The Institute of Chartered Accountants of Pakistan

Final Examination

Module F
4 December 2014
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Taxation

Q.1 Bharosa Limited (BL) was incorporated on 1 July 2011 as an un-listed public company under the Companies Ordinance, 1984. The company is engaged in the business of manufacturing and distribution of soap and toiletries. On 1 November 2013 BL was enlisted on Karachi and Lahore Stock Exchanges. Following is an extract from BL's un-audited summarised profit and loss account for the year ended 30 September 2014:

	Rupees
Sales	24,900,000
Cost of sales	(13,718,000)
Gross profit	11,182,000
Administrative and selling expenses	(6,900,000)
Financial charges	(980,000)
Other income	1,500,000
Profit before taxation	4,802,000

Additional information:

(i) Sales include insurance compensation of Rs. 5,000,000 received from Big Insurance Limited against the loss of one of BL's factory buildings which was destroyed by fire due to short circuit. This building was constructed in July 2011 at a cost of Rs. 6,000,000. The accounting and tax WDV of the building when it caught fire were Rs. 5,347,000 and Rs. 4,374,000 respectively. However, no depreciation on this building was charged in the books for the year.

BL reconstructed a similar building at a cost of Rs. 3,800,000. Construction of the new building was completed in November 2013 and BL installed used plant and machinery therein at a cost of Rs. 1,500,000. The unit was given on lease to Mr. Marvi on 1 January 2014 at a monthly lease rent of Rs. 150,000. The relevant depreciation at the rate of 5% and 10% on building and plant and machinery respectively and property tax of Rs. 96,000 which was paid in respect of the new building were properly recorded in BL's books as part of Administrative expenses. The amount of lease rent received from Mr. Marvi is included in sales.

(ii) Cost of sales includes the following:
- a compensation of Rs. 100,000 payable annually to a former employee, who was injured and permanently disabled while on duty.
- a penalty of Rs. 25,000 on failure to deposit income tax withheld from the salaries of factory staff.
- Accounting depreciation of Rs. 870,000.

(iii) Administrative and selling expenses include the following:
- impairment loss of Rs. 200,000 on BL's investment in ABC (Pvt.) Limited. The loss occurred due to considerable decrease in the breakup value of these shares as compared to their book value.
- legal fees of Rs. 50,000 and Rs. 125,000 which were paid in connection with the filing of statements with Karachi and Lahore Stock Exchanges and increase in BL's authorized capital respectively.
- scientific research expenditure of Rs. 400,000 which was incurred in Cannes, France. The research has helped BL in improving the quality of its products.
- Rs. 480,000 which was incurred in relation to an advertising campaign launched prior to the introduction of a new product line in an effort to enhance public awareness.

- a donation of Rs. 300,000 was paid to a fund which is listed in the second schedule of the Income Tax Ordinance, 2001 for the promotion of science and technology in Pakistan.
- Workers' Welfare Fund of Rs. 98,000 and accounting depreciation of Rs. 1,100,000.

(iv) Financial charges include a profit of Rs. 180,000 earned from saving accounts maintained with banks.

(v) Other income includes sale proceeds of Rs. 700,000 from sale of shares in Nafa (Pvt.) Limited. BL purchased these shares in June 2012 at a cost of Rs. 230,000.

(vi) The tax written down values of BL's assets on 1 October 2013 were:

Building (excluding the building destroyed by fire) Rs. 3,270,000			
Plant and machinery	Rs. 3,400,000	Motor vehicles	Rs. 1,500,000
Furniture	Rs. 2,380,000	Computers	Rs. 1,100,000

(vii) Tax paid u/s 147 amounted to Rs. 260,000 whereas tax deducted by banks u/s 151 from profit on debt amounted to Rs. 18,000.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute the taxable income and net tax payable by/refundable to BL for the tax year 2015.
Note: Show all relevant exemptions, exclusions and disallowances. Tax rates are given on the last page. **(25)**

Q.2 (a) Under the provisions of Income Tax Ordinance, 2001 briefly explain the following:
(i) Group taxation **(04)**
(ii) Pre-commencement expenditure **(05)**

(b) Sweet Limited (SL) is an unlisted public company engaged in the business of manufacture and sale of sugar. SL's income year ends on 30 September each year. In tax year 2014 following taxes were deducted/paid by SL:

	Rupees
Advance tax paid under section 147	20,500,000
Paid on import of machinery	2,250,000
Deducted by banks on profit on debt	250,000

SL filed its return of income for the tax year 2014 on the due date for filing of return with a gross tax liability of Rs. 32,500,000.

Required:
In view of the provisions of the Income Tax Ordinance, 2001 explain whether the advance tax paid quarterly by SL under section 147 could result in any further tax liability to the company, if yes, compute the amount of such additional tax liability. **(08)**

Q.3 (a) After providing a reasonable opportunity of showing cause and of being heard, Mr. Khayanat was declared a defaulter by the Officer Inland Revenue under the Sales Tax Act, 1990. However, at the time of issuance of a demand note to the Recovery Officer, Mr. Khayanat died.

Required:
In view of the Sales Tax Rules, 2006 explain the status of the proceedings against Mr. Khayanat under the above circumstances and provisions relating to the payment of the dues as stated in the demand note. **(04)**

(b) Under the provisions of the Sales Tax Act, 1990 identify the disputes in relation to which a registered person may apply to the Board for the appointment of a committee for the resolution of a dispute which is under litigation in any Court or an Appellate authority. Explain the composition of such committee and state the time frame within which such committee may be constituted by the Board. **(06)**

(c) Explain the following under the provisions of the Sales Tax Act, 1990:
  (i) Similar supply in relation to the open market price of goods **(02)**
  (ii) Special returns **(04)**

Q.4 Harfun Limited (HL) is registered as a manufacturer cum commercial importer with the Inland Revenue Department for sales tax purposes. Besides carrying on various trading businesses across the country, HL is primarily engaged in the business of production and supply of syrups and squashes covered under third schedule of the Sales Tax Act, 1990. Following data has been extracted from HL's records for the month of November 2014.

(i) Taxable purchases of raw material of Rs. 8,750,000 were made from registered AOP.
(ii) Packing materials of Rs. 450,000 were purchased from registered distributors.
(iii) Rs. 158,000 was paid to a local beverage company for providing mineral water at HL's annual dinner arranged for the entertainment of its customers and employees.
(iv) Preservatives of Rs. 589,000 were purchased from a cottage industry.
(v) Mango and banana worth Rs. 1,500,000 were purchased from local registered person for further processing.
(vi) 3,000 boxes of Lemon and Mango squashes were imported from Malaysia at the price of Rs. 550 per box. The value determined by custom authorities under section 25 of the Customs Act, 1969 amounted to Rs. 680 per box. The retail price however was fixed at Rs. 625 per box. HL sold 2,800 boxes of squashes to BM Limited.
(vii) For the purpose of generating steam for one of its production processes, HL purchased fuel wood from registered wholesalers for Rs. 1,050,000.
(viii) HL also purchased a fiscal electronic cash register and office equipments from a corporate supplier at a price of Rs. 650,000 and Rs. 375,000 respectively. These items were purchased on 60 days credit.
(ix) A mixing machine was acquired by HL on finance lease. The total lease rentals to be paid to the lessor are Rs. 3,000,000. The fair value of the machine at the inception of the lease amounted to Rs. 2,500,000. HL has the option to purchase the machine at the end of the lease term (in three years' time) and the directors estimate that it is more likely that this option to purchase will be exercised.
(x) Delivery trucks worth Rs. 2,340,000 were purchased for timely distribution of goods to customers.
(xi) Cool day light energy saver lamps were sold to AF Engineering for Rs. 500,000.
(xii) Locally produced squashes worth Rs. 13,800,000 were sold to corporate distributors.

All the above figures are **exclusive of sales tax**, wherever applicable. Sales tax is payable at the rate of **17%**.

Required:
In the light of the provisions of the Sales Tax Act, 1990 and Rules made thereunder, compute the amount of sales tax payable by or refundable to HL for the tax period November 2014. **(18)**

Q.5 Under the provisions of the Federal Excise Act, 2005 briefly describe the following:
(a) The liability for payment of excise duty in case of closure of a private company and sale of a business to another person as an ongoing concern. **(09)**
(b) Franchise **(03)**

Q.6 Khawar Associates (KA) is engaged in the business of supplying stationery items to both the individuals and corporate customers. Following is an extract from the summarised income statement for the year ended 30 June 2014.

	Rupees
Sales	2,348,000
Cost of sales	(1,230,000)
Operating expenses	(470,000)
Profit before tax	648,000

Following further information is also available:

(i) The above sales include the following:
- An amount of Rs. 573,000 (net of tax) received from Mr. Iqbal. Mr. Iqbal is registered for sales tax purposes. The rate of withholding tax is 4.5% of the gross receipts.
- Goods worth Rs. 825,000 sold to SP Limited (SPL). SPL deducted tax of Rs. 37,125 from the payment against this sale.
- The rest of the sales were made to individual customers having turnover of less than fifty million rupees.

(ii) Cost of sales includes Rs. 20,000 paid to SPL as a penalty for late delivery of goods.

(iii) Operating expenses include the following:
- Salaries of Rs. 50,000 paid to part time sales staff working exclusively on SPL's assignment. The rest of the expenses were common to all the customers.
- A donation of Rs. 60,000 to an educational institution established by the Provincial Government.
- Zakat of Rs. 10,000 under the Zakat and Ushr Ordinance, 1980.

(iv) KA also received a dividend of Rs. 36,000 (net of tax) from a private company.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute KA's taxable income for tax year 2014. Give reasons for the treatment of the amounts of donation and dividend as mentioned above. **(12)**

(THE END)

EXTRACTS FROM THE INCOME TAX ORDINANCE, 2001

The First Schedule

Division II
Rates of Tax for Companies

1. The rate of tax imposed on the taxable income of a public/private company shall be 33%.
2. The rate of tax imposed on the taxable income of a small company shall be 25%.

THE THIRD SCHEDULE
Part I
Depreciation rates

1.	Building (all types)	10%
2.	Furniture and fittings	15%
3.	Plant and machinery	15%
4.	Motor vehicles (all types)	15%
5.	Computer hardware	30%

Part II
Initial Allowance and First Year Allowance

The rate of initial allowance for eligible depreciable assets shall be 25%.

The Institute of Chartered Accountants of Pakistan

Advanced Taxation

Final Examination	5 June 2014
Summer 2014	100 marks - 3 hours
Module F	Additional reading time – 15 minutes

Q.1 Saif is a country manager in Rio (Pvt.) Limited (RPL), a company engaged in the business of manufacturing and supply of beauty products. During tax year 2014, RPL paid him a monthly basic salary of Rs. 600,000. He is also entitled to a bonus of Rs. 900,000 to be paid in July 2014.

In addition to above, Saif was also provided the following:

(i) A company maintained car for both his personal and official use. The car was obtained on lease in 2013 at total rentals of Rs. 2,000,000 to be paid over the lease term. The fair market value of the car at the commencement of lease was Rs. 1,500,000. RPL also paid Rs. 100,000 for its maintenance to a local workshop.

(ii) A fully furnished two storey bungalow in a posh locality. The annual rental value of the bungalow was Rs. 2,400,000.

On 1 January 2014 Saif let out the first floor of the bungalow to his brother Moiz at a monthly rent of Rs. 75,000 and also insured it against the risk of fire. The premium payable to the insurance company amounted to Rs. 50,000. Saif paid 50% of the premium immediately and agreed to pay the balance on 1 July 2014. He also bought an LCD TV for Rs. 70,000 for the first floor.

(iii) Reimbursement of Rs. 120,000 against air tickets for family vacation. Total cost of tickets was Rs. 200,000. Saif paid Rs. 10,000 as advance tax on purchase of tickets.

(iv) On 1 January 2014 RPL sold certain items of old stock to Saif for Rs. 5,000. The net realizable value of the stock in RPL's books as on 30 June 2013 and 31 December 2013 were Rs. 12,000 and Rs. 14,000 respectively. The original cost of the stock was Rs. 25,000.

(v) Withholding tax deducted by RPL from Saif's salary amounted to Rs. 2,100,000.

Following further information is also available:

(i) On 1 July 2013 he borrowed Rs. 3,000,000 from a bank at 11% mark-up. The amount is payable in two equal annual instalments starting from 1 July 2014. Out of the above loan, Saif utilized Rs. 2,550,000 for the acquisition of a plot of land in an industrial area and Rs. 450,000 for the purchase of a car for his son. On 1 September 2013 he let out the plot of land to Amir at a monthly rent of Rs 25,000. He also received an un-adjustable deposit of Rs. 150,000 and paid Rs. 10,000 for levelling and cutting of grass, Rs. 15,000 against ground rent and Rs. 18,000 for rent collection.

(ii) On 1 May 2014 he sold 1,200 shares in Mio Limited at Rs. 50 per share and incurred incidental expenses of 0.5% of sale proceeds. Mio Limited is an unlisted company in which 55% of the shares are held by Chinese Government. Saif had received these shares on 30 June 2013 as dividend in specie from Rahat (Pvt.) Limited. He holds 12,800 shares in Rahat (Pvt.) Limited costing Rs. 35 each.

(iii) In August 2013 Saif started a fitness club for corporate executives. The admission and monthly membership fees for the potential members were fixed at Rs. 25,000 and Rs. 5,000 respectively. A group of 20 persons joined the club in August 2013 whereas 25 persons joined in January 2014 and 30 in March 2014.

Following items were included in club's profit and loss account for the tax year 2014:

- Monthly salary of Rs. 60,000 to Saif and Rs. 45,000 to his son by way of a direct transfer of funds to their bank accounts. His son is a trainer at the club. Withholding tax deducted from their salaries amounted to Rs. 13,000 and Rs. 4,750 respectively.
- Rs. 2,750,000 against import of old fitness machines from China. The withholding tax paid at import stage was Rs. 150,000.
- Fine of Rs. 15,000 which was paid when the truck delivering the fitness machines from the port to the club was found to be overloaded.
- A fire occurred in a section of the club and repairs had to be undertaken as follows:
  - Cost of replacing electrical wiring damaged by fire Rs. 85,000
  - Cost of a new non-removable fire protection screen installed to prevent fire in future Rs. 200,000.
- Other miscellaneous expenses amounting to Rs. 120,000.

(iv) On 15 June 2014 Saif donated a plot of land to Pakistan Sports Board. He had purchased this plot in tax year 2001 at a price of Rs. 300,000. However, at the time of donation, a broker had given him an offer of Rs. 500,000 for the said plot.

Required:
Under the provisions of Income Tax Ordinance, 2001 and Rules made thereunder, compute the taxable income and income tax payable by or refundable to Saif for the tax year 2014. **(25)**
Note: Show all relevant exemptions, exclusions and disallowances. Tax rates are given on last page.

Q.2 (a) Describe the following concepts as envisaged under the Sales Tax Act, 1990:
(i) Joint and several liability of registered persons in supply chain. **(03)**
(ii) Change in the rate of tax. **(06)**

(b) Under the provisions of Sales Tax Rules, 2006, on receipt of the demand note from the referring authority, a recovery officer shall serve upon the defaulter a notice attaching his moveable and immovable property.

List any **five** particulars which are not liable to attachment and sale in execution of such notice. **(05)**

Q.3 Under the provisions of Income Tax Ordinance, 2001 and Rules made thereunder, compute the taxable income or explain the tax treatment, wherever applicable, in each of the following cases:

(i) Hamid held 2,000 shares in Beta Limited (BL) which he had acquired on 1 July 2013 at Rs. 15 each. BL subsequently merged into Gama Limited (GL) through a scheme approved by the High Court. GL issued 1 share for 2 shares held in BL. **(03)**

(ii) Bari acquired 100 shares in Pie Limited (PL) on 1 January 2014 at Rs. 40 per share and deposited them into CDC account. On the same date i.e. 1 January 2014, PL declared 25% bonus shares with 1 April 2014 as the date of entitlement. On 31 March 2014, the market value of these shares was Rs. 50 each. On 15 April 2014 Bari disposed of 50 shares in PL at Rs. 40 each. The bonus shares were credited to Bari's account on 15 May 2014. He sold the remaining shares including bonus shares on 18 May 2014 at Rs. 40 each **(06)**

(iii) Anjum borrowed 5,000 shares from Nazia for a short term. The value of the borrowed shares was agreed at Rs. 100 per share. Anjum agreed to pay, for the specified period, a mark-up of Rs. 2 per share to Nazia at the time of settlement. Anjum sold the borrowed securities at Rs. 105 each and subsequently, on the date of return of borrowed securities, re-purchased 5,000 shares at Rs. 95 per share. **(06)**

Q.4 Omega Limited (OL), a conglomerate, is registered at the large taxpayers unit (LTU) of Inland Revenue Department, Karachi for the last one year. OL is engaged in multiple businesses across Pakistan. However, due to regulatory issues, OL commenced its business operations in May 2014. Following information has been extracted from OL's records for the month of May 2014:

(i) Taxable purchases of Rs. 100,000 were made from an unregistered supplier.

