land or any rights in building or land used for the purpose of industrial undertaking situated in an urban area is transferred to any SEZ.</p> <p>2) Transfer is due to shifting of undertaking to any SEZ.</p> <p>3) Within a period of one year before or three years after the date on which such transfer took place, the assessee—</p> <p>a. shall purchase machinery or plant for the purposes of business of industrial undertaking in the Special economic zone to which the said undertaking is shifted;</p> <p>b. shall acquire building or land or construct building for the purposes of his business in the SEZ;</p> <p>c. shall shift the original assets and transferred the establishment of such undertaking to the SEZ; and</p> <p>d. incurred expenses on such other purposes as may be specified in a scheme framed by the Central Government for the purposes of this section.</p>	Amount of capital gains derived on account of transfer of capital assets or the amount of cost and expenses incurred in relation to all or any of the purposes, whichever is lower.
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In the above, Seven Exemptions have been given instead of three exemptions as per question. This is given for the benefit of students.

## 2 Definition of Income

Knowing that defining “income” *per se* is difficult, the legislature defines “income” under section 2(24) in an illustrative manner to include –

- a) Profits and gains;
- b) Dividend;
- c) Voluntary contributions received by a charitable or religious trust or institution;
- d) Value of any perquisite or profit in lieu of salary taxable u/s. 17 and special allowance or benefit specifically granted either to meet personal expenses or for the performance of duties of an office or an employment of profit;
- e) Export incentives;
- f) Any interest, salary, bonus, commission or remuneration earned by a partner of a firm from such firm;
- g) Any capital gains chargeable u/s.45;
- h) Profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society;

- i) Profits and gains of any business of banking carried on by a co-operative society with its members;
- j) Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever;
- k) Any sum received by the assessee from his employees towards welfare fund contributions such as provident fund, superannuation fund etc;
- l) Any sum received under a key man insurance policy including the sum allocated by way of bonus on such policy;
- m) Non-compete fee and any compensation for not sharing of any intangible asset such as know-how, patent, trademark;
- n) *Any gifts as referred to in sec.56(2)(vi).*

Explanation.– For the purposes of this definition,–

'lottery' includes winnings from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;

'card game and other game of any sort' includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game;

### 3 **Benefit of indexation is not available in case of**

- Short term capital assets;
- Bonds and debentures;
- Where option of 10% tax rate is availed u/s.112;
- Slump sale u/s.50B.
- Sale of shares by non-residents.

### 4 **Residential status in case of Hindu Undivided Family**

**Resident:**A Hindu undivided family is said to be resident in India if control and management of its affairs is wholly or partly situated in India.

**Non-Resident:** The Hindu undivided family is non-resident in India if control and management of its affairs is wholly situated outside India.

**Resident and Not Ordinarily Resident:** If the control and management of the affairs of the HUF is wholly or partly situated in India and if the manager of the family satisfies any of the following conditions, the HUF shall be considered as "Not Ordinarily Resident"

- a) he has been a **non-resident** in India in 9 out of the 10 preceding previous years; (OR)
- b) he has been in India for a period of not exceeding 729 days during the 7 preceding previous years.

**Resident and Ordinarily Resident:** If the control and management of the affairs of the HUF is wholly or partly situated in India and if the manager of the family

fails to satisfy both the above conditions, the HUF shall be considered as “Ordinarily Resident”

- 5 Tax treatment in the hands of Mr. Pandu for the assessment year 2008-09**  
The assessee Pandu has utilised the capital gains on sale of one residential house for construction of the first floor of another residential house owned by him. By doing so he has fulfilled the requirements of Sec.54 which requires purchase or construction of another residential house within the stipulated period. Construction of a first floor in the existing building should be treated as an independent residential unit by itself and therefore, Pandu is entitled to the exemption u/s.54. Therefore, there will be no capital gains tax liability as held by the Madras High Court in *CIT vs. P. V. Narasimhan* (1989) 181 ITR 101.

