

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2014

Ans.1

Saif
Computation of income tax liability
For the tax year 2014

		Rupees
Income from Salary:		
Basic Salary (600,000×12)		7,200,000
Guaranteed bonus		-
Air ticket reimbursed		120,000
Perquisite representing car	W-1	75,000
<i>(Rs. 100,000 spent by RPL on maintainence is exempt in the hands of Saif)</i>		
Perquisite representing accommodation	W-2	3,240,000
Old stock purchased from RPL (Rs. 14,000 – Rs. 5,000)		9,000
Total income under the head salary		10,644,000
Income from property:		
Rent of plot of land (25,000 × 10)		250,000
Amount not adjustable against the rent		-
<i>(Nothing is to be included in the chargeable income as this provision of law is attracted where the owner of building and not land receives such amount.)</i>		
Less:		
Repairs 1/5 th of rent (grass cutting and leveling of ground)		-
<i>(Admissible only against the rent of the building)</i>		
Interest on loan [3,000,000 × 11% × 85%] × [10 ÷ 12]		(233,750)
<i>(interest on only that portion of the loan which is utilized for the acquisition of land is admissible)</i>		
Ground rent		(15,000)
Rent collection charges (250,000 × 6%)		(15,000)
<i>(Lower of actual expenditure or 6% of rent is admissible)</i>		
		(263,750)
		(13,750)
Capital Gain:		
Consideration received on sale of 1,200 shares in Mio Ltd.(1,200 × Rs. 50)		60,000
Less: Cost of acquisition ((12,800×35)÷(12,800+1,200)×1,200)		(38,400)
Incidental expenses (0.5% × 60,000)		(300)
Net gain on disposal of securities		21,300
<i>Since more than 50% of the shares in Mio Limited are held by China Government, the company is treated as a public company for capital gain purposes.</i>		
Income from business:		
Admission fee received (75 × 25,000)		1,875,000
Membership fee received {(20 × 11 + 25 × 6 + 30 × 4) × Rs. 5,000}		2,450,000
		4,325,000
Less: Admissible expenses:		
Salaries paid:		
	– Saif (inadmissible being the owner of the club)	-
	– Son (45,000 × 11)	(495,000)
Fines (inadmissible)		-
Cost of repair of electrical wiring		(85,000)
Depreciation:		
	– Fitness machines	W-3 (996,875)
	– Fire screen	W-3 (72,500)
Other misc. expenses		(120,000)
		2,555,625

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2014

Income from other sources:	
Rent received from letting out the first floor of the bungalow (75,000 × 6)	450,000
Less: Premium paid (Rs. 50,000 – Rs. 25,000)	(25,000)
LCD T.V (inadmissible being capital in nature)	-
	425,000
Total income	13,632,175
Less: Separate block income - capital gain	(21,300)
Less: Donation of plot to Pakistan Sports Board	(500,000)
Taxable income	13,110,875

Computation of net tax liability:	
Tax on Rs. 7,000,000	1,425,000
Tax @ 30% on the amount exceeding Rs. 7,000,000 (i.e. on 6,110,875)	1,833,263
Tax payable under NTR	3,258,263
Add: tax payable under separate block of income (8% × 21,300)	1,704
Total gross tax payable	3,259,967
Less: Taxes withheld at source	
▪ from salary (2,100,000 + 13,000)	(2,113,000)
▪ on air tickets	(10,000)
▪ on import stage	(150,000)
Net tax payable	986,967

Note:

W-1 Perquisite representing car:

The perquisite shall be computed as below:

FMV of the car at the commencement of lease term	1,500,000
5% of the FMV (1,500,000 × 5%)	75,000

W-2 Perquisite representing accommodation:

The perquisite shall be computed as below:

Annual basic salary	7,200,000
Value of perquisite 45% of the basic salary (7,200,000 × 45%)	3,240,000

The annual rental value of the bugalow at Rs. 2,400,000 is not relevant for the purpose of computing the value of perquisite representing accommodation.

W-3 Depreciation:

	Fire Screen	Fitness machine
Cost of fitness machine	200,000	2,750,000
Less: Initial depreciation @ 25%	(50,000)	(687,500)
	150,000	2,062,500
Normal depreciation @ 15%	22,500	(309,375)
WDV at 30-06-2014	127,500	1,753,125
Total depreciation (Initial + Normal)	72,500	996,875

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2014

- Ans.2 (a) (i) **Joint and several liability of registered persons in supply chain.**
Where a registered person receiving a taxable supply from another registered person is in the knowledge or has reasonable grounds to suspect that some or all of the tax payable in respect of that supply or any previous or subsequent supply of the goods supplied would go unpaid, such person as well as the person making the taxable supply shall be jointly and severally liable for payment of such unpaid amount of tax.
- (ii) **Change in the rate of tax.**
If there is a change in the rate of tax—
- taxable supply made by a registered person shall be charged to tax at such rate as is in force at the time of supply;
 - imported goods shall be charged to tax at such rate as is in force;
 - in case the goods are entered for home consumption, on the date on which a goods declaration is presented under section 79 of the Customs Act, 1969 (IV of 1969); and
 - in case the goods are cleared from warehouse, on the date on which a goods declaration for clearance of such goods is presented under section 104 of the Customs Act, 1969 (IV of 1969);
- Provided that where a goods declaration is presented in advance of the arrival of the conveyance by which the goods are imported, the tax shall be charged as is in force on the date on which the manifest of the conveyance is delivered:
Provided further that if the tax is not paid within seven days of the presenting of the goods declaration under section 104 of the Customs Act the tax shall be charged at the rate as is in force on the date on which tax is actually paid.
- (b) **Property not liable to attachment and sale in execution.**
Following particulars shall not be liable to attachment or sale, namely:
- (i) the necessary wearing apparel, cooking vessels, beds and bedding of the defaulter, his wife and children, and such personal ornaments, as, in accordance with religious usage, cannot be parted with by any woman;
 - (ii) tools of artisan, and, where the defaulter is an agriculturist, his implements of husbandry and such cattle and seed grain as may, in the opinion of the Recovery Officer, be necessary to enable him to earn his livelihood as such;
 - (iii) stipends and gratuities allowed to a pensioner of a Government or payable out of any service or family pension fund notified in the official Gazette by the Federal Government or the Provincial Government in this behalf, and political pensions;
 - (iv) the wages of labourers and domestic servants, whether payable in money or in kind;
 - (v) salary to the extent of first hundred rupees and one half of the remainder;
 - (vi) all compulsory deposits and other sources in or derived from any fund to which the Provident Funds Act, 1925 (XIX of 1925), for the time being applies, in so far as they are declared by the said Act not to be liable to attachment;
 - (vii) any allowance forming part of the emoluments of any servant of the Government or local authority which the Federal Government or Provincial Government may, by notification in the official Gazette, declare to be exempt from attachment, and any subsistence grant or allowance made to any such servant while under suspension;
 - (viii) any expectancy of succession by survivor-ship or other merely contingent or possible right or interest; and
 - (ix) a right to future maintenance.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2014

- Ans.3 (i) The extinguishment of 2,000 shares in BL will be treated as tax neutral event (as there is no change in ownership of the shareholder (Hamid) is involved) and 1,000 shares in GL will have the same cost base i.e. Rs. 30,000 (Rs. 30 per share). Therefore, no CGT will be collected on such transfer.

Purchases / Acquisitions				Disposal		
Date	No. of shares	Price	Cost*	15 April 2014	18 May 2014	Total
1-Jan-14	100	40	4,000	50		50
1-Jan-14	Bonus shares issued @ 25% (Date of entitlement 1-04-14) (Date of credit 15-5-2014)				75	75
1-Apr-14	100	*32	3,200			
15-May-14	25	*32	800			
				50	75	125
Selling price per share				40	40	
Sales proceed				2,000	3,000	5,000
Less: Cost				1,600	2,400	4,000
				400	600	1,000

It is assumed that there is no change in market value of the shares from 01-04-2014 to 18-05-2014.

	No. of shares	Price	Amount
Net gain/ loss of the borrower			
Sale of borrowed shares	5,000	105	525,000
Repurchase of shares and returned to the lender	(5,000)	95	(475,000)
0.50% of sale proceeds as incidental expenses on sale			(2,625)
0.50% repurchase price being incidental expenses on acquisition			(2,375)
Financial Cost paid to the lender		2	(10,000)
Net gain (Capital gain)	-		35,000
Financial income of Nazia (Taxable)			10,000
No CGT to be collected as for Nazia, on return 'of the borrowed shares by Anjum, the cost and date of acquisition shall remain the same as was before lending the shares to Anjum.			0

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2014

Ans.4

Omega Limited (OL)
Computation of Net Sales Tax Liability
For the tax period May 2014

SALES TAX CREDIT (INPUT TAX)	Taxable Value	Sales Tax Rate	Amount of Sales Tax
Purchases from un-registered supplier N.1	100,000		-
<i>Federal excise duty on services under sales tax mode:</i>			
– Services rendered by bank in Islamabad			5,000
Punjab sales tax on banking services in Lahore			2,000
Service charges charged by the bank on issue of cheque book in Karachi			-
Imports made ten days before the start of business			5,000
Purchases from registered corporate suppliers	725,000	17%	123,250
Advance against purchases to a registered supplier N.2	75,000		-
Purchase of tyres and tubes [R.58T(5) of STSPR,2007]	850,000		-
Input Tax for the month			135,250
SALES TAX DEBIT (OUTPUT TAX)			
Toll services to AOP N.3	45,000	2%	900
Supply of finished cloth to Asia Airways N.3	500,000	17%	85,000
Goods sold to Small Corporation	250,000	17%	42,500
Sale of furniture to un-registered school N.4	125,000	17%	21,250
Stock of unsold furniture	200,000	17%	34,000
Supply of tooth brushes in villages and towns	250,000	17%	42,500
Govt. Grant on tooth brushes N.5	150,000		-
Sale of sugar to Sweet (Pvt.) Ltd. N.6	240,000		-
Output tax for the month			226,150
Less: Sales Tax deducted by Aisa Airways (500,000 × 17% /5)			(17,000)
Debit for the month			209,150
Sales tax withheld from un-registered supplier (100,000 × 1/117) N.1			855
Sales tax withheld from advance paid to Pearl Limited (75,000 × 17/117/5)			2,179
Admissible credit (lower of 135,250 or 90% of 226,150)			135,250
Sales tax payable (209,150 – 135,250) + (855+2,179)			76,934

- N.1** Withholding tax would be charged @ 1% of the value of supply excluding sales tax. The value of sales tax is worked out on the basis of gross value of taxable supply. Input tax cannot be claimed in the absence of a tax invoice.
- N.2** In the absence of sales tax invoice / advance payment receipt input tax cannot be claimed.
- N.3** supplies of goods, useable as industrial inputs, to registered or unregistered persons of the five sectors (including textile), is charged to tax at the rate of 2%, whereas supplies to persons not belonging to the said five sectors shall be charged to tax at the rate of 17%
- N.4** 1% extra tax is not charged in case of supply of goods to the end user/consumer.
- N.5** Sales tax is levied on the amount received from the recipient of goods and not from anyone other than the recipient.
- N.6** Excise duty on sugar is charged only by manufacturers or at import stage.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2014

Ans.5 (a) **Registration:**

If a cottage industry is engaged in the production or manufacture of goods liable to duty of excise under the Federal Excise Act, 2005 it shall, unless otherwise specified, be required to obtain registration in the prescribed manner regardless of its annual turnover or volume of sales of such goods.

The provisions of Sales Tax Act, 1990, including those relating to exemption threshold shall not apply where the cottage industry obtains or is liable to obtain registration for the purposes of Federal Excise Act but does not have or is not liable to registration under the Sales Tax Act, 1990.

(b) (i) **Manufacturer:**

Following person(s) are construed to be included in the word 'manufacturer':

- Any person who employs hired labour in the production or manufacture of goods; or
- Any person who engages in the production or manufacture of goods on his own account if such goods are intended for sale: and
- Any person who, whether or not he carries out any process of manufacture himself or through his employees or any other person, gets any process of manufacture carried out on his behalf by any person who is not in his employment.

(ii) **Sales tax mode:**

Sales tax mode means the manner of collection and payment under the Sales Tax Act, 1990, and rules made thereunder, of the duties of excise chargeable under the Federal Excise Act specified to be collected and paid as if such duties were tax chargeable under section 3 of the Sales Tax Act and all the provisions of the Sales Tax Act and rules, notifications, orders and instructions made or issued thereunder shall, mutatis mutandis, apply to the excise duty so chargeable.

Ans.6 (a) **Profit on debt:**

Profit on a debt, whether payable or receivable, means—

- (i) any profit, yield, interest, discount, premium or other amount owing under a debt, other than a return of capital; or
- (ii) any service fee or other charge in respect of a debt, including any fee or charge incurred in respect of a credit facility which has not been utilised;

Any profit received by a non-resident person on a security issued by a resident person shall be exempt from tax under the Ordinance where-

- (i) the persons are not associates;
- (ii) the security was widely issued by the resident person outside Pakistan for the purposes of raising a loan outside Pakistan for use in a business carried on by the person in Pakistan;
- (iii) the profit was paid outside Pakistan; and
- (iv) the security is approved by the '[Board]' for the purposes of exemption.

(b) **Tax admissible expenses and Tax reliefs.**

Tax admissible expenses: are the expenses borne by a person that legitimately reduce the revenue to arrive at its taxable income.

Tax relief:

Tax reliefs are the allowances and deductions which also serve to reduce the final tax liability. Such deductions are often not directly associated with the earning of revenue, but have been given by the revenue authority to encourage certain activities. They may be deducted from income to arrive at the tax base on which tax is computed, or deducted directly from the actual tax liability by way of tax credit.

(c) **Resale price method:**

The following steps shall apply in determining the arm's length result under the resale price method, namely:-

- (i) determine the price that a product purchased from an associate has been sold to a person who is not an associate (referred to as the "resale price"); and
- (ii) from the resale price is subtracted a gross margin (referred to as the "resale gross margin") representing the amount that covers the person's selling and other operating expenses and, in light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit;
- (iii) from that amount is subtracted any other costs associated with the purchase of the product, such as customs duty; and
- (iv) the amount remaining is the arm's length result.

(THE END)

ADVANCED TAXATION
Suggested Answers
Final Examinations – Winter 2013

Ans.1

Mr. Iqbal
Computation of income tax liability
For the tax year 20X4

	Rupees
Income from Salary:	
Basic Salary (300,000 × 12)	3,600,000
Cost of living allowance (50,000 × 12)	600,000
Milk allowance (10,000 × 12)	120,000
Special bonus	300,000
Perquisite representing car	60,164
Benefit on purchase of car (600,000 – 250,000)	350,000
Reimbursement of driver's salary to Mr. Iqbal	36,000
Perquisite representing accommodation	1,620,000
Share option scheme (2.5-1.5 × Rs. 100 × 4,000)	400,000
Shares issued as a reward	-
Total income under the head salary	7,086,164
Income from property:	
Rent received	800,000
Less:	
Repairs 1/5 th of rent (Rs. 200,000 being more than 1/5 th would not be admissible)	(160,000)
Fire insurance premium	(30,000)
Ground rent	(10,000)
Salary paid to watchman	-
Interest paid to scheduled bank	(15,000)
	(215,000)
	585,000
Capital Gain:	
Sale of 3,000 shares in Tameer Inc. (3,000 × \$3 × Rs. 100)	900,000
Less: Cost of acquisition of shares (\$1.0 + \$1.5 × Rs. 100 × 3,000)	(750,000)
Net gain on disposal of shares	150,000
Income from business:	
Brokerage fee received	200,000
Less: Expenses:	
Telephone and travelling	(30,000)
Service fees to brother (voluntary payment-gift)	-
	170,000
Income from other sources:	
Bank profit covered under FTR	-
Compensation against delayed tax refund	25,000
	25,000
Total income	8,016,164
Less: Zakat paid	(25,000)
Taxable income	7,991,164
Computation of net tax liability:	
Tax on Rs. 7,000,000	1,425,000
Tax @ 30% on the amount exceeding Rs. 7,000,000 (7,991,164 – 7,000,000)	297,349
Total gross tax payable under NTR	1,722,349
Less: Tax credit	
Investment in life insurance [500,000 × 1,722,349 ÷ 7,991,164]	(107,766)
Contribution to an approved pension fund [1,500,000 × 1,722,349 ÷ 7,991,164]	(323,298)
	(431,064)
Net tax payable under NTR	1,291,285
Add: tax payable under FTR (Bank profit)	15,000
Total tax payable	1,306,285
Less: Taxes withheld at source	
from salary	(1,200,000)
by bank	(15,000)
Net tax payable	91,285

ADVANCED TAXATION
Suggested Answers
Final Examinations – Winter 2013

Note:

- (1) As the earlier car was provided to Mr. Iqbal for business use, no personal benefit was derived by him; hence, no amount is taxable as a perquisite.
- (2) Where the issuance of shares is subject to a restriction on the sale or transfer of the allotted shares, no amount is chargeable to tax to the employee until the earlier of:
- The time the restriction is removed; or
 - The time the employee actually disposes of the shares.
- Since neither of these events occurred before 30 June 20X4, no amount is taxable as salary of Mr. Iqbal for the tax year 20X4.
- (3) According to Section 62(1) of the Income Tax Ordinance, 2001 a resident person who has invested in new shares offered to the public by a listed company and has also paid life insurance premium on a policy to the life insurance company shall be entitled for a tax credit, only on any one type of investment. Since the amount paid by Mr. Iqbal in respect of life insurance premium is more than the amount invested by him in right shares, he would be entitled for a tax credit on investment in life insurance policy.

W-1 Perquisite representing car:

The perquisite shall be computed as below:

FMV of the car	1,800,000
10% of the FMV (1,800,000 × 10%)	180,000
Restricted to the number of days it was used in the tax year (122 ÷ 365)	60,164

W-2 Perquisite representing accommodation:

The perquisite shall be computed as below:

Annual basic salary	3,600,000
Value of perquisite 45% of the basic salary (3,600,000 × 45%)	1,620,000

The fair rent of the accommodation at Rs. 85,000 per month is not relevant for the purpose of computing the value of perquisite representing accommodation.

Ans.2

- (a) (i) **Time of supply:**
Time of supply, in relation to,-
- a supply of goods, other than under hire purchase agreement, means the time at which the goods are delivered or made available to the recipient of the supply or the time when any payment is received by the supplier in respect of that supply, whichever is earlier;
 - a supply of goods under a hire purchase agreement, means the time at which the agreement is entered into; and
 - services, means the time at which the services are rendered or provided;
- (ii) **CREST:**
'Crest' means the computerized program for analyzing and cross-matching of sale tax returns, also referred to as computerized Risk-based Evaluation of Sale Tax;
- (iii) **Supply chain:**
'Supply chain' means the series of transactions between buyers and sellers from the stage of first purchase or import to the stage of final supply;
- (b) **Scope of special audit:**
The scope of the special audit shall be the expression of professional opinion with respect to the following, namely:-
- (i) whether the records, tax invoices and monthly returns have been maintained, issued or furnished correctly by the registered person; and
- (ii) whether the monthly returns furnished by the registered person correctly reflect that-
- all taxable supplies in the tax period as revealed by the records and tax invoices; and
 - all input tax, output tax and the net amount of sales tax payable or refundable, as the case may be,
- are in accordance with the provisions of the Sales Tax Act and are duly substantiated by the records required to be maintained for the purpose.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Winter 2013

Ans.3

Masawi Limited (ML)
Computation of Net Sales Tax Liability
For the tax period November 2013

	Taxable Value	Sales Tax Rate	Amount of Sales Tax
SALES TAX CREDIT (INPUT TAX)			
Purchase of raw material from registered suppliers	5,000,000	17%	850,000
Purchase of raw material from un-registered suppliers	1,000,000	-	-
Import of raw material	800,000	17%	136,000
Advertising services	500,000	17%	85,000
Less: un-adjustable input tax (relating to zero rated) W-1			(211,709)
Input Tax for the month			859,291
SALES TAX DEBIT (OUTPUT TAX)			
Taxable supplies to registered persons	4,675,000	17%	794,750
Taxable supplies to un-registered persons	2,125,000	18%	382,500
Taxable supplies to duty free shops	1,020,000	0%	0
Export to Qatar	680,000	0%	0
Juices provided to workers	100,000	17%	17,000
Output tax for the month	8,600,000		1,194,250
Less: Sales Tax deducted by withholding agent $(4,675,000 \times 20\% \times 17\% \div 5)$			(31,790)
Debit for the month			1,162,460
Sales tax withheld as withholding agent from registered suppliers $(5,000,000 \times 17\% \div 5)$			170,000
Sales tax withheld as withholding agent from un-registered suppliers $(620,000 \times 17/117) + (380,000 \div 95\%) \times 17/117$			148,205
Sales tax withheld as withholding agent from advertising services $(500,000 \times 17\%)$			85,000
Admissible credit (lower of 859,291 or 90% of 1,194,250)			859,291
Sales tax payable $(1,162,460 - 859,291) + (170,000 + 148,205 + 85,000)$			706,374
Refund claim (input consumed in zero rated supplies) (W-1)			211,709
W-1: Apportionment of input tax			
	Taxable Value	Rate	Sales Tax
Domestic Purchases	5,000,000	17%	850,000
Imports -domestic consumption	800,000	17%	136,000
Advertisement services	500,000	17%	85,000
Residual input tax	TOTAL		1,071,000
			Rupees
Total sales			8,600,000
Supplies to duty free shop			1,020,000
Export supplies			680,000
Refundable input tax $(1,071,000 \times 1,700,000 \div 8,600,000)$			211,709

Ans.4 (a) Assuming Maroof Limited is a listed company, its income would be assessed under normal tax regime under the percentage of completion method as follows:

Maroof Limited (ML) – Long term Contract		
Taxable income		
Tax year 2013		Rupees
Estimated Profit × percentage of completion $[40,000,000 \times 55\%]$		22,000,000
Withholding tax credit available		
Income received: February 2013		12,622,000
May 2013		15,760,000
		28,382,000
Withholding tax paid $(28,382,000 \times 6.5 \div 93.5)$		1,973,080
Tax year 2014		Rupees
Taxable Profit		18,000,000
Estimated Profit × percentage of completion $[40,000,000 \times 45\%]$		
Withholding tax credit available		
Income received: September 2013		35,000,000
December 2013		30,118,000
		65,118,000
Withholding tax paid $(65,118,000 \times 6.5 \div 93.5)$		4,526,920

ADVANCED TAXATION
Suggested Answers
Final Examinations – Winter 2013

Working:	
Taxable income = (estimated profit) × (percentage of contract completed)	
Estimated profit = (Total contract price – Total costs)	
(100,000,000 – 60,000,000) = 40,000,000	
Percentage of contract completed = $\frac{\text{Contract costs incurred}}{\text{Total contract costs}}$	
30 June 2013 [33,000,000 ÷ 60,000,000]	55%
30 June 2014 [27,000,000 ÷ 60,000,000]	45%

Note: In case, if Maroof Limited is an unlisted company, its income would be assessed under final tax regime and its gross receipts would be treated as taxable income. Moreover, the rate of deduction of withholding tax in case of companies is 6% therefore, ML would be entitled for a refund of 0.5% of additional withholding tax deducted by the withholding agent.

(b) (i) Exceptions to the rule:

The following are the exceptions:

- any royalty where the property or right giving rise to the royalty is effectively connected with a permanent establishment in Pakistan of the non-resident person;
- any fee for technical services where the services giving rise to the fee are rendered through a permanent establishment in Pakistan of the non-resident person; or
- any royalty or fee for technical services that is exempt from tax under this Ordinance.

(ii) Prescribed Person:

The 'prescribed person' with reference to deduction of tax from rent of immovable property means:

- the Federal Government;
- a Provincial Government;
- a Local Government;
- a company;
- a non-profit organization or a charitable institution;
- a diplomatic mission of a foreign state;
- a private educational institution, a boutique, a beauty parlour, a hospital, a clinic or a maternity home;
- individuals or association of persons paying gross rent of rupees one and a half million and above in a year; or
- any other person notified by the Board for the purpose of this section.