(ii) Invoices issued by OL's bank against various excisable / taxable services rendered to OL shows a sum of Rs. 5,000 as federal excise duty towards services rendered in Islamabad, Rs. 2,000 towards Punjab sales tax for services rendered in Lahore and Rs. 500 as service charges for issuing a new cheque book in Karachi on the last working day of the month.

(iii) OL's Textile Division rendered toll manufacturing to Big Associates for which value of supply has been estimated at Rs. 45,000. Big Associates operates a large garments unit which is registered under the sales tax act as an AOP. During the month, finished cloth of Rs. 500,000 was sold to Asia Airways Limited for its aircraft's seats. Sales invoices were settled during the month.

(iv) Sales tax of Rs. 5,000 was paid on imports made ten days before the start of business.

(v) OL sold goods worth Rs. 250,000 to Small Corporation, a proprietary concern registered under the Sales Tax Act, 1990. However, due to limited storage capacity at buyer's premises the goods are still lying at OL's godown. In view of its revenue recognition policy, OL has not recognized any revenue in the accounts.

(vi) Other purchases amounting to Rs. 725,000 were made on 45 days credit from corporate suppliers. All the suppliers were withholding tax agents.

(vii) OL's Furniture Division supplied furniture of Rs. 125,000 to an unregistered school in Karachi. However, in view of negative market feedback and consequential losses, OL has decided to close down the Furniture Division at the end of May 2014. Stock of unsold furniture at the close of month amounted to Rs. 200,000.

(viii) As part of a strategic tripartite contract, OL supplied 'tooth brushes' worth Rs. 400,000 in small villages and towns at a discounted price of Rs. 250,000. The terms of the contract stipulate that the balance amount of Rs. 150,000 will be reimbursed to the company by the Government of Pakistan.

(ix) OL paid an advance of Rs. 75,000 to a registered supplier, Pearl Limited, against future purchases. However, Pearl Limited has not issued any document against the advance receipt.

(x) OL sold sugar worth Rs. 240,000 to SPL. The sugar was purchased in February 2014.

(xi) OL procured tyres and tubes of Rs. 850,000 from a distributor for trading purposes.

All the above figures are **exclusive of sales tax / federal excise duty**, wherever applicable. Sales tax is payable at the rate of **17%**.

Required:
In the light of the provisions of Sales Tax Act, 1990 / Federal Excise Act, 2005 and Rules made thereunder, compute the sales tax payable by or refundable to OL for filing the sales tax-cum-federal excise return for the tax period May 2014. **(18)**

Q.5 (a) Explain the circumstances under which a cottage industry is required to be registered under the Federal Excise Act, 2005. Also state the condition under which the provisions of Sales Tax Act, 1990 would not be applicable to such cottage industry. **(05)**

(b) Under the provisions of Federal Excise Act, 2005 describe the following:

(i) The person(s) who are construed to be included in the word 'Manufacturer'. **(04)**

(ii) The concept of 'Sales tax mode'. **(03)**

Q.6 (a) What do you understand by 'Profit on a debt'? Describe the circumstances under which any profit received by a non-resident person on a security issued by a resident person shall be exempt from tax under the Income Tax Ordinance, 2001. **(06)**

(b) Briefly explain the difference between tax admissible expenses and tax reliefs as provided in the Income Tax Ordinance, 2001. **(05)**

(c) For the purpose of computing income of a person from a transaction with an associate, certain steps are applied by the Commissioner in determining the arm's length result. Briefly describe those steps under the 'resale price method' as provided in the Income Tax Rules, 2002. **(05)**

(THE END)

EXTRACTS FROM THE INCOME TAX ORDINANCE, 2001

THE FIRST SEHEDULE
RATES OF TAX
Division I
Rates of Tax for Salaried Individuals

S. #	Taxable Income	Rate of Tax
8.	Rs. 3,000,001 to Rs. 3,500,000	Rs. 362,500+22.5% of the amount exceeding Rs. 3,000,000
9.	Rs. 3,500,001 to Rs. 4,000,000	Rs. 475,000+25% of the amount exceeding Rs. 3,500,000
10.	Rs. 4,000,001 to Rs. 7,000,000	Rs. 600,000+27.5% of the amount exceeding Rs. 4,000,000
11.	Above Rs. 7,000,000	Rs. 1,425,000+30% of the amount exceeding Rs. 7,000,000

Division III
Rate of dividend tax

The rate of tax imposed under section 5 on dividend received from a company is 10%

Division VII
Capital gains on disposal of securities

S. #	Period	Tax Year	Rate of Tax
1.	Where holding period of a security is less than six months.	2014	10%
		2015	17.5%
2.	Where holding period of a security is more than six months but less than twelve months.	2014	8%
		2015	9.5%
3.	Where holding period of a security is twelve months or more.	-	0%

THE THIRD SCHEDULE
Part I
Depreciation rates

1.	Building (all types)	10%
2.	Furniture and fittings	15%
3.	Plant and machinery	15%
4.	Motor vehicles (all types)	15%
5.	Computer hardware	30%

Part II
Initial Allowance and First Year Allowance

The rate of initial allowance for eligible depreciable assets shall be 25%.

Advanced Taxation

Final Examination	5 December 2013
Winter 2013	100 marks - 3 hours
Module F	Additional reading time – 15 minutes

Q.1 Mr. Iqbal, aged 45 years, is working as a Chief Engineer in a listed company Tameer Limited (TL). The company is engaged in the manufacture of chipboards for the local market. He derived following emoluments during the tax year ended 30 June 20X4:

	Rupees
Basic salary (per month)	300,000
Cost of living allowance (per month)	50,000
Milk allowance (per month)	10,000

In addition to the above emoluments, Mr. Iqbal was also provided the following:

(i) Special bonus equal to one month's basic salary paid on 5 June 20X4.

(ii) A new company maintained car for his personal use. The car was purchased on 1 March 20X4 at a cost of Rs. 1,800,000. However, the cost of the car would have been Rs. 3,000,000 had the company obtained it on finance lease. Mr. Iqbal, in accordance with the terms of his employment, purchased his previous car from TL for Rs. 250,000. This car was provided to him solely for business purposes. The fair market value of the car at the time of sale to Mr. Iqbal was Rs. 600,000.

(iii) A reimbursement of Rs. 36,000 in respect of driver's salary. Mr. Iqbal paid Rs. 60,000 to the driver for four months.

(iv) A fully furnished accommodation in DHA, Karachi. The fair market value of the rent was estimated to be Rs. 85,000 per month.

(v) An option to acquire 4,000 shares in TL's parent company, Tameer Inc. which is listed on New York Stock Exchange was granted to him in May 20X3. Mr. Iqbal exercised the option on 5 January 20X4 at a price of USD 1.5 per share. The market value of the shares at the close of business on 5 January 20X4 was USD 2.5 per share. He sold 3,000 shares on 30 June 20X4 at a price of USD 3 per share. The dollar rupee parity on both the above dates was USD 1 = Rs.100.

(vi) On 15 May 20X4 Mr. Iqbal was provided 800 shares in TL as a reward for his excellent performance. However, he was restricted from selling or transferring these shares before 16 November 20X4. The market value of these shares at the close of business on 15 May 20X4 was Rs. 12.5 per share.

Mr. Iqbal received additional income from the following sources, for the tax year 20X4:

(i) Brokerage fee of Rs. 200,000 in connection with the transfer of two apartments in Islamabad. The brokerage fee was received in cash. Mr. Iqbal incurred an expense of Rs. 30,000 against telephone costs and air travel to Islamabad in connection with the above deal. He also paid Rs. 10,000 as a gift to his brother for showing the apartments to his clients in Islamabad.

(ii) Profit of Rs. 150,000 on a savings account maintained with an Islamic bank. The bank deducted withholding tax of Rs. 15,000 and Zakat of Rs. 25,000.

(iii) He also received an income tax refund of Rs. 225,000 related to tax year 20X2. The amount included Rs. 25,000 being compensation for delayed refund.

(iv) Annual rent of Rs. 800,000 from letting out a building to KK Enterprise. Following expenses were incurred by Mr. Iqbal in relation to the building: Repairs Rs. 200,000, Fire insurance premium Rs. 30,000, Ground rent Rs. 10,000, Watchman's salary Rs. 8,000 and Interest of Rs. 15,000 on a loan obtained for building renovation by creating first charge on the building in favour of a scheduled bank.

Other related information is as under:

- TL deducted withholding tax of Rs. 1,200,000 from Mr. Iqbal's salary during tax year 20X4.
- On 1 July 20X3, Mr. Iqbal acquired a life insurance policy and paid a premium of Rs. 500,000. He also contributed Rs. 1,600,000 to an approved pension fund.
- On 1 August 20X3, he purchased 50,000 shares in a listed company AB Limited at a price of Rs. 20 each. On 1 January 20X4, AB Limited announced 20% right shares to existing shareholders at a price of Rs. 18 per share. On 25 January 20X4, Mr. Iqbal subscribed the right issue in full.
- During tax year 20X3 his assessed taxable income was Rs. 3,000,000.

Required:
Under the Income Tax Ordinance, 2001 and Rules made thereunder, compute the taxable income and income tax payable by or refundable to Mr. Iqbal for the tax year ended 30 June 20X4. **(22)**

Note: Show all exemptions, exclusions and disallowances where relevant. Tax rates are given on last page.

Q.2 (a) Describe the following with reference to the Sales Tax Act, 1990:
(i) Time of supply (ii) CREST (iii) Supply chain **(09)**

(b) Under the Sales Tax Rules, 2006 the Board or the Commissioner may appoint a Chartered Accountant for conducting special audit of the records of a registered person.

Explain the scope of special audit under the above circumstances. **(06)**

Q.3 Masawi Limited (ML) is engaged in the business of production and supply of packaged fruit and vegetable juices. ML is incorporated under the Companies Ordinance, 1984 and is duly registered with the Inland Revenue Department for sales tax purposes. Following data has been extracted from ML's records for the month of November 2013:

	Rupees
Purchases:	
Raw material:	
▪ from local registered suppliers	5,000,000
▪ from local un-registered suppliers	1,000,000
▪ import	800,000
Supplies:	
Taxable supplies to registered persons	4,675,000
Taxable supplies to un-registered persons	2,125,000
Taxable supplies to duty free shops	1,020,000
Export to Qatar	680,000

Following information is also available:

(i) Raw materials purchased from un-registered suppliers include preservatives purchased from FJ Limited at a discounted price of Rs. 380,000. ML received a normal discount of 5% on this purchase.

(ii) Juices worth Rs. 100,000 were provided to the workers at the company's workshop free of cost.

(iii) Rs. 500,000 was paid to an advertising agency through banking channels for providing advertising services on television in Pakistan.

(iv) 20% of the taxable supplies to registered persons were made to private limited companies and public sector organizations whereas the rest of the supplies were made to wholesalers / retailers.

(v) ML had no outstanding liability against purchases at the end of November 2013.

All the above figures are exclusive of sales tax, wherever applicable. Sales tax is payable at the rate of **17%**. The goods supplied by ML are not subject to federal excise duty.

Required:
Under the provisions of Sales Tax Act, 1990 and Rules made thereunder, calculate the amount of sales tax payable by or refundable to ML for the tax period November 2013. **(18)**

Q.4 (a) Maroof Limited (ML) is a resident company engaged in the business of construction for the past many years. In July 2012, the company was awarded a contract for the construction of roads in district Badin at a total contract price of Rs. 100,000,000. ML estimated to incur total cost of Rs. 60,000,000 on the project.

Work on the project started in September 2012 and was completed in November 2013. ML received following amounts after deduction of 6.5% withholding tax:

Months	Feb. 2013	May 2013	Sep. 2013	Dec. 2013
Amount received (Rs.)	12,622,000	15,760,000	35,000,000	30,118,000

The actual costs incurred by ML for the tax years 2013 and 2014 were Rs. 33,000,000 and Rs. 27,000,000 respectively.

Required:
Under the provisions of Income Tax Ordinance, 2001 calculate ML's taxable income and withholding tax credit, if any, for the tax years 2013 and 2014. **(08)**

(b) Explain the following in relation to Income Tax Ordinance, 2001:
(i) Exceptions to the rule that 'a tax shall be imposed at a specified rate on every non-resident person who receives any Pakistan source royalty or fee for technical services'. **(03)**
(ii) The term 'Prescribed person' with reference to deduction of tax from rent of immovable property. **(06)**
(iii) Significance of the Circulars issued by the Board. **(04)**

Q.5 Big Limited (BL) was incorporated in Pakistan in 1992. It holds the entire share capital of several locally incorporated companies including Zeta Limited (ZL). Following information has been extracted from ZL's records for the year ended 30 September 2013:

	Rs. in '000
Income from business	500
Capital gain	800
Income from other sources	100
Total income before tax	1,400

ZL is engaged in the business of manufacturing scaffoldings since its incorporation. Following further information is available from ZL's records:

(i) The income from business includes deemed income in respect of a loan of Rs. 85,000 received otherwise than by a crossed cheque.
(ii) Business losses brought forward from tax years 2012 and 2013 amounted to Rs. 130,000 and Rs. 200,000 respectively. ZL's tax assessment has been finalized upto tax year 2012.
(iii) Capital losses brought forward from assessment years 2007 and 2008 amounted to Rs. 50,000 and Rs. 65,000 respectively.
(iv) The amount of tax depreciation adjusted during the year against income from business amounted to Rs. 490,000. Unabsorbed tax depreciation brought forward from previous assessment years amounted to Rs. 135,000.
(v) A loss from speculation business brought forward from tax year 2012 amounted to Rs. 100,000.
(vi) One of BL's subsidiaries, which is qualified for group relief, surrendered its assessed losses of Rs. 250,000 in favour of ZL. These losses include brought forward business loss of Rs. 25,000, capital loss of Rs. 45,000 and an unabsorbed tax depreciation of Rs. 10,000.

Required:
Under the provisions of Income Tax Ordinance, 2001 compute the taxable income of Zeta Limited for the tax year 2014 and the amount of loss, if any, to be carried forward to next tax year. State the reason where any of the loss cannot be adjusted against the given income. **(13)**
Note: The order in which various deductions are to be set-off against ZL's income should be followed.