**PRIME ACADEMY  
PROGRESS TEST – JANUARY 2008**

**Time Allowed : 2 Hours**

**FINAL**

**Maximum Marks : 75**

**INDIRECT TAX**

**PART B**

**Answer any Five Questions:**

**(5X10 = 50 Marks)**

- 1(a)** Export of Services Rules, 2005 were made effective from March 15, 2005. Answer the following questions with reference to the said Rules :
- (i) What are the three categories of taxable services dealt with under Rule 3 ? (ii) What are the three options available to exporter of taxable services under these Rules for claiming exemption or rebate of service tax? **(2 x 3 = 6 marks)**
- (b)** Answer the **two** of the following with reference to the Finance Act, 1994 as amended relating to applicability of service tax :
- (i) Entrance fee and life membership fee paid by members of a club providing various services and facilities and organising get togethers and functions for its members
- (ii) Construction of residential complex having ten bungalows
- (iii) Selling of SIM (Subscribers Identification Module) Card and the process of activation thereof by mobile cellular telephone companies
- (iv) Study material or written test provided by Commercial Training and Coaching Centre **(2 x 2 = 4 marks)**
- 2(a)** What do you understand by Centralised Registration **(5 Marks)**
- (b)** Who is the Authority to grant Centralised Registration **(2 Marks)**
- (c)** Give the provisions for Service Tax Payment if details from branches / offices not received before 5<sup>th</sup> : **(3 Marks)**
- 3(a)** Whether Service Tax under the provisions of Finance Act, 1994 is chargeable on any following **two Services**:
- (i) Use of the precincts of a Religious place as a Mandap
- (ii) Payment of service is received in India in convertible Foreign exchange
- (iii) An interior decorator provides service of beautification of spaces in Srinagar
- (iv) Services provided by a sub-broker to an investor **(2 X 2 = 4 marks)**
- (b)** M/s.ABCL providing management consultancy to its client do not maintain any separate accounts and have paid Rs.1,00,000 as service tax and excise duty towards input services and input material/capital goods used by them. They have used the inputs for partially exempted and partially taxable services. They are now providing the output services for which current tax liability is Rs.1,40,000. How much credit of Rs.1,00,000/- can be availed by them for paying output service tax liability, if they do not maintain any separate accounts. **(3 Marks)**
- (c)** Mr.BXZ, a Chartered Accountant, raised an Invoice for RS.28,060 (25,000 + 3060 Service Tax) to a client on 20.1.2007. The client however refuses to pay Service Tax and has paid only a lump sum of Rs.25,000 on 28.4.207 for full and final settlement – What will be the liability of Mr.BXZ ? **(3 Marks)**

**4(a)** Answer any **two** of the following with reference to the provisions of the Finance Act, 1994 as amended relating to Service tax.

- (i) Is Service tax payable as services provided to a developer or an unit in the Special Economic Zone (SEZ)?
- (ii) When could an assessee surrender his Certificate of Registration under Service tax?
- (iii) Whether an assessee could claim refund of the input service tax credit under Rule 4 of the Service Tax Credit Rules, 2002? **(3 X 2 = 6 Marks)**

**(b)** Briefly discuss the provisions of the Finance Act, 1994 as amended relating to Service tax with respect to any **one** of the following taxable services:

- (i) Event Management
- (ii) Convention **(4 Marks)**



- 5(a)** Answer any **four** of the following questions –
- Under which Act is the Service tax levied?
  - At what rate is Service tax levied?
  - When is Service tax payable?
  - Is Service tax payable on advances received by Service provider?
  - When was service provided by a practicing Chartered Accountant brought within the purview of Service Tax?
- [4x1 = 4 marks]**
- (b)** Answer any **two** of the following as to whether the same is to be included for purpose of determining the value of Taxable Service:
- The cost of parts or accessories sold to the customer during the course of repair of motor cars.
  - The aggregate of commission or brokerage charged by a broker on the sale or purchase of securities
  - The Cost of unrecorded magnetic tape or storage devices sold to the client during the course of providing the service
- [2 x 2 = 4 marks]**
- (c)** Define any **one** of the following terms in relation to Service tax:
- Mandap
  - Facsimile (FAX)
  - Practicing Chartered Accountant.
- [ 2 marks]**
- 6(a)** Answer any **Three** of the following with reference to the Finance Act, 1994 as amended relating to applicability of Service Tax:
- One professionally qualified engineer with one non-professionally qualified engineer rendering engineering consultancy services under the name and style of ABC Consultancy Pvt. Ltd.
  - Business Auxiliary services provided by a Commission Agent
  - An institute providing pre-school coaching and training
  - Ship repair services including dry docking within port premises
  - Blood test and analysis services provided by a Commercial pathology laboratory
- (3 X 2 = 6 Marks)**
- (b)** (i) M/s. Banu Consultants are a labour contractor of manpower to M/s. Suraj Creations. They charge to the principal employer for the wages of their labour which amounts to Rs.120,000 plus their service charges of Rs.12,000 for arranging the labour. The issue is whether service tax is payable on the gross amount charged by them or only their charges for labour. Examine the case and advise suitably.
- (ii) For providing Beauty Treatment Services, a parlour uses materials such as cosmetics and toilet preparations. Whether the cost of such materials will be included in the value of taxable service? Whether any abatement is admissible on account of the value of materials consumed in providing the service ?
- (2 X 2 = 4 Marks)**
- 7(a)** Answer any **Three** of the following with reference to the Finance Act, 1994 as amended relating to applicability of Service tax:
- Services rendered by a broker of the Delhi Stock Exchange to a broker of the Chennai Stock Exchange.
  - A practicing Chartered Accountant also provides manpower recruitment services to his client.
  - Initial deposit made by subscriber at the time of application for a telephone connection.
  - Cargo handling services in relation to Agricultural Produce and Cold Storage.
  - Services by a consulting engineer relating to Computer Software
- (3 X 2 = 6 Marks)**

**(b)** Answer any **two** of the following with reference to the provisions of the Finance Act, 1994 as amended relating to Service Tax

(i) Are services provided in the State of Jammu and Kashmir liable for Service tax?

(ii) What are the due dates for filing of returns under the Service Tax Law?

(iii) Does the doctrine of 'unjust enrichment' apply to payment under the Service Tax Law?

**(2 X 2 = 4 Marks)**

**PRIME ACADEMY**  
**PROGRESS TEST – JANUARY 2008**  
**FINAL**  
**INDIRECT TAXES**

**Part B**

**Answers**

**1(a)(i) :**

Rule 3 of Export of Services classifies the Taxable Service under the following three categories :-

1. Immovable Property situated abroad
2. Services performed outside India
3. Recipient of Service located outside India

There is also one more category provided in the rules is – Services which cannot be treated as “Export of Services” under any situation.

**1(a)(ii) :**

Exporter of taxable services has got following three options available under Export of Services Rules, 2005 for claiming exemption or rebate of Service Tax.

1. Export without payment of service tax and utilize Cenvat Credit for payment of tax on other services;
2. Export without payment of service tax and claim rebate of service tax paid on input services and excise duty paid on inputs
3. Pay Service Tax on exported service and claim rebate

**1(b) :**

Entrance fee and life membership fee paid by members of a club providing various services and facilities and organizing get together and functions for its members will be liable to Service Tax and it is payable by the Service Provider under “**Club or Associations’ Service**” (w.e.f.16.6.2005 – service tax is payable on services ‘provided or to be provided by Service Provider and thus will be payable on Life Membership Fees also).

Construction of residential complex having ten bungalows will not be liable to Service Tax since under “**Construction Service**”, residential complex having only 12 or less units will not be taxable. In the instant case, it is only 10 and hence, it is not taxable.

Service Tax is not applicable on Selling of SIM (Subscribers Identification Module) Card and the process of activation thereof by mobile cellular telephone companies under “**Telecommunication Service**” in view of latest decision of the Tribunal in the case of **Idea Mobile Communication Ltd. Vs. CCE (2006) 5 STT 352 (CESTAT)**,

wherein it was held that if Sales Tax is paid on sale of SIM Card, service tax is not payable.