(iii) Circulars issued by the Board:

- To achieve consistency in the administration of the Income Tax Ordinance and to provide guidance to taxpayers and officers of the Board, the Board may issue Circulars setting out the Board's interpretation of the Ordinance.
- A circular issued by the Board shall be binding on all Income Tax Authorities and other persons employed in the execution of the Ordinance, under the control of the said Board other than Commissioners of Income Tax (Appeals).
- A Circular shall not be binding on a taxpayer.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Winter 2013

Ans.5

Zeta Limited
Computation of taxable income
For the tax year 2014

	Rs. in '000
Income from Business:	
Profit / (loss) before taxation	500
Add: Tax depreciation for the year	490
Less: Deemed income	(85)
Total business income / (loss) before tax	905
Less: B/f assessed business loss - tax year 2012	(130)
Less: B/f un-assessed business loss – tax year 2013	-
	775
Less: Group Relief Scheme:	
Assessed losses	250
Less: B/f assessed business loss not to be surrendered	(25)
B/f assessed capital loss not to be surrendered	(45)
Loss including dep. surrendered by subsidiary in favour of ZL	(180)
	595
Less: Tax depreciation – current year	(490)
Unabsorbed tax depreciation – brought forward	(135)
Total business income / loss for the year	(30)
Capital Gain:	
Gain for the year	800
Less: B/f capital loss – tax year 2007	-
Less: B/f capital loss – tax year 2008	(65)
	735
Income from Other Sources:	
Income for the year	100
Add: deemed income	85
	185
Taxable income for the year	890
Business loss carried forward to next tax year	Nil
Unabsorbed depreciation carried forward to next tax year	Nil
Speculation loss carried forward to next tax year	100

Note:

- (1) Only the loss which has been assessed or determined under the provisions of Income Tax Ordinance, 2001 can be carried forward and set-off under the respective provisions of the Ordinance, therefore the un-assessed business loss carried forward from tax year 2013 cannot be set-off against the business income of 2014.
- (2) Capital loss brought forward from tax year 2007 cannot be set off against capital gains of tax year 2014 as no loss can be carried forward to more than six tax years immediately succeeding the tax year for which the loss was first computed.
- (3) The speculation loss carried forward from tax year 2012 can only be set-off against income from speculation business chargeable to tax in tax year 2014. Since in tax year 2014 ZL has no speculation income, therefore the brought forward loss would be carried forward to the next tax year. However, such a loss cannot be carried forward to more than six tax years immediately succeeding the tax year for which the loss was first computed i.e. 2012.
- (4) Under group relief only the losses other than the capital and brought forward losses can be surrendered in favour of a subsidiary of a holding company.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Winter 2013

Ans.6 (i) Conveyance:

'conveyance' means any means of transport used for carrying goods or passengers such as vessel, aircraft, vehicle or animal etc.

(ii) Distributor:

'distributor' means a person appointed by a manufacturer or for a specified area to purchase goods from him for sale to a wholesale dealer in that area;

(iii) Mode of recovery of duty in case of short payment:

Notwithstanding the provisions of this Act or the rules made thereunder, where a registered person pays the amount of duty less than the duty due as indicated in his return, the short paid amount of duty along with default surcharge shall be recovered from such person by stopping removal of any goods from his business premises and through attachment of his business bank accounts without prejudice to any other action under the Federal Excise Act or the rules made thereunder:

Provided that no penalty under this Act or rules made thereunder shall be imposed unless a show cause notice is given to such person.

(iv) Particulars to be stated on the invoice issued at the time of providing services:

A registered person shall be required to issue serially numbered invoice for each transaction at the time of providing or rendering services containing the following particulars:

- (a) name, address and registration number of the seller;
- (b) name, address and registration number of the buyer;
- (c) date of issue of the invoice;
- (d) description of services;
- (e) value exclusive of excise duty;
- (f) amount of excise duty; and
- (g) value inclusive of excise duty.

(THE END)

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2013

Ans.1 (a) Securities:

"Security" means,

- (i) share of a public company,
- (ii) voucher of Pakistan Telecommunication Corporation,
- (iii) Modaraba Certificate,
- (iv) an instrument of redeemable capital; and
- (v) derivative products.

Holding period:

Securities held for a period upto a maximum of 182 days and for a period upto a maximum of 365 days shall be taken as held for 6 months and 1 year respectively.

In case of short positions, holding period shall be the period intervening between the date when a security is sold short and the date when the security is purchased to cover the short position.

In case of futures contracts, holding period shall be the period intervening between the date of entry into a futures contract and the date of exit from such contract.

(b) Computation of capital gain on sale of securities:

Purchases/Acquisitions				Disposal					
Date	No. of Shares	Price	Cost**	01-5-13	07-5-13	21-5-13	31-5-13	31-5-13	31-5-13
31-3-12	1,400	20	28,000	600	800				
15-9-12	700	22	15,400			700			
01-4-13	900	18	16,200				400	500	
31-5-13	500	23	11,500						500
Total	3,500		71,100	600	800	700	400	500	500
Selling price per share				17	19	18	26*	26*	26*
Sale proceed				10,200	15,200	12,600	10,400	13,000	13,000
Less: Cost				12,000	16,000	15,400	7,200	9,000	11,500
				(1,800)	(800)	(2,800)	3,200	4,000	1,500
Less: 0.5% of sale proceeds as expense				51	76	63	52	65	65
(Loss)/Gain on disposal				(1,851)	(876)	(2,863)	3,148	3,935	1,435
Adjustment of eligible losses				-	-	2,863	(2,863)		
Loss not eligible for set off				1,851	876				
Net Gain on disposal				-	-	-	285	3,935	1,435
Holding period				396	402	248	60	60	0
Tax rate applicable				0%	0%	8%	10%	10%	10%
Tax to be collected				-	-	-	28.5	393.5	143.5
Total tax									565.5

**** Incidental expenses @ 0.50% of cost of acquisition of securities has been ignored.**

Ans.2 (a)

Requirement of registration:

- (i) Manufactures other than those classified as cottage industry are required to be registered under the Sales Tax Rules 2006. Cottage industries are those whose annual turnover from taxable supplies made in any tax period during the last twelve months ending any tax period does not exceed Rs. 5,000,000 or whose annual utility bills for the same period does not exceed Rs. 700,000. Therefore, in this case since the manufacturer is a cottage industry, it is not required to be registered and pay any sales tax.
- (ii) Since a distributor is required to be registered with Inland Revenue Department irrespective of his turnover, therefore, in this case the distributor would register with the Inland Revenue Department and pay sales tax of Rs. 480,000 on his turnover of Rs. 3,000,000.
- (iii) Since an importer is required to be registered with Inland Revenue Department irrespective of his turnover, therefore, in this case the importer would be required to register himself with the Inland Revenue Department. Sales tax at import stage would be paid on the basis of import value. However, the amount of output tax would be Rs.1,920,000
- (iv) A commercial exporter is not required to be registered with Inland Revenue Department. However, an exporter who intends to obtain sales tax refund against his zero-rated supplies must get registration before making an application for such refund. Therefore, in this case since the exporter intends to claim a refund of Rs. 200,000 he must get himself registered with Inland Revenue Department.

(b) Adjustment of output tax:

The adjustment in output tax can only be made if the corresponding credit note is issued within 180 days of the date of the relevant supply.

As the supply was made on 4 December 2012, the 180 days would expire on 2 June 2013. Therefore, AL cannot issue the credit note after 2 June 2013 unless the collector, at AL's request, giving reasons in writing, extend the period of 180 days by a further 180 days.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2013

Ans.3

Pills (Pvt.) Limited (PPL)
Computation of taxable income
Tax year 20X2

	(Rupees in '000)		
	Exports	Local	Total
Sales as per profit and loss account [20:80]	7,830	31,320	39,150
Add: Foreign withholding tax deducted	1,170	-	1,170
Less: Sales tax @ 16% [31,320 × 16/116]	-	(4,320)	(4,320)
Sales (adjusted for tax purposes)	9,000	27,000	36,000
Cost of sales (common expense)	6,425	19,275	25,700
Less: Inadmissible expenses			
Accounting depreciation	(360)	(1,080)	(1,440)
Add: Admissible expenses			
Tax depreciation: Leased Machinery	24	72	96
Professional books	115	345	460
All other assets [1,440/2,250 × 1,800]	288	864	1,152
	67	201	268
Tax adjusted cost of goods sold	6,492	19,476	25,968
Gross profit	2,508	7,524	10,032
Administrative and selling expenses		5,350	5,350
Less: Inadmissible expenses			
Professional books- Capital expenditure		(800)	(800)
Donation to a private hospital		(200)	(200)
Accounting depreciation		(810)	(810)
Total inadmissible expenses		(1,810)	(1,810)
Add: Admissible expenses			
Tax depreciation on other assets [810/2,250 × 1,800]		648	648
Tax adjusted administrative & selling expenses		4,188	4,188
Finance cost		1,500	1,500
Less: Interest to non-resident in excess of 3:1		(156)	(156)
Less: Interest expenses on finance lease		(180)	(180)
Add: Lease rentals		500	500
Tax adjusted finance cost		1,664	1,664
Other charges		2,000	2,000
Less: Shares under group scheme		(1758)	(1758)
Tax adjusted other charges		242	242
Net income		1,430	3,938
Add: Other income		900	
Less: Accounting gain on sale of delivery van		(130)	
Add: Tax gain on sale of delivery van		85	
Taxable income		2,285	
Scheme of taxation	FTR	NTR	
Rate of tax	1%	35%	
Gross tax liability	78.3	799.75	
Add: Tax payable on deemed dividend		50	
Less: taxes paid u/s 154 and sec. 147	(78.3)	(400)	
	-		
Tax payable	-	449.75	

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2013

Explanation of items not included in the computation:

- (i) Rent payable Rs. 600,000:
Withholding tax is deducted at the time of payment of rent and not on the basis of accrual. Since the above amount was payable on 31 December 20X2, therefore it can be claimed as admissible deduction.
- (ii) Interest free loan to a shareholder Rs. 500,000:
A loan made by a private company to a shareholder to the extent of accumulated profits which, in substance, is a distribution is treated as dividend.
PPL is therefore liable to pay withholding tax of Rs. 50,000 on the amount of loan.
- (iii) Donation of Rs. 200,000:
A donation is not business expenditure. However, donations to institutions, approved by the Commissioner and FBR are eligible for tax reliefs. Since the hospital to which donation was made is not run by the Federal or Provincial or a Local Government, it cannot be claimed as admissible deduction and no tax credit would be allowed against the same.
- (iv) Foreign withholding tax of Rs. 1,170,000:
Taxes paid in Indonesia and Singapore against export sales are not eligible to be claimed in Pakistan because tax credit for tax paid outside Pakistan is not allowed in case of FTR.

Reasons for the treatment of items in note (iii) and (vii).

1) **Thin capitalization:**

A foreign-controlled resident company whose foreign debt to foreign equity ratio, at any time during a tax year, is in excess of 3:1, will not be allowed to claim as deduction the amount of interest on that part of its foreign debt which is in excess of 3:1 ratio.

Since PPL is a foreign-controlled resident company, it cannot claim interest paid by it to its foreign controller, Capsule plc., on that part of its foreign debt of Rs. 8,500,000 which is in excess of 3:1 ratio.

Disallowed interest in excess of debt to equity ratio of 3:1

	Rs. in '000
Amount of foreign debt	8,500
PPL's equity at the beginning of the year	4,000
Share of Capsule plc. in the equity of PPL (0.6 x 4 million)	2,400
Thin capitalization ratio = Foreign debt/Foreign equity/3 (8,500/2,400/3)	1.18055
Total amount of interest expense on foreign debt	1,020
Less: Deductible interest expense on foreign debt (1,020,000 / 1.18055)	(864)
Amount of inadmissible interest expense	156

2) **Leased Machinery:**

In case of a finance lease the interest charged to the accounts of Rs. 180,000 is an inadmissible deduction.

However, the lease rentals of Rs. 500,000 are an admissible deduction.

After the transfer of machinery to PPL at residual value of Rs. 640,000, tax depreciation would be admissible on it.

For the purpose of calculating tax depreciation, the residual value of the machinery (and not its market value) shall be treated as its tax written down value (WDV). As residual value is the consideration that was paid by PPL.

The depreciation is allowed for the full year, even if the machinery is used for a single day.

The machinery would not be eligible for initial allowance as it was already in use of PPL.

	Rs. in '000
Tax depreciation at the rate of 15% on Rs. 640,000	96

Ans.4 (a) Default Surcharge:

If a person does not pay the duty due or any part thereof within the prescribed time or receives a refund of duty or drawback or makes an adjustment which is not admissible to him, he shall, in addition to the duty due, pay default surcharge at the rate of KIBOR plus three per cent of the duty due, refund of duty or drawback.

Period of default under the above circumstances:

- (i) the period of default shall be considered from the date following the due date on which the duty was payable to the preceding day on which the duty is actually paid; and
- (ii) in case of inadmissible adjustment or refund of duty or drawback, the period of default shall be considered from the date of such adjustment or as the case may be, refund of duty or drawback is received.

(b) (i) Special excise duty:

The term Special excise duty refers to a special duty levied on goods produced or manufactured in Pakistan and imported into Pakistan at a rate provided in the Act. Such duty is levied in addition to any duty levied in the First Schedule attached to the Federal Excise Act 2005.

(ii) KIBOR:

It means Karachi Inter-Bank offered Rate prevalent on the first day of each quarter of the financial year.

Ans.5 (a) Stock-in-trade:

A person accounting for income chargeable to tax under the head "Income from Business" on a cash basis may compute the person's cost of stock-in-trade on the prime-cost method or absorption-cost method, and a person accounting for such income on an accrual basis shall compute the person's cost of stock-in-trade on the absorption-cost-method.

(b) Foreign Government Officials:

Any salary received by an employee of a foreign government as remuneration for services rendered to such government shall be exempt from tax under this Ordinance provided

- (i) The employee is a citizen of the foreign country and not a citizen of Pakistan;
- (ii) The services performed by the employee are of a character similar to those performed by employees of the Federal Government in foreign countries;
- (iii) The foreign government grants a similar exemption to the employees of the Federal Government performing similar services in such foreign countries.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2013

Ans.6

Tender Pops Limited (TPL)
Computation of Net Sales Tax Liability
For the tax period May 2013

SALES TAX CREDIT (INPUT TAX)	Gross Value	Taxable Value	Sales Tax
Purchase of raw material from registered suppliers	20,000,000	20,000,000	3,200,000
Sales tax paid on electricity bill	-	-	25,000
Local items under third sch. [75,000 x 200]	11,250,000	15,000,000	2,400,000
Packing material from a cottage industry-exempt	2,000,000	-	-
(-)Inadmissible/un-adjustable input W-1			(318,781)
Input Tax for the month			5,306,219
SALES TAX DEBIT (OUTPUT TAX)			
Domestic Supplies to registered persons	18,650,000	18,650,000	2,984,000
Supply of old stock at 30% discount	350,000	500,000	80,000
Domestic Supplies to un-registered persons	8,000,000	8,000,000	1,280,000
Local third sch. Items to wholesalers	9,900,000	11,000,000	1,760,000
Supplies against international tender – zero rated	3,000,000	-	0
Supply against hire purchase agreement	459,000	450,000	72,000
Settlement of debt	175,000	200,000	32,000
Advance received against supply of goods	100,000	100,000	-
Output tax for the month			6,208,000
Admissible credit (90% of 6,208,000 or input tax whichever is lower)			(5,306,219)
Sales Tax payable			917,781
Refund claim (input consumed on tender)		(W-1)	318,781
W-1: Apportionment of input tax			
	Gross Value	Taxable Value	Sales Tax
Input tax for the month (Excl. third Sch. Items)	22,000,000	20,000,000	3,225,000
			Rupees
Total sales [18,650+8000+3000+200+500] x 1000			30,350,000
Supplies against international tender – Zero rated supplies			3,000,000
Un-adjustable input tax (3,000,000×3,225,000/30,350,000)			318,781

(THE END)

ADVANCED TAXATION
Suggested Answers
Final Examination - Winter 2012

Ans.1

Computation of income tax liability
For the tax year 20X2

	Rs. '000
Income from Salary:	
From KKHU:	
Basic Salary (500 x 6)	3,000
Medical allowance (60 x 6)	360
Less: exempt up to 10% of basic salary	(300)
	60
Leave fare assistance	240
From DPL:	
Basic Salary (800 x 6)	4,800
Medical allowance (80 x 6) [exempt being 10% of basic salary]	-
Utilities allowance (100 x 6)	600
Amount received as consideration for joining DPL	3,000
Assets received for use at home (200 x 15% / 2)	15
Perquisite in the form of concessional loan (10%-8% x 5,000 x (3/12))	25
Total income under the head salary	11,740
Capital Gain:	
Gain on disposal of painting	(W-1) 176
Less: 1/ of gain is exempt due to sale after one year	(44)
Net gain on disposal of painting	132
Sale of shares in ABL	(W-2) 50
Taxable income for the year	11,922
Computation of net tax liability:	
Tax on taxable income [@ 20% on 9,422 + 420]	2,304.4
Tax on dividend in specie at 10% under FTR	37.5
Net tax payable	2,341.9

W-1 Gain on disposal of painting:

Loss of a capital asset is treated as a disposal of an asset and the date on which it is lost is considered as its date of disposal. The insurance claim received by Mr. Yaqeen, is assumed to be equal to the fair market value on the date of disposal and is taken as the consideration received.

The gain is calculated as follows:

	Rs. '000
Consideration received	600
Less: Cost of acquisition:	
Purchase price	(350)
Insurance premium	(24)
Lawyers fees	(50)
	(424)
	176

W-2 Gain on sale of shares in ABL:

Any dividend in specie derived in the form of shares in a company as defined in the Companies Ordinance, 1984 is exempt from tax. However, such dividend is taxed at the time of disposal of such shares. In the given scenario, the fair market value of only 15,000 shares would be taxed as dividend in the tax year 20X2. Taxation of the remaining 5,000 shares would be effected in the tax year in which they are disposed off.

ADVANCED TAXATION
Suggested Answers
Final Examination - Winter 2012

The amount of dividend taxed is treated as the cost of the shares.

Calculation of dividend income and tax thereon:

Dividend income (15,000 x 25)
Tax @ 10%

Rs. '000
375
37.5
425
(375)
50

Computation of capital gain:
Consideration received
Less: Cost of the dividend in specie
Capital gain

Explanation about items not included in the computation of taxable income:

- (i) An option to purchase shares under an employee scheme granted to an employee is not chargeable to tax unless such a right or option is exercised.
- (ii) As DPL is not a public company, the profit on debt paid to the company does not qualify for tax credit.
- (iii) The perquisites received by an employee in the form of free or subsidised medical treatment provided by a hospital or clinic is exempt from tax. For the purpose of calculating the perquisites, an ex-employee is included in the definition of employee.
- (iv) Any foreign source income, in a tax year, of a citizen of Pakistan who was not a resident in any of the four tax years preceding the tax year in which he became a resident shall be exempt from tax in the tax year in which he became resident and in the following tax year. Therefore, salary arrears received by Mr. Yaqeen from his ex-employer in Norway is exempt from tax in the tax year 20X2.
- (v) Rental income from agricultural land received by an owner of such land is treated as agricultural income and is exempt from tax. Therefore, the amount of Rs. 600,000 received by Mr. Yaqeen is an exempt income.
- (vi) Subject to certain conditions and limitations, a loan utilized for the construction of a new house or the acquisition of a house is entitled for tax credit. However, the loan obtained by Mr. Yaqeen was for the purpose of renovation of his existing residential house, therefore, it is not eligible for any tax credit.

Ans.2 (a) Persons regarded as representative in each of the following cases:

The representative in respect of each of the following cases means:

- (i) **Individual under legal disability:** the guardian or manager who receives or is entitled to receive income on behalf, or for the benefit of the individual.
- (ii) **Association of persons:** If Association of person is a firm then partner, in other cases a director or a manager or secretary or agent or accountant or any similar officer of the association.
- (iii) **Federal Government:** any individual responsible for accounting for the receipt and payment of moneys or funds on behalf of the Federal Government.

Personal liability of the representative:

Under following circumstances, every representative shall be personally liable for the payment of any tax due by him in the capacity of representative, where he-

- (i) Alienates, charges or disposes of any moneys received or accrued in respect of which the tax is payable; or
- (ii) Disposes of or parts with any moneys or funds belonging to the registered person that is in the possession of the representative or which comes to the representative after the tax is payable, if such tax could legally have been paid from or out of such moneys or funds.

(b) **Service of notice:**

any notice required to be served on any non-resident person, for the purposes of Sales Tax Act, shall be treated as properly served on the non-resident person if:-

- (i) Personally served on the representative of the person;
- (ii) Sent by registered post or courier service to the person's registered office or address for service of notices under the Act, in Pakistan, or where the person does not have such office or address, the notice is sent by registered post to any office or place of business of the person in Pakistan; or
- (iii) Served on the person in the manner prescribed for service of a summons under the code of Civil Procedure, 1908 (Act V of 1908)

Ans.3 (a) Persons who may opt out of presumptive tax regime (PTR):

Following persons may opt out of the PTR

- Commercial importers
- Exporter / Export indenting agent
- Prescribed persons receiving payment from a resident person for the sale of goods

Conditions:

The above persons may opt for the Normal tax regime (NTR) provided the tax liability under NTR does not fall below a certain percentage of the tax already deducted or collected, in the following manner:

- In case of commercial importers where tax withheld at the time of imports constitutes final tax under PTR, the tax liability under NTR must be at least 60% of tax collected on imports;
- In case of an exporter or an export indenting agent, the tax liability under NTR must be at least 50% of tax deducted on exports or commission as the case may be;
- Where tax deducted on sale of goods is final, the tax liability under NTR must be at least 70% of tax deducted on sale of goods.

(b) **Associates:**

Two persons shall be associates where the relationship between the two is such that one may reasonably be expected to act in accordance with the intentions of the other, or both persons may reasonably be expected to act in accordance with the intentions of a third person.

ADVANCED TAXATION
Suggested Answers
Final Examination - Winter 2012

The circumstances under which the following may be regarded as associates:

- **A member of an association of persons and the association:**
Where the member, either alone or together with an associate or associates under another application of this section, controls fifty per cent or more of the rights to income or capital of the association;
- **A shareholder in a company and the company:**
Where the shareholder, either alone or together with an associate or associates, controls either directly or through one or more interposed persons
 - (i) fifty per cent or more of the voting power in the company;
 - (ii) fifty per cent or more of the rights to dividends; or
 - (iii) fifty per cent or more of the rights to capital;

(c) **Tax evasion:**

It refers to all attempts to minimise a taxpayer's liability through illegal means. It is a punishable offence in the eyes of law.

It arises when a taxpayer intentionally conceals the true nature of his/her tax affairs, for instance failing to declare income on his/her tax return.

Tax avoidance:

It refers to all attempts to minimise a taxpayer's liability through legal means and without violating the tax laws.

It pertains to a situation when a taxpayer legitimately takes advantage of the deductions, concessions and benefits provided by the tax laws in order to reduce or defer his/her tax liability.