Q.6 Under the provisions of Federal Excise Act, 2005 explain the following:
(i) Conveyance **(02)**
(ii) Distributor **(02)**
(iii) Mode of recovery of duty in case of short payment **(03)**
(iv) Particulars to be stated on the invoice issued at the time of providing services **(04)**

(THE END)

EXTRACTS FROM THE INCOME TAX ORDINANCE, 2001

THE FIRST SEHEDULE
RATES OF TAX
Division I
Rates of Tax for Salaried Individuals

S. #	Taxable Income	Rate of Tax
8.	Rs. 3,000,001 to Rs. 3,500,000	Rs. 362,500+22.5% of the amount exceeding Rs. 3,000,000
9.	Rs. 3,500,001 to Rs. 4,000,000	Rs. 475,000+25% of the amount exceeding Rs. 3,500,000
10.	Rs. 4,000,001 to Rs. 7,000,000	Rs. 600,000+27.5% of the amount exceeding Rs. 4,000,000
11.	Above Rs. 7,000,000	Rs. 1,425,000+30% of the amount exceeding Rs. 7,000,000

Division VII
Capital Gains on disposal of Securities

S. #	Period	Tax Year	Rate of Tax
1.	Where holding period of a security is less than six months.	2013	10%
		2014	10%
2.	Where holding period of a security is more than six months but less than twelve months.	2013	8%
		2014	8%
3.	Where holding period of a security is twelve months or more.	-	0%

The Institute of Chartered Accountants of Pakistan

Advanced Taxation

Final Examination | 6 June 2013
Summer 2013 | 100 marks - 3 hours
Module F | Additional reading time – 15 minutes

Q.1 (a) What is meant by "Securities" under the provisions of Income Tax Ordinance, 2001? Briefly describe "Holding period" in relation to securities as provided under the Income Tax Rules, 2002. **(05)**

(b) Mr. Parekh acquired and disposed of 3,500 shares of a listed company, Big Limited (BL). The details are as follows:

Dated	Acquisition		Disposal	
	No. of shares	Rate	No. of shares	Rate
31-03-2012	1,400	20	-	-
15-09-2012	700	22	-	-
01-04-2013	900	18	-	-
01-05-2013	-	-	600	17
07-05-2013	-	-	800	19
21-05-2013	-	-	700	18
31-05-2013	500	23	400	25
31-05-2013	-	-	1,000	27

Required:
Under the provisions of Income Tax Ordinance, 2001 and Rules made thereunder, calculate the amount of capital gain / loss and tax thereon, if any, on the above transactions. Ignore incidental expenses on cost of **acquisition** of securities.
Note: Tax rates are given on the last page. **(16)**

Q.2 (a) Under the provisions of Sales Tax Act, 1990 and Rules made thereunder, briefly explain whether the persons under each of the following situations are required to be registered with Inland Revenue Department. Also compute the amount of sales tax, if any, payable by or refundable to such persons. The rate of sales tax is **16%**.

(i) A manufacturer whose annual turnover during the last twelve months ended 31 March 2013 is Rs. 4,500,000 and the amount of his annual utility bills for the same period is Rs. 700,000.
(ii) A distributor whose annual turnover during the last twelve months is Rs. 3,000,000.
(iii) An importer whose annual turnover is Rs. 12,000,000.
(iv) A commercial exporter who intends to claim a refund of Rs. 200,000. **(13)**

(b) Aroma Limited (AL), a company registered under the Sales Tax Act, 1990 is engaged in the business of production and supply of assorted blend of tea in the local market. Mr. Pali, the sales director, requested the finance manager to issue a credit note in favour of one of AL's customers, who had bought 50 kg of a special blend of tea on 4 December 2012. Finance manager issued the credit note on 5 June 2013.

Required:
In view of the Sales Tax Rules, 2006 explain whether AL can adjust the amount of its output tax in relation to the above credit note in its return for June 2013. **(04)**

Q.3 Pills (Pvt.) Limited (PPL) is engaged in the business of manufacturing wide range of pharmaceutical products for both local and overseas markets. Following is an extract from PPL's profit and loss account for the year ended 31 December 20X2:

	Rs. in '000
Sales	39,150
Cost of sales	(25,700)
Gross profit	13,450
Administrative and selling expenses	(5,350)
Financial charges	(1,500)
Other charges	(2,000)
Other income	900
Profit before taxation	5,500

Additional information:

(i) 20% of the above sales are made to customers in Indonesia and Singapore. Export sales are stated after deduction of foreign withholding tax of Rs. 1,170,000.

(ii) Local sales are inclusive of 16% sales tax. All the above expenses, other than cost of sales, are related only to the company's local sales.

(iii) On 1 January 20X2, Capsule plc. a Malaysian company which owns 60% of the share capital in PPL, granted a loan of Rs. 8,500,000 to PPL at a mark-up of 12% per annum. The loan was given for the production of Hepatitis vaccines in Swat, a project fully approved by the Federal Government. The principal repayment is due to commence from July 20X3. Mark-up on above loan, included in financial charges, amounted to Rs. 1,020,000. PPL's equity at the beginning of the year amounted to Rs. 4,000,000.

(iv) On 15 June 20X2, Capsule plc., under a group scheme, awarded its own shares to some of the senior employees of PPL. As the shares were vested immediately, PPL recognised an expense of Rs. 1,758,000 at a grant date fair value of the award, with a credit recognised in equity. The expense is included in other charges.

(v) Administrative and selling expenses include the following:
- Rs. 800,000 paid against professional books purchased from a website of a company in UK. No tax was withheld by PPL from such payment.
- Rs. 200,000 paid as donation to a hospital established under a private trust.
- Rs. 600,000 payable as rent to the landlord for PPL's parking area. Withholding tax has not been deducted from this amount.

(vi) On 1 July 20X2, PPL granted an interest free loan of Rs. 500,000 to one of its shareholders.

(vii) Financial charges include interest of Rs. 180,000 on account of machinery obtained on finance lease. Total lease rentals paid during the year amounted to Rs. 500,000. At the end of the lease term which expired on 31 August 20X2, the machinery was transferred to PPL at a residual value of Rs. 640,000. The market value of the machinery on the date of its transfer amounted to Rs. 760,000.

(viii) Other income includes gain on sales of delivery van of Rs. 130,000. The van was acquired on 1 January 20X1 at a cost of Rs. 900,000 and was depreciated at the rate of 20% per annum. No depreciation is charged by PPL in the year of disposal.

(ix) Accounting depreciation charged to cost of sales and administrative and selling expenses amounted to Rs. 1,440,000 and Rs. 810,000 respectively.

(x) Tax depreciation on assets acquired before January 20X2 amounted to Rs. 1,800,000.

(xi) Tax paid u/s 147 amounted to Rs. 400,000 whereas tax deducted u/s 154 by banks from export proceeds amounted to Rs. 78,300.

Required:

Under the provisions of Income Tax Ordinance, 2001 compute the taxable income and net tax payable for the tax year 20X3. Give reasons for the treatment of items in (iii) and (vii) above. Also explain the treatment of items not appearing in your computation.

Note: Tax rates are given on the last page. **(25)**

Q.4 (a) Under the provisions of Federal Excise Act, 2005 describe the circumstances under which a person is liable to pay default surcharge. What would be the period of default under the above circumstances? **(06)**

(b) Under the provisions of Federal Excise Act, 2005 explain the following:

(i) Special excise duty **(04)**

(ii) KIBOR **(02)**

Q.5 (a) Under the provisions of Income Tax Ordinance, 2001 briefly describe the method(s) under which a person accounting for income under the head "Income from Business" may compute the cost of stock-in-trade. **(03)**

(b) In the light of the provisions of Income Tax Ordinance, 2001 narrate the circumstances under which salary received by an employee of a foreign government shall be exempt from tax. **(04)**

Q.6 Tender Pops Limited (TPL) is registered under the Sales Tax Act, 1990. The company is engaged in the business of manufacture and supply of consumer goods. Following information has been extracted from TPL's records for the month of May 2013:

	Rupees
Purchases:	
Raw material from local registered suppliers	20,000,000
Local items governed under third schedule (75,000 @ Rs. 150 each)	11,250,000
Packing material from a local cottage industry	2,000,000
Supplies:	
Taxable supplies to registered persons	19,000,000
Taxable supplies to un-registered persons	8,000,000
Local third schedule items to wholesalers (55,000 @ Rs. 180 each)	9,900,000
Taxable supplies against international tender for Afghan refugees.	3,000,000

Following information is also available:

(i) TPL has entered into a hire purchase agreement with Web Limited for the supply of goods worth Rs. 459,000 inclusive of 2% mark-up.

(ii) Goods worth Rs. 200,000 were supplied to a creditor against final settlement of his debt of Rs. 175,000.

(iii) Taxable supplies to registered persons include the sale of old stock at a discounted price of Rs. 350,000. TPL allowed an unusually high discount of 30% to the customer. The discount amount was however reflected on the invoice.

(iv) Sales tax paid on electricity bill was Rs. 25,000.

(v) TPL received advance of Rs. 100,000 for the supply of goods to one of its customers.

(vi) Third schedule items are sold in the market at a retail price of Rs. 200 per unit.

(vii) Supplies against international tender were made to WFP in full compliance with the procedures laid down by State Bank of Pakistan and foreign exchange regulations.

All the above figures are exclusive of sales tax, wherever applicable. Sales tax is payable at the rate of **16%**.

Required:
Under the provisions of Sales Tax Act, 1990 and Rules made thereunder, calculate the sales tax payable by or refundable to TPL for the tax period May 2013. **(18)**

(THE END)

EXTRACTS FROM THE INCOME TAX ORDINANCE, 2001

The First Schedule

Division II
Rates of Tax for Companies

1. The rate of tax imposed on the taxable income of a public/private company shall be 35%.
2. The rate of tax imposed on the taxable income of a small company shall be 25%.

Division VII
Capital Gains on disposal of Securities

S.No.	Period	Tax Year	Rate of Tax
1.	Where holding period of a security is less than six months.	2012	10%
		2013	10%
2.	Where holding period of a security is more than six months but less than twelve months.	2012	8%
		2013	8%
3.	Where holding period of a security is twelve months or more.	-	0%

The Third Schedule

Depreciation Rates

1.	Building (all types)	10%	2.	Furniture and fittings	15%
3.	Plant and machinery	15%	4.	Motor vehicles (all types)	15%
5.	Computer hardware	30%			

Initial Allowance and First Year Allowance

The rate of initial allowance for eligible depreciable assets shall be 50%.

The Institute of Chartered Accountants of Pakistan

Advanced Taxation

Final Examination
Winter 2012
Module F

6 December 2012
100 marks - 3 hours
Additional reading time - 15 minutes

Q.1 Mr. Yaqeen, a Pakistani citizen, returned to Pakistan on 30 June 20X1 after residing for six years in Norway. On 1 July 20X1 he joined a private hospital KKUH and received following emoluments:

	Rupees
Basic salary (per month)	500,000
Medical allowance (per month)	60,000
Leave fare assistance	240,000

On 1 January 20X2 Mr. Yaqeen resigned from the hospital and joined Dil (Private) Limited (DPL), a company engaged in health care and production of dental products. Mr. Yaqeen received Rs. 3,000,000 from DPL as consideration for joining the company. DPL agreed to pay following emoluments to Mr. Yaqeen for the tax year 20X2:

	Rupees
Basic salary (per month)	800,000
Medical allowance (per month)	80,000
Utilities allowance (per month)	100,000

On 1 January 20X2 DPL provided him with refrigerator, cooking range and washing machine for his use at home. The book value of these appliances was Rs. 200,000 and these were returnable to the company after four years. 15% depreciation was charged by DPL on these appliances.

On 31 March 20X2 he was given an option to purchase 2,000 shares of DPL at Rs. 50 per share. The breakup value of the company on that date was Rs. 150 per share.

On 1 April 20X2 he received a loan of Rs. 5,000,000 from DPL for the purchase of a house. The profit on loan was payable at the rate of 8% per annum. The prescribed bench mark rate is 10% per annum.

Other information relevant to Mr. Yaqeen for the tax year 20X2 is as under:

(i) On 15 April 20X2 he fell ill and was admitted to KKUH where he had been working during his employment. The hospital incurred Rs. 50,000 on his treatment but charged nothing to him.

(ii) On 30 April 20X2 he received salary arrears of Rs. 900,000 from his ex-employer in Norway.

(iii) Mr. Yaqeen had 30 acres of agricultural land in Dheer which he did not cultivate himself. During tax year 20X2 he received annual rent of Rs 600,000 from the tenant cultivating the land.

(iv) On 1 May 20X2 he spent Rs. 800,000 on the renovation of his residential house. The entire amount was obtained as a loan from a scheduled bank on which a profit of Rs. 20,000 was paid to the bank during the tax year 20X2.

(v) On 15 June 20X2 he received insurance claim of Rs. 600,000 against theft of a painting which was stolen on 31 May 20X2. The painting was purchased by him on 1 January 20X1 for Rs. 350,000. He had paid insurance premium of Rs. 24,000 and also paid lawyer's fee of Rs. 50,000 who represented him in the settlement proceedings.

(vi) On 15 July 20X1 Mr. Yaqeen received 20,000 shares in AB (Private) Limited (ABL), a company incorporated under the Companies Ordinance, 1984 as a dividend in specie. On 30 June 20X2 he sold 15,000 shares in ABL for Rs. 425,000. The fair market value of these shares, on the date of issue, was estimated at Rs. 25 per share.

Required:
Under the provisions of Income Tax Ordinance, 2001 compute the taxable income and net tax payable for the tax year 20X2. Give brief reasons for the treatment of items in (v) and (vi) above. Also explain the treatment of any items that are not appearing in your computation.

Note: Tax rates are given on the last page. **(25)**

Q.2 (a) Who may be regarded as the representative of the following under the provisions of Sales Tax Act, 1990?
(i) Individual with legal disability
(ii) Association of persons
(iii) Federal Government
Also identify the circumstances when such representative becomes personally liable for the payment of any tax due by the above registered persons. **(08)**

(b) In view of the provisions of Sales Tax Act, 1990 when does a notice served by the commissioner on a non-resident individual is treated as properly served? **(04)**

Q.3 Under the provisions of Income Tax Ordinance, 2001:
(a) Identify the persons and the conditions subject to which such persons paying taxes under Presumptive tax regime may opt for Normal tax regime. **(05)**
(b) What is meant by “Associates”? State the circumstances under which the following may be regarded as associates:
- A member of an association of persons and the association
- A shareholder in a company and the company **(07)**

(c) State the meaning of the terms “Tax evasion” and “Tax avoidance” giving example of the situation when each can occur. **(04)**

Q.4 (a) Mr. Sohail, a resident individual, owns a building in Clifton area of Karachi. On 1 October 20X1 he rented out the building to Mr. Baqir at an annual rent of Rs. 1,200,000. This amount included Rs. 15,000 per month for arranging two security guards for the building. Following expenses were incurred by Mr. Sohail on the building during the tax year 20X2.

	Rupees
Repairs and renovation	35,000
Property tax	20,000
Insurance premium	10,000
Rent collection charges	3,000

Mr. Sohail also paid a salary of Rs. 4,000 per month to each of the two security guards at the building.

Required:
Under the provision of Income Tax Ordinance, 2001 calculate the taxable income of Mr. Sohail under the appropriate heads of income for the tax year 20X2. **(06)**

(b) Under the provisions of **Income Tax Rules, 2002** briefly describe the following:
(i) Derivative Products **(03)**
(ii) Wash Sales **(03)**
(iii) Tax Swap Sales **(03)**

Q.5 Under the provisions of Federal Excise Act, 2005 and Rules made thereunder, explain:
(a) “Due date” and “Duty due” **(04)**
(b) “Establishment” and “Person” **(04)**
(c) How and under what circumstances a collector may suspend a person’s registration. **(04)**

Q.6 Mazboot Furnishers (MF), a retailer, has been in operation for a number of years but was not registered with Inland Revenue Department due to low turnover. However, after engaging in engraving process of household furniture, MF was compelled to register with the sales tax authorities and got registration as a manufacturer-cum-retailer. The application for registration was made on 1 November 2012 and the certificate of registration was issued on 7 November 2012.

Following information has been extracted from MF's records for the month of November 2012:

	Rupees
Sales	700,000
Less: Cost of sales	
Opening stock	125,000
Purchases	250,000
	375,000
Less: closing stock	(95,000)
	280,000
Add: engraving charges	50,000
	(330,000)
Gross profit	370,000
Less: Operating expenses	
Salaries and wages	(45,000)
Rent	(25,000)
Insurance	(30,000)
Bank charges	(15,000)
General expenses	(25,000)
Depreciation	(15,000)
	(155,000)
Net profit	215,000

Additional information:

(i) 20% of the sales relates to goods purchased locally and exported to customers in Iran whereas 5% of the sales were made against international tenders.

(ii) Opening stock is verifiable and consists of purchases made in different months as follows:
- 15 August Rs. 50,000 (import)
- 10 September Rs. 25,000 (local)
- 4 October Rs. 50,000 (local)

(iii) Rent was payable to Dir Furnishers, a local vendor.

(iv) Insurance expense includes Rs. 25,000 paid against fire and theft insurance whereas Rs. 5,000 relates to staff's health insurance policies.