Study Material or Written Test provide by Commercial Training and Coaching Centre is taxable under “**Commercial Training or Coaching Service**” - since it has been clearly provided under Sec.65(105)(zxc) of the Finance Act that any service provided or to be provided to any person by a commercial training or coaching centre in relation to training or coaching is taxable service.

## **2(a)**

### Centralized Registration :

In some cases, a person liable for paying Service Tax on taxable service –

(i) provides such service from more than one premises or offices ((e.g) providing banking service or maintenance service from various branches / offices); or (ii) receives such service in more than one premises or offices (e.g. GTA Services Sponsorship Services provided to body corporate or firm located in India, mutual fund agent’s service, insurance agent’s service etc. where he is liable under reverse charge method); or (iii) is having more than one premises or offices, which are engaged in relation to such service in any other manner, making such person liable for paying service tax (e.g. import of services where person receiving service is liable u/s.66A).

In such cases, such person can obtain Centralized Registration, at his option, if (a) he has centralized billing system or centralized accounting system in respect of such service, and (b) such centralized billing or centralized accounting systems are located in one or more premises.

He can register such premises or offices from where centralized billing or centralized accounting system or located. (Rule 4(2) as amended w.e.f.2.11.2006).

Further, more than one centralized registration of regional/ zonal offices at various places is permissible as per MF(DR) Circular No.B1/6/2005-TRU dated 27.7.2005.

## **2(b)**

### Authority to grant centralised registration :

Centralised Registration will be granted by Commissioner in whose Jurisdiction the premises or offices, from where Centralised billing or accounting is done are located (Rule 4(3) as amended w.e.f.2.11.2006).

## **2(c)**

### Provisional payments if details from branches / offices not received before 5<sup>th</sup>:

As per Rule 6(4A) of Service Tax Rules (inserted w.e.f. 16.6.2005), if details from Branch / Offices are not available before 5<sup>th</sup> of the next month, the person having centralised registration can pay tax on higher side. He can himself adjust the excess tax paid against the excess tax paid against tax liability of subsequent period. After adjustment he should inform Superintendent of Central Excise within 15 days from date of adjustment.

Such self adjustment is permissible without any monetary limit in case of persons holding centralised registration – rule 6(4B)(ii) inserted w.e.f.1.3.2007.

However, such adjustment is possible only when excess tax was paid as details of payments received at other offices or premises was not received in time or for other reasons provided in Service Tax Rules. If excess payment was for some other reason, then such self adjustment will not be permissible. In such case, refund claim will have to be filed.

**3(a):**

(i) No. Not liable to Service Tax. Use of Precincts of a Religious Place as a Mandap is exempted from Service Tax as per Notification No.14/2003-ST dated 20.6.2003. Religious Place means place which is meant for conduct of prayers or worship pertaining to religion.

(ii) Payment of Service is received in India convertible Foreign Exchange – It is taxable in the hands of ‘Service Receiver’ under the Reverse Charge Method, if the Service Provider does not have any place of business in India. However, even if the payment for service is received in foreign exchange, if the Service Provider do have an office in India, then the service is taxable in the hands of such Service Provider only and not on the Service Receiver.

(iii) Sec.64(1) of the Finance Act, reads that this Service Tax applicable to whole of India except Jammu and Kashmir. Hence, an Interior decorator providing beautification of spaces in Srinagar will not be liable to Service Tax since services is provided and consumed within Jammu and Kashmir.

(iv) It is taxable under Stock Broker’s Services as Sec.65(105)(a) of the Finance Act provides that any service provided or to be provided to any person, by a stock broker in connection with the sale or purchase of securities listed in recognized Stock Exchange, is a taxable service. Further, as per Sec.65(101), ‘a Stock Broker’ means a person who has either made an application for registration or is registered as a stock broker or sub-broker, as the case may be in accordance with the rules and regulations made under SEBI Act, 1992.

**3(b):**

As per Service Tax Regulations, if the service provider uses common inputs both for exempted as well as un-exempted services, he should maintain separate records for input services used for exempted output services and should not avail Cenvat on such inputs/input services. However, if he does not maintain separate records and inventories of inputs/input services used in exempted output services, he can utilize Cenvat credit only upto 20% of service tax payable on output service.