Ans.4 (a)

**Computation of taxable income
For the tax year 20X2**

	Rupees
Income from property:	
Rent received from Mr. Baqir for 9 months (1,200,000 x 9 / 12)	900,000
Less: amount for the services of two guards for 9 months (15,000 x 9)	(135,000)
	765,000
Less: expenses incurred on building:	
Repairs and renovation	-
Property tax	-
Insurance premium	-
Rent collection charges	-
Taxable Property income (Separate block of income)	765,000
Income from other sources:	
Received against the provision of services of two security guards	135,000
Less: admissible deductions	
Salary paid to each guard @ Rs. 4,000 per month for 9 months	(72,000)
Taxable income from other sources	63,000
Total income including property income (to be taxed as separate block)	828,000

- (b) (i) **Derivative products**
Means a financial product which derives its value from the underlying security or other assets, may be traded on a stock exchange of Pakistan and includes deliverable futures contracts, cash settled futures contracts, contracts of rights and options.
- (ii) **Wash Sales**
Wash sale is sale of a security at loss and repurchase of the same security soon before or afterwards the sale so as to realize an unrealized loss to make it claimable as a set off against capital gain. The security sold in a wash sale is repurchased with the aim to re-acquiring it at or near its sale value in order to maintain the risk return profile of portfolio.
- (iii) **Tax Swap Sales**
Where the investor having realized loss (as in the case of a wash sale) on a particular security does not repurchase the same security but chooses another similar security in the same sector thus not only minimizing or eliminating altogether liability on account of tax on capital gain, but also maintaining the portfolio broadly at the same risk return profile.

Ans.5 (i) Due date:

In relation to furnishing a return under the FEA, 2005, means the day of the month following the end of the month, or such other date as the Federal Government may, by notification in the official Gazette, specify.

Duty due:

Due duty means duty in respect of supplies made or services provided or rendered during a month and shall be paid at the time of filing of return.

(ii) **Establishment:**

Includes an undertaking, firm or company, whether incorporated or not, an association of persons and an individual.

Person:

Includes a company, an association, a body of individuals, incorporated or not, a public or local authority, a Provincial Government or the Federal Government.

(iii) **Suspension of registration:**

- Where a Collector has reasons to believe that;
- a registered person is found to have issued false invoices; or
- evaded duty; or
- has committed any offence or irregularity to evade duty; or
- avoid his obligations under the Act or the Rules

He may, after confirming the facts and veracity of the information and giving opportunity to such person to clarify his position, suspend his registration.

ADVANCED TAXATION
Suggested Answers
Final Examination - Winter 2012

**Computation of Net Sales Tax Liability
For the tax period November 2012**

SALES TAX CREDIT (INPUT TAX)	Gross Value	Taxable Value	Sales Tax
Domestic Purchases:			
– Opening stock	75,000	50,000	8,000
– During the month	250,000	250,000	40,000
Opening stock- Imports (@19%)	50,000	50,000	9,500
Rent	25,000	-	-
Shoes for staff- input cannot be claimed	6,250	-	-
Printed stationery	5,000	5,000	800
Staff entertainment-input cannot be claimed	3,750	-	-
Fixed assets (Machinery)	300,000	300,000	48,000
Fixed assets (Car)	780,000	-	-
<i>Federal excise duty on services under sales tax mode:</i>			
Insurance- Theft and fire	25,000	25,000	2,500
Insurance-Health (exempt)	5,000	-	-
Bank charges	15,000	15,000	1,500
Inland carriage of goods by air	10,000	10,000	1,000
(-) Inadmissible/un-adjustable input(A+B)W-1			(25,450)
Input Tax for the month			85,850
SALES TAX DEBIT (OUTPUT TAX)			
Domestic Supplies to registered persons	525,000	525,000	84,000
Supplies against international tender - exempt	35,000	35,000	-
Exports – zero rated	140,000	140,000	0
Output tax for the month			84,000
Admissible credit (90% of 84,000 or input tax excluding F.A whichever is lower)			(85,850)
Sales Tax payable			-
Input tax to be carried forward (84,000 - 85,850)			1,850
Refund claim (input consumed in export)		(W-1)	20,360
W-1: Apportionment of input tax	Gross Value	Taxable Value	Sales Tax
Input tax for the month (8 items)	730,000	705,000	110,800
Less: Imports – Opening stock	50,000	50,000	(9,000)
Residual input tax (7 items)	TOTAL		101,800
			Rupees
Total sales			700,000
Export supplies			140,000
Refundable input tax on export (140,000×101,800/700,000)		A	20,360
Supplies against international tender – exempt supplies			35,000
Inadmissible input tax (35,000×101,800/700,000)		B	5,090

(b) **Tax paid on stocks acquired before registration:**

The tax paid on goods purchased by MF, who subsequently registered with the Inland Revenue Department, has been treated as input tax, as such goods were purchased by them from a registered person against prescribed sales tax invoice issued during a period of thirty days before making an application for registration and constitute their verifiable unsold stock on the date of compulsory registration.

In case of goods imported by MF, the tax paid thereon during a period of ninety

ADVANCED TAXATION
Suggested Answers
Final Examination - Winter 2012

days before making an application for registration has been treated as an input tax assuming MF holds the bill of entry relating to such goods and also that these are verifiable unsold or un-consumed stocks on the date of compulsory registration.

Therefore, in view of the above, input tax paid on goods purchased locally by MF in October 2012 i.e. not more than 30 days prior to application for registration and input tax paid at import stage on goods imported in August 2012 i.e. not more than 90 days prior to application for registration can be claimed by MF with its November 2012 return.

(THE END)

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2012

Ans.1 (a)

Saturn Limited
Computation of taxable income and income tax liability
For the tax year 20X2

Amount in Rupees

	Pakistan source income		Foreign source income		Total
	Local (NTR)	Export (FTR)	Korea	China	
Income from Business:					
Profit before taxation	4,000,000	3,500,000	800,000	1,000,000	9,300,000
Add/(Less): Inadmissible expenses / (income):					
Profit on debt [Note-(i)]	1,000,000	-	-	(1,000,000)	-
Excess provision written back admissible as straight deduction [Note-(ii)]	(100,000)	-	-	-	(100,000)
Taxable income for the period	4,900,000	-	800,000	-	5,700,000
Less: Donation (PM Fund) [Note-(iii)]	(600,000)				(600,000)
Taxable income	4,300,000		800,000	-	5,100,000
Tax rate [Note-(iv)]	35%	1% of the export proceeds	35%	35%	
Tax liability	1,505,000	70,000	280,000	-	1,855,000
Less: foreign tax credit (lesser of foreign tax paid or Pakistan tax payable on such income)	-	-	(250,000)	-	(250,000)
Less: taxes paid during the year	(1,600,000)	(70,000)	-	-	(1,670,000)
Net tax payable / (refundable)	(95,000)	-	30,000	-	(65,000)

Notes:

- (i) Profit on debt paid by a resident in respect of a debt utilized for the purpose of carrying on business outside Pakistan through a Permanent Establishment is a foreign source income. Therefore, profit on debt paid by SL shall not be admissible against local source income. However, it is admissible against income earned from China branch.
- (ii) Since excess provision for bad debts had not been previously allowed as deductible expense. Therefore it would not be chargeable to tax.
- (iii) Donation paid to Prime Minister's Relief Fund is exempt from tax and is allowed as a direct deduction from taxable income.
- (iv) In case of China branch, since the foreign income tax paid of Rs. 400,000 is in excess of the Pakistan income tax of Rs. NIL, the tax credit allowed would be restricted to Rs. NIL and the excess amount of Rs. 400,000 would not be allowed to be refunded, carried back to the previous tax year, or carried forward to the next tax year.

(b) **Selection for audit:**

Following methods are provided under the Ordinance for selecting a person for audit of his income tax affairs:

The Board may select SL for the audit of its Income Tax affairs through computer ballot which may be random or parametric as the Board may deem fit.

The Commissioner may call for any record or documents including books of accounts maintained by SL under the Ordinance or any other law for the time being in force for conducting audit of the income tax affairs.

The Commissioner shall however, first record the reasons for the above action in writing and shall also communicate those reasons to SL.

The fact that SL has been audited in a tax year 20X2 shall not preclude it from being audited again in the next and following tax years, provided that there are reasonable grounds for conducting such audit.

Ans.2 (a) Procedure for appointment as e-intermediary:

A person, desirous of being appointed as e-intermediary and having sufficient information technology infrastructure and professional experience in the field of providing taxation services, shall apply to the e-declaration administrator on the prescribed format.

The e-declaration Administrator, after receipt of application for appointment as e-intermediary, and after verification, as aforesaid, shall forward the application along with his specific recommendations to the Board for appointment of the applicant as e-intermediary.

The Board, after receipt of the recommendations from the e-declaration Administrator, may appoint the applicant as an e-intermediary and issue him a unique user identifier, subject to such conditions, restrictions and limitations, as may be prescribed:

(b) Responsibilities of an e-intermediary:

Following are the responsibilities of an e-intermediary:

- (i) The e-intermediary shall be responsible for security and confidentiality of the 'Unique User Identifier' allotted to him.
- (ii) The e-intermediary shall retain the data relating to all e-declarations transmitted by him electronically on behalf of a registered person, for a period of five years following the date of such declarations.

(c) Cancellation of appointment as an e-intermediary:

Where the Board is satisfied that the e-intermediary has--

- (i) failed to comply with any of the conditions prescribed by the Board; or
- (ii) acted in contravention of any of the provisions of the Act or these rules; or
- (iii) failed to take adequate measures for security and confidentiality of the Unique User Identifier; or
- (iv) been convicted in an offence under the Act or any other law for the time being in force;

the Board may cancel the appointment of such e-intermediary after affording him an opportunity of being heard.

Pending consideration whether the appointment of the e-intermediary be cancelled as above, the Board may suspend the appointment.

An e-intermediary who intends to surrender his appointment, shall file an application to this effect to the Board.

The Board may, on receipt of an application from e-intermediary, cancel his appointment after necessary inquiry, as it may deem proper to conduct.

Ans.3 (a) Discontinued business enterprise:

where any business enterprise is discontinued and any amount of duty chargeable on the business enterprise, whether before, or in the course of, or after its liquidation cannot be recovered from the business enterprise, every person who was an owner of, or partner in, or director of, the business enterprise shall, jointly and severally with such persons, be liable for the payment of such duty.

(b) Transfer of ownership of a business to another person as an ongoing concern:

In the case of transfer of ownership of a business or part thereof involving any charge of duty to another person as an ongoing concern, the chargeable duty shall be paid by the person to whom ownership is transferred provided that if any amount of duty payable by such person remains unpaid, such unpaid amount of duty shall be the first charge on the assets of the business and shall be payable by

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2012

transferee of business:
Provided that no business enterprise or a part thereof shall be transferred unless the outstanding duty is paid and a no objection certificate in this behalf is obtained from the Collector concerned.

Ans.4

**Computation of income tax liability
For the tax year 20X2**

	SL	VL	ML
Income from Business:	Rupees in '000		
Profit / (loss) before taxation	3,700	(1,400)	1300
Add: / (Less): Inadmissible expenses / (income)			
Accounting depreciation for the year	760	660	100
Scientific research incurred in Belgium	1,000	-	-
Employee loan written off	-	80	-
Sales promotion expenses	-	600	-
Capital (gain) / loss on sale of shares	-	500	(400)
Gain on sale of machinery – non recognition rule	(100)	-	-
Profit on debt assessable separately	(150)	-	(300)
Income from transportation business – FTR	-	-	(600)
Total business income / (loss) before tax	5,210	440	100
Less: B/f assessed business loss	(200)	(500)	(50)
	5,010	(60)	50
Less: Tax depreciation W-1	(1,140)	(990)	(135)
Amortization of sales promotion expenses (600,000/3)	-	(200)	-
Unabsorbed tax depreciation	(250)	(500)	(100)
Total business income / loss for the year	3,620	(1,750)	(185)
Capital Gain:			
Gain on sale of shares in private company	-	-	400
Less: 1/4 th of gain is exempt due to sale after one year	-	-	(100)
Less: B/f capital loss	-	-	(200)
	-	-	100
Income from Other Sources:			
Profit on debt assessable separately	150	-	300
Total income for the year	3,770	(1,750)	215
Add: unabsorbed dep. un adj against non-business income	-	-	185
Total taxable income before availing group relief	3,770	(1,750)	400
Less: Group Relief Scheme:			
B/f assessed business loss not to be surrendered	-	500	-
Loss surrendered by VL in favour of SL	(1,250)	1,250	-
Taxable income for the year	2,520	0	400
Business loss carried forward to next tax year	Nil	(500)	Nil
Unabsorbed depreciation carried forward to next tax year	Nil	Nil	(185)
Capital loss carried forward to next tax year (250,000+500,000)	(750)	(750)	Nil
Computation of net tax liability:			
Tax regime	NTR	NTR	NTR/FTR
Tax on taxable income [@ 35% or 1% of turnover whichever is higher]	882	60	140
Add: Tax under FTR on transport business –Paid u/s 234	-	-	40
Total tax liability	882	60	180
Less: Tax deduction at source:			
Advance tax paid u/s 147,148 and 153	(789)	(275)	(30)
Motor vehicle tax paid under u/s 234 (final tax)	-	-	(40)
Net tax payable / (refundable)	93	(215)	110

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2012

W-1 Tax depreciation for the year:

Rupees in '000

	Plant & Machinery and Delivery Trucks	Others	Total
SL	645	495	1,140
VL	660	330	990
ML	-	135	135

Assets	Opening WDV	Addition / (Deletion)	Total	Rate	Depreciation for the year
Plant & machinery SL	4,500	(200)	4,300	15%	645
Plant & machinery VL	4,200	200	4,400	15%	660
Delivery truck ML	-	1,500	1,500	15%	-

Ans.5

Ummeid Limited (UL)
Computation of Net Sales Tax Liability
For the tax period May 2012

SALES TAX CREDIT (INPUT TAX)	Gross Value	Taxable Value	Sales Tax
Domestic Purchases:			
– From registered suppliers	25,000,000	24,900,000	3,984,000
– From un-registered suppliers	10,000,000	-	-
Imports - domestic consumption	4,000,000	4,000,000	640,000
Raw material destroyed by fire [Note-1]	1,000,000	-	-
Input tax not adj. in Oct. 2011 [Note-2]	200,000	-	-
(-) Inadmissible/un-adjustable input W-1			(2,023,001)
Input Tax for the month			2,600,999
SALES TAX DEBIT (OUTPUT TAX)			
Domestic Supplies:			
– To registered persons	20,500,000	18,000,000	2,880,000
– To un-registered persons	9,000,000	9,000,000	1,440,000
Exempt goods	6,000,000	-	-
Exports	12,500,000	12,500,000	0
Supplies to AB Limited	500,000	500,000	0
Supplies for the maintenance of aircraft	2,000,000	2,000,000	0
Output tax for the month			4,320,000
Admissible credit (2,600,999 or 90% of 4,320,000 whichever is lower)			(2,600,999)
Sales Tax payable			1,719,001
Add: Input tax on goods destroyed by fire			160,000
Add: Excess tax collected- incidence passed on to consumers [Note-3]			19,200
Net sales tax payable with return			1,898,201
Return of excess tax collected- incidence not passed on to consumers			44,800
Refund claim (input consumed in export)		(W-1)	1,204,167
Refund claim (input on zero rated supply to AB limited)		(W-1)	48,167
Refund claim (input on zero rated supply for aircraft)		(W-1)	192,667

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2012

W-1: Apportionment of input tax	Gross Value	Taxable Value	Sales Tax
	----- Rs. in '000 -----		
Domestic Purchases- registered suppliers	25,000,000	24,900,000	3,984,000
Imports - domestic consumption	4,000,000	4,000,000	640,000
Residual input tax	TOTAL		4,624,000

	Rupees
Total sales of manufactured goods	48,000,000
Exempt supplies	6,000,000
Inadmissible input on exempt supplies $(4,624 \times 6,000 / 48,000)$ (A)	578,000
Export supplies	12,500,000
Refundable input tax on export $(4,624 \times 12,500 / 48,000)$ (B)	1,204,167
Zero rated supplies to AB Limited	500,000
Refundable input tax on Zero rated supplies $(4,624 \times 500 / 48,000)$ (C)	48,167
Zero rated supplies for aircraft maintenance (weight > 8,000 Kg.)	2,000,000
Refundable input tax on Zero rated supplies $(4,624 \times 2,000 / 48,000)$ (D)	192,667
Total inadmissible input tax (A) + (B) + (C) + (D)	2,023,001

Brief reasons for the treatment of following:

Notes:

1. Goods destroyed by fire:

Goods destroyed by fire and subsequently compensated by an insurance company does not constitute supply as defined in section 2(33) of the Sales Tax Act, 1990. Sales tax paid on the goods destroyed in fire is therefore not refundable or adjustable. If the amount of sales tax involved has already been adjusted in the monthly return, it should be repaid to / recovered by the Government. Adjustment is only allowed where inputs are used in making taxable supplies.

2. Input tax not claimed in the return:

Any input tax not deducted by a registered person within the relevant tax period may be claimed in the return for any of the six succeeding tax periods. In this case, the six succeeding tax periods elapsed in April 2012; UL therefore cannot adjust the amount of input tax of Rs. 32,000 from its output tax for the month of May 2012.

This amount can now only be adjusted with the permission of Federal Government or the Board subject to such conditions as it may deem fit.

3. Additional sales tax collected from the customer:

Any person who has collected any tax, under misapprehension of any provision of the Act or otherwise, which is in excess of the tax actually payable and the incidence of which has been passed on to the consumer, shall pay the amount of tax so collected to the Federal Government.

In this case, since 70% of the stock, on which excess tax of Rs. 44,800 was collected, is still unsold, UL should return this amount to AB Limited. However, the balance amount of Rs. 19,200, the incidence of which has been passed on to the consumers should be deposited with the Federal

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2012

Government.

Ans.6 (a) Government grant:

The management's contention of claiming Rs. 20 million as exempt from tax is not correct as Rs. 20 million is a capital receipt.

The cost of an asset does not include the amount of any grant, subsidy, rebate, commission or any other assistance.

Therefore, in determining the cost of machinery for tax purposes Rs. 20 million received from the Federal Government (FG) would be reduced from the cost of new machinery.

The cost of new plant and machinery for tax purposes would be:

Actual amount of cost (Rs.)	50,000,000
Less: grant received from the FG	<u>(20,000,000)</u>
	<u>30,000,000</u>

(b) Medical expenses of CEO:

Every person paying an amount to a non-resident person is required to deduct tax from the gross amount paid unless the non-resident person is not chargeable to tax in respect of the amount.

A non-resident's business income is chargeable to tax if such income is a Pakistan source income.

Since JH Hospital in Boston, USA (JHH) is a non-resident company and the medical treatment provided by it to the CEO was also outside Pakistan, US\$ 30,000 cannot be attributable to any business activity of JHH in Pakistan and therefore, US\$ 30,000 paid by ML cannot be regarded as a Pakistan source income of JHH.

As US\$ 30,000 is not chargeable to tax in Pakistan, ML was not required to deduct tax. ML was also not required to inform the Commissioner in writing prior to making the payment, as the medical expenses were paid in accordance with the State Bank's regulations.

In view of above, US\$ 30,000 is a deductible expense for the tax year 20X2.

(c) Dividend received from exempt income:

Where any income is exempt from tax under the Ordinance, the exemption, in the absence of a specific provision to the contrary, shall be limited to the original recipient of that income and shall not extend to any person receiving any payment wholly or in part out of that income.

In view of above, the benefit of the RFL's exempt income, being wholly agricultural in nature, cannot be extended to Mr. Pansari who has received dividend from such exempt income and therefore, Rs. 45,000 received by him as dividend is chargeable to tax.

(d) Payment to non-resident and deductibility of an expense:

Where the business of a non-resident person comprises the rendering of independent services (including professional services and the services of entertainers and sports persons), the remuneration received by such person shall be regarded as Pakistan-source business income if the remuneration is paid by a resident person or borne by a permanent establishment in Pakistan of a non-resident person.

Since GL is a Pakistan resident company, Rs. 10 million receivable by the Indian artist would be regarded as her Pakistan source income.

GL is also required to deduct withholding tax at the specified rate from such payment, as every person paying an amount to a non-resident person is required to deduct tax from the gross amount paid at the specified rate.

In view of the above, GL after deducting withholding tax from the payment of Rs 10 million can claim it as deductible expenditure.

(THE END)

ADVANCED TAXATION
Suggested Answers
Final Examination – Winter 2011

A.1 Advice to Mateen and Vaqas

Computation of tax impact on different structures

	Rupees
(i) Partnership	
Profit before taxation	1,095,000
Add: Inadmissible expenses:	
Salaries: Mateen	1,100,000
Vaqas	970,000
Accounting depreciation	975,000
	4,140,000
Less: Admissible expenses:	
Tax depreciation	(1,462,500)
Taxable income	2,677,500

Computation of tax payable by partnership:	Rupees
Total taxable income	2,677,500
Tax on Rs. 2,677,500 @ 25%	669,375

An AOP is liable to pay tax separately from its members and where an AOP has paid tax, the amount received by members (including salaries) out of the income of AOP is exempt from tax. Since both Mateen and Vaqas have no other income except for the share in AOP, no tax is payable by them separately.

(ii) Company (Public/Private)	Rupees
Taxable income as per (i) above	2,677,500
Less: Salaries: Mateen	(1,100,000)
Vaqas	(970,000)
Adjusted taxable income	607,500
Tax @ 35%	212,625
Profit after tax	394,875

Calculation of Dividend:

Accounting profit before tax	1,095,000
Less: tax (as calculated above)	(212,625)
Profit after tax	882,375
Dividend on Rs. 882,375 @ 60%	(529,425)
Profit retained after dividend	352,950

Total tax payable by the business:

On company profits	212,625
Add: Tax payable on salaries by -	
▪ Mateen (1,100,000 x 10%)	110,000
▪ Vaqas (970,000 x 9%)	87,300
Tax payable on dividend:	
Mateen (529,425 x 60% = 317,655)	31,766
Vaqas (529,425 x 40% = 211,770)	21,177
Total tax payable in case of a company	462,868

(iii) Small Company	Rupees
Taxable income as per (i) above	2,677,500
Less: Salaries: Mateen	(1,100,000)
Vaqas	(970,000)
Adjusted taxable income	607,500
Tax @ 25%	(151,875)
Profit after tax	455,625

ADVANCED TAXATION
Suggested Answers
Final Examination – Winter 2011

Calculation of Dividend:

Accounting profit before tax	1,095,000
Less: tax (as calculated above)	<u>(151,875)</u>
Profit after tax	943,125
Dividend on Rs. 943,125 @ 60%	<u>(565,875)</u>
Profit retained after dividend	<u><u>377,250</u></u>

Total tax payable by the business:

On company profits	151,875
Add: Tax payable on salaries by -	
▪ Mateen (1,100,000 x 10%)	110,000
▪ Vaqas (970,000 x 9%)	87,300
Tax payable on dividend:	
Mateen (565,875 x 60% = 339,525)	33,953
Vaqas (565,875 x 40% = 226,350)	<u>22,635</u>
Total tax payable in case of a company	<u><u>405,763</u></u>

Based on the above information it would be better for Mateen and Vaqas to operate as a limited liability company in 'small company' category, if possible, being lowest tax impact (Rs. 405,763). Even as normal limited liability company the tax impact is Rs. 462,868 as against the amount of tax of Rs. 669,375 payable in case of partnership.

A.2 (a) Recovery of arrears of tax:

For the purpose of recovery of tax, penalty or any other demand raised under the Sales Tax Act, 1990 the officer of Inland Revenue shall have the same powers which under the Code of Civil Procedure 1908 (V of 1908), a Civil Court has for the purpose of recovery of an amount due under a decree.

Where any amount of tax is due from any person, the officer of Inland Revenue may:-

- (i) deduct the amount from any money owing to person from whom such amount is recoverable and which may be at the disposal or in the control of such officer or any officer of Income Tax, Customs or Federal Excise Department;
- (ii) require by a notice in writing any person who holds or may subsequently hold any money for or on account of the person from whom tax may be recoverable to pay to such officer the amount specified in the notice;
- (iii) stop removal of any goods from the business premises of such person till such time the amount of tax is paid or recovered in full;
- (iv) require by a notice in writing any person to stop clearance of imported goods or manufactured goods or attach bank accounts;
- (v) seal the business premises till such time the amount of tax is paid or recovered in full;
- (vi) attach and sell or sell without attachment any movable or immovable property of the registered person from whom tax is due; and
- (vii) recover such amount by attachment and sale of any moveable or immovable property of the guarantor, person, company, bank or financial institution where a guarantor or any other person, company, bank or financial institution fails to make payment under such guarantee, bond or instrument.