(v) General expenses comprises of charges paid against inland carriage of furniture by air, purchase of shoes for field staff, expenses incurred on the purchase of printed stationery and staff entertainment expenses in the ratio of 40:25:20:15 respectively.

(vi) 65% of the depreciation relates to a car which was acquired for Rs. 780,000 whereas 25% depreciation pertains to a wood engraving machine purchased for Rs. 300,000. The car as well as engraving machine was acquired at the beginning of November 2012.

(vii) All purchases, unless otherwise mentioned, are from local registered suppliers against prescribed sales tax invoices.

All the above figures are **exclusive of federal excise duty (FED) and sales tax**, wherever applicable. Sales tax is payable at the rate of **16%.** The goods supplied by MF are not subject to duty under the Federal Excise Act, 2005.

Required:

Under the provisions of Sales Tax Act, 1990, Federal Excise Act, 2005 and Rules made thereunder, calculate the following for filing the sales tax-cum-federal excise return for November 2012.

(a) Sales tax and FED payable/refundable/carried forward, if any, assuming the rate of duty is **10%** on all excisable items/services. **(16)**

(b) Give brief reasons for the treatment accorded to opening stock. **(04)**

(THE END)

EXTRACTS FROM THE FIRST SCHEDULE OF THE INCOME TAX ORDINANCE, 2001

PART I

Division I – Rate of Tax for Salaried Individuals

S. #	Taxable Income	Rate of Tax
1.	Rs. 0 to 400,000	0%
2.	Rs. 400,000 to Rs. 750,000	5% of the amount exceeding Rs. 400,000
3.	Rs. 750,000 to Rs. 1,500,000	Rs. 17,500+10% of the amount exceeding Rs. 750,000
4.	Rs. 1,500,000 to Rs. 2,000,000	Rs. 95,000+15% of the amount exceeding Rs. 1,500,000
5.	Rs. 2,000,000 to Rs. 2,500,000	Rs. 175,000+17.5% of the amount exceeding Rs. 2,000,000
6.	Rs. 2,500,000 and above	Rs. 420,000+20% of the amount exceeding Rs. 2,500,000

Division III

Rate of Dividend Tax

The rate of tax imposed on dividend received from a company shall be 10%.

The Institute of Chartered Accountants of Pakistan

Advanced Taxation

Final Examination	7 June 2012
Summer 2012	100 marks - 3 hours
Module F	Additional reading time – 15 minutes

Q.1 (a) Saturn Limited (SL), an unlisted public company, is engaged in the manufacture and sale of Talc both locally and in international markets. The company has two overseas branches located in Korea and China. Following information has been extracted from company's records for the year ended 31 March 20X2:

	Pakistan Operation		Overseas Branches	
	Local	**Export**	**Korea**	**China**
	---------------Amount in Rupees---------------			
Sales	10,000,000	7,000,000	6,000,000	8,000,000
Profit before taxation	4,000,000	3,500,000	800,000	1,000,000
Taxes paid during the year	1,600,000	70,000	250,000	400,000

SL's net profit from local operation includes the following:

(i) Profit on debt amounting to Rs. 1,000,000 paid by SL to a Swiss bank against a short term loan obtained to meet the working capital requirements of its China branch.

(ii) Rs. 100,000 written back on account of excess provision for bad debts, made last year.

A donation of Rs. 600,000 deposited to Prime Minister's Flood Relief Fund 2010 has been erroneously excluded from the computation of income.

Required:

Under the provisions of Income Tax Ordinance, 2001 compute the taxable income and net tax payable / refundable for the tax year 20X2. Give brief reasons for the treatment of the items excluded from computation or for which no expense deduction is allowed. ***(12 marks)***

(b) Identify the authority and briefly describe the methods by which SL may be selected for the audit of its Income Tax affairs in the tax year 20X2. Also state whether SL can again be selected for audit in tax year 20X3 if nothing was found during its audit in the tax year 20X2. ***(06 marks)***

Q.2 Mr. Abid is a recently qualified chartered accountant. He wants to establish a sales tax practice and intends to become an e-intermediary for the purpose of electronically filing the returns and other prescribed documents on behalf of his clients. Under the provisions of Sales Tax Rules, 2006 advise Mr. Abid on the following:

Required:

(a) Procedure for appointment as e-intermediary. ***(05 marks)***

(b) Responsibilities of an e-intermediary. ***(03 marks)***

(c) Cancellation of appointment as an e-intermediary. ***(05 marks)***

Q.3 Briefly describe the provisions of Federal Excise Act, 2005 with respect to the liability for payment of excise duty in case of following:

(a) Discontinued business enterprise. ***(04 marks)***

(b) Transfer of ownership of a business to another person as an ongoing concern. ***(05 marks)***

Q.4 Sun Limited (SL), a listed company, owns 100% ordinary share capital of an unlisted public company Venus Limited (VL). Both SL and VL are engaged in the manufacturing and supply of chemicals.

VL holds 85% ordinary share capital of Mars Limited (ML), who is engaged in the trading of packing materials and sells its products to individual customers. Following information has been extracted from the records of the above companies for the period ended 31 March 20X2:

(i)

	SL	VL	ML
	Rs. in '000		
Sales	17,000	6,000	3,500
Profit/(loss) before taxation	3,700	(1,400)	1,300

(ii) The above profit/(loss) for each company has been arrived at after inclusion/adjustment of the following:

In case of SL:

- Rs. 1,000,000 paid by SL towards a scientific research conducted in Belgium. The research helped SL in improving the quality of its products.
- Income of Rs. 150,000 on account of profit on debt.
- Gain of Rs. 100,000 on sale of machinery to VL. The cost of machinery was Rs. 300,000 and its tax written down value at the time of transfer to VL was Rs. 200,000.

In case of VL:

- Rs. 80,000 written off against a loan provided to an employee.
- Sales promotion expenses of Rs. 600,000 paid by VL to Moon Advertisers. The benefits are expected to extend to three years.
- A loss of Rs. 500,000 on disposal of shares in a private company. These shares were acquired by VL on 31 March 20X0.

In case of ML:

- Net income of Rs. 600,000 from a goods transportation business. ML started this business during the year and earned gross revenue of Rs. 1,500,000. Withholding tax of Rs. 30,000 was deducted by customers from ML's gross receipts.
- A gain of Rs. 400,000 on disposal of shares in a private company. These shares were acquired by ML on 01 April 20X0.
- Income of Rs. 300,000 on account of profit on debt.

(iii) Accounting depreciation of SL, VL and ML amounted to Rs. 760,000, Rs. 660,000 and Rs. 100,000 respectively.

(iv) A delivery truck costing Rs. 1,500,000 was purchased by ML during the year for its new transportation business.

(v) The tax written down values of the plant and machinery of SL, VL and ML as at 01 April 20X1 were Rs. 4,500,000, Rs. 4,200,000 and Rs. Nil respectively.

(vi) Tax depreciation on all assets, other than plant and machinery and delivery truck, of SL, VL and ML amounted to Rs. 495,000, Rs. 330,000 and Rs. 135,000 respectively.

(vii) The assessed losses brought forward from tax year 20X1 were as follows:

	SL	VL	ML
	Rs. in '000		
Business loss	200	500	50
Unabsorbed tax depreciation	250	500	100
Capital loss	750	250	200

(viii) Following taxes were deducted / paid during the year:

	SL	VL	ML
	Rs. in '000		
Advance tax u/s 147, 148 and 153	789	275	-
Motor vehicle tax under u/s 234	-	-	40

Required:
Assuming SL wants to avail the benefits of group relief as envisaged under the Income Tax Ordinance, 2001, compute the taxable income, net tax payable / refundable and unabsorbed losses, if any, to be carried forward for each of the above three companies for the tax year 20X2.
Note: Show all relevant exemptions, exclusions and disallowances. Tax rates are given on the last page.
(22 marks)

Q.5 Ummeid Limited (UL) is registered under the Sales Tax Act, 1990. The company is engaged in the manufacture and sale of a range of fibre glass products. Following information has been extracted from UL's records for the month of May 2012.

	Rupees
Purchases:	
Local:	
▪ raw material from registered suppliers	25,000,000
▪ raw material from un-registered suppliers	10,000,000
Import of raw material	4,000,000
Supplies:	
Local:	
▪ taxable supplies to registered persons	20,500,000
▪ taxable supplies to un-registered persons	9,000,000
▪ exempt goods	6,000,000
Export to Portugal	12,500,000

Additional information:

(i) Raw materials purchased from a registered supplier in April 2012 were destroyed by fire. However, UL received full insurance claim of Rs. 1,000,000 against such loss. Input tax paid on such raw material was however adjusted by UL in its April 2012 return.

(ii) On scrutiny of the company's previous sales tax returns, the internal auditor has pointed out that input tax on raw materials of Rs. 200,000 purchased in October 2011 from a local registered supplier has not been claimed / adjusted by UL.

(iii) UL under misapprehension collected additional sales tax of Rs. 64,000 from one of its customers. 70% of the goods on which additional sales tax was collected are still lying with the customer as unsold stock.

(iv) Taxable supplies to registered persons include the following:
- Goods worth Rs. 500,000 supplied to AB Limited which is registered as an exporter with the Large Taxpayer Unit.
- Supplies of Rs. 2,000,000 to a domestic airline for regular maintenance of an aircraft weighing 8,500 kilograms.

(v) Raw materials purchased from local registered suppliers include an invoice of Rs. 100,000 which was issued in the name of a director of UL.

All the above amounts are **exclusive** of sales tax, wherever applicable. Sales tax is payable at the rate of **16%**. The value of imported raw material is inclusive of custom duty and federal excise duty. However, other goods are not subject to duty under the Federal Excise Act, 2005.

Required:
In the light of the provisions of Sales Tax Act, 1990 and Rules made thereunder, calculate the sales tax payable by or refundable to UL for the tax period May 2012. Give brief reasons for the treatment of:
- goods destroyed by fire;
- the input tax not claimed in the return for the month of October 2011; and
- additional sales tax collected from the customer. ***(18 marks)***

Q.6 Under the provisions of Income Tax Ordinance, 2001 discuss the tax treatment in case of each of the following independent situations.

(a) Khalq Limited (KL) is engaged in the manufacture and supply of polio vaccines. In order to meet the increasing demand for vaccines, KL expanded its manufacturing facilities in July 20X1. This expansion project involved a capital expenditure of Rs. 75 million including a cost of Rs. 50 million which was spent on the acquisition of new plant and machinery.

The Federal Government, realising the importance of the project, voluntarily paid a grant of Rs. 20 million to KL towards the cost of new machinery. KL transferred the amount of grant to capital reserve in its financial statements for the year ended 31 March, 20X2. The management is of the view that Rs. 20 million should be claimed as exempt from tax in the return of income for the tax year 20X2. ***(05 marks)***

(b) Moon Limited (ML), an unlisted public company, engaged in the manufacture of sports goods, remitted US $ 30,000 to JH Hospital in Boston, USA for the medical treatment of its CEO. According to the terms of his employment the CEO is entitled to free provision of medical treatment and hospitalization. The amount was remitted on 1 March 20X2 in compliance with the regulations of the State Bank of Pakistan. The management of ML is of the view that the expenditure would not be allowed as a deductible expense in tax year 20X2 as no tax was withheld from the payment to JH Hospital in Boston, USA. ***(06 marks)***

(c) Mr. Pansari, a resident taxpayer, is operating a departmental store in Lahore. He received a dividend of Rs. 45,000 from Rasila Farms Limited (RFL) for the year ended 31 March 20X2. The amount received was credited to his capital account. Mr. Pansari is of the view that since RFL derives its entire income from agriculture, which is exempt from tax, the dividend of Rs. 45,000 being paid from an exempt income is also not chargeable to tax. ***(03 marks)***

(d) Gadget Limited (GL) is a public company engaged in the manufacture and sale of electrical appliances. During tax year 20X2, GL launched an advertising campaign for the promotion of a new product. An Indian artist was hired for making a TV commercial at an agreed remuneration of Rs. 10 million. GL's management is of the view that in order to claim the expense as deductible, payment of Rs. 10 million should be made through normal banking channel and no tax should be deducted from the payment as the entire advertisement was produced in India. ***(06 marks)***

(THE END)

EXTRACTS FROM THE FIRST SCHEDULE OF THE INCOME TAX ORDINANCE, 2001

Division II
Rates of Tax for Companies

1. The rate of tax imposed on the taxable income of a public/private company shall be 35%.
2. The rate of tax imposed on the taxable income of a small company shall be 25%.

The Third Schedule
Depreciation Rates

1.	Building (all types)	10%	2.	Furniture and fittings	15%
3.	Plant and machinery	15%	4.	Motor vehicles (all types)	15%
5.	Computer hardware	30%			

The Institute of Chartered Accountants of Pakistan

Advanced Taxation

Final Examination	8 December 2011
Winter 2011	100 marks - 3 hours
Module F	Additional reading time – 15 minutes

Q.1 Mateen and Vaqas are planning to commence a business venture selling pesticides to the farmers. They are however, not certain whether the business venture should be in the form of a partnership or a limited liability company. They intend to make investment and share the profits in the following ratio:

- Mateen 60%
- Vaqas 40%

Further, in case of incorporation of a limited liability company they would distribute 60% of the after tax profits as dividends.

Following are the expected results of their twelve months' operation:

	Rupees
Sales	10,500,000
Cost of sales	(4,410,000)
Gross profit	6,090,000
Salaries and wages	(3,165,000)
Rent and rates	(582,000)
Travelling and entertainment	(273,000)
Depreciation	(975,000)
Profit before taxation	1,095,000

Salaries and wages include salaries of Rs. 1,100,000 and Rs. 970,000 to be paid to Mateen and Vaqas respectively.

Depreciation relates to delivery vehicles. In the first year tax depreciation allowance on these vehicles is estimated at Rs. 1,462,500.

Required:
Under the provisions of Income Tax Ordinance, 2001 advise Mateen and Vaqas on the preferable structure of their business, whether it should be a partnership or a limited liability company, in terms of the amount of tax payable, assuming that they have no other sources of income.
(For the purpose of your calculations, tax rates are given at the end of this paper.) ***(11 marks)***

Q.2 (a) Describe the powers of an officer of Inland Revenue with regard to the recovery of arrears of tax as enumerated under the Sales Tax Act, 1990. ***(10 marks)***

(b) In view of the provisions of Sales Tax Act, 1990 identify the persons who may be regarded as the representative of a non-resident person for a tax year. ***(04 marks)***

Q.3 Explain the following in the light of the provisions of Federal Excise Act, 2005.

(a) The persons who are liable to pay Federal Excise Duty. ***(05 marks)***

(b) The alternative sources on which duty may be levied and collected by the Board, in lieu of levying and collecting duties on goods and services. ***(02 marks)***

(c) The circumstances under which duty drawback may be allowed to a taxpayer. Also state the relevant authority who may grant such drawback. ***(04 marks)***

Q.4 Mega Limited (ML), an unlisted public company, owns an industrial undertaking which is engaged in the manufacturing and supply of specialized machinery to power projects.

Following is the extract from the profit and loss account of ML for the period ended 30 June 20X8:

	Rs. in '000
Sales	1,100,000
Cost of Sales	(792,000)
Gross Profit	308,000
Administrative and selling expenses	(135,000)
Financial charges	(110,000)
Other charges	(27,500)
Other income	117,000
Profit before taxation	152,500

Additional information:

(i) In July 20X7, ML purchased and installed plant and machinery for the purpose of balancing, modernization and replacement of existing plant and machinery from an Austrian based non-resident supplier at a cost of Rs. 52 million. The title in goods was transferred outside Pakistan. ML did not deduct any tax from payments made to the supplier. The plant is depreciated on a straight line basis over its useful life of ten years. The investment in plant was made with borrowed funds.

(ii) Cost of sales includes a penalty of Rs. 0.5 million paid in respect of breach of customs regulations.

(iii) Administrative expenses include amounts of Rs. 4.8 million, paid against purchase of industrial software having a useful life of three years and Rs. 5 million paid in cash for electricity expenses. The software was installed and used with effect from 01 April 20X8.

(iv) Other charges include a donation of Rs. 13 million paid to a university established under provincial law by the Government of Punjab.