Therefore, in the case of M/s.ABCL :

Service Tax Liability on Output Service provided by ABCL	: Rs.1,40,000
Less : 20% of Input Service Tax Credit (20% of 1,40,000)	: (Rs. 28,000)
	-----

Balance amount payable : Rs.1,12,000  
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Therefore, M/s.ABCL can avail only Rs.28,000 for paying Output Service Tax Liability. He will have to pay Rs.1,12,000 in cash, even though in his books, credit amount of Rs.72,000 is still available. However, he can carry forward this amount and utilise this credit, if any opportunity arises at a later point of time.

**3(c) :**

Rule 6(1) of Service Tax Rules makes it clear that service tax is payable on value of taxable services received. Thus, if service provider does not receive any payment from his customer, there is no liability of service tax. Service tax is payable only on 'value of taxable service' actually '*received*', and not on amount '*billed*'.

If the service receiver does not pay full amount of Bill and pays less amount, reasonable interpretation is that proportionately less tax is payable. In the instant case, the gross amount charged can be taken as inclusive of service tax and the 'value' and 'service' tax is to be calculated by back calculations.

In this case, the Service Tax payable will be as follows :-

$$\begin{aligned}\text{Assessable Value} &= \text{Cum Tax Price} / (1 + \text{Rate of Tax}) \\ &= \text{Rs.25,000} / (1 + 12.36\%) \end{aligned}$$

Assessable Value = 22,250 and

Therefore, Mr. BXZ, Chartered Accountant has to pay the Service Tax amount of Rs.2750 under Chartered Accountants' Service.

**4(a) :**

(i) No Service Tax is not payable on the Services provided to a Developer or an Unit in Special Economic Zone (SEZ). As per Notification No.4/2004 dated 31/3/2004, Services provided to SEZ Unit or SEZ Developer for consumption within SEZ are exempt from Service Tax.

(ii) As per Rule 4(7) of Service Tax Rules, If an assessee ceases to carry on the activity for which he is registered under Service Tax, he should surrender the Registration Certificate to the Superintendent of Central Excise. However, Assessee should file upto-date-returns and apply for cancellation. Registration may be cancelled if any demands are pending.

(iii) An Assessee can claim refund of Input Tax Credit under Rule 4 of Service Tax Credit Rules, 2002 provided the Output Service is exported. However, the refund of Input Service

Credit will be restricted to those Input Services having nexus with the Output Services to be exported. Credit to be quantified correctly.

**4(b) :**

(i) Event Management Service :

Tax on this Service was introduced w.e.f. 16.8.2002.

As per Sec.65(105)(zu), any service provided or to be provided to a client, by an event manager in relation to event management is 'Taxable Service'.

As per Sec.65(40) 'event management' means any service provided in relation to planning, promotion organising or presentation of any arts, entertainment, business, sports, marriage or any other event and includes any consultation provided in this regard.

As per Sec.65(41), 'event manager' means any person who is engaged in providing any service in relation to event management in any manner.

As event manager is hired to execute an event such as product launch of any corporate, promotional activities, concerts/rock show, office meets, award functions, beauty pageants, entertainment events, exhibitions, private functions, sports events. Event Manager uses his expertise and ideas to manage an event. All services provided by event manager including consultation provided for organising event are taxable.

(ii) Convention Service :

Tax on this Service was introduced w.e.f 16.7.2001

As per Sec.65(105)(zc), any Service provided or to be provided to a client, by any person in relation to holding of convention in any manner, is a taxable service.

As per Sec.65(32), "Convention" means a formal meeting or assembly which is not open to the general public, but does not include a meeting or assembly, the principal purpose of which is to provide any type of amusement, entertainment or recreation.

The services could be in the nature of providing room/hall for convention, video conferencing, head projectors, LCD projector, speakers, microphones, technical staff for operating these equipment, stationery etc.

In case of Convention service provided by any person, service tax is payable only on 60% of the gross amount charged by the service provider for providing taxable service, if the gross amount includes charges for catering services.

**5(a)**

Service Tax was introduced for the first time in 1994 through the insertion of Chapter V of Finance Act, 1994.