ADVANCED TAXATION
Suggested Answers
Final Examination – Winter 2011

(b) Representative of a non-resident person:

Any person in Pakistan may be regarded as the representative of a non-resident person for a tax year:

- (i) who is employed by, or on behalf of, the non-resident person;
- (ii) who has any business connection with the non-resident person;
- (iii) from or through whom the non-resident person is in receipt of any income, whether directly or indirectly;
- (iv) who holds, or controls the receipt or disposal of any money belonging to the non-resident person;
- (v) who is the trustee of the non-resident person; or
- (vi) who is declared by the Commissioner by an order in writing to be the representative of the non-resident person. But before such declaration, the Commissioner would give an opportunity of being heard to such person.

A.3 (a) Persons liable to pay Federal Excise Duty:

The liability to pay duty shall be:-

- (i) in case of goods produced or manufactured in Pakistan, of the person manufacturing or producing such goods;
- (ii) in case of goods imported into Pakistan, of the person importing such goods;
- (iii) in case of services provided or rendered in Pakistan, of the person providing or rendering such service, provided where services are rendered by the person out of Pakistan, the recipient of such service in Pakistan shall be liable to pay duty; and
- (iv) in case of goods produced or manufactured in non-tariff areas and brought to tariff areas for sale or consumption therein, of the person bringing or causing to bring such goods to tariff areas.

(b) The alternative sources on which duty may be levied and collected by the Board:

The Board may, by notification in the official Gazette, in lieu of levying and collecting duties of excise on goods and services, as the case may be, levy and collect duties, on the production capacity of plants, machinery, undertakings, establishments or installations producing or manufacturing such goods.

(c) Duty drawback:

The Board may, by notification in the official Gazette, grant drawback of duty paid on any goods used in the manufacture of any goods manufactured in and exported out of Pakistan, or shipped as provisions or stores for consumption on board a ship or aircraft proceeding to a destination outside Pakistan, at such rate or rates and subject to such conditions and limitations as may be specified in the notification.

ADVANCED TAXATION
Suggested Answers
Final Examination – Winter 2011

A.4 (a)

MEGA LIMITED
Computation of income tax liability
For the tax year 20X8

Rs. in '000

Income from Business:	
Accounting profit before taxation	152,500
Add/(Less): Inadmissible expenses/ (income):	
Accounting depreciation on new plant and machinery	5,200
Penalty paid to custom authorities	500
Industrial software	4,800
Electricity expenses paid in cash	-
Donation paid to a university	13,000
Profit received from UAE Govt. against consultancy services	(27,000)
Royalty received from Singapore	(50,000)
Foreign tax paid on royalty	10,000
	(43,500)
	109,000
Less: Admissible expenses:	
Initial allowance on new plant and machinery	(26,000)
Normal depreciation on new plant and machinery	(3,900)
Tax amortization of industrial software (4.8/3x3/12)	(400)
	(30,300)
Taxable income for the period	78,700
Less: B/f tax loss of Rs. 31.3 million [Inadmissible as it relates to a period beyond six years]	-
Unabsorbed tax depreciation	(11,000)
Unabsorbed amortization of pre-commencement expenditure	(7,700)
Taxable income	60,000
Computation of net tax liability:	
Tax on Rs. 60 million @ 35%	21,000
Less: Tax credit	
on donation Rs. 13 million or 20% of taxable income whichever is lower [60 million x 20% = 12 million] x 35%	(4,200)
for investment in plant and machinery @ 10%	(5,200)
Foreign tax paid on royalty received from Singapore [since the royalty income is exempt from tax, no credit would be allowed]	-
	11,600
Add: Tax payable on services rendered outside Pakistan [@ 1% of gross receipt]	900
Total tax payable	12,500
Less: Tax deduction at source:	
Advance tax paid under section 147	(5,000)
Paid on import of raw material	(55)
Paid on import of plant and machinery	(1,560)
Deducted and paid by banks on profit on debt	(250)
	(6,865)
Net tax liability	5,635
Tax payable on the basis of turnover [Rs.1.1 billion @ 1%]	11,000
Total tax payable as per above	12,500

Note:

- Since the amount of tax payable on taxable income is higher than the turnover tax, the company would pay normal tax on its income.
- Nothing would be deducted from payments to non-resident against import of plant and machinery since the title was transferred outside Pakistan

ADVANCED TAXATION
Suggested Answers
Final Examination – Winter 2011

(b) **Incidence of further tax liability:**

ML was required to estimate the tax payable for the relevant tax year at any time before the last instalment was due and in case the tax payable was likely to be more than the amount otherwise payable on the turnover basis, it had to pay the additional amount over the remaining instalments.

Where the tax paid under section 147 is less than ninety per cent of the tax chargeable for the relevant tax year, the taxpayer is liable to pay default surcharge at the rate of KIBOR plus three percent per quarter on the amount of shortfall for the period. [Such default surcharge shall be calculated from the first day of April in that year to the date on which assessment is made or the thirtieth day of June of the financial year next following, whichever is the earlier.]

Under the given circumstances, the total advance tax paid by ML under section 147 along with the amount of taxes suffered at source amounted to Rs. 6.865 million which is less than ninety per cent of the amount of tax charged to ML for the tax year 20X8. Therefore, ML is exposed to the levy of default surcharge under section 205(1B).

A.5

SUNSHINE LIMITED (SL)
Computation of Net Sales Tax Liability
For the tax period November 2011

Rs. in '000

SALES TAX CREDIT (INPUT TAX)	Gross Value	Taxable Value	Sales Tax
Domestic Purchases for Alpha @16%	10,000	10,000	1,600
Domestic Purchases for Gama @16%	15,000	15,000	2,400
Fixed Assets (Machinery)	0	0	3,000
Input tax not adjusted in October 2011	0	0	500
(-) Inadmissible/un-adjustable input (W1)			(2,436)
Input Tax for the month			5,064
SALES TAX DEBIT (OUTPUT TAX)			
Domestic Supplies of Alpha to registered persons (N-1)	15,000	17,000	2,720
Domestic Supplies of Alpha to un-registered persons	3,000	3,000	480
Domestic Supplies of Gama (Exempt goods)	18,000	0	0
Export to Turkey (Gama)	7,000	7,000	0
Domestic Supplies of Beta [third sch. item at retail price]	5,000	6,250	1,000
Supply of Beta to Export Processing Zone	625	625	0
Free replacement of defective units of Alpha (N-2)	1,000	0	0
Supply of Beta to employees [third sch. item at retail price]	1,250	1,250	200
Output tax for the month			4,400
Admissible credit (90% of 4,400 or input tax for the month excluding fixed assets whichever is lower)			(5,064)
Sales Tax to be carried forward (4,400-5,064)			664
Refund claim (input consumed in export) (W-1)			672
Refund claim (input on Zero rated supply to EPZ) (W-1)			36

W-1: Apportionment of input tax

	Gross Value	Taxable Value	Sales Tax
Residual input tax	----- Rs. in '000 -----		
Domestic Purchases of Alpha @16%	10,000	10,000	1,600
Domestic Purchases of Gama @16%	15,000	15,000	2,400

ADVANCED TAXATION
Suggested Answers
Final Examination – Winter 2011

Apportionment of residual input tax:		Rs. in '000
Alpha		
Zero rated Supply of Beta to Export Processing Zone		625
Domestic Supplies of Alpha to registered persons		17,000
Domestic Supplies of Alpha to un-registered persons		3,000
Domestic Supplies of Beta		6,250
Supply of Beta to employees		1,250
Total sales of Alpha and Beta		28,125
Refundable input tax on Zero rated sales (625*1,600/28,125)	(A)	36
Gama		
Exempt sales of Gama		18,000
Export sales of Gama		7,000
Total sales of Gama (Exempt + Export)		25,000
Inadmissible input tax on exempt sales (18,000*2,400/25,000)	(B)	1,728
Refundable input tax on export sales (7,000*2,400/25,000)	(C)	672
Total inadmissible/ adjustable input tax	(A)+(B)+(C)	2,436

A.6 (a) **Tax avoidance scheme:**

Tax avoidance scheme means any transaction where one of the main purposes of a person in entering into the transaction is the avoidance or reduction of any person's liability to tax under the Income Tax Ordinance.

Re-characterization of income and deductions:

For the purposes of determining liability to tax under the Income Tax Ordinance, 2001 the Commissioner may –

- (i) Re-characterize a transaction or an element of a transaction that was entered into as part of a tax avoidance scheme;
- (ii) disregard a transaction that does not have substantial economic effect; or
- (iii) Re-characterize a transaction where the form of the transaction does not reflect the substance.

(b) (i) **Compulsory taxation under Final Tax Regime:**

Taxes withheld from the payments made to a non-resident person on the execution of a construction contract constitute final tax on the income from such contracts only when such person opts to be taxed under Presumptive Tax Regime.

Provided that the non-resident person:

- furnishes a declaration of option in writing;
- Such declaration is furnished within 3 months of the commencement of the tax year; and
- Such declaration shall be irrevocable; and
- Shall remain in force for 3 years.

(ii) **Taxation of a permanent establishment in Pakistan of a non-resident person:**

The tax implication in each of the following cases, while determining the chargeable income of the permanent establishment, would be:

▪ **Head office expenditure:**

In computing the income of a permanent establishment in Pakistan of a non-resident person chargeable to tax under the head "Income from Business" for a tax year:

ADVANCED TAXATION
Suggested Answers
Final Examination – Winter 2011

No deduction shall be allowed for head office expenditure in excess of the amount as bears to the turnover of the permanent establishment in Pakistan the same proportion as the non-resident's total head office expenditure bears to its worldwide turnover.

▪ **Compensation for management services performed by the branch:**

In the determination of the income of a permanent establishment (P.E):

No account shall be taken of amounts charged by the P.E to the head office by way of compensation for management services performed by the P.E

However, amounts charged by the P.E towards reimbursement of actual expenses incurred by the P.E to third parties shall be taken into account while determining the income of P.E.

▪ **Profit payable on debt to finance the operations of the branch:**

In computing the income of a permanent establishment in Pakistan of a non-resident person chargeable under the head "Income from Business":

No deduction shall be allowed for any profit paid or payable by the non-resident person on debt to finance the operations of the permanent establishment.

A.7 Rose Patel Limited – Long term contracts

Taxable income:

Tax Year		Rupees
20X2	(2,250,000 x 46%)	1,035,000
20X3	(2,250,000 x 39%)	877,500
20X4	(2,250,000 x 15%)	337,500

Working:

Taxable Income (estimated profit) x (percentage of contract completed)	Rupees
Estimated Profit (Total contract price – Total costs) (9,000,000 – 6,750,000)	2,250,000

$$\text{Percentage of contract completed} = \frac{\text{Contract costs incurred}}{\text{Total contract costs}}$$

Tax Year		
20X2	$\frac{3,105,000}{6,750,000}$	46%
20X3	$\frac{2,632,500}{6,750,000}$	39%
20X4	$\frac{1,012,500}{6,750,000}$	15%

(THE END)

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2011

A.1

Mr. Khan

Computation of Taxable income and Tax thereon
Tax Year 20X4

	Rs. in '000
Income from Salary	
Basic salary for six months $(350,000 \times 6)$	2,100
Conveyance allowance $(50,000 \times 6)$	300
Value of accommodation $(45\% \text{ of basic salary or fair market rent whichever is higher})$ <i>(Rule 4)</i>	945
Company maintained car $(2.0 \text{ million} \times 5\% \times 1/2)$	50
Interest free loan $[(2.5 \text{ million} - 1.5 \text{ million}) \times 0.13 \times 6/12]$	65
Interest on amount of loan utilized for the purchase of asset $[\text{Sec.13(8)}]$	-
Amount of loan waived by TL $(2.5 \text{ million} \times 25\%)$	625
Compensation under redundancy scheme (B)	4,000
Unapproved gratuity $(2.0 \text{ million} - 75K \text{ exempt under clause 13 of Part I of Second Schedule})$	1,925
Car purchased $(1.5 \text{ million} - 1.0 \text{ million}) [\text{Sec. 13(11)}]$	500
Total Salary Income	10,510
Income from property	
Rent from Mr. Riaz for the Shop – March to June $(137,500 \times 4)$	550
Non-adjustable security deposit $(500,000 \times 1/10) [\text{Sec. 16(1)}]$	50
Refundable security deposit – <i>not taxable (Rs. 600,000)</i>	-
Rent from bank for the residential portion – April to June 2011 $(100,000 \times 3)$	300
Total Property Income – Separate Block of Income (C)	900
Capital Gain	
Sale of share of a listed company	-
(Gain on sale of listed shares, which were held for the period of more than 12 months is not taxable)	-
	11,410
Less: Donation paid to an un-approved trust (inadmissible deduction)	-
Taxable income	11,410
Computation of tax liability and tax payable:	
<i>(as salary income is more than 50% of the total income so Mr. Khan shall be treated as salaried person)</i>	
Total taxable income	11,410
Less: Property income (separate block)	(900)
Less: Redundancy payment $(\text{on the assumption that Mr. Khan, by notice in writing to the Commissioner, would elect to be taxed on the basis of average rate of tax})$	(4,000)
Salary Income (excluding redundancy payment) (A)	6,510
(a) Tax on Rs. 6,510 K @ 20%	1,302
(b) On redundancy payment at the average rate of tax $(4.0 \text{ million} \times 18\%)$	720
(c) On income from property $(12,500 + 7.5\% \times 500,000)$	50
Total tax liability	2,072
Less: Tax deducted at source from:	
Salary income	(1,837)
Property income	(197.5)
Balance tax payable	37.5

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2011

A.2 (a) **Tax paid on stocks acquired before registration:**

The tax paid on goods purchased by Ms. Hina who subsequently got voluntary registration under the Act or the rules made thereunder, shall be treated as input tax, subject to the following conditions:

In case of locally purchased packed dates:

- (i) The dates were purchased from a registered person against a valid sales tax invoice.
- (ii) The invoice was issued during a period of thirty days before making the application for registration; and
- (iii) Such dates constitute her verifiable unsold stock on the date of application for voluntary registration.

In case of imported coffee:

- (i) The tax paid on the coffee at import stage must be during a period of ninety days before making an application for registration.
- (ii) She holds the bill of entry relating to such coffee; and
- (iii) The unsold or un-consumed stocks are verifiable on the date of application for voluntary registration.

- (b) In view of the above, the following amount of input tax can be claimed by Ms. Hina with her sales tax return for the month of May 2011.

In case of locally purchased packed dates:	41,325
(458 packets of dates purchased on March 28, 2011)	
In case of imported coffee:	39,900
(42 kg of coffee imported on February 25, 2011)	
	81,225

- A.3 (i) The Commissioner's contention is incorrect as the tax collected on import of plant and machinery by an industrial undertaking for its own use is not final tax and hence it is adjustable.

- (ii) Apportionment is only required for those expenditures which are common in nature.

The expenditures included in cost of goods manufactured should not be apportioned unless these include any item which can be considered as a common expenditure.

The Commissioner's contention with regard to cost of goods manufactured is, therefore, incorrect unless he can prove otherwise, as discussed above.

- (iii) Immovable property is not covered under the definition of "Capital asset", therefore, any gain on sale of immovable property would not be considered as a capital gain. However, such gain would be treated as income from business and would be charged to tax accordingly. The amount of gain is calculated as follows:

	Rs. in million
Sale proceed of immovable property	120
Less: Tax WDV	
Cost of immovable property (consideration received)	120
Tax depreciation charged (Rs. 90m - Rs. 70m)	(20)
Tax WDV	100
Tax gain on disposal	20

Therefore, the gain of Rs. 20 million would be offered to tax as income from business instead of Rs. 50 million as shown in the financial statements.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2011

- (iv) Where a person has been allowed a deduction for any expenditure incurred in deriving income from business and the person has not paid the liability or a part of the liability to which the deduction relates within three years of the end of the tax year in which the deduction was allowed, the unpaid amount should be chargeable to tax under the head business income in the first tax year following the expiry of three years' period.

The Commissioner's observation is, therefore, correct that such Royalty having not been paid for over three years should have been offered to tax in the current tax year.

- (v) Bad debt is allowed if the amount of debt was previously included in the person's income from business or in respect of money lent by a financial institution in deriving income from business. Since BL is not a financial institution, loan written off could not be allowed as Bad debt and, therefore, the Commissioner's contention is correct.

A.4

Gadget Limited (GL)
Computation of Net Sales Tax Liability
For the Tax Period May 2011

		Rs. in '000	
		Taxable Value	Sales Tax
Sales Tax Credit (Input Tax)			
Domestic purchases:			
– Steel sheets, copper wire, aluminum and allied R.M		2,500	425
– Lubricants, spare parts and stores excluding cash purchases (5,400 – 900)		4,500	765
– Gift items for customers -carpets, fancy watches etc.		-	-
– Printed stationary for the maintenance of factory record		500	85
Federal Excise Duty on Services Under Sales Tax Mode:			
– On banking services			
▪ L/C opening charges		500	50
▪ Safe custody fee		100	10
– On billboard advertisement		700	70
		8,800	1,405
Less: Purchases returned		900	(153)
Input tax attributable to both taxable and zero rated goods			1,252
Less: un-adjustable input tax (export and zero rated)	W-1		(668)
Input tax for the month			584

		Rs. in '000	
		Taxable Value	Sales Tax
Sales Tax Debit (Output Tax)			
Domestic supply of manufactured goods:			
– Electric switch-gears and electric motors to diplomatic mission in Islamabad		1,900	0
– Air Coolers to customers based in LHR, ISD and FSD		7,000	1,190
– Supply of motors and switches for consumption onboard a container ship		650	0
Export of electric air coolers to customers in Spain and Zanzibar		3,800	0
Federal Excise Duty on Services Under Sales Tax Mode:			
On franchise services		1,400	140
Output tax for the month			1,330
Sales tax withheld by the return filer as withholding agent from the payment on account of stationery (1%)		500	5
Admissible credit (90% of 1,330 or 584 whichever is lower)			(584)
Sales tax payable	(1,330 + 5 – 584)		751
Refund claim (input on export and zero rated supplies)	W-1		668

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2011

	Rs. in '000	
	Taxable Value	Sales Tax
W-1		
Domestic purchases:		
– Steel sheets, copper wire, aluminum and allied R.M	2,500	425
– Lubricants, spare parts and stores	4,500	765
– stationary for the maintenance of inventory record	500	85
Federal Excise Duty on Services Under Sales Tax Mode:		
– On banking services		
▪ L/C opening charges	500	50
▪ Safe custody fee	100	10
– On bill board advertisement	700	70
Total		1,405
Total sales of manufactured goods		13,350
Export supplies		3,800
Other zero rated supplies (1,900 + 650)		2,550
		6,350
Input tax on zero rated and export to be claimed as a refund (6,350 /13,350 x 1,405)		668

A.5 (a) **Tax credit to a person registered under the Sales Tax Act, 1990:**

A registered manufacturer under the Sales Tax Act, 1990 shall be entitled to a tax credit of two and a half percent of tax payable for a tax year. Subject to the following conditions:

- (i) Ninety percent of its sales during the said tax year are to persons who are registered under the Sales Tax Act, 1990.
- (ii) The person shall provide complete details of the persons to whom the sales were made.
- (iii) The income is not covered under final tax or minimum tax.
- (iv) Any unadjusted tax credit for the tax year shall not be carried forward to the next year.

(b) **Principles of taxation of joint venture:**

- (i) A joint venture is treated as an association of persons and is liable to tax separately from its members.

In case a joint venture has net taxable income, tax would be calculated according to the rules and principles applicable to the relevant head of income.

In case a joint venture incurs a loss in a tax year, the entire loss would be carried forward to the following tax year and so on for a maximum period of six tax years.

- (ii) **Share of profits of company to be added to taxable income:**

The share of profit derived by SPL and ECPL from the joint venture shall be added to their respective taxable incomes. Tax liability of each company will then be calculated on their total taxable income.

Tax liability so arrived at will be reduced by an amount of tax credit calculated in accordance with the following formula:

$$(A/B) \times C$$

Where -

A is the amount of share of profit received by SPL or ECPL from the joint venture;

B is the taxable income of the joint venture; and

C is the amount of tax assessed on the joint venture.

SPL and ECPL's share in the loss of the joint venture would not be allocated to them.

Where SPL and ECPL's share in the profit of a joint venture are added to their respective taxable income; They would not be permitted a subsequent set-off in case the venture sustains a loss.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2011

However, SPL & ECPL being the members of a joint venture shall be allowed to set-off their own tax losses against their share of profit from the venture and pay tax on their adjusted income.

In case, the net effect of the above set-off results in a tax loss, both the companies shall be entitled to carry forward their respective losses to the following tax year.

(c) Foreign-source income of short-term resident individuals:

Short-term resident individual is an individual who is:-

- (i) a resident solely by reason of his employment; and
- (ii) present in Pakistan for a period or periods not exceeding three years.

The foreign source income of such individuals shall be exempt from tax under the Ordinance.

However, the following incomes are not covered under this exemption provision:

- (i) any income derived from a business of the person established in Pakistan; or
- (ii) any foreign-source income brought into or received in Pakistan by the person.

A.6 Group Taxation:

Holding companies and subsidiary companies of 100% owned group may opt to be taxed as one fiscal unit.

Following conditions are required to be fulfilled for availing such benefit:

- (a) Besides consolidated group accounts as required under the Companies Ordinance, 1984, computation of income and tax payable shall be made for tax purposes.
- (b) The companies in the group shall give irrevocable option for taxation as one fiscal unit.
- (c) The group taxation shall be restricted to companies locally incorporated under the Companies Ordinance, 1984.
- (d) The relief under group taxation would not be available to losses prior to the formation of the group.
- (e) The option of group taxation shall be available to those group companies which comply with such corporate governance requirements as may be specified by the Securities and Exchange Commission of Pakistan from time to time and are designated as companies entitled to avail group taxation.
- (f) Group taxation may be regulated through rules as may be made by the Board.

A.7 (a) Certain transactions not admissible:

- (i) Notwithstanding, the payment was made through a crossed pay order drawn on the business bank account of the buyer, the transaction is inadmissible for the purpose of claiming input tax since the payment was made after 180 days of the issuance of the tax invoice.
- (ii) The payments made through credit card are treated as transactions through the banking channel, subject to the condition that such transactions are verifiable from the bank statements of the respective buyer and the supplier.

Under the circumstances, since Mr. Baba paid the amount using his personal credit card which would not be verifiable from the bank account of X Limited (i.e. business bank account), the company shall not be entitled to claim input tax credit, adjustment or deduction, or refund, repayment or draw-back or zero

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2011

rating of tax payment.

- (iii) The tax charged on the acquisition of fixed assets shall be adjustable against the output tax in twelve equal monthly installments. Z Limited would therefore, be entitled to claim Rs. 2.125 million each month in equal installment.
- (iv) Since extra tax has been paid on the specified electric goods they shall be exempt from payment of sales tax on subsequent supplies. However, no input tax adjustment would be allowed to Mr. Haq on such purchases. Therefore he would not be entitled to claim the entire amount of Rs. 88,750.

(b) Definite information includes information on:

- (i) sales or purchases of any goods made by the taxpayer
- (ii) receipts of the taxpayer from services rendered; or
- (iii) any other receipts that may be chargeable to tax under the Ordinance; and
- (iv) the acquisition, possession or disposal of any money, asset, valuable article by the tax payer; or
- (v) investment made by the taxpayer; or
- (vi) expenditure incurred by the taxpayer.