(v) Other income includes the following:

- An amount of Rs. 27 million earned from consultancy services provided to the UAE Government. The gross receipts from such services were Rs. 90 million. No tax was paid by the company in UAE on such income.
- A royalty of Rs. 50 million which was received from Solar Pte Limited, a company based in Singapore, for providing scientific and commercial knowledge under an agreement. Withholding tax of Rs. 10 million was deducted by Solar Pte Limited from such payment. This amount is included in other charges.

The above amounts were brought into Pakistan in foreign exchange through normal banking channels in compliance with the foreign exchange regulations of the State Bank of Pakistan.

(vi) Unadjusted business loss, brought forward from tax year 20X1, amounted to Rs. 50 million. This loss is inclusive of an unabsorbed tax depreciation of Rs.11 million and amortisation of pre-commencement expenditure of Rs. 7.7 million.

(vii) Following taxes were deducted / paid by the company during the year:

	Rs. in '000
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 by banks on profit on debt	250

(viii) Assume that tax depreciation on all assets acquired before July 20X7 is the same as their accounting depreciation.

Required:

(a) Under the provisions of Income Tax Ordinance, 2001 compute the taxable income and net tax liability of ML for the tax year 20X8. ***Tax rates are given on the last page***.
(*Show all exemptions, exclusions and disallowances where relevant.*) ***(21 marks)***

(b) Based on the computation of tax liability in (a) above, briefly explain whether the advance tax paid quarterly by ML under section 147 could result in any further tax liability to the company with reference to the provisions of Income Tax Ordinance, 2001. ***(05 marks)***

Q.5 Sunshine Limited (SL), a registered person under the Sales Tax Act, 1990 is engaged in the production and supply of three products Alpha, Beta and Gama. Beta is a by-product of Alpha and is governed under the third schedule. It is sold in the market at a retail price of Rs. 25 per unit.

Following information is available from SL's records for the month of November 2011:

Purchases:	**Rupees**
Raw material used in the production of Alpha	10,000,000
Raw material used in the production of Gama	15,000,000
Supplies:	
Local taxable supplies of Alpha to registered persons	15,000,000
Local taxable supplies of Alpha to un-registered persons	3,000,000
Local supplies of Gama to registered persons	18,000,000
Export of Gama to Turkey	7,000,000
Local taxable supplies of Beta to wholesalers (250,000 units @ Rs. 20 each)	5,000,000
Supply of 25,000 units of Beta to Export Processing Zone for further processing	625,000

Additional information:

(i) Supplies of Alpha to registered persons include sale of Rs. 2,000,000 to an associated company. The open market price of Alpha at the time of sale was Rs. 4,000,000.

(ii) Free replacement of defective units is made in the case of Alpha, which is sold under warranty. The market value of replacement units during the month of November 2011 was Rs. 1,000,000.

(iii) SL provided 50,000 units of Beta to its employees free of charge.

(iv) In November 2011 SL imported new machinery from Japan for the purpose of launching a new product Zeta. The production of Zeta is expected to commence from April 2012. Sales tax paid on this machinery amounted to Rs. 3,000,000.

(v) Input tax of Rs. 500,000 was inadvertently not adjusted in the return for the month of October 2011.

(vi) The local supplies of Gama are exempt from the charge of sales tax.

(vii) All purchases are from registered suppliers.

All the above figures are exclusive of sales tax, wherever applicable. Sales tax is payable at the rate of 16%. The above products are not subject to duty under the Federal Excise Act, 2005.

Required:
In the light of the provisions of Sales Tax Act, 1990 and Rules made thereunder, calculate the sales tax payable/refundable/carried forward, if any, for the tax period November 2011. ***(15 marks)***

Q.6 (a) In the light of the provisions of Income Tax Ordinance, 2001 explain the term "Tax avoidance scheme". Under what circumstances the Commissioner may exercise his powers to recharacterise or disregard a transaction? ***(05 marks)***

(b) A foreign company, for the purpose of executing construction contracts, intends to establish a branch office in Pakistan.

Required:
Under the provisions of Income Tax Ordinance, 2001 advise the company on the following:

(i) Circumstances under which taxes withheld from the payments made to a non resident person would be construed as final tax under the presumptive tax regime. ***(03 marks)***

(ii) The tax implication in each of the following cases while determining chargeable income of the branch office in Pakistan.

- Head office expenditure
- Compensation for management services performed by the branch
- Profit payable on debt to finance the operations of the branch ***(05 marks)***

Q.7 Rose Petal Limited (RPL) is engaged in the construction business for the past many years. In April 20X1, Sind Provincial Government awarded a contract of Rs. 9.0 million to RPL for the construction of 10 primary schools in the districts of Khairpur and Badin over a period of three years. The company expects to earn a profit of 25% of the contract value. The project was scheduled to start in July 20X1 and be completed on 30 June 20X4.

The amount received and costs incurred by RPL on the contract over the period of three years were as under:

Tax Year	Receipts	Costs
	Rupees	
20X2	3,000,000	3,105,000
20X3	3,000,000	2,632,500
20X4	3,000,000	1,012,500

Required:
Under the provisions of Income Tax Ordinance, 2001 calculate the taxable income for each of the above three tax years. ***(10 marks)***

(THE END)

EXTRACTS FROM THE FIRST SCHEDULE OF THE INCOME TAX ORDINANCE, 2001

Division I – Rate of Tax for Salaried Individuals

S. #	Taxable Income	Rate of Tax
(1)	(2)	(3)
8	Where the taxable income exceeds Rs. 900,000 but does not exceed Rs. 1,050,000,	9.00%
9	Where the taxable income exceeds Rs. 1,050,000 but does not exceed Rs. 1,200,000,	10.00%
10	Where the taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 1,450,000,	11.00%
11	Where the taxable income exceeds Rs. 1,450,000 but does not exceed Rs. 1.700,000,	12.50%
12	Where the taxable income exceeds Rs. 1,700,000 but does not exceed Rs. 1.950,000,	14.00%

Division IB
Rate of Tax for Association of Persons

The rate of tax imposed on the taxable income of Association of Persons shall be 25%.

Division II
Rates of Tax for Companies

1. The rate of tax imposed on the taxable income of public/private company shall be 35%.
2. The rate of tax imposed on the taxable income of a small company shall be 25%.

Division III
Rate of Dividend Tax

The rate of tax imposed on dividend received from a company shall be 10%.

The Third Schedule
Depreciation Rates

1.	Building (all types)	10%	2.	Furniture and fittings	15%
3.	Plant and machinery	15%	4.	Motor vehicles (all types)	15%
5.	Computer hardware	30%			

Initial Allowance and First Year Allowance

The rate of initial allowance for eligible depreciable assets shall be 50%.

The Institute of Chartered Accountants of Pakistan

Advanced Taxation

Final Examinations Module F – Summer 2011	**Reading time – 15 minutes**	June 9, 2011 100 marks – 3 hours

Q.1 Mr. Khan has been working for a listed company Turtle Limited (TL) for the last many years. The details of his emoluments during the tax year ended June 30, 20X4 are as under:

	Rupees
Basic salary (per month)	350,000
Conveyance allowance (per month)	50,000

In addition to the above cash emoluments, Mr. Khan was also provided with the following:

(a) A rent free furnished accommodation with a fair market rent of Rs. 100,000 per month.
(b) An 1800cc company maintained car, both for business and private use. The car was purchased by TL on July 1, 20X1 at a fair market value of Rs. 2,000,000.
(c) On July 1, 20X3 he was provided with an interest free loan of Rs. 2,500,000 which is repayable in lumpsum in December 20X4. The prescribed benchmark rate is 13% per annum. On December 1, 20X3 Mr. Khan utilized 60% of the amount of loan for purchasing a double storey bungalow. The total cost of the bungalow was Rs. 25,000,000. The bungalow, on its ground floor, also had a suitable space for opening a departmental store.

In order to increase its operational efficiency, TL announced a redundancy scheme to its employees. Mr. Khan opting for the scheme resigned from TL with effect from January 1, 20X4. Upon resignation, 25% of his outstanding loan balance was waived by TL and the remaining loan amount was adjusted from his final settlement. He received the following payments from TL:

	Rupees
Compensation under the redundancy scheme	4,000,000
Gratuity under unapproved scheme	2,000,000

Following further information is also available:

(i) Tax of Rs. 1,837,000 was withheld by TL from the above payments.
(ii) Mr. Khan was allowed to purchase the 1800cc car at an accounting book value of Rs. 1,000,000 which he sold in the open market at a price of Rs. 1,500,000.
(iii) On March 1, 20X4 Mr. Khan rented out the ground floor of his bungalow to Mr. Riaz, for establishing a departmental store, at a monthly rent of Rs. 137,500. Due to the strategic location of the store, he also received adjustable and non-adjustable deposits of Rs. 600,000 and Rs. 500,000 respectively.
(iv) On April 1, 20X4 he rented out the residential portion of the bungalow to a Commercial Bank for their marketing executive. He received gross amount of Rs. 2,400,000 as two year's advance rent. The Bank deducted tax of Rs. 197,500 from such payment.
(v) A donation of Rs. 500,000 was made to an un-approved trust for the construction of mosque.
(vi) In July 20X1, Mr. Khan was issued shares in TL. The fair market value of shares at the time of issue was Rs. 500,000. He disposed off these shares in June 20X4 at a gain of Rs. 500,000.

Required:
Compute the taxable income, tax liability and tax payable/ refundable, if any, to Mr. Khan for the tax year 20X4. The average rate of tax of Mr. Khan for the last three years was **18%**. ***(20 marks)***

Note: *Show all exemptions, exclusions and disallowances where relevant. Tax rates are given on the last page.*

Q.2 Ms. Hina started her business on January 12, 2011 at a kiosk, located at Karachi Airport. She sells an exclusive blend of coffee imported from Kenya and packed dates purchased from a company in Khairpur. Ms. Hina though not registered with Inland Revenue Department, paid sales tax on all taxable purchases.

In order to increase the efficiency and profit margin of her business, she decided to get herself registered with the sales tax authorities enabling her to reclaim the input tax on her purchases. She made an application for voluntary registration under the Sales Tax Act, 1990 on April 25, 2011 and was registered with effect from May 2, 2011. Following was the position of her unsold stock of coffee and dates at April 25, 2011:

S. No.	Description	Date of purchase	Sales Tax paid (Rs.)
(i)	25 kg of coffee imported	January 15, 2011	23,750
(ii)	125 packets of dates purchased	February 2, 2011	12,325
(iii)	42 kg of coffee imported	February 25, 2011	39,900
(iv)	458 packets of dates purchased	March 28, 2011	41,325

Required:
In the light of the provisions of Sales Tax Act, 1990.
(a) Explain whether and under what circumstances Ms. Hina could reclaim the amount of tax paid on the unsold stock acquired before registration.
(b) Calculate the amount of input tax, if any, which she can reclaim with her sales tax return for the month of May 2011. ***(07 marks)***

Q.3 Beetle Limited (BL), an industrial undertaking, is engaged in the manufacture and supply of pesticides. The company manufactures its products from the raw material imported from Malaysia. BL also imports certain pesticides from Dubai, which are supplied to the local distributors without any further processing.

After scrutiny of the tax return filed by BL for the tax year 20X4, the Additional Commissioner has issued a notice under section 122(5A) in which he has raised the following issues:

(i) Tax collected on the import of certain plant and machinery installed at BL's factory has been claimed as an adjustment in the return. The Commissioner is of the view that such tax should instead be treated as a final tax.
(ii) While computing the taxable income, BL has not apportioned the "Cost of goods manufactured" between its income from sale of manufactured products and income from sale of commercial imports. The Commissioner wants such costs to be apportioned between the two revenue streams.
(iii) The audited financial statements show a gain of Rs. 50 million on the disposal of an immovable property comprising office in a commercial building. This property was purchased by the company for Rs. 90 million and was sold for Rs. 120 million. Its tax written down value at the time of disposal was Rs. 70 million. The gain has not been offered to tax by BL. The Commissioner wants to add the amount of Rs. 50 million to the company's taxable income.
(iv) The financial statements also disclose an outstanding liability on account of royalty of Rs. 250 million. This amount payable to BL Dubai Plc. is outstanding for the last four years, pending approval from the State Bank of Pakistan. The expense was claimed by BL in the tax year 20X0. The Commissioner wants to add back the amount to the taxable income of BL.
(v) Bad debts written off during the year include an amount of Rs. 10 million which was provided to a distributor as a loan who has now been declared insolvent. The Commissioner wants to add this amount to the taxable income of BL.

Required:
Under the provisions of Income Tax Ordinance, 2001 explain, giving reasons, as to whether or not the Commissioner's contention with regard to each of the above situation is valid. ***(12 marks)***

Q.4 Gadget Limited (GL) is registered at the Large Taxpayer Unit (LTU) of Inland Revenue Department, Islamabad. It is engaged in the manufacture and supply of electrical appliances. Following information has been extracted from GL's records for the month of May 2011.

	Rupees
Purchases:	
Steel sheets, copper wire, aluminum and allied raw materials	2,500,000
Lubricants, spare parts and stores (include cash purchases of Rs. 900,000)	5,400,000
Gift items for customers - carpets, fancy watches etc.	700,000
Supplies:	
Electric switch-gears and electric motors to diplomatic mission in Islamabad	1,900,000
Air Coolers to customers based in Lahore, Islamabad and Faisalabad	7,000,000
Electric air coolers to customers in Spain and Zanzibar	3,800,000

Following information is also available:

(i) Technical fee of Rs. 1,400,000 was paid to Mr. Michael in Finland for the grant of right, under a contract, to use the latest Humidifier Process for the production of air coolers.
(ii) Rs. 700,000 was paid against bill board advertisement to Z Inc. which is registered with LTU.
(iii) Motors and switches of Rs. 650,000 were supplied for consumption on board a container ship with gross tonnage of 150 LDT. The ship was proceeding to the port of Antwerp.
(iv) Printed stationery of Rs. 500,000 was purchased from registered suppliers for the maintenance of factory records. These suppliers are however not registered with LTU.
(v) Rs. 500,000 was paid to bank on account of L/C opening charges and Rs. 100,000 on account of safe custody fees.
(vi) Sub-standard supplies of Rs. 900,000 were returned to vendors. Proper debit/credit notes were raised in this regard.

All payments for the purchase of goods and services have been made through crossed cheque or crossed pay order/credit card except as otherwise indicated. Sales tax is payable at the rate of **17%**. All the above figures are **exclusive of federal excise duty (FED) and sales tax** wherever applicable. The goods manufactured by GL are not subject to duty under the Federal Excise Act, 2005.

Required:
In the light of the provisions of Sales Tax Act, 1990 and Federal Excise Act, 2005 compute the following for filing the sales tax-cum-federal excise return for the tax period May 2011.

(a) Sales tax payable/refundable.
(b) FED payable, assuming the rate of duty is **10%** on all excisable items/ services. ***(18 marks)***

Q.5 (a) Describe the benefits available under the Income Tax Ordinance, 2001 to persons who are registered under the Sales Tax Act, 1990. Also state the conditions which such persons are required to fulfill in order to be eligible for claiming such benefits. ***(05 marks)***

(b) Skilled (Pvt.) Limited (SPL) wants to form a joint venture with Expert Consultants (Pvt.) Limited (ECPL) for providing disaster management services to corporate clients.

Required:
Under the provisions of Income Tax Ordinance, 2001 advise the CEO of the two companies about the tax treatment of the following:

(i) Income / loss derived by the joint venture; and
(ii) Share of venturer's profit / loss from such venture. ***(09 marks)***

(c) Who may be regarded as short-term resident individual under the Income Tax Ordinance, 2001? Discuss the provisions relating to the taxability of foreign source income of such individuals. ***(04 marks)***

Q.6 Al Maratib, a large group of companies is contemplating to avail the benefits of Group Taxation by offering it to be taxed as one fiscal unit.

Required:
In the light of the provisions of Income Tax Ordinance, 2001 explain the provisions of Group Taxation to the chairman of the group. ***(08 marks)***

Q.7 (a) Under the provisions of Sales Tax Act, 1990 and Rules made thereunder, certain restrictions have been placed on the adjustment of input tax. Explain those provisions in respect of each of the following situations.