Service Tax is levied at the rate of 12% of value of Taxable Services along with 2% of Education Cess and 1% Secondary and Higher Education Cess (SHE Cess) totaling to 12.36%.

Service Tax is payable on 5<sup>th</sup> of the month (6<sup>th</sup> of the month in case of electronic payments) in which the payments are received towards value of Taxable Services.

As per Ministry of Finance Circular dated 13<sup>th</sup> May, 2005, after 13.5.2005 service tax is be payable on advances received even if services is rendered later.

Practising Chartered Accountant Service was brought within Service Tax net with effect from 16.10.1998.

**5(b):**

(i) No. Normally, the cost of parts and accessories sold to customer during the course of repair of motor cars will not be included in the Assessable Value for payment of Service Tax. Service Tax is payable for Services rendered under this category is payable under 'Authorized Service Station Service'. However, where the quantum of bifurcation of service and sale activity is not possible, then in such cases, Service Tax is payable on the Total Assessable Value (which would be inclusive of sale of parts and accessories).

(ii) The aggregate of commission or brokerage charged by a broker on sale or purchase of securities is included in the Value of Taxable Service of such Broker under 'Stock Brokers' Service'. Under this Service, any service provided or to be provided to any person by a Stock Broker in connection with the sale or purchase of securities listed on recognized stock exchange is 'taxable service'.

(iii) The cost of unrecorded magnetic tape or storage devices to the client during the course of providing the Service is not taxable in as much as the cost of such tapes and the cost of the services relating to recording programmers or any other service are separately quantifiable. But, if the bifurcation of sale and service quantum is not payable, then the Service Tax Payment is to be made on the Gross Value (including the Cost of Storage Devices) under Video Tape Production Services.

**5(c) :**

(a) Mandap:

"Mandap" means any immovable property as defined in Sec.3 of the Transfer of Property Act, 1882 and includes any furniture, fixtures, light fittings and floor coverings therein let out for consideration for organising any official, social or business function. (Explanation :- For the purpose of this Section - social function includes marriage).

(b) Fascimile :

Equipment by which text, photographs and drawings can be transmitted and received through a telephone system. The image, on paper is scanned to translate it into a series of electrical pulses. Inside the Fax Machine, a Modem converts the pulses into a digital form that can be transmitted through the telephone system. At the receiving end, the fax machine modem converts the signal back into pulses and prints these as dots as build up a copy of the original document.

(c) Practising Chartered Accountant :



Under Sec.65(83), “Practicing Chartered Accountant” means a Person who is a Member of the Institute of Chartered Accountants of India and is holding a Certificate of Practice granted under the provisions of the Chartered Accountants Act, 1949 and includes any concern engaged in rendering services in the field of Chartered Accountants.

**6(a) :**

(i) It is taxable in the hands of ABC Consultancy Pvt. Ltd. under Consulting Engineer Service. As per Sec.65(31), ‘Consulting Engineer’ means any professionally qualified engineer, any body corporate or any other firm, who directly or indirectly renders any advice, consultancy of technical assistance in any manner to a client in one or more disciplines of engineering. Therefore, the Engineering Consultancy Services provided by ABC Consultancy Pvt. Ltd. is liable to Service Tax irrespective of it consisting both qualified and non-qualified engineer.

(ii) Service Tax is applicable on Services Provided by a Commission Agent under Business Auxiliary Service since in the definition of the said Service, the services provided by Commission Agent have also been included with effect from 16.6.2005.

(iii) No. Commercial Training or Coaching Centre means any Institute or Establishment providing Commercial Training or Coaching for imparting skill or knowledge or lessons on any subject or field other than sports, with or without issuance of certificate and includes coaching or tutorial classes but does not include pre-school coaching and training centre. Hence, Pre-School Coaching and Training are not liable for Service Tax Payment.

(iv) Yes. It is taxable with effect from 1.5.2006 under ‘Ship Management Service’ which includes the supervision, maintenance, survey and repair of ship and hence, ship repair including dry docking within port premises will be covered under Ship Management Service.