A.8 (a) **Collection of excess duty:**

Every person who for any reason whatever has collected or collects any duty, which is not payable as duty or which is in excess of the duty actually payable and the incidence of which has been passed on to the consumer, shall pay the amount so collected to the Federal Government and all the provisions of Federal Excise Act or rules made there under shall apply for the recovery of such amount and claim for the refund of any such amount paid or recovered shall not be admissible on any ground whatever.

(b) **Duty on services provided free of charge:**

Where any services are liable to duty under Federal Excise Act at a rate dependent on the charges therefore, the duty shall be paid on total amount of charges for the services including the ancillary facilities or utilities, if any, irrespective whether such services have been rendered or provided on payment of charge or free of charge or on any concessional basis.

(THE END)

ADVANCED TAXATION Suggested Answers Final Examinations – Winter 2010

A.1 (a) Foreign controller:

Foreign controller means a non-resident person who holds 50% or more of the underlying ownership in a resident company (Foreign-controlled resident company) either alone or together with an associate or associates.

The direct and indirect holding of the three lenders are calculated below:

Direct holding of BP	= 60% i.e. more than 50%
Indirect holding of BP (through ATX)	= 10%
Direct holding of ATX	= 10%
Indirect holding of ATX (through BP)	= 60%
Total holding of ATX along with associate	= 70% i.e. more than 50%
Indirect holding of FRS – 90% x 30%	= 27% i.e. less than 50%

Therefore BP and ATX would be classified as foreign controller whereas FRS Limited is not a foreign controller in relation to thin capitalization rules.

(b) Aggregate outstanding balance of loans received by RL from foreign controllers as at June 30, 20X2:

	Amount in million
Received from:	
BP	\$ 4.2
ATX GmbH	\$ 3.8
	\$ 8.0
@ Rs. 85 (\$ 8.0 million x 85)	Rs. 680.0

	Rs. in million
Total equity at the beginning of the year:	
Net assets as at June 30, 20X2 (2900 – 2670)	230
Less: After tax profit for the year	(150)
	80
Add: Interim dividend paid during the year	100
Equity at the beginning of the year	180
Foreign debt from BP	
\$ 4.2 million x 85 (at 30.06.20X2)	357
Foreign debt from ATX	
\$ 3.8 million x 85 (at 30.06.20X2)	323
	680

Calculation of foreign equity share:

Effective share of BP and ATX in the equity of RL (0.7 x 180 million)	126
Maximum allowable debt for BP and ATX is 126 × 3 million =	378

Interest relating to the above amount would be allowed as deductible profit.

ADVANCED TAXATION Suggested Answers Final Examinations – Winter 2010

Computation of allowable profit on debt

	Rupees
Profit on debt paid/accrued for BP (10-08-20X1 to 14-05-20X2)	
Total interest expenses (357 million × 12% × 277/365)	32,511,452
Profit on debt paid/accrued for BP and ATX (15-05-20X2 to 30-06-20X2):	
BP part of loan: $357/680 \times 378 \text{ million} \times 47/365 \times 12\%$	3,066,460
Profit on debt paid/accrued for BP and ATX GmbH (15-05-20X2 to 30-06-20X2):	
ATX part of loan: $323/680 \times 378 \text{ million} \times 47/365 \times 8\%$	1,849,611
Profit on debt paid/accrued for FRS in tax year 20X2:	
$85,000,000 \times 10\% \times 289/365$ (fully deductible)	6,730,137
	44,157,660

Therefore total profit on debt allowable for tax purposes under the provisions of Income Tax Ordinance, 2001 is Rs. 44,157,660.

A.2 Persons authorized to represent a taxpayer:

The following persons are authorized to represent a taxpayer before the adjudicating authority and Appellate Tribunal, namely:

- (a) A person in the employment of the taxpayer working on a full-time basis and holding at least a bachelors' degree in any discipline from a university recognized by the Higher Education Commission provided that such person shall represent only the taxpayer in whose employment he is working on full-time basis;
- (b) An advocate entered in any rolls, and practicing as such, under the Legal Practitioners and Bar Councils Act, 1973 (XXXV of 1973);
- (c) A person holding a Bachelor or Master degree in Commerce;
- (d) A person who has retired or resigned after putting in satisfactory service in the Sales Tax Department or Customs Department or Federal Excise Department for a period of not less than ten years in a post or posts not inferior to that of an Assistant Collector;

Provided that no such person shall be entitled to represent a taxpayer for a period of one year from the date of his retirement or resignation, or in a case in which he had made, or approved, as the case may be, any order under the relevant Acts; and

- (e) An accountant.

Disqualifications:

The following persons shall not be entitled to represent a taxpayer, namely:

- (a) Any person who has been convicted as a result of any criminal proceedings under any law for the time being in force in Pakistan;
- (b) A person who has been dismissed or compulsorily retired from service;
- (c) A person who is an un-discharged insolvent; and
- (d) A person who has been found guilty of misconduct as defined in clause (xxxix) of sub-

rule (1) of rule 2.

A.3 (a) Disposal of business by individual to wholly-owned company:

Where a resident individual disposes of all the assets of his business to a resident company, no gain or loss shall be taken to arise on the disposal if the following conditions are satisfied, namely:-

- (i) the consideration received by the transferor for the disposal is a share or shares in the company (other than redeemable shares);
- (ii) the transferor must beneficially own all the issued shares in the company immediately after the disposal;
- (iii) the company must undertake to discharge any liability in respect of the assets disposed of to the company;
- (iv) any liability in respect of the assets disposed of to the company must not exceed the transferor's cost of the assets at the time of the disposal;
- (v) the fair market value of the share or shares received by the transferor for the disposal must be substantially the same as the fair market value of the assets disposed of to the company less any liability that the company has undertaken to discharge in respect of the assets; and
- (vi) the company must not be exempt from tax for the tax year in which the disposal takes place.

(b) Necessary changes to be made to the proposed scheme of transfer:

According to the proposed scheme, Mr. Adnan is fulfilling almost all the conditions mentioned above, except the following:

- (i) **Consideration to be received:**
Mr. Adnan is required to receive the entire purchase consideration in the form of shares only instead of 50% in the form of shares and 50% cash.
- (ii) **Ownership interest in the company:**
As Mr. Adnan, immediately after the disposal of his herbal business to MPL, is required to beneficially own the entire paid up share capital of MPL, therefore, he must acquire the ownership interest of his brother Rais who is also willing to dispose off his holding in MPL. However, Mr. Adnan is not required to acquire the ownership interest of his spouse Razia as he already beneficially owns her ownership interest.
- (iii) **Transfer of liabilities**
As MPL is required to undertake all the liabilities in respect of the assets disposed of by Herbal Traders. Mr. Adnan should ensure that MPL assumes all the liabilities of Herbal Traders including the liability of Barkat Enterprises.

Accordingly, Mr. Adnan will have to make the aforesaid changes to his proposed scheme of transfer in order to get exemption from capital gain tax.

(c) (i) Number and the value of shares to be received by Mr. Adnan:

The fair market value of the consideration, in the form of shares, received by Mr. Adnan in relation to transfer of his herbal business must substantially be the same as the fair market value of the net assets (i.e. assets less liabilities) transferred by him to MPL.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Winter 2010

Therefore, net worth of consideration of sales to be received by Mr. Adnan is computed below:

	Rupees
FMV of fixed assets	5,200,000
FMV of patents	2,300,000
Stock in trade (NRV)	4,000,000
Cash and bank balance	3,000,000
Trade debtors (3.0 m – 1.0m)	2,000,000
	16,500,000
Less: Total liabilities including the liability of Barkat Enterprises	(7,500,000)
Net worth of consideration of sales to be received by Mr. Adnan	9,000,000

Generally, for private limited companies, the break-up value of the shares is considered as the FMV, this would mean that the shares to be issued to the individual must be equal to the FMV of the net assets acquired by MPL.

Breakup value of MPL per share	Rs.15
Number of shares to be issued to Mr. Adnan (9,000,000/15)	600,000

(ii) **MPL's Cost of acquisition of assets:**

	Rupees
Tax WDV of fixed assets	3,000,000
Tax WDV of patents	2,500,000
Stock in trade	4,000,000
Cash and bank balances	3,000,000
Trade debtors	3,000,000
Total cost of assets with MPL	15,500,000

(iii) **Mr. Adnan's cost in respect of the shares received by him as consideration.**

Total cost of assets with MPL (calculated in (c)(ii) above)	15,500,000
Less: Total liabilities assumed by MPL	(7,500,000)
	8,000,000
Total number of shares received by Mr. Adnan	600,000
Cost of shares received as consideration	Rs. 13.33

A.4 Power to withdraw approval:

The Regional Commissioner may, at any time, withdraw the approval, if he is satisfied that:

- (a) the constitution, memorandum and articles of association, trust deed, rules and regulations or bye-laws, as the case may be, specifying the aims and objects of the organization do not provide for prohibiting the making of any changes in the constitution, memorandum and articles of association, trust deed, rules, regulations and bye-laws without prior approval of the Regional Commissioner;
- (b) the organization has:
 - (i) been or is being used for personal gain of any particular person or a group of

ADVANCED TAXATION Suggested Answers Final Examinations – Winter 2010

- persons;
- (ii) been propagating the view of a particular political party or a religious sect;
 - (iii) been or is being managed in a manner calculated to personally benefit its members or their families; or
 - (iv) has not been, or will not be, able to achieve its declared aims and objects in view of its set up, administration or otherwise as evaluated and certified by an independent certification agency;
 - (v) failed to give valid reasons for setting apart, or not utilizing, or accumulating surpluses, excluding restricted funds, in excess of twenty five per cent of the income for the year;
 - (vi) failed to file the return of income supported with the specified documents and also
 - a detailed performance evaluation report after every three years.

Provided that where such detailed performance evaluation report is not submitted on or before the 30th of September following every three Tax Years, Regional Commissioner of Income Tax shall issue a show cause notice for withdrawal of approval to the concerned organization as stated above;

- (vii) Failed to file statements of deduction of income tax under section 165 of the Income Tax Ordinance, 2001 read with rule 44.

A.5 Resident Individual:

Residential status of the following persons for the tax year ended June 30, 20X2 under the given circumstances.

- (i) For the tax year ended June 30, 20X2, the relevant period is July 01, 20X1 to June 30, 20X2. Therefore, the stay of Mr. Mubeen for the purpose of tax year 20X2 is:

Month	Days
July 20X1	31
August 20X1	31
September 20X1	30
Total	92

Since his stay in Pakistan is less than 183 days in tax year 20X2, he is a non resident for tax purposes.

- (ii) Since Mr. Rana never travelled abroad in his life before proceeding to Canada for assuming his job responsibilities, the number of days he spent in Pakistan for the tax year 20X2 is:

Month	Days
July 20X1	31
August 20X1	31
September 20X1	30
October 20X1	31
November 20X1	30
December 20X1	29
Total	182

The day he spent in Pakistan on June 30, 20X2, while in transit, would not be counted

ADVANCED TAXATION Suggested Answers Final Examinations – Winter 2010

as day of his presence in Pakistan.

Therefore, Mr. Rana is a non- resident person as his total stay in tax year 20X2 is less than 183 days.

- (iii) A Federal Government Employee posted abroad in terms of his employment is considered as a resident person irrespective of his physical presence in Pakistan. Therefore Mr. Baber is a resident individual for tax year 20X2.
- (iv) In case of Mr. Francis, it is immaterial where he stayed in Pakistan. The calculation will be made from the day of his arrival in Pakistan to the day of his departure from Pakistan. Therefore, the total number of days he spent in Pakistan during the calendar year 20X1 i.e. the year starting from January 01, 20X1 to December 31, 20X1 (Special tax year 20X2) is:

Month	Days
July 20X1	1
August 20X1	31
September 20X1	30
October 20X1	31
November 20X1	30
December 20X1	31
Total	154

In view of the permission granted by Commissioner Income Tax to Mr. Francis to use special tax year, the number of days he spent in Pakistan beyond December 31, 20X1 would fall under tax year 20X3. Therefore, 31 days which he spent in January 20X2 would not be included in tax year 20X2.

As a result, Mr. Francis is a non- resident person as his total stay in tax year 20X2 is less than 183 days.

- A.6 (a) In case the consideration for a supply is in kind or is partly in kind and partly in money, the value of the supply shall mean the open market price of the supply excluding the amount of tax.

Therefore, value of supply shall be Rs 2,500,000 and not the consideration received i.e. Rs 2,375,000.

However, if the sales tax invoice reflects trade discount of Rs 125,000 and discount allowed is in conformity with the normal business practices, then the value of taxable supply will be taken at Rs 2,375,000.

- (b) **Return of supply:**

Tameer Limited (TL) would follow the following procedure:

- (i) TL shall issue a Debit Note (in duplicate) in respect of Iron Bars supplied to it by Folad Limited (FL), indicating the quantity being returned, its value determined on the basis of the value of Iron Bars as shown in the tax invoice issued by FL and the amount of related sales tax paid thereon, as well as the following, namely:-

- name and registration number of the recipient (i.e. TL);
- name and registration number of the supplier (i.e. FL);
- number and date of the original sales tax invoice;

ADVANCED TAXATION
Suggested Answers
Final Examinations – Winter 2010

- the reason of issuance of the Debit Note; and
- signature and seal of the authorized person issuing the note.

(ii) The original copy of the debit note shall be sent to FL and the duplicate copy shall be retained by TL for record.

A.7 (a) **Records:**

Every person registered under Federal Excise Act, 2005 shall maintain and keep for a period of six years at his business premises or registered office in English or Urdu language the following records of excisable goods, namely:

- (i) records of clearances and sales made and the amount of the duty charged;
- (ii) records of goods purchased and the amount of the duty, if any, on purchases;
- (iii) records of goods cleared and sold without payment of duty;

- (iv) records of invoices, bills, accounts, agreements, contracts, orders and other allied business matters;
- (v) records of production, stocks and inventory;
- (vi) records of imports and exports; and
- (vii) such other records as may be specified by the Board.

(b) (i) **Non-fund banking services:**

Includes all non-interest based services provided or rendered by the banking companies or non-banking financial institutions against a consideration in the form of a fee or commission or charges.

(ii) **Franchiser:**

Means any person who enters into franchise and includes any associate of franchiser to enter into franchise on his behalf, and the term 'franchisee' shall be construed accordingly.

ADVANCED TAXATION Suggested Answers Final Examinations – Winter 2010

A.8

Kamyab Engineering Limited
 Computation of Sales Tax Payable/Refundable
 For the tax period November 2010

	<i>Rs. in '000</i>	
	Taxable Value	Sales Tax
Sales Tax Credit (Input Tax)		
Domestic purchases:		
– From registered persons	70,700	12,019
– From unregistered persons	-	-
Commercial imports @ (17+2) 19%	10,000	1,900
Electricity Bills	-	60
Gas Bills	-	21
Mobile Phone	-	26
Uniforms for line staff	-	-
		14,026
Less: Inadmissible / un-adjustable input tax (W-1)		(3,307)
Input tax for the month		10,719
Input tax on purchases outstanding for more than 180 days is presumed to be taken care of in October's return.		
Sales tax debit (output tax)		
Domestic supplies of manufactured goods:		
– to registered persons	40,000	6,800
– to unregistered persons	24,000	4,080
– Exempt goods	-	-
– Export to Malaysia	-	-
Supplies of imported goods (W-2)	12,560	2,135
Output tax for the month		13,015
Sales tax payable (13,015 – 10,719)		2,330
Input tax credit to be carried forward (13,015 - 2135) x 90% > (10,719 - 1900)		-
Refund claim (input consumed in export) (W-2)		1,791
Less:		
– Penalty		(50)
– Additional tax		(25)
Net amount refundable		1,716

Note:

If a registered person is liable to pay any tax, default surcharge or penalty payable under any law administered by the Board, the refund of input tax shall be made after adjustment of unpaid outstanding amount of tax or, as the case may be, default surcharge and penalty.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Winter 2010

W-1: Apportionment of input tax

	Gross value	Taxable Value	Sales tax
Domestic purchases from registered persons	70,700	70,700	12,019
Electricity bills	-	-	60
Gas bills			21
Mobile Phone bills			26
Residual input tax Total			12,126
Total sales of manufactured goods			88,000
Exempt supplies			11,000
Exports			13,000
Inadmissible tax on exempt supplies (11,000 ÷ 88,000 × 12,126)			1,516
Input tax on exports – to be claimed as a refund (13,000 ÷ 88,000 × 12,126)			1,791
Total inadmissible/ un-adjustable input tax			3,307
W-2:			
Commercial imports			12,500
Less: Markup on appliances sold on installment basis (2 ÷ 102 × 2,040)			(40)
			12,460
Add: Appliances provided to managing director			100
Value of commercial imports			12,560

(THE END)

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2010

A.1 (a)

BURQ ENTERPRISES

Personal status: Association of Persons
Residential status: Resident
Tax Year: 2010
Income year ending: June 30, 2010

Computation of taxable income and tax liability

		Trading	Consultancy Services
		Rupees in '000	
Net Sales of generators (574,200 / 1.16)		495,000	0
Receipt from consultancy services		0	55,000
Cost of sales	(W-1)	(350,000)	0
Gross profit		145,000	55,000
Administrative and selling expenses	(W-2)	(72,900)	(8,100)
Finance cost	(W-3)	(7,800)	0
Other Income	(W-4)	450	50
Net Income		64,750	46,950
Scheme of taxation		FTR	NTR
Rate of tax		4% of the value of goods	25% of the net income
Tax liability		16,520	11,738
Less: Tax deducted at source		(16,520)	(3,300)
Net tax payable		0	8,438

Rs. in '000

W-1: Cost of sales

Cost of sales of generators	429,520
Less: Inadmissible expenses	
Customs duty	0
Sales tax paid at import stage	(63,000)
Withholding tax paid on commercial imports (413.0 m x 4%)	(16,520)
	350,000

W-2: Administrative and selling expenses

As per profit and loss account	96,300
Less: Inadmissible expenses	
Withholding tax suffered on receipts from consultancy @6%	(3,300)
Salaries paid to Mr. and Mrs. Adil (500,000x2x12)	(12,000)
	81,000

W-3:

Finance cost	9,000
Less: Inadmissible expenses	
Interest paid on capital to Mrs. Adil	(1,200)
	7,800

W-4: Other Income

Fair market value of the equipment at the time of disposal	1,500
Less: WDV of the equipment at the time of disposal	(1,000)
Gain on disposal of asset	500

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2010

(b)

MR. ADIL

Personal status: Individual
Residential status: Resident
Tax Year: 2010
Income year ending: June 30, 2010

Computation of income and tax liability of Mr. Adil

	Rupees
Income from Business	
Share of profit from AOP for rate purposes only	(W-5) 22,875,000
Income from Property	
Rental income from the apartment (Fair market rent)	147,000
Non adjustable rent $[\{110,000 - [(85,000/10) \times 2]\} / 10]$	9,300
	156,300
Capital Gain	
Gain on sale of bonus shares	(W-6) 60,000
Total income including share of profit from AOP	23,091,300
Less: Property income taxable as a separate block	(156,300)
Income taxable at normal rates (including share from AOP)	22,935,000
Tax @25%	5,733,750
Tax Liability	
Tax payable calculated u/s 88 $(5,733,750 / 22,935,000 \times 60,000)$	15,000
Tax payable on property income $(156,300 - 150,000 \times 5\%)$	315
Total tax liability	15,315
W-5: Share of profit from AOP	Rupees
Net Income from AOP (NTR only)	46,950,000
Less: Salaries paid to partners	(12,000,000)
Interest paid to Mrs. Adil on capital	(1,200,000)
Total divisible profit	33,750,000
Share of Mr. Adil 50%.	16,875,000
Add: Salary received from partnership	6,000,000
Total share from AOP	22,875,000
W-6: Gain on sale of bonus shares	
Cost of original shares $(50,000 \times \text{Rs. } 150 \text{ each})$	7,500,000
Total number of original shares	50,000
Bonus issue in the ratio of 1:5	10,000
Total number of shares(Including bonus shares)	60,000
Cost per share $(7,500,000 / 60,000)$	125
Number of bonus shares sold $(10,000 \times 80\%)$	8,000
Consideration received for bonus shares $(\text{Rs. } 135 \times 8,000) \text{ Rs.}$	1,080,000
Cost of bonus shares sold $(8,000 \times \text{Rs. } 125)$	1,000,000
Gain on disposal of shares	80,000
Less: exempt amount – 25% of the gain	(20,000)
Taxable gain	60,000

Assuming that the entire share of profit of the partners is available to them for withdrawal, they are considered to have received the amount.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2010

A.2

BIG PHARMA LIMITED
Computation of income tax liability
For the tax year 2010

			<i>Rs. in 000'</i>
Accounting profit before taxation			17,150
Add: Inadmissible expenses:			
Accounting depreciation recorded in:			
▪ Cost of sales		3,200	
▪ Administrative expenses		800	
Provision for slow moving stock		1,300	
Demurrage		-	
Royalty		-	
Damages paid to distributors on breach of contract		-	
Provision for bad debts		1,100	
Small items of office equipments charged off		1,400	
Unrealized exchange loss		1,350	
Interest on foreign debt		1,300	
WWF as per accounts		350	
Loss from Oman branch		3,400	
Profit from Qatar branch		(2,700)	
Net loss from foreign source (to be carried forward for adjustment against foreign source income of the following tax year, if any.)		700	
			11,500
			28,650
Less: Admissible expenses:			
Tax depreciation		6,000	
Bad debts written off	(W-1)	300	
			(6,300)
Taxable income for the period			22,350
Less: brought forward tax loss			(6,100)
Taxable income			16,250
WWF	(W-2)		(350)
Net taxable income			15,900
			5,565
Tax @ 35%			350
WWF			5,915
Less: Tax deduction at source:			
by distributors		(2,450)	
on import of raw material		(2,000)	
minimum tax (C/F from 2009)		(450)	
taxes paid in Qatar (since 2,700x35%=945 Therefore)		(225)	
unadjusted foreign tax credit		-	
			(5,125)
Net Liability			790

Rs. in '000

W-1: Computation of bad debts written off:

Opening balance of provision for bad debt account	2,500
Add: provision during the year	1,100
	3,600
Less: Closing balance of provision for bad debt A/c	(3,100)
Debts written off during the year	500
Less: loan to Oman branch written off [W1(a)]	200
Bad debt written off allowed for tax purpose	300

<p>ADVANCED TAXATION Suggested Answers Final Examinations – Summer 2010</p>
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W-1a Since the loan to Oman branch had not been offered to tax as business income previously, the same could not be claimed as admissible deduction even if it is written off.

W-2 WWF

WWF is payable @ 2% of accounting profit before charging WWF or taxable income whichever is higher.

	Rs. in 000
Taxable income (Rs.)	16,250
Accounting profit (Rs. 17,150 + 350)	17,500

∴ 2% of accounting profit i.e. Rs. 350,000 is higher than 2% of taxable income i.e. 325,000.

A.3 (a) Returns:

Being a registered person, Mr. Furqan was required to file a nil /null return for each tax period irrespective of the fact that he did not carry out any taxable activity after the registration.

Failure of Mr. Furqan to file a return by the due date may result in imposition of penalty.

(b) De-registration:

Reasons for De-registration:

Mr. Furqan may be liable for deregistration due to any of the following reasons:

- (i) He ceases to carry on his business;
- (ii) His supplies have become exempt from tax;
- (iii) His taxable turnover during the last 12 months has remained below the threshold;
- (iv) He transfers or sells his business;
- (v) Merger with another person; or
- (vi) Failure to file tax return for six consecutive months.

Procedure of de-registration:

A registered person shall apply to the Local Registration Office (LRO), on the prescribed form, stating the reason(s) for the cancellation of his registration.

The LRO, upon completion of any audit or inquiry which may have been initiated consequent upon the application of the registered person for deregistration shall direct the applicant to discharge any outstanding liability which may have been raised therein by filing a final return.

The LRO may, after satisfaction, recommend to the Central Registration Office (CRO) to cancel the registration.