(i) X Limited is registered with Inland Revenue Department. It purchased copper wires of Rs. 24 million on credit, for the manufacture of electric fans. The payment was made after 210 days of the issuance of tax invoice by way of a crossed pay order drawn on the business bank account of the company.

(ii) Mr. Baba is working with Y Limited as director procurement. He paid Rs. 698,456 on behalf of the company for the purchase of lubricants using his own credit card.

(iii) Z Limited acquired new machinery for its manufacturing department at a price of Rs. 150 million. Sales tax paid at the time of purchase amounted to Rs. 25.5 million.

(iv) Mr. Haq is registered as a wholesaler under the Sales Tax Act, 1990. He paid sales tax of Rs. 88,750 including extra tax of Rs. 3,750 on the purchase of certain specified electric appliances from a manufacturer in Lahore. ***(07 marks)***

(b) "The Commissioner may amend an assessment order for a tax year only on the basis of definite information acquired from an audit or otherwise". What do you understand by the term "Definite information" as described in the Income Tax Ordinance, 2001? ***(03 marks)***

Q.8 Explain the provisions of Federal Excise Act, 2005 with regard to the following:

(a) Excess duty collected from the customer. ***(05 marks)***
(b) Duty on services provided free of charge. ***(02 marks)***

(THE END)

EXTRACTS FROM THE FIRST SCHEDULE OF THE INCOME TAX ORDINANCE, 2001
Division I – Rate of Tax for Salaried Individuals

S. No.	Taxable Income	Rate of Tax
(1)	(2)	(3)
16.	Where the taxable income exceeds Rs. 2,850,000 but does not exceed Rs. 3,550,000,	17.50%
17.	Where the taxable income exceeds Rs. 3,550,000 but does not exceed Rs. 4,550,000,	18.50%
18.	Where the taxable income exceeds Rs. 4,550,000.	20.00%

Division VI – Income from property

S. No.	Gross amount of rent	Rates of tax
(1)	(2)	(3)
1.	Where the gross amount of rent does not exceed Rs. 150,000.	NIL
2.	Where the gross amount of rent exceeds Rs. 150,000 but does not exceed Rs. 400,000.	5 percent of the gross amount exceeding Rs. 150,000.
3.	Where the gross amount of rent exceeds Rs. 400,000 but does not exceed Rs. 1,000,000.	Rs. 12,500 plus 7.5 percent of the gross amount exceeding Rs. 400,000.
4.	Where the gross amount of rent exceeds Rs. 1,000,000.	Rs. 57,500 plus 10 percent of the gross amount exceeding Rs. 1,000,000.

The Institute of Chartered Accountants of Pakistan

Advanced Taxation

Final Examinations – Winter 2010 | December 9, 2010
Module F | 100 marks - 3 hours

Q.1 Rainbow Limited (RL) is incorporated under the Companies Ordinance, 1984 and is engaged in the manufacturing of solar powered equipments. RL is 60% owned by a Dubai based company Burj P.l.c (BP), 10% by a German company ATX Gmbh and 30% by a Pakistani company Muqami Limited (ML).

BP in turn is 70% controlled by ATX Gmbh whereas the Pakistani company ML is 90% owned by a French company FRS Limited.

On August 10, 20X1 RL received a loan of US$ 4.2 million from BP to partly finance a major industrial investment project at an interest rate of 12% per annum. Interest is to be paid quarterly in arrears by the 6^{th} day of the next quarter.

On September 15, 20X1 RL received another loan of US$ 1.0 million from FRS Limited for the same project at an interest rate of 10% per annum. Interest is to be paid monthly in arrears by the 3^{rd} day of each following month.

On May 15, 20X2 RL received a third loan of US$ 3.8 million from ATX Gmbh at an interest rate of 8% per annum. Interest is to be paid quarterly in arrears by the 4^{th} day of the next quarter.

The above loans are duly registered with the State Bank of Pakistan and the principal repayment in each case would commence from the year 20X3.

The following information is available in respect of RL at June 30, 20X2.

	Rs. in million
Assets	2,900
Liabilities	2,670
Net profit after taxation for the year	150
Interim dividend paid during the year	100

Assume that the dollar rupee parity during the year ended June 30, 20X2 remained constant at US$1=Rs. 85.

Required:

(a) State, with reasons, which of the above lenders can be classified as "Foreign controller" in relation to the thin capitalisation rules under the Income Tax Ordinance, 2001. ***(04 marks)***

(b) Calculate the deductible profit on debt for the tax year ended June 30, 20X2. ***(15 marks)***

Q.2 Hip Hop (Private) Ltd (HHPL), a registered tax payer, has received a notice from the department of Inland Revenue requiring it to show cause in respect of discrepancies in the quarterly sales tax return.

The management wants to appoint a representative to persuade their case before the adjudicating authority. Under the provisions of Sales Tax Rules, 2006 advise the management about the qualification and disqualifications of the person to act as the authorized representative of HHPL.

(09 marks)

Q.3 Herbal Trading (HT) is a sole proprietorship business owned by Mr. Adnan. The business is engaged in the manufacturing and supply of Herbal Medicines for the past many years. On May 01, 2010 Mr. Adnan decided to transfer his proprietary business, including all the assets and liabilities, to a private limited company Medicare (Pvt.) Limited (MPL). Following is an extract from the balance sheet of HT immediately before the disposal of business to MPL.

Herbal Trading
Balance Sheet as at April 30, 2010

Capital and Liabilities	Rupees	Assets	Rupees
Owner's Capital	9,000,000	Fixed Assets (WDV)	5,400,000
Accumulated Profit	1,500,000	Patents (WDV)	2,000,000
	10,500,000	Stock in Trade	4,600,000
Short Term Loan	500,000	Debtors	3,000,000
Trade Creditors	7,000,000	Cash and Bank Balances	3,000,000
	18,000,000		18,000,000

Following information is available relating to the proposed scheme of transfer and the status of MPL:

(i) 50% of the purchase consideration would be paid to Mr. Adnan in terms of fully paid shares of MPL whereas the remaining 50% would be paid in cash.
(ii) The break-up value of each share of MPL as at April 30, 2010 is Rs. 15.
(iii) MPL has a share capital of Rs. 30 million consisting of equity shares of Rs. 10 each. Mr. Adnan owns 70% of the paid up share capital of MPL whereas the remaining 30% is equally owned by his spouse Razia, whose income is clubbed with Mr. Adnan, and his elder brother Rais. Due to financial constraints, Rais is considering to dispose off his ownership interest in the company.
(iv) MPL would assume all the liabilities of HT with the exception of Rs. 2 million, which is payable to Barkat Enterprises.
(v) The net realizable value of stock in trade as at April 30, 2010 is Rs. 4 million.
(vi) Rs. 1.0 million receivable against sale of medicines to Parker & Sons last year is not recoverable due to insolvency of the customer. All possible efforts have already been made by HT for the recovery of debt.
(vii) Following is the tax written down value (WDV) and fair market value (FMV) of HT's patents and fixed assets as at April 30, 2010:

	Rupees		
	Cost	**Tax WDV**	**FMV**
Fixed assets	7,000,000	3,000,000	5,200,000
Patents	5,000,000	2,500,000	2,300,000

Required:

(a) Any transaction that is related to disposal of assets becomes the subject matter of gain or loss. Advise Mr. Adnan about the conditions, which are required to be fulfilled under the Income Tax Ordinance, 2001 if he wishes to avoid recording any gain or loss on the disposal of his business to MPL. ***(07 marks)***

(b) Advise the necessary changes, if any, required to be made by Mr. Adnan in his proposed scheme of transfer in order for it to be in compliance with the conditions identified in part (a) above. ***(03 marks)***

(c) Calculate the following, assuming the conditions in (a) above have been fully complied with.
  (i) Number and the value of shares to be received by Mr. Adnan from MPL. ***(06 marks)***
  (ii) MPL's cost of acquisition of assets. ***(03 marks)***
  (iii) Mr. Adnan's cost in respect of the shares received by him as consideration. ***(02 marks)***

Q.4 The income of an approved non profit organization, subject to certain conditions, is exempt from tax under the provisions of Income Tax Ordinance, 2001. Rahat Foundation, an approved NGO, operating in Gilgit Baltistan has recently received a notice from the Regional Commissioner of Income Tax, requiring it to justify as to why its approval should not be withdrawn under the relevant provisions of the Income Tax Rules, 2002.

Required:
Advise the management of Rahat Foundation about the circumstances under which the Regional Commissioner of Income Tax may withdraw the approval granted to the Foundation. ***(12 marks)***

Q.5 In view of the provisions of Income Tax Ordinance, 2001 and the stated rules, determine the residential status of the following persons for the tax year ended June 30, 20X2 under the given circumstances.

(i) Mr. Mubeen came to Pakistan for the first time on a special assignment from his company on April 01, 20X1 and left the country on September 30, 20X1.
(ii) Mr. Rana, who had never travelled abroad in his life, got a job in Canada. He went to Canada on December 29, 20X1 to assume his responsibilities as a CFO. In June, 20X2 his company sent him to India on a training workshop. On June 30, 20X2 on his way back to Canada he had to stay in Karachi for a whole day in transit.
(iii) Mr. Baber, a Federal Government Employee was posted to the Pakistan mission in Geneva from July 01, 20X1 to June 30, 20X2.
(iv) Mr. Francis, a sugar dealer in Brazil, came to Pakistan on July 31, 20X1. During his visit he stayed at Lahore for 60 days and spent the rest of the days in Karachi. He left the country on January 31, 20X2. Assume that the Commissioner has granted him permission to use calendar year as a special tax year. ***(06 marks)***

Q.6 (a) Folad Limited (FL) has supplied 50 tons of Iron Bars to Tameer Limited (TL). The market price of the supply is Rs. 2.5 million exclusive of sales tax. Owing to financial difficulties, TL has requested to settle the price by transferring a piece of land having a market value of Rs. 2.3 million and to pay Rs. 75,000 in final settlement along with the applicable sales tax by way of a cheque drawn in favour of FL.

Required
Comment on the chargeability of sales tax in the above situation. ***(04 marks)***

(b) Under the provisions of Sales Tax Rules, 2006 narrate the procedure to be followed by Tameer Limited, in the above situation, if it decides to return 20 tons of Iron Bars to Folad Limited due to sub-standard quality. Assume that both FL and TL are registered taxpayers. ***(05 marks)***

Q.7 (a) Briefly describe the requirements relating to the maintenance and keeping of records by a person registered under the provisions of Federal Excise Act, 2005. ***(05 marks)***

(b) Explain the following under the provisions of Federal Excise Act/Rules, 2005.
(i) Non-fund banking services ***(02 marks)***
(ii) Franchiser ***(02 marks)***

Q.8 Kamyab Engineering Limited (KEL) is registered under the Sales Tax Act, 1990. The company is engaged in the manufacture and supply of appliances. Following information has been extracted from the records of KEL for the month of November 2010.

	Rs. in '000
Purchases:	
Local:	
▪ components from registered suppliers	70,700
▪ components from un-registered suppliers	15,250
Import of finished goods (inclusive of custom duty and FED)	10,000
Supplies:	
Manufactured goods:	
▪ local taxable supplies to registered persons	40,000
▪ local taxable supplies to un-registered persons	24,000
▪ exempt goods	11,000
▪ export to Malaysia	13,000
Commercial imports	12,500

Following additional information is also available:

(i) Supplies from commercial imports include appliances of Rs. 2,040,000 which were sold on instalment basis to an industrial consumer at a mark-up of 2%.
(ii) Imported appliances worth Rs. 100,000 were provided to the company's managing director for use at his residence.
(iii) Sales tax of Rs. 60,000, Rs. 21,000 and Rs. 26,000 was paid in cash on account of electricity, gas and mobile phone bills respectively.
(iv) Sales tax of Rs. 85,000 was paid by the company on purchase of uniforms for its line staff.
(v) An amount of Rs. 200,000 on account of purchases made from a registered supplier is outstanding since March 2010. The related input tax was accounted for in the relevant tax period.
(vi) A penalty of Rs. 50,000 and additional tax of Rs. 25,000 was levied on KEL under the Income Tax Ordinance, 2001 which was unpaid as of November 30, 2010.

Sales tax is payable at the rate of 17%. All the above figures are exclusive of sales tax, wherever applicable.

Required:
(a) Sales tax payable / refundable.
(b) Input tax credit to be carried forward, if any. *(15 marks)*

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2010

June 10, 2010

ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 Mr. and Mrs. Adil are equal partners in Burq Enterprises (BE). The firm is engaged in the import and supply of electric generators. It also provides project consultancy services to various corporate customers. Following figures have been extracted from the accounting records of the firm for the tax year 2010:

	Rs. in '000
Sales of imported generators	574,200
Receipts from consultancy services	55,000
Total revenue	629,200
Cost of sales (generators)	(429,520)
Gross profit	199,680
Administrative and selling expenses	(96,300)
Finance cost	(9,000)
Profit before taxation	94,380

Following further information is also available from the records:

(i) The generator sales are inclusive of 16% sales tax.
(ii) Cost of sales includes customs duty of Rs. 50.0 million, sales tax Rs. 63.0 million and withholding taxes paid at import stage @ 4% of the value of goods of Rs. 413.0 million.
(iii) Administrative and selling expenses are common in nature. These include salary of Rs. 500,000 paid to each partner every month and withholding taxes deducted @ 6% on receipts from consultancy services.
(iv) Finance cost is related to commercial imports except interest of Rs. 1.20 million paid to Mrs. Adil on her capital account.
(v) On January 01, 2010 Adil started using one of the office equipment at his residence. The market price of the equipment at that time was Rs. 1.5 million with a written down value of Rs. 1.0 million.
(vi) On July 01, 2009 Adil let out his apartment to a close relative at a monthly rent of Rs. 10,500. The fair market rent in the area was Rs. 12,250. He also received a non-adjustable deposit of Rs. 110,000. Another non-adjustable deposit of Rs. 85,000 received from an earlier tenant in July 2007 was refunded.
(vii) Adil purchased 50,000 shares of Rs. 10 each, of an unlisted public company in July 2005 at the rate of Rs. 150 per share. In August 2006 he received bonus shares, ranking pari passu, in the ratio of 1 bonus share for every 5 shares held. In May 2010 he sold 80% of his bonus shares at a price of Rs. 135 per share.

Required:
In the light of the provisions of Income Tax Ordinance, 2001, compute the taxable income and tax liability of the following for the tax year 2010:
(a) Burq Enterprises **(10)**
(b) Mr. Adil **(09)**

Q.2 Big Pharma Limited (BPL) is engaged in the manufacturing of pharmaceuticals products. The Company has three branches in Pakistan and one branch each in Qatar and Oman. BPL sells its products through various distributors. Assume that the company's profit and loss account and the related details for the period ending June 30, 2010 are as under:

	Rs. in '000
Sales	96,000
Cost of sales	(66,850)
Gross profit	29,150
Administrative and selling expenses	(10,600)
Finance cost	(3,100)
Other charges (including WWF of Rs. 0.350 million)	(2,400)
Other income	4,100
Profit before taxation	17,150

Cost of sales includes:	**Rs. in '000**
Accounting depreciation	3,200
Provision for slow moving stock	1,300
Demurrage paid to custom authorities	100
Royalty paid against manufacturing rights to a non resident	1,200

Administrative and selling expenses include:	**Rs. in '000**
Accounting depreciation	800
Damages paid to distributors on breach of contract	300
Provision for bad debts	1,100
Small items of office equipment charged off (Useful life is more than 1 year)	1,400

Opening and closing balance of provision for bad debt account was Rs. 2.50 million and 3.10 million respectively. Bad debts written off during the year include an interest free loan of Rs. 0.20 million provided to Oman branch.

Finance cost includes unrealized exchange loss of Rs. 1.35 million and interest of Rs. 1.30 million paid on a working capital loan acquired from a non resident foreign bank. No tax was deducted by the company on payment of interest considering the bank did not have any permanent establishment in Pakistan.