(v) No. Blood Test and Analysis services provided by a Commercial Pathology Laborite is not liable to pay Service Tax. Because, under ‘Technical Testing and Analysis Services’, it has been provided that it includes testing and analysis undertaken for the purpose of clinical testing of drugs and formulations, but does not include testing or analysis for the purpose of determination of nature of diseased condition, identification of disease, prevention of any disease or disorder in human beings or animals.

**6(b)**

(i) The taxable service is only ‘Service of Supply of Manpower’ and not the ‘Service of Manpower’ as such. Thus, only charges of labour contractor for ‘supply of manpower’ should be taxable and not entire amount which includes wages to workmen. Therefore, in this case, only Rs.12,000 for arranging the labour is only taxable for Service Tax Payment and not entire amount of Rs.1,32,000.

(ii) Yes. As per Rule 5 of Service Tax (Determination of Value) Rules, 2006 – where any expenditure or costs are incurred by the Service Provider in the course of providing taxable service, all such expenditure or costs shall be treated as consideration for the purpose of taxable service provided or to be provided and shall be included in the value for the purpose of charging

service tax on the said service. Therefore, the cost of input materials and toilet preparations used in providing the service is includible in the value of services. Further, there is no abatement available for the value of material consumed in providing the Service for Beauty Treatment Service specifically.

**7(a):**

(i) Yes. Services rendered by a broker of Delhi Stock Exchange to a Broker of Chennai Stock Exchange is attracting Service Tax liability. Because, the definition of 'Taxable Service' under Stock Broker's Service provides that 'Taxable Service' means any service provided to or to be provided to any person by a stock broker in connection with the sale or purchase of securities listed on a recognized Stock Exchange. Therefore, the Services provided by one broker to another broker will also be included for the purpose of this section.

(ii) Practicing Chartered Accountant has to make Service Tax Payment only under Practicing Chartered Accountants' Service, though he provides the service under Manpower Consultancy Service also, in as much as his main service is only CA Service and the other service is only an ancillary service to his main service, he not have to get himself registered under the other service and he can continue to pay the ST liability under the main service, but separately indicating in the monthly return filed the nature of Services.

(iii) It is taxable under "Telecommunication Service" (inserted w.e.f.1.6.2007). If a Service is provided by a Telegraph Authority in connection with Telephone Connection (u/s.65(105)(b)) and hence, security deposit made by the subscriber in connection with getting a telephone connection is taxable under "Telecommunication Service" (earlier it was known as Telephone Service w.e.f.1.7.94).

(iv) No. Cargo Handling Services relating to agriculture produce or goods intended to be stored in a cold storage are exempt from Service Tax vide Notification No.10/2002-ST dated 16.8.2002 and hence, no Tax is payable.

(v) No. Services by a Consulting Engineer relating to Computer Software is exempt from Service Tax. Earlier, (i.e) prior to 19.9.2004, software professionals having degree or diploma in software or computer engineers providing services under various disciplines of engineering are taxable under Consulting Engineer Service. However, w.e.f.10.9.2004, services relating to computer hardware engineering and software engineering have been taken out of the purview of taxable service and hence, no tax is payable.

**7(b) :**

(i) No. Service Tax will not be payable if Services provided in Jammu and Kashmir. However, if a person from Jammu and Kashmir provides service outside Jammu and Kashmir in any other part of India, that service will be taxable as location where the service is provided is relevant. Merely, an Office is situated in Jammu & Kashmir does not disown Service Tax liability if the services are provided and consumed outside Jammu and Kashmir.

(ii) Every assessee has to submit half yearly return in Form ST-3 in triplicate within 25 days of the end of the half year. 'Half Year' means 1<sup>st</sup> April to 30<sup>th</sup> September and 1<sup>st</sup> October to 31<sup>st</sup> March of Financial Year.

(iii) One of the important conditions for eligibility to Service Tax is that the service provider should not have passed on the burden of tax to another person. This is 'Doctrine of Unjust Enrichment'. If this doctrine is attracted, then the refund will be quantified by the Department, but the amount will not be refunded to the applicant, but will instead be credited to the Consumer Welfare Fund.