The registration shall be cancelled from such date as may be specified, but not later than three months from the date of application or the date all the dues outstanding against such person are deposited by him, whichever is later.

In case of the failure of a registered person for filing a tax return for the six consecutive months, the LRO may, after issuing a notice in writing and after giving an opportunity of being heard to such person and after satisfying itself that no tax liability is outstanding against such person, recommend to the CRO for the cancellation of the registration.

(c) Withholding agents:

Following persons are specified as withholding agents for the purpose of deduction and deposit of sales tax:

- (i) federal and provincial government departments;
- (ii) autonomous bodies;
- (iii) public sector organizations;
- (iv) where taxpayers fall in the jurisdiction of Large Taxpayers Units for the purpose of sales tax, federal excise duty or income tax; and

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2010

(v) recipients of services of advertisement, who are registered for sales tax.
Withholding agent includes the accounting office which is responsible for making payment against the purchases made by a government department.

A.4 (a) (i) Authors:

Where the time taken by an author of a literary or artistic work to complete the work exceeds twenty-four months, the author may elect to treat any lump sum amount received by the author in a tax year on account of royalties in respect of the work as having been received in that tax year and the preceding two tax years in equal proportions.

Therefore, Mr. Danishwar can spread the amount of Rs. 900,000 over the period of three years in equal proportions i.e. Rs 300,000 each starting from tax year 2010 to preceding two tax years 2009 and 2008.

(ii) Foreign-source income of returning expatriates:

Any foreign-source income derived by a citizen of Pakistan in a tax year who was not a resident individual in any of the four tax years preceding the tax year in which the individual became a resident shall be exempt from tax in the tax year in which the individual became a resident individual and in the following tax year.

Since, Mr. Bari became a resident in tax year 2009 the foreign source income derived in the tax year 2010 would be exempt from tax.

(iii) Transfers of assets:

Any income arising from any asset transferred by a person directly or indirectly to the person's spouse or minor child shall be treated as the income of the transferor.

The above provision shall not apply to any transfer made for adequate consideration.

However, a transfer shall not be treated as made for adequate consideration if the transferor has provided, by way of loan or otherwise, to the transferee, directly or indirectly, the funds for the acquisition of the asset.

Therefore, in this case, Rs. 840,000 received by Mrs. Ravi and Ashok will be included in the taxable income of Mr. Ravi.

(b) (i) Employee share scheme:

Where shares issued to an employee under an employee share scheme are subject to a restriction on the transfer of the shares -

- no amount shall be chargeable to tax to the employee under the head "Salary" until the earlier of -
 - ▲ the time the employee has a free right to transfer the shares; or
 - ▲ the time the employee disposes of the shares; and
- the amount chargeable to tax to the employee shall be the fair market value of the shares at the time the employee has a free right to transfer the shares or disposes of the shares, as the case may be, as reduced by any consideration given by the employee for the shares including any amount given as consideration for the grant of a right or option to acquire the shares.

The cost of the shares to the employee shall be the sum of -

- the consideration, if any, given by the employee for the shares;
- the consideration, if any, given by the employee for the grant of any right or option to acquire the shares; and
- the amount chargeable to tax under the head "Salary".

ADVANCED TAXATION Suggested Answers Final Examinations – Summer 2010

(ii) Tax Year 2008:

In tax year 2008 no income would be added to Mr. Hayat's salary as he did not have a right to transfer the shares.

Tax Year 2009:

In tax year 2009, when Mr. Hayat got the option to transfer the shares, the market value was Rs. 20 per share, therefore, Rs 120,000 (6000x Rs.20) would be added to his income.

Tax Year 2010:

In tax year 2010, following amount would be added to Mr. Hayat's income.

Consideration received on sale of shares	210,000
Less: Cost of shares (amount charged in 2009 to income)	<u>(120,000)</u>
Gain on sale to be taxed as income	<u>90,000</u>

A.5 (a) Bad Debts:

A person shall be allowed a deduction for a bad debt in a tax year if the following conditions are satisfied, namely:

- (i) The amount of the debt was:
 - previously included in the person's income from business chargeable to tax; or
 - in respect of money lent by a financial institution in deriving income from business chargeable to tax;
- (ii) the debt or part of the debt is written off in the accounts of the person in the tax year; and
- (iii) there are reasonable grounds for believing that the debt is irrecoverable.

The amount of the deduction allowed to a person for a tax year shall not exceed the amount of the debt written off in the accounts of the person in the tax year.

(b) (i) Recovers Rs. 200,000:

	Rupees
Total amount written off in the accounts	500,000
Less: amount allowed as deduction in tax year 2007	<u>(350,000)</u>
Excess amount disallowed	150,000
Less: amount recovered	<u>(200,000)</u>
Excess amount to be included in income of BL	<u>(50,000)</u>

(ii) Recovers Rs. 120,000:

	Rupees
Total amount written off in the accounts	500,000
Less: amount allowed as deduction in tax year 2007	<u>(350,000)</u>
Excess amount disallowed	150,000
Less: amount recovered	<u>(120,000)</u>
Short fall to be allowed as bed debt deduction	<u>30,000</u>

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2010

A.6 (a)

Olive Limited (OL)
Computation of Net Sales Tax Liability
For the tax period May 2010

Rs. in '000

SALES TAX CREDIT (INPUT TAX)	Gross Value	Taxable Value	Sales Tax
Domestic Purchases(excluding fixed assets) @16%	6,000	6,000	960
Imports excluding fixed assets including 2% VAT on commercial imports @ (16+2)18%	8,000	8,000	1,440
Imports excluding fixed assets-domestic consumption	15,000	15,000	2,400
Fixed Assets (Machinery) - to be credited 1/12	1,200	100	16
Fixed Assets (Vehicle) - Inadmissible	1,500	0	0
Service charges-clearing agent	125	125	20
Advertisement services	650	650	104
(-) Inadmissible input- exempt supplies- (W-1)			(1000)
Input Tax for the month			3,940
(+) Previous month credit brought forward			325
Accumulated credit			4,265
SALES TAX DEBIT (OUTPUT TAX)			
Domestic Supplies of manufactured goods	20,000	20,000	3,200
Exempt goods	4,000	0	0
Supplies of imported goods	10,000	10000	1,600
Exports	4,000	4,000	0
Output tax for the month			4,800
Less: Sales Tax deducted by withholding agent			(238)
Debit for the month			4,562
Sales tax withheld by the return filer as withholding agent (W-2)			164
Admissible credit (4,265or90% of 4,800 or 4,562 whichever is lower)			4,265
Sales Tax payable (4562-4265)+164			461
Excess un-adjusted credit			0
Refund claim (input consumed in export)- (W-1)			500
Balance credit to be carried forward			0

W-1: Apportionment of input tax

	Gross Value	Taxable Value	Sales Tax
----- Rs. in '000 -----			
Domestic Purchases(excluding fixed assets)	6,000	6,000	960
Imports excluding fixed assets-domestic consumption	15,000	15,000	2,400
Fixed Assets- to be credited 1/12	1,200	100	16
Service charges-clearing agent	125	125	20
Advertisement services	650	650	104
Residual input tax	TOTAL		3,500

	Rupees
Total sales other than sales out of imports	28,000
Exempt supplies	4,000
Inadmissible input tax (3,500*4,000/28,000)	(A) 500
Total sales other than sales out of imports	28,000

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2010

Export supplies		4,000
Inadmissible/ refundable input tax (3,500*4,000/28,000)	(B)	500
Total inadmissible input tax	(A) + (B)	1,000

W-2: Computation of sales tax withheld by a return filer as withholding agent

	<i>Rs. in '000</i>
Tax withheld from suppliers (given)	60
Tax withheld from payment of advertisement services	104
Total	164

A person who is a recipient of advertisement services is required to withhold and deposit the amount of sales tax mentioned on the invoice and where sales tax amount is not indicated, the recipient of advertisement services shall deduct and deposit the sales tax at the applicable rate.

(b)

Olive Limited (OL)
Computation of Special Excise Duty
For the tax period May 2010

	Gross Value	Taxable Value	SED
<i>Rs. in '000</i>			
SPECIAL EXCISE DUTY			
Goods chargeable to SED	20,000	20,000	200
(-) SED on inputs used in manufacturing of Goods supplied for domestic consumption (W-3)			(150)
(-) SED paid on goods used in manufacturing of Goods exported (drawback) (W-3)			(30)
Net SED payable			20
Total of sales tax and SED payable with return			481

W-3: Total Special Excise Duty

	Taxable Value	SED
<i>Rs. in '000</i>		
Domestic Purchases (excluding fixed assets)	6,000	60
Imports excluding fixed assets-domestic consumption	15,000	150
Special excise duty paid		210
SED on inputs used in manufacturing of goods supplied for domestic consumption (210/28,000*20,000)		150
SED paid on material used in manufacturing of Goods exported (drawback) (210/28000 * 4000)		30

As the special excise duty paid at the local or import stage is only adjustable against the special excise duty chargeable on the goods manufactured, therefore, the input paid for the manufacturing of exempt supply is not allowed to be adjusted, hence excluded as above.

A.7 (a) In the light of the provisions of Federal Excise Act, 2005, fill in the following blanks with the appropriate answers.

- (i) Every person who for any reason whatever has collected any duty in excess of the duty actually payable and the incidence of which has been passed on to the consumer, shall pay the amount so collected to the Federal Government.
- (ii) “Non-tariff area” means Azad Jammu and Kashmir, Northern Areas and such other territories or areas to which the Federal Excise Act does not apply.

ADVANCED TAXATION
Suggested Answers
Final Examinations – Summer 2010

- (iii) “Establishment” includes an undertaking, firm or company, whether incorporated or not, an association of persons and an individual.
- (iv) “Distributor” means a person appointed by a manufacturer in or for a specified area to purchase goods from him for sale to a wholesale dealer in that area.
- (b) (i) **Applicable value and rate of duty:**
The value and the rate of duty applicable to any goods or services shall be the value, retail price, tariff value and the rate of duty in force.
- in the case of goods, on the date on which the goods are [supplied] for export or for home consumption;
 - in the case of services, on the date on which the services are provided or rendered; and
 - in the case of goods produced or manufactured outside the areas to which this Act has been applied and brought to such areas for a sale or consumption therein, the date on which the goods are brought to those areas.
- (ii) **Supply:**
Supply includes sale, lease or other disposition of goods and shall include such transaction as the Federal Government may notify in the official Gazette from time to time.

(THE END)

ADVANCED TAXATION
Suggested Answers
Final examinations-Winter 2009

Ans.1

Ms. Saima

Computation of taxable income
For the Tax year- 2009

	Rupees
Income from salary	
Gross salary (500,000 x 12)	6,000,000
Bonus	1,000,000
Tax borne by the employer	200,000
Income from salary	(Note 1) 7,200,000
 Capital gain	 (Note 2)
Fair market value of the painting at the time of gift	1,000,000
Less: Cost of the painting to be taken as the fair market value at the time of its transfer to Saima	(500,000)
	500,000
Less: Exempt amount- 25% of the gain	(125,000)
	375,000
 Income from other sources	
Loan received from sister	(Note 3) 5,000,000
 Taxable Income	 <u><u>12,575,000</u></u>

Income from property - (separate block of income):

Forfeited deposit under the agreement for sale of land is covered by the definition of rent and thus, subject to final tax regime and not included in taxable income.

Under the non recognition rule no gain or loss is taken to arise on the disposal of an asset by reason of the transmission of the asset to an executor or beneficiary on the death of a person. Further, any gain on the sale of plot by Saima would not be taxable as it falls under the provincial jurisdiction.

FINAL TAX REGIME

Services rendered as a visiting faculty:

Since withholding tax was deducted from the payment of Rs. 470,000 made to Ms. Saima by the local engineering university, as a visiting faculty member, it shall not be included in the taxable income of Ms. Saima under any head of Income. The tax deducted thereon shall be treated as a final tax. However, Rs. 70,000 incurred by Ms. Saima towards these services shall not be allowable as an admissible deduction.

Prizes and winnings

The tax deducted on a prize won in quiz competition is subject to final tax and, therefore, the related income is not included in the taxable income.

Note 1

No exemption shall be allowed on medical allowance as she is also eligible for medical reimbursement under the terms of the employment. Such reimbursement is, however, not taxable.

Note 1.1

Where an employer agrees to pay the tax chargeable on an employee's salary, the amount of the employee's income chargeable under the head "Salary" shall be grossed up by the amount of tax payable by the employer.

Note 2

A gain arising on the disposal of a capital asset by a person in a tax year, other than a gain that is exempt from tax, shall be chargeable to tax in that year under the head "Capital gain".

No gain or loss is taken to arise on disposal of an asset by way of a gift provided that the gift is to a resident person.

ADVANCED TAXATION
Suggested Answers
Final examinations-Winter 2009

Since Saima's brother stayed in Pakistan for only two months in aggregate, he does not qualify to be treated as a resident person. Therefore, gain arising from the gift of the painting is taxable as capital gains in the hands of Saima.

Note 2.1

Where the capital asset becomes the property of the person by inheritance, the fair market value of the asset, on the date of its acquisition is treated to be the cost of the asset.

Note 3

Any amount received as a loan, advance, deposit or gift by a person in a tax year from another person (not being a banking company or financial institution) otherwise than by a crossed cheque drawn on a bank or through a banking channel from a person holding a National Tax Number *shall be treated as income chargeable to tax under the head "Income from Other Sources" for the tax year in which it was received.

Therefore the amount received by Ms. Saima from her sister would be chargeable to tax as income from other sources.

- Ans.2 (i) **Special procedure for the payment of sales tax by importers:**
Minimum value addition tax forms part of input tax and the importer is entitled to deduct the same from output tax due for the tax period.
- (ii) The value addition sales tax is not applicable on goods imported by a manufacturer for in-house consumption. As such, there will be no further tax liability on this account.
- (iii) Since SL did not claim adjustment of input tax in the relevant tax period, they can claim the same within a period of one year of the date of payment. However, SL should have informed the collector for the adjustment of the tax credit since it was not claimed within the relevant tax period. The collector may, after satisfying himself that input tax adjustment is due and admissible, allow SL to take such adjustment in the tax period as may be specified by him.
- (iv) **Adjustable input tax:**
Input tax paid on acquisition of fixed asset shall be adjustable against the output tax in twelve equal monthly installments. Therefore, SL should claim Rs 100,000 each month for twelve months.
- (v) Payment of utility bills is allowed to be made in cash even if the amount of transaction is in excess of Rs 50,000. SL was, therefore, entitled to claim the input tax credit in respect of the bills paid through cash.
- (vi) **Input tax:**
Sales tax paid under the Provincial Sales tax laws is covered by the definition of "input tax" and, therefore, adjustable against the output tax.
- In this case, SL was entitled to claim the adjustment of input tax paid on the advertisements, which were subject to sales tax under the Provincial sales tax.
- (vii) **Sale of taxable activity or transfer of ownership:**
Since Supreme Limited (SL), a registered person, acquired the business of textile products from another registered person, Sun Textiles (ST), as an ongoing concern, sales tax chargeable on taxable goods or part thereof shall be accounted for and paid by SL.

ADVANCED TAXATION
Suggested Answers
Final examinations-Winter 2009

Ans.3 (i) **Recouped expenditure:**

Recoument of an expenditure, in cash or in kind, can only be included in the income chargeable to tax, in the tax year in which it is received, if previously, the same has been allowed as a deduction in computing the taxable income. Since the expenditure incurred by PPL on marketing of a commercially imported product was never allowed as an admissible expense as it related to an income which was taxable under FTR, it cannot be added to the taxable income of the company at the time of its recoument.

- (ii) Expenses on account of "Travel fare" even if paid in cash, can be claimed as admissible deductions. Therefore, the company can claim the entire amount of Rs. 500,000 as admissible deduction.
- (iii) Any expenditure that provides an advantage or benefit for a period of more than one year is included in the definition of intangibles and is required to be amortized over the period of the expected benefit.

As such PPL would be allowed to charge only 1/3rd of the expense in 2009 which would be Rs. 30.0 million.

Ans.4 (a) **Entertainment Expenditure:**

Entertainment" means the provision of meals, refreshments, and reasonable leisure facilities in accordance with the tradition of business and subject to overall norms and customs of business in Pakistan.

A deduction for entertainment expenditure shall be limited to expenditure incurred wholly and exclusively for the purposes of the business and which is:

- (i) expenditure incurred outside Pakistan on entertainment in connection with business transactions or where such expenditure is allocated as head office expenditure;
- (ii) expenditure incurred in Pakistan on entertainment of foreign customers and suppliers;
- (iii) expenditure incurred on entertainment of customers and clients at the person's business premises;
- (iv) expenditure incurred on entertainment at a meeting of shareholders, agents, directors or employees; or
- (v) expenditure incurred on entertainment at the opening of branches.

(b) **Apportionment of expenditures:**

"Common expenditure" means expenditure that is not clearly allocable to any particular class or classes of income, such as general administrative and other such allocable expenditures.

- (i) Any common expenditure including financial expenses, excluding relatable or attributable to the non-business advances or loans and any expenditure incurred for a particular class or classes of income; relatable to business including presumptive and exempt income, shall be allocated to each class of income according to the following formula, namely:-

$$A \times B / C$$

Where

A is the amount of the expenditure incurred;

B is the total amount of gross receipts (without deduction of expenditures) for the tax year for the class of income; and

C is the total amount of gross receipts (without deduction of expenses) and net gains for the tax year of all classes of income.

- (ii) Where, however, net gain, brokerage, commission and other income is to be taken into account on turnover of such transactions, such income shall be compared with gross profit from business for adopting figures for components "B" and "C" of the formula above.

While allocating expenditures among different classes of income as per above, consideration shall be given to the nature and source of each class of income, on reasonable basis to earn each class of income (particularly, in allocating selling expenses).

ADVANCED TAXATION
Suggested Answers
Final examinations-Winter 2009

Ans.5

Fresh Stream Limited (FSL)
Computation of taxable income
Tax year 2009

	(Rupees in '000)			
	Exports	Imports	Local	Total
Sales	500,000	1,000,000	3,500,000	5,000,000
Less: Cost of sales				
Imported finished goods	-	300,000	-	300,000
Raw materials consumed during the year	125,000	-	875,000	1,000,000
Electricity & gas	37,500	-	262,500	300,000
Salaries, wages and other benefits	100,000	-	700,000	800,000
Local freight charges	12,500	-	87,500	100,000
Depreciation	62,500	-	437,500	500,000
Cost of goods manufactured / sold	337,500	-	2,362,500	2,700,000
Gross profit	<u>162,500</u>	<u>700,000</u>	<u>1,137,500</u>	<u>2,000,000</u>
Add: Inadmissible expenses				
Accounting depreciation	62,500	-	437,500	500,000
Withholding taxes paid on imports	-	9,800	-	9,800
Salaries & wages paid in cash inadmissible	7,500	-	52,500	60,000
Total inadmissible expenses	<u>70,000</u>	<u>9,800</u>	<u>490,000</u>	<u>569,800</u>
Less: Admissible expenses				
Tax Depreciation	54,348	-	380,435	434,783
Gross profit (adjusted for tax purposes)	<u>178,152</u>	<u>709,800</u>	<u>1,247,065</u>	<u>2,135,017</u>
Administrative & selling expenses (other than amortization expenses)	72,500	145,000	507,500	725,000
Amortization of export quota (Accounting)	25,000	-	-	25,000
Less: Inadmissible expenses				
Provincial tax based on profits is not admissible	50	100	350	500
Penalties due to non-compliance with laws	2,500	5000	17500	25,000
Accounting depreciation	7,500	15000	52500	75,000
Accounting amortization (export quota)	25,000	-	-	25,000
Total inadmissible expenses	<u>35,050</u>	<u>20,100</u>	<u>70,350</u>	<u>125,500</u>
Add: Admissible expenses				
Tax depreciation	6,522	13,043	45,652	65,217
Amortization of export quota (Tax)	37,500	-	-	37,500
Total admissible expenses	<u>44,022</u>	<u>13,043</u>	<u>45,652</u>	<u>102,717</u>
Tax adjusted administrative & selling expenses	106,472	137,943	482,802	727,217
Finance cost	25,000	50,000	175,000	250,000
Less: Interest expenses on finance lease	(1,000)	(2,000)	(7,000)	(10,000)
Add: Lease rentals	10,000	20,000	70,000	100,000
Tax adjusted finance cost	<u>34,000</u>	<u>68,000</u>	<u>238,000</u>	<u>340,000</u>
Net income	<u>37,680</u>	<u>503,857</u>	<u>526,263</u>	<u>1,067,800</u>
Add: Other income			500,000	
Less: Capital gains exempt from tax			(10,000)	
Taxable Income for the year			<u>1,016,263</u>	
Rate of tax	1%	3.50%	35%	
Gross tax liability	<u>5,000</u>	<u>9,800</u>	<u>355,692</u>	<u>370,492</u>

Allocation of Tax Depreciation Between Cost of Sales and Admin. and Selling expenses:

The tax depreciation would be allocated in the ratio of accounting depreciation as follows:

	Cost of Sales	Admin & Selling	Total
Accounting Depreciation	500,000	75,000	575,000
% of allocation	87%	13%	
Tax Depreciation	434,783	65,217	500,000

ADVANCED TAXATION
Suggested Answers
Final examinations-Winter 2009

Ans.6 (a)

Alpha Limited (AL)
Computation of net sales tax liability
For the tax period November 2009

	Value	Rate%	Sales tax
	Rs. in '000		Rs. in '000
Output Tax			
Supplies of own manufactured products	20,000	16%	3,200
Supplies of exempt manufactured products	2,000	-	-
Sale of commercially imported finished products	2,750	16%	440
Sale of imported third schedule items	7,500	16%	1,200
Supplies of locally produced third schedule items to wholesalers (30,000 × 250)	7,500	16%	1,200
Total output tax	39,750		6,040
Less: Sales return (3,000,000 – 1,000,000)	(2,000)	16%	(320)
Net output tax for the month	37,750		5,720
Input Tax			
Import of raw material for own consumption (10,000×110%)	11,000	16%	1,760
Commercial imports (2,000 x 110%)	2,200	18%	396
Import of third schedule items (1000x110%) (See Note)	1,100	18%	198
Local purchase of third schedule items (50,000×250)	12,500	16%	2,000
Total input tax relating to both exempt and taxable supplies			4,354
Less: input tax attributable to exempt supplies			(160)
Total input tax for the month			4,194
Sales tax payable with return			1,526

Note:

Third Schedule applies only to locally manufactured goods. Hence, even though items being imported fall in the category of Third Schedule, the principles do not apply. The principles of commercial importer would apply.

	Rs. in 000
Total supplies of manufactured goods	20,000
Exempt supplies	2,000
Total taxable and exempt supplies	22,000
Supplies of exempt manufactured products	2,000
Total input tax relating to exempt and taxable supplies (manufactured)	1,760
Input tax attributable to exempt supplies	
(Exempt supplies/total supplies) × common input tax (2,000 ÷ 22,000 × 1,760)	160

(b) **Alpha Limited (AL)**
Computation of federal excise duty
For the tax period November 2009

Output Tax	Value	Rate %	FED
	Rs. in '000		Rs. in '000
Manufactured products	6,000	10%	600
Less: Sales return debit/credit notes are available (3,000,000 – 2,000,000)	1,000	10%	(100)
Net output tax			500
Input Tax			
Import of raw material (4,000,000x110%)	4,400	10%	440
FED payable with return			60

ADVANCED TAXATION
Suggested Answers
Final examinations-Winter 2009

Ans.7 (a) **Records:**

A registered person making taxable supplies shall maintain and keep at his business premises or registered office in English or Urdu language the following records of goods purchased, imported and supplied (including zero-rated and exempt supplies) made by him or by his agent acting on his behalf in such form and manner as would permit ready ascertainment of his tax liability during a tax period-

- (i) records of supplies made shall indicate the description, quantity and value of goods, name and address of the person to whom supplies were made and the amount of the tax charged;
 - (ii) records of goods purchased shall show the description, quantity and value of goods, name, address and registration number of the supplier and the amount of the tax on purchases;
 - (iii) records of goods imported shall show the description, quantity and value of goods and the amount of tax paid on imports;
 - (iv) records of zero-rated and exempt supplies;
 - (v) double entry sales tax accounts;
 - (vi) invoices, credit notes, debit notes, bank statements, banking instruments in terms of section 73, inventory records, utility bills, salary and labour bills, rental agreements, sale-purchase agreements and lease agreements; and
 - (vii) such other records as may be specified by the Board.
- (b) Any person engaged in the production or manufacture of goods or providing or rendering services liable to duty of excise under the Excise Act shall, unless otherwise specified, be required to obtain registration in the prescribed manner regardless of his annual turnover or volume of sales of such goods or services.