Other income includes:	**Rs. in '000**
Profit from Qatar branch	2,700
Loss from Oman branch	(3,400)

Tax depreciation for the year was Rs. 6.00 million. There was also a carried forward tax loss of Rs. 6.10 million and an unadjusted foreign tax credit of Rs. 0.12 million from tax year 2009. Following taxes were paid by the company during the year:

	Rs. in '000
Deducted and paid by distributors	2,450
Paid on import of raw material	2,000
Taxes paid in Qatar	225
Unadjusted minimum tax for prior years	450

Required:
Compute the income tax liability of the company for the tax year 2010. Tax rate applicable to the company is 35%. **(13)**

Q.3 (a) Mr. Furqan intended to commence a manufacturing business and obtained the sales tax registration in November 2009. Due to unavoidable circumstances, he could not start his business as stipulated. No sales tax returns were filed since he did not carry on any taxable activity. In April 2010, he received a notice from the department of Inland Revenue directing him to furnish the return by May 15, 2010.

Required:
Advise Mr. Furqan as regards the following:

(i) Whether he is required to file the sales tax return and the consequences, if any, for non-filing of such return under the Sales Tax Act, 1990. **(03)**

(ii) Various reasons on account of which he may be liable for de-registration from sales tax. Also state briefly, the procedure for de-registration as enumerated under the Sales Tax Rules, 2006. **(08)**

(b) List the persons specified as “Withholding agents” for the purpose of collection of sales tax under the Sales Tax Special Procedure (Withholding) Rules, 2007. **(03)**

Q.4 (a) In the light of the provisions of Income Tax Ordinance, 2001, briefly explain the taxability of income in each of the following situations.

(i) Mr. Danishwar, a renowned author, completed his book on “Human Behavior” in two and a half years time. He received a lump sum amount of Rs. 900,000 in May 2010 on account of royalty. **(03)**

(ii) Mr. Bari, a Pakistani national, was working as a clearing agent in Taiwan for the past six years. He came back to Pakistan in July 2008 and joined a clearing house of his brother Ikram. In March 2010 he received Rs. 1.0 million as his share of commission from the discontinued business in Taiwan. **(03)**

(iii) Mr. Ravi transferred his house to a trust with a condition that out of the total rental income of Rs. 840,000 per annum, Rs. 500,000 would be paid to his wife and the balance of Rs. 340,000 would be paid to his minor son Ashok. Ravi also provided Rs. 350,000 to the trustees for the acquisition of his property. **(03)**

(b) Mr. Hayat, chief engineer in Mega Limited, had received 6000 shares of the company in July 2007, under an employee share scheme. Mr. Hayat had the option to transfer the shares in tax year 2009 or thereafter. The market value of shares at the time of issue was Rs. 12 per share. In 2009 the share attained a market value of Rs. 20; however, Mr. Hayat sold the shares in May 2010 when the share price was Rs. 35 per share.

Required:

(i) With reference to above, briefly explain the relevant provisions of the Income Tax Ordinance, 2001 relating to employee share scheme. **(06)**

(ii) Compute the amount to be included in the taxable income of Mr. Hayat for each tax year. **(04)**

Q.5 (a) In the light of the provisions of Income Tax Ordinance, 2001, describe the conditions which need to be satisfied before a person can claim deduction for a bad debt. **(03)**

(b) Barn Limited (BL) wrote off a debt amounting to Rs. 500,000 in June 2007. A suit was, however, filed by the company for the recovery of the debt. Tax authorities allowed Rs. 350,000 as a deduction in tax year 2007. In tax year 2010, court adjudicated the case in favour of BL. In view of the provisions of Income Tax Ordinance, 2001 compute the amount which would be added to income or expense, as the case may be, if the company.

(i) Recovers Rs. 200,000

(ii) Recovers Rs. 120,000 **(04)**

Q.6 Olive Limited (OL) is registered at the Large Taxpayer Unit of the Inland Revenue Department. It is engaged in the manufacture and trading of FMCG in the country. During the month of May 2010 following activities were carried out by the company:

	Rs. in '000
Purchases:	
(Items subject to sales tax and special excise duty):	
▪ Import of raw material for in-house consumption	15,000
▪ Import of finished products	8,000
▪ Packing material manufactured locally	6,000
Supplies:	
▪ Manufactured products:	
- local sales (subject to sales tax and special excise duty)	20,000
- Exempt goods	4,000
- Export to Bangladesh	4,000
▪ Commercial imports	10,000

Following information is also available:

(i) In order to meet the high consumer demand, OL purchased a new machinery for Rs. 1,200,000. The machinery was put to use during the same month. A motor vehicle of Rs. 1,500,000 was also acquired for the sales department.
(ii) Sales tax of Rs. 20,000 was paid under Provincial Sales Tax Ordinance on services provided by clearing agents for imports.
(iii) Rs. 650,000 were paid against advertisement services.
(iv) Sales tax of Rs. 60,000 was deducted from payments to suppliers of packing material.
(v) Sales tax withheld by customers amounted to Rs. 238,000.
(vi) Sales tax credit of Rs. 325,000 was brought forward from previous month.

Sales tax and special excise duty are payable at the rate of 16% and 1% respectively. All the above amounts are exclusive of sales tax and special excise duty, wherever applicable.

Required:
In view of the provisions of Sales Tax Act, 1990 and Federal Excise Act, 2005, compute the following for the tax period May 2010. Show computation wherever necessary.

(a) Sales tax liability and net sales tax payable with return. **(15)**
(b) Special excise duty payable **(05)**

Q.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 ___________
(ii) ___________ means Azad Jammu and Kashmir, Northern Areas and such other territories or areas to which the Federal Excise Act does not apply.
(iii) ___________ includes an undertaking, firm or company, whether incorporated or not, an association of persons and an individual.
(iv) ___________ 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. **(02)**

(b) Explain the following with reference to the provisions of Federal Excise Act, 2005.
(i) Applicable value and rate of duty. **(04)**
(ii) Supply **(02)**

(THE END)

RATES OF TAX
Division I
Rates of Tax for Individuals and Association of Persons

S. No.	Taxable Income	Rate of Tax
(1)	(2)	(3)
1.	Where the taxable income does not exceed Rs. 100,000	0.00%
2.	Where the taxable income exceeds Rs. 100,000 but does not exceed Rs. 110,000	0.50%
3.	Where the taxable income exceeds Rs. 110,000 but does not exceed Rs. 125,000	1.00%
4.	Where the taxable income exceeds Rs. 125,000 but does not exceed Rs. 150,000	2.00%
5.	Where the taxable income exceeds Rs. 150,000 but does not exceed Rs. 175,000	3.00%
6.	Where the taxable income exceeds Rs. 175,000 but does not exceed Rs. 200,000	4.00%
7.	Where the taxable income exceeds Rs. 200,000 but does not exceed Rs. 300,000	5.00%
8.	Where the taxable income exceeds Rs. 300,000 but does not exceed Rs. 400,000	7.50%
9.	Where the taxable income exceeds Rs. 400,000 but does not exceed Rs. 500,000	10.00%
10.	Where the taxable income exceeds Rs. 500,000 but does not exceed Rs. 600,000	12.50%
11.	Where the taxable income exceeds Rs. 600,000 but does not exceed Rs. 800,000	15.00%
12.	Where the taxable income exceeds Rs. 800,000 but does not exceed Rs. 1,000,000	17.50%
13.	Where the taxable income exceeds Rs. 1,000,000 but does not exceed Rs. 1,300,000	21.00%
14.	Where the taxable income exceeds Rs. 1,300,000	25.00%

DIVISION VI
Income from property

S. No.	Gross amount of rent	Rate of taxes
1.	Where the gross amount of rent does not exceed Rs. 150,000.	NIL
2.	Where the gross amount of rent exceeds Rs. 150,000 but does not exceed Rs. 400,000.	5 percent of the gross amount exceeding Rs. 150,000.
3.	Where the gross amount of rent exceeds Rs. 400,000 but does not exceed Rs. 1,000,000.	Rs. 12,500 plus 7.5 percent of the gross amount exceeding Rs. 400,000.
4.	Where the gross amount of rent exceeds Rs. 1,000,000.	Rs. 57,500 plus 10 percent of the gross amount exceeding Rs. 1,000,000.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

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ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 Ms. Saima is a telecommunication engineer working with a leading GSM operator as their chief technical officer for the last many years. She has provided you with the following information relating to her assessment for the year ended June 30, 2009.

(i) Monthly salary of Rs. 500,000 was paid to her by the company consisting of the following:

	Rupees
Basic Salary	400,000
Medical allowance	40,000
Conveyance allowance	60,000

The salary was credited to her bank account on the 25th of every month. She incurred actual medical expenses of Rs. 100,000 during the year. These expenses were reimbursed to her by the company in accordance with the terms of her employment.

(ii) She received a bonus of Rs. 1.0 million. Employer also agreed to pay tax on such bonus to the extent of Rs. 200,000.

(iii) Apart from her employment with a GSM operator, she also served as a visiting faculty member at a local engineering university and received a total of Rs. 470,000. Ms. Saima incurred an expenditure of Rs. 70,000 towards this service. Withholding tax was deducted from the payments made by the university.

(iv) In August 2008, she participated and won a quiz competition arranged by Pakistan Urdu Academy. The prize money of Rs. 200,000 was paid to her after deduction of a tax of Rs. 40,000.

(v) She inherited a plot of land from her father on his death in July 2000. On October 1, 2008 she entered into a contract of sale with Mr. Moin for a consideration of Rs. 50.0 million. Mr. Moin paid a deposit of Rs. 1.0 million and agreed to pay the balance within one month of the date of contract. On due date, Mr. Moin defaulted in making the payment upon which Ms. Saima forfeited the deposit in accordance with the terms of the contract. Later on, the plot was sold to Mr. Parkash at a price of Rs. 50.0 million.

(vi) Ms. Saima purchased another plot of land for a consideration of Rs. 56 million. She borrowed Rs. 5.0 million from her sister for the purchase of this plot. The amount was received in cash.

(vii) Ms. Saima also inherited a painting from her father. The painting was valued at Rs. 500,000. On April 1, 2009 she gifted the painting to her brother who came from Canada after five years. He went back to Canada after staying in Pakistan for a period of two months. The value of the painting was Rs. 1.0 million when it was gifted.

Required:
Compute the taxable income of Ms. Saima for the tax year 2009. Give brief reasons under the Income Tax Ordinance, 2001 in support of your treatment of each of the above items. **(18)**

Q.2 Supreme Limited (SL), a registered importer, exporter and manufacturer, is primarily engaged in the manufacture and export of a wide range of consumer durables, falling under the third schedule to the Sales Tax Act, 1990. Following activities were carried out by the company during the year:

(i) In view of the high cost of manufacturing the product locally, SL imported certain finished beauty products from France. In addition to the normal sales tax, value addition tax of 2% was levied by the collector of customs on the value of imports. Tax credit was not claimed by the company on the value addition tax.

(ii) A number of raw materials were imported for in-house consumption in various manufacturing processes. Sales tax on account of minimum value addition was not paid at the import stage. The management is now considering paying it with the monthly returns.

(iii) At the time of preparing sales tax return for the month of January 2009, it was found that an input tax credit pertaining to June 2008 inadvertently remained unclaimed. An adjustment was, therefore, claimed in January 2009 without any intimation to the sales tax authorities.

(iv) In June 2009, SL acquired a new plant for the manufacture of beauty soaps. Sales tax of Rs. 1.2 million paid at the time of purchase was claimed as an input tax in the monthly return for June 2009.

(v) Electricity bill of Rs. 100,000 for June 2009 was paid in cash. The company however, did not claim the related input tax credit as cash transactions exceeding Rs 50,000 are inadmissible.

(vi) Sales tax paid on advertisements in electronic media was not claimed as it was paid under the Punjab Sales Tax Ordinance, 2000.

(vii) The company acquired an existing manufacturing business of textile products from Sun Textiles (ST) as an ongoing concern. ST is registered under the Sales Tax Act, 1990.

Required:
In the light of the provisions of Sales Tax Act, 1990 advise the management of the company as to the chargeability/ adjustment of sales tax in each of the above situations. **(11)**

Q.3 Plasma Pakistan (Pvt.) Limited (PPL) is engaged in the manufacture and sale of pharmaceutical products. During 2009, it started a new business related to aerated water. After scrutiny of the tax return filed by the company for the tax year 2009, the Additional Commissioner has issued a notice under section 122(5A) in which he has raised the following issues:

(i) The parent company reimbursed 60% of the expenses, incurred by PPL in 2007, on marketing a new product imported from Germany. The commissioner wants to add the recouped expenditure to the taxable income of the company.

(ii) Expenses incurred under the account head “Travel fare” aggregating to Rs. 500,000 were paid in cash and should be added back.

(iii) The commissioner wants to disallow an expense of Rs. 90.0 million, incurred by PPL on the promotion of a vaccine which is expected to generate revenue for three years.

Required:
With reference to the provisions of Income Tax Ordinance, 2001 advise the management about the tax implications in each of the above situations. **(06)**

Q.4 In the light of the provisions of Income Tax Rules, 2002 you are required to explain the following:

(a) Expenditures which can be described as entertainment expenditures and limitations as to the admissibility of such expenditures. **(05)**

(b) Meaning of the term “Common expenditure” and the rule relating to the apportionment of such expenditures. **(07)**

Q.5 Fresh Stream Limited (FSL) is engaged in the manufacturing and import of food & beverages. Following is the extract from the profit and loss account of FSL for the period ended June 30, 2009.

		Rs. in '000
Sales	(Note 1)	5,000,000
Cost of sales	(Note 2)	(3,000,000)
Gross profit		2,000,000
Administrative and selling expenses	(Note 3)	(750,000)
Finance cost	(Note 4)	(250,000)
Other income	(Note 5)	500,000
Profit before taxation		1,500,000
Provision for taxation		(200,000)
Profit after taxation		1,300,000

Following additional information is also available:

1. Sales:

Net exports to Afghanistan (self manufactured)	495,000
Tax deducted on export @ 1%	5,000
Local sales out of imports	1,000,000
Local sales of manufactured items	3,500,000
	5,000,000

2. Cost of sales:

Imported finished goods (C & F)	300,000
Raw materials consumed during the year	1,000,000
Electricity & gas (incurred in cash)	300,000
Salaries, wages and other benefits	800,000
Local freight charges (paid in cash)	100,000
Depreciation	500,000
Cost of goods manufactured during the year	2,700,000
	3,000,000

- Cost of imported finished goods includes withholding taxes paid on imports @ 3.5%. The value of goods for the purpose of advance tax deduction amounted to Rs. 280.0 million.
- 10% of the total salaries were paid in cash. Of these, Rs. 20.0 million were paid to daily wage employees @ Rs. 400 per day, whereas Rs. 60.0 million were paid to contract employees who earn a monthly salary of Rs. 20,000 each.

3. Administrative & selling expenses

Salaries and other benefits	200,000
Advertisement expenses	100,000
Insurance	85,000
Rent, rates and taxes	65,000
Entertainment expenditure	25,000
Contributions to approved retirement funds	100,000
Depreciation	75,000
Amortization	25,000
Penalties paid under Sales Tax Act	25,000
Miscellaneous expenses	50,000
	750,000

- Rent, rates & taxes include Rs. 0.5 million paid under a provincial tax law imposed on all beverage manufacturing companies having a manufacturing facility in the province of Punjab. The said tax was computed as 0.1% of the accounting profit before tax.

- On July 1, 2008, FSL acquired export quota from the Government of Pakistan by paying an amount of Rs. 375.0 million having useful life of 15 years. For accounting purposes, the cost of export quota has been amortized over the period of 15 years.
- Depreciation computed under the Income Tax Ordinance, 2001 on all depreciable assets is Rs 500.0 million.

4. **Finance cost** includes Rs 10.0 million paid to a scheduled bank on account of vehicles obtained on lease. Total lease rentals paid for such vehicles were Rs 100.0 million.

5. **Other income** includes a gain of Rs 10.0 million on disposal of shares of Alpine Limited, a company listed on Karachi Stock Exchange. These shares were acquired by the company in the year 2007 at a cost of Rs 5.0 million.