A person who is already registered under the Sales Tax Act, 1990, shall not be required to take separate registration for excise purpose and his sales tax registration shall be deemed to be a registration for the purpose of Excise Act.

- (c) (i) **Goods:**
Goods means goods leviable to excise duty under the Excise Act or as specified in the First Schedule and include goods manufactured or produced in non-tariff area and brought for use or consumption to tariff area.
- (ii) **Wholesale dealer:**
Wholesale dealer means a person who buys or sells goods wholesale for the purpose of trade or manufacture, and includes a broker or commission agent who, in addition to making contracts for the sale or purchase of goods for others, stocks such goods belonging to others as an agent for the purpose of sale.
- (iii) **Adjudicating authority:**
Adjudicating authority means any authority competent to pass any order or decision under the Excise Act or the rules made there under, but does not include the Board or Appellate Tribunal.

(THE END)

Advanced Taxation
Suggested Answer
Final Examinations – Summer 2009

Ans.1 (a) **Thin capitalization Rule**

Where a “foreign controlled resident company” (other than a financial institution or a banking company) or a branch of a foreign company operating in Pakistan, has a foreign debt to foreign equity ratio in excess of three to one (3:1) at any time during a tax year, a deduction shall be disallowed for the profit on debt paid by the Company in that year on that part of the debt which exceeds the three to one ratio.

(b)

Joy Limited
Calculation Of Thin Capitalization

Accounting Year Tax Year	Rupees in million		
	31-12-2009 2010	31-12-2010 2011	31-12-2011 2012
(i) Foreign Debt:			
Existing loan from DSI			
Loan	300	250	200
Less: Repayment	50	50	50
Balance at year end	<u>250</u>	<u>200</u>	<u>150</u>
Maximum amount of existing foreign debt, due during the year	<u>300</u>	<u>250</u>	<u>200</u>
New foreign debt from DSI long term loan (To date position)	<u>1,250</u>	<u>5,000</u>	<u>5,000</u>
Amount of Foreign Debt (at any time in a tax year)	<u>1,550</u>	<u>5,250</u>	<u>5,200</u>
(ii) Foreign Equity of Joy Limited:			
Paid up capital owned by DSI & SWI (A)	500	500	500
Opening Retained earnings (B)	500	1,200	2,050
Proportionate share of DSI and SWI in profit for the tax year	700	850	1,000
Closing retained earnings	1,200	2,050	3,050
Total Foreign Equity of Joy Limited (A+B)	<u>1,000</u>	<u>1,700</u>	<u>2,550</u>
(Paid-up capital + opening Retained Earnings)			
(iii) Admissible / Inadmissible interest expense:			
Loan + Equity	2,550	6,950	7,750
Admissible foreign debt (ii x 3)	3,000	5,100	7,650
Amount in Excess of permissible limit	-	150	-
Interest expense	150	520	515
Admissible / Inadmissible interest expense	150	(15)	515

(c) **Loan from unrelated foreign company**

If Joy acquires a new loan from another foreign company not related to the Green Sea Group, than provisions of thin capitalization rule would not be applicable, provided that such other foreign company does not have similar outstanding debt obligation to DSI or SWI (i.e. foreign controller of Joy Limited) or a non-resident associate of the foreign controller..

ALTERNATIVE FOR FIRST SENTENCE OF THE ABOVE PARAGRAPHS

Thin capitalization rule is applicable only when a company acquires a foreign loan form a non-resident person (i.e. a foreign controller) or its associates.

Ans.2 (a) Triangle Limited can adjust the losses surrendered by ABC Limited against its income under the head “Income from Business” in the tax year and the following two tax years subject to the following conditions:

- (i) there is continued ownership of fifty-five percent of the share capital of ABC Limited for five years, if Triangle Limited is a listed company or seventy-five percent or more in the case of its being an unlisted company;
- (ii) Any of the company is not engaged in the business of trading.
- (iii) If Triangle Limited is an unlisted company with seventy-five percent of ownership of share capital of ABC Limited it should get itself listed within three years from the year in which loss is claimed;

Advanced Taxation
Suggested Answer
Final Examinations – Summer 2009

- (iv) The group companies are locally incorporated companies under the Companies Ordinance, 1984 (XLVII of 1984);
- (v) The loss surrendered and loss claimed under this section shall have approval of the Board of Directors of both the companies;
- (vi) The ABC Limited continues the same business during the said period of three years;
- (vii) All the companies in the group shall comply with such corporate governance requirements as may be specified by the SECP from time to time, and are designated as companies entitled to avail group relief; and
- (viii) Any other condition as may be prescribed.
- (b) ABC Limited may surrender its assessed loss for the tax year but shall not surrender capital loss or brought forward losses.

ABC Limited shall not be allowed to surrender its assessed losses for set off against income of the Triangle Limited for more than three tax years.

Where the losses surrendered by ABC Limited are not adjusted against income of Triangle Limited in the said three tax years, ABC Limited shall carry forward the unadjusted losses in accordance with the requirements of the provisions relating to carry forward of business losses.

Ans.3 (a)

Vakeel Associates
Personal status: Association of Persons
Residential status: Resident
National Tax Number: xxxxxxx-x
Tax Year: 2009
Income year ending: 30 June, 2009

Computation of taxable income and tax liability

	-----Rupees-----			
	Retainership fees	Fee from Thomas Associates	Other fees	Total
Gross receipt (Note 1)	10,000,000	2,500,000	13,250,000	25,750,000
Percentage (%)	38.8%	9.7%	51.5%	100%
Common expenses (Note 2)	(4,021,845)	(1,005,461)	(5,328,944)	(10,356,250)
Net income	5,978,155	1,494,539	7,921,056	15,393,750
Scheme of taxation	FTR	Exempt	NTR	
Rate of tax	6% of gross receipts	-	25% of net amount	
Tax liability	600,000	Nil	1,980,264	2,580,264
Less: Tax deducted at source	(600,000)	-	(50,000)	(650,000)
Net tax payable	-	-	1,930,264	1,930,264

Notes to the computation of income:

Note 1

Gross receipts

The gross receipts of the Firm are broadly classified into three categories:

- (i) Retainer ship fee from corporate clients;
- (ii) Fee from Thomas Associates; and
- (iii) Others

The reason for such classification is that; Receipts from Thomas Associates are exempt from tax pursuant to Clause (131) of Part I of the Second Schedule to the Ordinance. In terms of the said Clause, any income, by way of fees for technical services rendered outside Pakistan to a foreign enterprise under an agreement is exempt from tax, provided that such income is received in Pakistan

Advanced Taxation
Suggested Answer
Final Examinations – Summer 2009

Note 2

Apportionment of common expenses

The common expenses that are allocable to different classes of income on gross receipt basis are computed as follows:

Salaries expense	(Note 2.1)	6,600,000
Rental for office premises	(Note 2.2)	1,200,000
Tax depreciation	(Note 2.3)	2,406,250
Subscription fees payments	(Note 2.4)	Nil
Other expenses	(Note 2.5)	150,000
Total common expenses for apportionment		10,356,250

Note 2.1

Salary expense is computed as under:

Total salary expense		10,000,000
Less: Mr. & Mrs. Vakeel's salary (100,000 x 12 x 2)	2,400,000	
Bonus to employees	1,000,000	3,400,000
Common salary expense		6,600,000

Payment of salary to members of AOP is not an allowable deduction in accordance with section 21(j) of the Ordinance.

Bonus paid to employees on which tax has not been deducted is not an allowable deduction under section 21(c) of the Ordinance.

Note 2.2

Since an AOP is not a withholding tax agent for the purpose of section 155 of the Ordinance, rental for office premises amounting to Rs. 1,200,000 would not be disallowed on account of non-deduction of tax under section 21(c) of the ordinance.

Note 2.3

Tax depreciation in respect of the depreciable assets is computed as under:

Asset	Cost	Initial allowance	Reduced cost	Normal depreciation	Total depreciation
Furniture & Fittings	2,000,000	Nil	2,000,000	300,000	300,000
PCs & Laptops	1,600,000	800,000	800,000	240,000	1,040,000
Vehicle	2,400,000	Nil	2,400,000	360,000	360,000
Technical books	750,000	375,000	375,000	56,250	431,250
Structural improvements	500,000	250,000	250,000	25,000	275,000
Total	7,250,000	1,425,000	5,825,000	981,250	2,406,250

Furniture and fittings have been specifically excluded from the definition of eligible depreciable asset therefore; initial allowance would not be allowed on it.

Road transport vehicle is not within the ambit of section 21(j) of the Ordinance. Moreover, it does not qualify as an eligible depreciable asset for claiming initial allowance.

Technical books constitute eligible depreciable assets and accordingly an initial allowance and normal depreciation would be claimed in respect of the books.

Structural improvements are also eligible depreciable assets and therefore, both initial allowance and normal depreciation would be computed in respect of such improvements.

Advanced Taxation
Suggested Answer
Final Examinations – Summer 2009

Note 2.4

Payment for a transaction under a single account head which, in aggregate, exceeds Rs. 50,000 is required to be paid through banking channels. An exception to this principle is the payment of taxes, duties, fee, fines or any other statutory obligation. As payment made to Pakistan Bar Council does not represent a statutory obligation therefore, the same would be disallowed.

Note 2.5

Other expenses claimable for tax purposes is computed as under:

Other expenses – as per books	1,300,000
Less: Taxes charged off: 6% on retainer ship fee	(600,000)
1% on foreign receipts	(50,000)
Structural improvements	(500,000)
Other expense – claimable for tax purposes	150,000

Structural improvement to office premises is not allowable as an expense it constitutes a depreciable asset and hence depreciation is claimed in respect of the amount.

(b) **Computation of income and tax liability Mrs. Vakeel**

Mrs. Vakeel
Personal status: Individual
Residential status: Resident
National Tax Number: xxxxxx-x
Tax Year: 2009
Income year ending: June 30, 2009

Income from Business

Share of profit from the AOP for rate purposes only	(Note 1)	6,406,743
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Income from Property

Rental income from the Firm		1,200,000
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Capital gains

(i) Foreign source income:		
Shares of Fortune Inc. USA	(Note 2)	2,475,000
Total income (including share of profit from AOP)		10,081,743

Less: Rental income – taxable as a separate block		(1,200,000)
Income taxable at normal rates (including share from AOP)		8,881,743
Less: share of profit from AOP	(Note 3)	(6,406,743)
Amount taxable @ 25%		2,475,000

Tax liability

On rental income – Rs.72,500 + 15% of 200,000		102,500
On balance income – Rs.2,475,000 x 25%		618,750
Total tax liability		721,250

Less: Foreign tax credit (1000x80)	(Note 4)	80,000
Net tax payable for the year		641,250

Note 1

Share of Profit from the AOP

The share of profit from the AOP is computed as under:

Income from the AOP (5,978,155 + 1,494,539 + 7,921,056)	15,393,750
Tax liability of the AOP	<u>2,580,264</u>
Net income from the AOP	<u>12,813,486</u>
 Share of Mr. & Mrs. Vakeel- 50% each (equal share)	 <u>6,406,743</u>

Assuming that the entire share of profit of the members of AOP is available to them for withdrawal, they are considered to have received the amount.

Note 2

Computation of Capital gain on disposal of shares:

Consideration for shares (1,000 x 60 x 80)		4,800,000
Less: Cost of the shares (1,000 x 25 x 60)	(Note 2.1)	<u>(1,500,000)</u>
Gain on disposal of shares		<u>3,300,000</u>
Exempt amount – 25% of the gain	(Note 2.2)	<u>825,000</u>
Taxable gain		<u>2,475,000</u>

Note 2.1

Where the capital asset becomes the property of the person under a gift, bequest or will, the fair market value of the asset, on the date of its transfer or acquisition by the person shall be treated to be the cost of the asset.

Note 2.2

Where a capital asset has been held for a period of more than one year, the amount of any gain arising on disposal of the asset shall be restricted to 75% of such gain.

Note 3

Share of profit from the AOP

Share of profit from an AOP is exempt from tax in the hands of a member. However, such share of profit would be included in member's income for rate purposes only.

Note 4

Foreign tax credit

Foreign tax credit is allowed to the extent of an amount equal to lower of Pakistan tax or foreign income tax paid. Pakistan tax in respect of foreign source income is calculated by applying the "average rate of Pakistan income tax" to the net foreign source income for the year. Since the foreign tax liability in respect of sale of shares is lower (Rs.80, 000) it would be taken as a foreign tax credit.

Ans.4 (a) **Non-recognition rules (No gain or loss on disposal of assets)**

Under the following circumstances no gain or loss shall be taken to arise on the disposal of an asset:

- (i) between spouses under an agreement to live apart;
- (ii) by reason of the transmission of the asset to an executor or beneficiary on the death of a person;
- (iii) by reason of a gift of the asset;
- (iv) by reason of the compulsory acquisition of the asset under any law where the consideration received for the disposal is reinvested by the recipient in an asset of a like kind within one year of the disposal;
- (v) by a company to its shareholders on liquidation of the company, or
- (vi) by an association of persons to its members on dissolution of the association where the assets are distributed to members in accordance with their interests in the capital of the association.

The above conditions shall not apply where the person acquiring the asset is a non-resident person at the time of the acquisition.

(b) **Non-arm's length transactions**

Where an asset is disposed of in a non-arm's length transaction:

- (i) the person disposing of the asset shall be treated as having received consideration equal to the fair market value of the asset determined at the time the asset is disposed; and
- (ii) the person acquiring the asset shall be treated as having cost equal to the amount determined as above.

Ans.5 **Assessment of persons about to leave Pakistan**

Where any person is likely to leave Pakistan during the currency of tax year or shortly after its expiry with no intention of returning to Pakistan, he shall give to the Commissioner a notice to that effect not less than fifteen days before the probable date of his departure which in this case is July 10, 2009.

The aforesaid notice shall be accompanied by a return or returns of taxable income in respect of the period commencing from the end of the latest tax year for which an assessment has been or, where no such assessment has been made, a return has been made, as the case may be, and ending on July 10, 2009. The said period would be considered as distinct and separate tax year.

The taxable income shall be charged to tax at the rates applicable to the relevant tax year and all the provisions of the ITO, 2001 shall, so far as may be, apply accordingly.

- Ans.6 (a) The Federal Government is empowered to levy and collect in addition to the normal tax such extra amount of tax on any goods or class of goods and on such persons or class of persons, in such mode, manner and at time, and subject to such conditions and limitations as it may, by rules, prescribe.

The extra tax can be imposed up to a maximum of 16% in addition to the normal sales tax.

(b) **Payment of sales tax**

Sales tax shall be paid at the time of:

- Payment of custom duty in the case of import of goods; and
- Filing of sales tax returns in the case of supplies made in Pakistan

However, in case of electronic filing of sales tax return, where due date for filing the return has been prescribed as 15th of a month, the tax due shall be deposited by the 15th and the return shall be submitted electronically by 18th of the same month.

Ans.7 (a) **Input tax** in relation to a registered person, means

- (i) tax levied under the Sales Tax Act, 1990 on supply of goods to the person;
- (ii) tax levied under the Sales Tax Act, 1990 on the import of goods by the person;
- (iii) in relation to goods or services acquired by the person, tax levied under the Federal Excise Act, 2005 in sales tax mode as a duty of excise on the manufacture or production of the goods, or the rendering or providing of the services;
- (iv) provincial sales tax levied on services rendered or provided to the person; and
- (v) levied under the Sales Tax Act, 1990 as adapted in the State of Azad Jammu and Kashmir, on supply of goods received by the person;

Output tax, in relation to a registered person, means:

- (i) tax levied under the Sales Tax Act, 1990 on a supply of goods, made by the person;
- (ii) tax levied under the Federal Excise Act, 2005 in sales tax mode as a duty of excise on the manufacture or production of the goods, or the rendering or providing of the services, by the person;
- (iii) provincial sales tax levied on services rendered or provided by the person.

(b) **Requirements for claiming input tax**

(i) Following are the conditions that needs to be satisfied for the adjustment of input tax against the output tax liability:

1. Input tax paid or payable during the tax period for the purpose of taxable supplies made or to be made is deductible from the output tax that is due in respect of that tax period provided that where a registered person did not deduct input tax within the relevant period,
 - he may claim it in the return for any six succeeding tax periods; or
 - may file a revised return, subject to the approval of collector of sales tax, within 120 days of the filing of original return; or
 - the collector may, after satisfying himself that input tax adjustment is due and admissible, allow the registered person to take such adjustment in the tax period as specified by the collector.
2. In order to claim input tax, the taxpayer in each of the following cases must hold in his name, bearing his sales tax registration number,
 - in case of local purchases, a valid tax invoice
 - in case of imported goods, a bill of entry or goods declaration, duly cleared by the customs under the Customs Act.
 - in case of goods purchased in auction, a treasury challan
3. Input tax may also be claimed if allowed by the Federal Government, by a special order, or by a Gazette notification, subject to such conditions, limitations or restrictions as may be specified therein.

(ii) In the following cases a registered person shall not be entitled to reclaim or deduct input tax.

- Tax on goods or services used or to be used for any purpose other than for taxable supplies made or to be made
- Extra tax levied under Section 3(5)
- Tax on goods or services in respect of which sales tax has not been deposited into the government treasury by the supplier
- On fake invoices
- On purchases made by such person who fails to furnish the information required by the FBR
- Such proportion of the input tax which is attributable to non-taxable supplies
- Tax on such goods or services which the Federal Government may specify through a Gazette notification
- Tax on goods which cannot be supplied to a non registered person, as specified by the federal government by way of a Gazette notification
- If the payment against purchases exceeding Rs. 50,000 is not made through proper banking channel.
- Tax on gifts and give aways.
- If payment in case of a transaction on credit is not made within one hundred and eighty days of issuance of the tax invoice.

Ans.8 **Conditions to be fulfilled for the adjustment of duties of excise**

Adjustment of excise duty shall be admissible only if FPL is registered under the FEA, 2005 and holds a valid proof to the effect that they have paid the price of perfumes purchased including the amount of duty and received the price of finished goods sold by them including the amount of duty through banking channels including online payments whether through credit card or otherwise.

Ans.9 (a) **Persons responsible to pay duty of excise**

The liability to pay duty of excise shall be:

- i. in case of goods produced or manufactured in Pakistan, of the person manufacturing or producing such goods;
- ii. in case of goods imported into Pakistan, of the person importing such goods;
- iii. in case of services provided or rendered in Pakistan, of the person providing or rendering such service provided where services are rendered by the person out of Pakistan, the recipient of such service in Pakistan shall be liable to pay duty; and
- iv. in case of goods produced or manufactured in non-tariff areas and brought to tariff areas for sale or consumption therein, of the person bringing or causing to bring such goods to tariff areas.

(b) **Invoices**

A person registered under Act shall issue for each transaction a serially numbered invoice at the time of clearance or sale of goods, including goods chargeable to duty at the rate of zero per cent, or providing or rendering services containing the specified particulars.

Where a registered person is also engaged in making supplies taxable under the Sales Tax Act, 1990, such person shall not be required to issue a separate invoice for excise purposes and the amount of excise duty and other related information may in such cases be mentioned on the invoice issued for sales tax purposes.

- (c) Franchise means an authority given by franchiser under which the franchisee is contractually or otherwise granted any right to produce, manufacture, sell or trade in or do any other business activity in respect of goods or to provide service or to undertake any process identified with franchiser against a fee or consideration including royalty or technical fee, whether or not a trade mark, service mark, trade name, logo, brand name or any such representation or symbol, as the case may be, is involved.

(The End)

ADVANCED TAXATION
Suggested Answers
Final Examinations - Winter 2008

Ans.1 (a) The tax paid on import of raw material and plant shall be adjustable because SSPL meets the following conditions:

- It is an industrial undertaking
- Raw material and plant shall be imported for its own use

The tax paid on import of finished goods shall be treated as final tax.

(b) Initial depreciation shall be admissible on the plant as it will be put into service for the first time, in Pakistan.

The normal depreciation on the plant would be admissible on the written down value of the plant. In the first year, it has to be computed on the amount of cost less initial allowance.

(c) Interest paid by SSPL would be Pakistan-source income of SSI, as it fulfils the criteria of being paid by a resident person for its business in Pakistan. Therefore, SSPL will have to deduct tax on payment of interest to SSI. With reference to the provisions of double tax treaty.

Since SSPL is a foreign controlled company, the admissibility of interest expense will be made in accordance with *thin capitalization rule*. Under this rule, SSPL will not be allowed to claim interest expense attributable to the amount of foreign debt which is in excess of three times of the foreign equity.

(d) Interest income of SSI shall be taxable in Pakistan because it is Pakistan-sourced as it is paid by SSPL i.e. a person who is resident in Pakistan* / borne by a permanent establishment of non-resident in Pakistan. Reference should be made to the double tax treaty.

Ans.2 (a) For a non-resident person, a representative shall be any person in Pakistan,

- (i) who is employed by the non-resident person;
- (ii) who has any business connection with the non-resident person;
- (iii) from whom the non-resident person is in receipt of any income;
- (iv) who holds, or controls the receipt or disposal of any money belonging to the non-resident person;
- (v) who is the trustee of the non-resident person; and
- (vi) who is declared by the Collector to be representative of the non-resident person.

(b) Every representative is personally liable for the payment of any unpaid tax of the registered person if the representative -

- (i) alienates, charges or disposes of any moneys received or accrued in respect of which tax is payable; or
- (ii) disposes of or parts with any moneys or funds belonging to the registered person that are in possession of the representative or which comes in the possession of the representative after the tax is payable, if such tax could legally have been paid from or out of such money or funds.

ADVANCED TAXATION
Suggested Answers
Final Examinations - Winter 2008

Ans.3

	Basis	Manufacturing	Imported FG	Export	Total
		-----Rupees-----			
Sales	Actual	924,306,539	* ⁵ 128,473,364	* ⁷ 24,405,541	1,077,185,444
Cost of goods sold		* ² (540,167,831)	* ¹ (111,715,969)	* ⁶ (13,991,500)	(665,875,300)
Gross profit		384,138,708	16,757,395	10,414,041	411,310,144
Admin expenses	Sales	(145,404,256)	(20,210,366)	(3,839,278)	(169,453,900)
Distribution & marketing	Sales	(32,506,395)	(4,518,205)	-	(37,024,600)
Financial charges (excluding premium on PIB)	Sales	(719,582)	(100,018)	(19,000)	(838,600)
Amortization of premium on PIB	Actual	(70,900)	-	-	(70,900)
Other income:					
Return on PIB	Actual	3,480,000	-	-	3,480,000
Scrap sales	Manufacturing	972,400	-	-	972,400
Duty draw back on exports - exempt	* ⁸ Exempt	-	-	-	-
Bad debts recovered	* ³ Sales	23,793	3,307	-	27,100
Add: Inadmissible deduction/admissible income					
Prov. for slow moving stocks	Sales	5,320,898	739,574	140,494	6,200,966
Provision for bad debts	* ³ Sales	199,672	27,753	-	227,425
Acc. dep. - manufacturing	actual	10,338,700	-	-	10,338,700
Acc. dep. - distribution & mark.	Sales	1,879,904	261,296	-	2,141,200
Acc. dep. - admin	Sales	4,081,265	567,273	107,762	4,756,300
Less: Admissible deduction/inadmissible income					
Bad debts written off	* ³ Sales	(33,526)	(4,660)	-	(38,186)
Stocks written off	Sales	(314,168)	(43,668)	(8,295)	(366,131)
Tax depreciation- (w-1)	Acc. dep.	(48,495,774)	(2,465,178)	(320,617)	(51,281,569)
Taxable income		182,890,739	(8,985,497)	6,475,107	180,380,349

W-1: Allocation of tax depreciation on the basis of accounting depreciation

	Manufacturing	Imported FG	Export	Total
	-----Rupees-----			
Acc. dep. - manufacturing	10,338,700	-	-	10,338,700
Acc. dep. - distribution & mark.	1,879,904	261,296	-	2,141,200
Acc. dep. - admin	4,081,265	567,273	107,762	4,756,300
	16,299,869	828,569	107,762	17,236,200
Tax depreciation	(48,495,774)	(2,465,178)	(320,617)	(51,281,569)

*¹ $127,721,264 \times 100/115 + 752,100 \times 100/115$

*² balancing

*³ Export sales were made on confirmed L/C. Therefore, effect of provision, recovery and write off of bad debts has not been taken on export sales.

*⁴ Marks shall also be allowed if it is ignored in the calculation.

*⁵ Imported finished goods = $127,721,264 + 752,100 = 128,473,364$,

*⁶ $14,645,500 - 752,100 \times 100/115 = 13,991,500$

*⁷ Export = $25,157,641 - 752,100 = 24,405,541$

Computation of gross tax liability

	Rupees
Tax on manufacturing income ($182,890,739 \times 35\%$)	64,011,759
Tax on finished goods ($111,715,969 \times 5\%$)	5,585,798
Export sales ($24,405,541 \times 1\%$)	244,055
Gross tax liability	69,841,612

Note: WWF may be ignored in the above calculations.

ADVANCED TAXATION
Suggested Answers
Final Examinations - Winter 2008

Ans. 4 (a) The tax paid at the import stage is considered to be the final tax on the income of the importer.

However, Since Mr. Akhtar is planning to start a large scale import and retail business, his business income may be subject to tax under normal tax regime if he fulfills the following conditions applicable to large import house:

- His business paid up capital exceeds Rs. 100 million;
- His imports exceeds Rs. 500 million during the tax year;
- Own total assets of his business are more than Rs. 100 million at the close of the Tax Year;
- He maintains computerized records of imports and sales of goods;
- He maintains a system for issuance of cash receipts on all (100%) the sales;
- He presents accounts for tax audit every year; and
- He is registered with the Sales Tax Department.

- (b)**
- (i) Mr. Akhtar shall not be required to register each outlet separately.
 - (ii) A person supplying goods to both the general body of consumers and to the wholesalers, shall be classified as a retailer in respect of supply of goods to the general public for the purposes of consumption.
 - (iii) In his case, the condition that the collection against sale shall be made through banking channel shall not apply and he can claim input tax on all sales.

Ans5 (i) Re-imburement of business expenditure does not attract withholding tax provision as they were incurred outside Pakistan.

(ii) Payment to debtor

Section 101(14) provides that any payment by a resident person to a non-resident person not specifically dealt with in section 101 shall be treated as Pakistan-source income of non-resident person. Therefore, general rate of withholding tax of 30% would be applicable on such payment unless a permission is obtained from the Commissioner for non-deduction of tax.

Where a non-resident person provides independent services including professional services any remuneration paid to him by a resident shall be treated as Pakistan source and tax shall be deducted thereon.

- (iii)** The 'rights to manufacture goods' is in the nature of intangible assets and is not covered under the definition of 'goods'. Therefore any payment on account of 'rights' cannot be treated as payment on account of 'goods' and is not subject to withholding tax under section 153 of the Income Tax Ordinance.
- (iv)** The Director Finance's total salary whether paid in or outside Pakistan, is chargeable to tax in Pakistan. In this case, the company will have to pay the tax from its own resources and then recover it from the employee.

Ans.6 (a) For the purposes of determining net liability of duty in respect of any goods, the duty already paid on dutiable goods used directly as input goods for the manufacture or production of such goods are deducted from the amount of duty calculated on such goods.

The aforesaid adjustment is admissible only if the registered person holds a valid proof to the effect that he has paid the price of goods purchased by him including the amount of duty and received the price of goods sold by him including the amount of duty through banking channels which includes online payment through credit card or otherwise.

Duty paid on goods exported out of Pakistan, shall also be adjustable.

ADVANCED TAXATION
Suggested Answers
Final Examinations - Winter 2008

(b) (i) Capital Assets

Capital asset means property of any kind held by a person, whether or not connected with a business, but excludes

- (a) Any stock-in-trade (not being stocks and shares), consumables stocks or raw materials held for the purpose of business;
- (b) Depreciable assets both tangible and intangible;
- (c) Immovable property
- (d) Movable property held for personal use, by the person or member of his family

(ii) Valuation of Capital Assets

No amount shall be included in the cost of a capital asset which is

- Deductible or deducted from income under any provision of the Income Tax Ordinance; or
- Any expenditure disallowed under section 21.

The fair market value of the asset on the date of its transfer or acquisition shall be treated to be the cost of the asset if the capital asset becomes the property of a person:

- (a) under a gift, bequest or will;
- (b) succession inheritance or devolution, or
- (c) distribution of assets on dissolution of an AOP or liquidation of a company,

(iii) Capital Gains

A gain arising on the disposal of a capital asset by a person in a tax year, other than a gain that is exempt from tax, shall be chargeable under the head capital gains.

Capital gain is computed in accordance with the following formula:

$$A - B$$

Where:

A = Consideration received by person on disposal of the asset

B = Cost of the asset

Where the capital asset has been held by a person for more than one year, the amount of gain on disposal shall be restricted to 3/4 of the gain.

(iv) Adjustment of Capital loss against capital gains

While computing the amount of capital gain any loss on disposal of capital asset shall be allowed to be deducted from such capital gain subject to the following:

- (i) gain on the disposal of such capital asset is chargeable to tax
- (ii) the loss is not related to following capital assets:
 - (a) a painting, sculpture, drawing or other work of art.
 - (b) jewellery
 - (c) a rare manuscript, folio or book
 - (d) a postage stamp or first day cover
 - (e) a coin or medallion; or
 - (f) an antique

- Ans. 7** (i) Where a person has made any investment or is the owner of any money or valuable article and offers no explanation about the nature and source of the investment or the explanation offered by him, in the opinion of the Deputy Commissioner, is not satisfactory, the value of the investment, shall be included in the person's income chargeable to tax under the head "Income from Other Sources" to the extent it is not adequately explained provided approval of the inspecting Additional Commissioner has been obtained.

Valuation of assets

The valuation of immovable property for the purposes of section 111 of the Income Tax Ordinance 2001, shall be taken to be, in the case of properties given on rent, the value equal to ten years annual rental value.

ADVANCED TAXATION
Suggested Answers
Final Examinations - Winter 2008

- (ii) Any amount received as a loan, advance, deposit for issuance of shares or gift by a person in a tax year from another person (not being a banking company or financial institution otherwise than by a crossed cheque drawn on a bank or through a banking channel from a person holding a National Tax Number shall be treated as income chargeable to tax under the head “Income from Other Sources” for the tax year in which it was received.

Therefore, the amount received in cash by Mr. Bilal can be treated as income, in the tax year 2004.

- (iii) Any amount of foreign exchange remitted from outside Pakistan through normal banking channels, that is encashed into Pakistani rupees by a scheduled bank and a certificate from such bank is produced to that effect, shall not be treated as an unexplained credit or insufficient explanation.

As the amount received by Mr. Bilal from his father fulfils the conditions stipulated in the above section it cannot be treated as concealment/income.

- Ans.8** (i) Under the amended provisions of Sales Tax Act of 1990, self-consumption of goods not produced or manufactured but acquired for trading or other wise, is not deemed to be “supply” and therefore not chargeable to tax. Consequently input tax relating to such products is not deductible. Sales Tax is chargeable on self-consumption of only manufactured products and input tax relating thereto is also deductible.
- (ii) The ‘sale price’ of the product sold includes the cost of parts, if any, to be supplied during the warranty period, therefore it is not considered as a ‘separate supply’ and hence no sales tax is chargeable at the time of disposal of ‘parts’ to meet the warranty claim.
- (iii) Sales Tax Rules, 2006 disallow the claim of input tax where the goods have been returned by the buyer on the grounds that such goods are not fit for consumption.

However, as per the provisions of Sales Tax Act 1990, where the goods, in respect of which input tax has been paid at the time of their acquisition and are intended to be used in making taxable supplies, then the Act does not prohibit the adjustment of such input tax against output tax for the relevant tax period. Therefore input tax already claimed cannot be disallowed as there is no prohibition under the law.

- (iv) The definition of “supply” under the Ordinance includes such goods which are put to private, business or non-business use. In this manner, 'intermediary goods' such as diesel also become taxable as these goods are used in production of taxable supplies.

Therefore input tax paid on HSD is allowable to the extent it is used in producing electricity which was ultimately used in the production of taxable supplies.

However, input tax on diesel relating to generation of electricity used for administrative purposes cannot be adjusted from output tax.

- (v) Value of taxable service shall be the total consideration or charges received by the customs agent for providing and rendering the services to Zeta Pakistan Limited excluding the amount of sales Tax and such other reimbursable expenses which he pays on behalf of his client against a proper receipt on invoice or bill.

(The End)

Advanced Taxation
Suggested Answer
Final Examinations – Summer 2008

Ans.1

Mr. Jahangir
Computation of Taxable Income
For the Tax Year 2008

	Rupees	Reasons for Treatment
Income from Salary		
Basic Salary	900,000	
Rent free furnished accommodation (45% of basic salary)	405,000	
Amount Chargeable to tax		
Fair market value on the date of issue	350,000	
Less: Amount paid on grant of option	(100,000)	
Less: Amount paid on date of issue	(200,000)	
	50,000	
	1,355,000	
Income from Capital Gain		
Sale of Shares (Gross)	373,000	
Less: Fair market value on the grant of issue	350,000	23,000
		Since the parent company is not listed in Pakistan, it is not a public company and therefore the capital gain is taxable.
Income from Business		
Profit from business	850,000	
Profit from sale of fixed assets (Rs. 2,600,000 - Rs. 2,200,000)	400,000	1,250,000
		[Section 95] Since the company to which assets have been transferred is exempt from tax, all gains on sale of fixed assets are taxable.
TAXABLE INCOME	2,628,000	

Note: value of option granted is not taxable.

Mrs. Jahangir
Computation of Taxable Income
For the Tax Year 2008

	Rupees	
Income from House Property (Rs.50,000 x 3)	150,000	Since Mrs. Jahangir is deriving income from other heads, rent received shall be chargeable to tax.
TAXABLE INCOME OF MRS. JAHANGIR	150,000	

Note: Tax deducted on dividend shall be treated as full and final and therefore dividend shall not be included in taxable income.

New Company
Computation of Taxable Income
For the Tax Year 2008

	Rupees
Profit of the company up to June 30, 2008	350,000
Less: Rent (Rs. 50,000 x 3)	(150,000)
	200,000

Advanced Taxation
Suggested Answer
Final Examinations – Summer 2008

Ans.2 (a) The taxable income accruing to Crown Enterprises as a result of such transaction is given below:

	Rs. in million	Reference Note
Gain on sale of land	Nil	(a)
Gain on sale of building	10	(b)
Gain on sale of plant and machinery	30	
Gain on sale of goodwill	120	(c)
Receipt against agreement to refrain from doing similar business	50	(d)
	210	

- (a) Unimproved land is not a depreciable asset. Moreover, it has also been specifically excluded from the definition of capital assets and therefore any gain on sale of land would not be taxed.
- (b) Building is depreciable asset and therefore its gain is taxable. However, since the consideration received on its disposal exceeds the cost, it has been taken as equal to cost.
- (c) Amount received in excess of fair value of tangible assets i.e. Rs. 120 million is goodwill. Goodwill is a capital asset. In this case it has been generated in the normal course of business and the seller has not paid any price for it. Hence its book value is NIL. Therefore, the whole amount of goodwill will be taxed as capital gain.
- (d) Consideration received for agreeing not to compete in the business activity is a receipt and shall be taxed as a capital gain. (The contention that it is a capital receipt and therefore exempt from tax is also a correct treatment)

(b) Withholding tax obligations

Land	It cannot be classified as “goods” and hence no tax is to be deducted.
Building	It cannot be classified as “goods” and hence no tax is to be deducted.
Inventory	These are “goods” and hence tax will be deducted @ 3.5%.
Plant and machinery	These shall be classified as “goods” and tax shall be deducted @ 3.5%.
Other assets	No tax will be deducted as they do not fall in the category of goods.
Good will	No tax will be deducted as it does not fall in category of goods.
Receipts against agreement to refrain from carrying out similar business	No tax will be deducted as it does not fall in category of goods.

Ans.3

ALTERNATE 1

Computation of Taxable Income

Holdings Limited

For the Tax Year 2008

	Rupees	
Total income under NTR (Rs. 4,115.16 million + Rs. 93.35 million)	4,208.51	W-1
Tax on taxable income @ 35%	1,473.00	
Tax on imports (covered under FTR)	153.00	
Less: Tax Credit on income from AOP (Rs. 80 / Rs.200 x Rs. 50)	(20.00)	
Less: Taxes paid u/s 147	(1,200.00)	
Less: Taxes u/s 153 on supply of good relating to manufacturing	(147.00)	
Less: Tax paid on imports	(153.00)	
Tax payable	106.00	

**Advanced Taxation
Suggested Answer
Final Examinations – Summer 2008**

Note:

An amount paid to commodity exchange for hedging is an allowable expense and therefore no adjustment is required for this amount.

No foreign tax credit shall be allowed on indenting commission because it is related to income which is covered under FTR.

Note: W-1 is common for both the alternatives i.e. 1 and 2 and are given after Alternative 2

ALTERNATE 2

Holdings Limited
Computation of Taxable Income
For the Tax Year 2008

	Rs. in million
Accounting profit before taxation	5,400.00
Add: Inadmissible deduction / Admissible Income	
Amortization of intangible assets	4.00
Provision for bad debts	6.00
Share of AOP received	80.00
	90.00
Less: Admissible deduction / Inadmissible Income	
Allowed amortization of intangible assets (Rs. 4 m / 10 yrs x 15 yrs)	6.00
Bad debts written off (Rs. 20.8m + Rs. 6m - Rs. 18.4m)	8.40
Share of AOP received	60.00
Indenting commission (Subject to FTR) (W-1)	11.16
Income attributable to sale of local products subject to FTR	23.34
Income attributable to imported products subject to FTR	1,172.59
	1,281.49
Taxable Income	4,208.51
Tax on taxable income @ 35%	1,473.00
Tax on imports (covered under FTR)	153.00
Less: Tax Credit on income from AOP ($80 / 200 \times 50$)	(20.00)
Less: Taxes paid u/s 147	(1,200.00)
Less: Taxes u/s 153 on supply of good relating to manufacturing	(147.00)
Less: Tax paid on imports	(153.00)
Tax payable	106.00

Note:

An amount paid to commodity exchange for hedging is an allowable expense and therefore no adjustment is required for this amount.

No foreign tax credit shall be allowed on indenting commission because it is related to income which is covered under FTR.

**Advanced Taxation
Suggested Answer
Final Examinations – Summer 2008**

W -1	Allocation Basis	Manufactured Products	Imported Products	Locally Purchased Products	
				Limited Companies	Others
Sales Ratio		70%	17%	2.6%	10.4%
Sales to Limited Companies		4,200.00	1,020.00	780.00	
Sales to Others (incl. indenting commission)		16,800.00	4,080.00		3,120.00
Total Sales		21,000.00	5,100.00	780.00	3,120.00
Gross Profit		6,180.00	2,040.00	156.00	624.00
Less: Adjustment of amortization	Direct cost	(2.00)	-	-	-
Adjusted GP		6,178.00	2,040.00	156.00	624.00
Allocation of selling and admin costs Other than Bad Debts	Sales Value	(2,095.80)	(508.98)	(77.84)	(311.38)
Bad debts written off	Sales Ratio	(5.88)	(1.43)	(0.22)	(0.87)
		(2,101.68)	(510.41)	(78.06)	(312.25)
Finance Costs	Sales Ratio	(840.00)	(204.00)	(31.20)	(124.80)
Other expenses	Sales Ratio	(630.00)	(153.00)	(23.40)	(93.60)
Other income		1,500.00	-	-	-
Adjustment of AOP share (60 × 25 ÷ 75)		20.00	-	-	-
Adjustment of Indenting Commission		(11.16)	-	-	-
		1,508.84	-	-	-
Taxable Income		4,115.16	1,172.59	23.34	93.35
Taxable under		NTR	FTR	FTR	NTR

Ans.4 Since the appeal has only been accepted partially, the Income Tax Department is justified in asking for additional tax.

However, since the demand has been reduced by 60% the additional tax claimed from the client should accordingly be reduced.

- Ans.5**
- (a) The Unit Trust is exempt from tax if the 'Accounting Income' of the Unit Trust for the year is distributed to the Unit-Holders to the extent of 90 percent. For the purposes of determining the threshold of 90%, income by way of capital gains shall be excluded.
 - (b) The income of the Asset Management Company (management fee less relevant expenses) would be taxable under the normal law at the rate of tax applicable to listed companies.
 - (c)
 - All taxpayers other than a company, shall be subject to final tax at the rate of 10% unless the recipient of dividend is exempted from tax.
 - Dividend income for any company is now subject to tax under the normal law. Hence the dividend received by a banking company will be subject to tax at the rate of 10%, but provisions of withholding tax shall not apply to it.

**Advanced Taxation
Suggested Answer
Final Examinations – Summer 2008**

- A unit trust whether listed or not is considered to be a public company within the meaning of ITO-2001. Capital gain on sale of shares of public company is exempt from tax.
- The capital gain to a banking company shall be taxed as follows:
 - In case of sale of units within one year 35%*
 - In case of sale of units after one year 10%*

Ans.6 (a)

	Rupees
Cost of the machine	20,000,000
Depreciation for tax year 2006	2,000,000
WDV on June 30, 2006	18,000,000
Depreciation for tax year 2007	1,800,000
WDV on June 30, 2006	16,200,000
Depreciation for tax year 2008	-
WDV on March 31 when transfer was made	16,200,000

- (b)** In the given situation, the **Cost of Machine** i.e Rs. 20.0 million will be treated to be the sales proceeds for the purpose of computing gain / loss on sale, for tax purposes.

Ans.7

**Shahid Limited
Computation of Sales Tax Payable
For the tax period March 2008**

	Rupees
Output Tax	
Sales tax on sale of shampoo (5,000 x Rs. 110 x 15%)	82,500
Exports to Azerbaijan	-
Local sales of hair oil (6,000 x Rs. 350 x 15%)	315,000
Total Output Tax	397,500
Input Tax	
Sales tax on purchase of shampoo (5,000 x Rs. 110 x 15%)	82,500
Sales tax paid on import of hair oil	
Rupees	
Import value (10,000xRs. 400)	4,000,000
Custom duty (10,000 x Rs. 20)	200,000
Value for sales tax	4,200,000
Sales tax @ 15% on Rs. 4,200,000	630,000
Provincial Sales tax paid on services provided by customs agents	150,000
	862,500
Admissible input tax (82,500+90% × 315,000)	366,000
Sales tax payable (Total output tax less admissible input tax)	31,500

**Advanced Taxation
Suggested Answer
Final Examinations – Summer 2008**

Comments on items not utilized in the above computation

- (i) Sales tax paid on acquisition of plant and equipment shall be adjustable in twelve equal installments after the start of new unit. Therefore, the company will get the input tax credit on this acquisition effective from June 30, 2008.
- (ii) Sales tax of Rs 50,000 paid on foods, beverages and consumption on entertainment for the Company's employees is not an admissible tax credit.

Alternate 2

Ans.7

**Shahid Limited
Computation of Sales Tax Payable
For the tax period March 2008**

	Rupees 17%
Output Tax	
Sales tax on sale of shampoo (5,000 x Rs. 110 x 15%)	82,500
Exports to Azerbaijan	-
Local sales of hair oil (6,000 x Rs. 350 x 15%)	315,000
Total Output Tax	397,500
Input Tax	
Sales tax on purchase of shampoo (5,000 x Rs. 110 x 17%)	82,500
Sales tax paid on import of hair oil	
Import value (10,000xRs. 400)	4,000,000
Custom duty (10,000 x Rs. 20)	200,000
Value for sales tax	<u>4,200,000</u>
Sales tax @ 17% on Rs. 4,200,000	714,000
Provincial Sales tax paid on services provided by customs agents	150,000
	957,500
Admissible input tax	NA
Sales tax refundable / adjustable	<u>150,000</u>

Comments on items not utilized in the above computation

- (i) Sales tax paid on acquisition of plant and equipment shall be adjustable in twelve equal installments after the start of new unit. Therefore, the company will get the input tax credit on this acquisition effective from June 30, 2008.
- (ii) Sales tax of Rs 50,000 paid on foods, beverages and consumption on entertainment for the Company's employees is not an admissible tax credit.

Ans.8 Sales Tax Special Procedure (Withholding) Rules 2007

- (i) Withholding agents are required to advertise or notify that they are withholding agents for the purpose of sales tax.
- (ii) A withholding agent shall deduct an amount equal to 20% of the total sales tax shown in the sales tax invoice.
- (iii) Under unavoidable circumstances, when the purchases are made from un-registered person, the

Advanced Taxation
Suggested Answer
Final Examinations – Summer 2008

withholding agent shall deduct sales tax at 15% of the value of taxable supplies made to him from the payment due to the supplier.

- (iv) Withholding agent who is not registered under the Sales Tax Act, 1990, can file a single return cum challan, in respect of all purchases for which the payment has been made in a month.
- (v) Withholding agent who is registered under the Sales Tax Act, 1990, shall deposit the sales tax withheld, in accordance with the requirements of Sales Tax Rules 2005.
- (vi) A certificate showing deduction of sales tax shall be issued to the supplier by the withholding agent.

Ans.9 Where a registered person, receiving a taxable supply from another registered person, knows or has reasonable grounds to suspect that some or all of the tax payable in respect of that supply or any previous or subsequent supply of the goods would remain unpaid, such person as well as the person making the taxable supply are jointly and severally liable for payment of such unpaid amount of tax. Moreover, the input tax claimed on such purchase shall also become inadmissible.

Ans.10 The destruction of goods by fire and subsequent compensation by the insurance company does not constitute supply as defined in Sales Tax Act 1990 for the following reasons:

- (i) it is neither a sale nor a lease.
- (ii) it is not done in the normal course of furtherance of business
- (iii) it is not done for consideration. Payment by the insurance company is actually compensation for loss and is not payment / consideration for delivery of goods

Since no supply is involved, no sales tax is leviable on the amount of compensation paid by the insurance company.

However in order to confirm that the loss was actually due to fire, a copy of FIR lodged immediately after the incident and Survey Report of the insurance company's appointed surveyor should be available on record.

The sales tax paid on the goods destroyed in fire is not refundable or adjustable as adjustment is only allowed where the inputs are used in making taxable supplies.

Ans.11 (i) Imported goods

Where any goods are chargeable to SED at the import stage, duty has to be assessed and paid on the value determined in accordance with the Customs Act, including customs duty.

(ii) Goods chargeable to SED on the basis of retail price

Where any goods are chargeable to SED on the basis of retail price, SED has to be paid on the retail price fixed by the manufacturer, inclusive of all duties, charges and taxes, other than sales tax, at which any particular brand or variety of such goods should be sold to the general body of consumers. If more than one such price is so fixed for the same brand or variety of goods, SED shall be payable on the highest of such price.

(The End)