Required:
In the light of the provisions of Income Tax Ordinance, 2001, compute the taxable income and gross tax liability of FSL. The normal tax rate applicable to the company is 35%. **(21)**

Q.6 Alpha Limited (AL) is engaged in the trading and manufacture of detergents and toiletries. During the month of November 2009 following activities were carried out by the company:

	Rs. in '000
Purchases:	
▪ Import of raw material for in house consumption:	
• subject to sales tax only	10,000
• subject to federal excise duty only	4,000
▪ Import of finished products for sale	2,000
▪ Import of items governed under the third schedule	1,000
▪ Local items governed under third schedule (50,000 @ Rs.175 each)	8,750
Supplies:	
▪ Manufactured products:	
• subject to sales tax only	20,000
• subject to federal excise duty only	6,000
▪ Exempt items out of manufactured products	2,000
▪ Commercial imports	2,750
▪ Imported third schedule items	7,500
▪ Local third schedule items to wholesalers (30,000 @ Rs. 225 each)	6,750

Goods costing Rs. 3.0 million were returned by different customers. Out of these, Rs. 1.0 million worth of goods were subject to federal excise duty only. Proper debit/credit notes have been raised in this regard. Retail price of local third schedule items is Rs. 250 each.

Sales tax is payable at the rate of 16% whereas custom duty and federal excise duty are levied at the rate of 10% each. All the above amounts are exclusive of any duty and taxes.

Required:
In the light of the provisions of Sales Tax Act, 1990 and Federal Excise Act, 2005, compute the following for the tax period November 2009. Give brief reasons, wherever necessary.

(a) Net sales tax payable with return. **(12)**
(b) Net federal excise duty payable with return. **(03)**

Q.7 (a) Describe the provisions of Sales Tax Act, 1990 relating to the maintenance and keeping of records by a registered person making taxable supplies. **(07)**
(b) Explain the requirements of registration as specified in Federal Excise Act, 2005. **(04)**
(c) Explain the following with reference to the provisions of Federal Excise Act, 2005.
(i) Goods **(02)**
(ii) Wholesale dealer **(02)**
(iii) Adjudicating authority **(02)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

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ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 Joy Limited is incorporated with a paid up capital of Rs. 500 million under the Companies Ordinance, 1984. Deep Sea Inc. USA (DSI) and Shallow Waters Inc. USA (SWI) hold 50% shares each. Green Sea Group is the parent company of both the DSI and SWI. Joy Limited is following a special tax year i.e. January-December.

On 30th April 2009, Joy Limited has an outstanding loan balance of Rs. 300 million payable to DSI with interest payable @10% per annum. This loan is repayable in equal annual installments of Rs. 50 million each, at the end of each year.

To finance a new project of Joy Limited, DSI is considering to provide another long term loan of Rs. 5.0 billion carrying interest @ 10% per annum. 25% of the loan is expected to be disbursed in the current year ending December 31, 2009 while the remaining 75% of the loan would be received by Joy Limited in December, 2010. The new loan would be repayable in twenty equal annual installments of Rs. 250 million each, with the first installment falling due in July 2012.

As on December 31, 2008, Joy Limited had a balance of Rs. 500 million in its retained earnings account. The profits forecast for three years is as under:

Tax Years	**2010**	**2011**	**2012**
	-------- Rs. in billions -------		
Profit	0.7	0.85	1.0

(a) Explain thin capitalization rule in the light of the provisions of Income Tax Ordinance, 2001. **(04)**

(b) If Joy Limited acquires the above long term loan from DSI, compute the following in respect of each tax year:
 (i) Amount of foreign debt
 (ii) Foreign equity of Joy Limited
 (iii) Admissible / inadmissible interest expense **(12)**

(c) What would be the implication of thin capitalization rule, if Joy Limited acquires a new loan from another foreign company not related to the Green Sea Group? **(03)**

Q.2 ABC Limited has incurred losses for the past few years. The Board of Directors of the company wants to surrender its assessed losses in favour of its holding company, Triangle Limited. In view of the provisions of Income Tax Ordinance, 2001 you are required to state the following:

(a) the conditions which must be fulfilled before Triangle Limited can adjust the losses surrendered by ABC Limited against its income under the head "income from business". **(04)**

(b) the limitations, if any, on the types of losses which can be surrendered and also the period beyond which such losses can not be surrendered. What would be the treatment of such losses if it remains unadjusted within the specified time period? **(03)**

Q.3 Mr. and Mrs. Vakeel, both lawyers of high repute, established their own law firm on July 01, 2008 with the name and style of Vakeel Associates. The firm is primarily engaged in providing services for both civil and criminal law suits and is equally managed by Mr. and Mrs. Vakeel. The profit and loss account of the firm, for the first year of their operations, is as follows:

	----- Rupees -----	
Gross receipt		25,750,000
Less: Salaries	10,000,000	
Rental for office premises	1,200,000	
Accounting depreciation	1,000,000	
Purchase of technical books	750,000	
Subscription fees	250,000	
Other expenses	1,300,000	14,500,000
Income for the year		11,250,000

Following further information is available from the firms record:

(i) Mr. and Mrs. Vakeel have an equal share of profits and losses in the firm.

(ii) During the year, the firm was engaged on a retainership basis by various corporate clients. Gross receipts from such clients amounted to Rs. 10,000,000. Tax at the rate of 6% of the gross receipts was deducted from payments to the firm by such clients. Tax so deducted was charged to ‘other expenses’.

(iii) Thomas Associates, a law firm based in UAE, appointed Vakeel Associates under an agreement to technically assist them in defending a particular law suit in Dubai. The sum agreed for the services amounted to Rs. 2,500,000. Mr. Vakeel stayed in Dubai for over a month, for the purpose of this assignment. The fee was transferred to the firm’s Bank account in Pakistan. No tax was deducted either by Thomas Associates or the bank transferring the amount from such payment.

(iv) The firm also provided advisory services in Pakistan to different law firms situated outside Pakistan. An amount equal to Rs. 5,000,000 was received from such services in foreign currency through normal banking channel. The bank collected tax at the rate of 1% from the gross receipts. The tax deducted from the proceeds was charged to ‘other expenses’.

(v) No tax has been deducted on any other receipts of the firm.

(vi) Salary expenses include an amount of Rs. 100,000 each paid to Mr. and Mrs. Vakeel every month.

(vii) Bonus amounting to Rs. 1,000,000 was paid to the employees of the firm (other than Mr. and Mrs. Vakeel). No tax was deducted from such payments.

(viii) The office premises are owned by Mrs. Vakeel and rent was paid to her without deducting any tax from such payments.

(ix) Subscription fee was paid in cash to Pakistan Bar Council without withholding any tax from such payment.

(x) During the year some structural improvements were made to the office premises at the cost of Rs. 500,000. This amount was also charged to ‘other expenses’.

(xi) Following details are available in respect of the firm’s assets:

Category of assets	**Cost of acquisition**	**Depreciation charged to accounts**
	----- Rupees ----	
Furniture and fittings	2,000,000	200,000
PCs and Laptops	1,600,000	320,000
Motor vehicle (provided to Mr. & Mrs. Vakeel)	2,400,000	480,000

(xii) In 2006, Mr. Fazil the father of Mrs. Vakeel gave her 1,000 shares of Fortune Inc. USA, a company listed on New York Stock Exchange, by way of a gift. Mr. Fazil had purchased those shares in 2003 at a cost of USD 10 per share, when he was working in the USA. The dollar rupee parity at the time of purchase was USD 1 = PKR 58. The fair market value of the shares at the time of transfer to Mrs. Vakeel was USD 25 (USD 1 = PKR 60). Mrs. Vakeel disposed off the shares during the year at a price of USD 60 per share. She also paid USD 1,000 in taxes in the USA, in respect of such receipts. The dollar rupee parity on the date of disposal was USD 1 = PKR 80.

Required:
In the light of the provisions of Income Tax Ordinance, 2001, compute the taxable income and tax liability of the following for the tax year 2009:

(a) Vakeel Associates. **(14)**

(b) Mrs. Vakeel. **(08)**

Show all necessary calculations and give brief reasons, wherever necessary, in support of your treatment of each item.

Note:-

(i) ***Rate chart is available on the last page***

(ii) ***Section references are not required***

Q.4 (a) Explain the conditions under which no gain or loss shall be taken to arise on the disposal of an asset, under the provisions of the Income Tax Ordinance, 2001. **(06)**

(b) When an asset is disposed of in a non-arms length transaction, how would you determine the consideration:
(i) received by a seller; and
(ii) paid by a buyer. **(03)**

Q.5 Mr. Hijrat has informed you that he would be permanently migrating to USA with his family on July 10, 2009 and has no intention of returning to Pakistan. He is seeking your advice as to his obligations, if any, under the Income Tax Ordinance, 2001 in this regard. **(04)**

Q.6 Narrate the provisions of Sales Tax Act, 1990 relating to the following:

(a) extra tax. **(04)**

(b) due date of payment of sales tax. **(03)**

Q.7 (a) Describe input tax and output tax as defined in the Sales Tax Act, 1990. **(05)**

(b) Mr. Insaf, the executive director of Super Tech (Pvt.) Ltd, a company engaged in the manufacture and sale of electronic goods, has reviewed the sales tax return for the month of May 2009, in place of its director finance, who is currently on leave. During the review he noticed that certain input tax has not been claimed by the company. He does not accept the view point of the chief accountant and is of the opinion that all input tax paid by the company should be available for adjustment. You are required to clarify the following matters in the light of Sales Tax Act, 1990.

(i) The conditions that need to be satisfied for the adjustment of input tax against the output tax liability and the remedy available to the company if it fails to adjust the input tax in the period in which it is paid. **(07)**

(ii) Identify the circumstances in which input tax is not allowed to be adjusted against the output tax liability. **(04)**

Q.8 Fragrance (Pvt.) Limited (FPL), buys perfumes from a local supplier, which are directly used in the production of toiletries. FPL wants to adjust the duty of excise paid on perfumes from the amount of duty on its finished products. Explain the necessary conditions required to be fulfilled for the adjustment of such duty, under the Federal Excise Act, 2005. **(04)**

Q.9 In the light of the Federal Excise Act, 2005 you are required to explain the following:

(a) the persons who are responsible to pay the duty of excise. **(04)**
(b) the requirements related to the issuance of invoices. **(05)**
(c) meaning of the term "franchise". **(03)**

RATES OF TAX
Division I
Rates of Tax for Individuals and Association of Persons

S. No.	Taxable Income	Rate of Tax
(1)	**(2)**	**(3)**
1.	Where the taxable income does not exceed Rs. 100,000	0.00%
2.	Where the taxable income exceeds Rs. 100,000 but does not exceed Rs. 110,000	0.50%
3.	Where the taxable income exceeds Rs. 110,000 but does not exceed Rs. 125,000	1.00%
4.	Where the taxable income exceeds Rs. 125,000 but does not exceed Rs. 150,000	2.00%
5.	Where the taxable income exceeds Rs. 150,000 but does not exceed Rs. 175,000	3.00%
6.	Where the taxable income exceeds Rs. 175,000 but does not exceed Rs. 200,000	4.00%
7.	Where the taxable income exceeds Rs. 200,000 but does not exceed Rs. 300,000	5.00%
8.	Where the taxable income exceeds Rs. 300,000 but does not exceed Rs. 400,000	7.50%
9.	Where the taxable income exceeds Rs. 400,000 but does not exceed Rs. 500,000	10.00%
10	Where the taxable income exceeds Rs. 500,000 but does not exceed Rs. 600,000	12.50%
11.	Where the taxable income exceeds Rs. 600,000 but does not exceed Rs. 800,000	15.00%
12.	Where the taxable income exceeds Rs. 800,000 but does not exceed Rs. 1,000,000	17.50%
13.	Where the taxable income exceeds Rs. 1,000,000 but does not exceed Rs. 1,300,000	21.00%
14.	Where the taxable income exceeds Rs. 1,300,000	25.00%

Division VI
Income from property

S. No.	Gross amount of rent	Rate of tax
1.	Where the gross amount of rent does not exceed Rs. 150,000.	Nil
2.	Where the gross amount of rent exceeds Rs. 150,000 but does not exceed Rs. 400,000.	5 percent of the gross amount exceeding Rs. 150,000.
3.	Where the gross amount of rent exceeds Rs. 400,000 but does not exceed Rs. 1,000,000.	Rs. 12,500 plus 10 percent of the gross amount exceeding Rs. 400,000.
4.	Where the gross amount of rent exceeds Rs. 1,000,000.	Rs. 72,500 plus 15 percent of the gross amount exceeding Rs. 1,000,000.

RATES OF NORMAL DEPRECIATION

I.	Building (all types).	10%
II.	Furniture (including fittings) and machinery and plant (not otherwise specified), motor vehicles (all types), ships, technical or professional books.	15%
III.	Computer hardware including printer, monitor and allied items (machinery and equipment used in manufacture of I.T. products), aircrafts and aero engines.	30%

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Winter 2008

December 4, 2008

ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 Styles & Styles, Inc. (SSI) is the parent company of a leading foreign group involved in the manufacturing and sales of consumer products all around the world. They are considering an option to enter into the Pakistani market. Based on data obtained through a market survey, they are in the process of preparing financial projections for a proposed local subsidiary in Pakistan, Styles & Styles Pakistan (Pvt) Limited (SSPL).

Under the proposed business model, business of SSPL is likely to be set-up as under:-

(i) SSPL would be incorporated with a share capital of Rs 100 million to be wholly owned through a UAE based group company Styles & Styles FZE. The investment in SSPL would be financed by the UAE company through an interest bearing loan agreement with SSI;
(ii) SSPL would be involved in commercial imports as well as local manufacturing of certain products for which the raw material would be imported from group companies;
(iii) To set up the manufacturing plant in Pakistan, certain second-hand plant and machinery will be imported from an unrelated supplier outside Pakistan. To save bank charges/commission etc. it was agreed that LC would not be opened and the payment will be remitted directly through bank, 30 days after the import of plant. The supplier is insisting that payment be made without deduction of withholding tax;
(iv) Construction of factory building is likely to be carried out by a leading Pakistani engineering company. A contract in this regard would be signed shortly after the incorporation of SSPL and thereafter a mobilization advance of Rs 50 million will be paid; and
(v) A foreign currency loan of US $ 75 million would also be provided by SSI, directly to SSPL. The loan would be payable over a period of five years carrying an arm's length interest rate.

Required:
The group wants to determine Pakistan tax implications, if any, and have requested you to advise on the following issues:

(a) Treatment of income tax paid at the import stage.
(b) Tax depreciation on the plant.
(c) Deduction of tax on interest paid by SSPL to SSI.
(d) Taxability of interest received by SSI. **(15)**

Q.2 The concept of representatives has recently been introduced in the Sales Tax Act, 1990 through the Finance Act, 2008. You are required to explain the following:

(a) Who can be treated as the representative of a non-resident person?
(b) Under what circumstances, a representative may become personally liable for the payment of any tax due by the non-resident? **(10)**

Q.3 PSK is a public listed company engaged in manufacturing and sale of goods. Extracts from the financial statements of the company for tax year 2008 are given below:

	Rupees
Sales:	
- local sales out of manufactured/packed goods	924,306,539
- local sales of imported finished goods	127,721,264
- export sales	25,157,641
Cost of goods sold	665,875,300
Administration expenses	169,453,900
Distribution and marketing cost	37,024,600
Other income	4,628,780
Financial charges	909,500

Following further information is available

(i) All exports were made through confirmed LCs except export to Afghanistan amounting to Rs. 1,610,000 which was received in Pak Rupees and no tax was deducted by the Banks.

(ii) Certain goods imported from Dubai were later exported to Malaysia, at a price of Rs. 752,100. Tax deducted on such goods at the import stage amounted to Rs. 25,000 whereas tax deducted from export proceeds amounted to Rs. 7,521. The transaction is included in export sales.

(iii) Imported goods are sold without any further processing, at a mark-up of 15% of cost.

(iv) Cost of export sales is Rs. 14,645,500.

(v) Distribution and marketing costs relate to local sales only.

(vi) Other income consists of the following:

	Rupees
Return on Pakistan Investment Bonds (PIBs)	3,480,000
Gain on sale of scrap	972,400
Duty drawback on exports	149,280
Bad debts previously written off, now reversed	27,100

(vii) Financial charges include amortization of premium on PIBs amounting to Rs. 70,900.

(viii) Data related to depreciation is as under:

Tax depreciation	51,281,569
Accounting depreciation:	
Cost of goods manufactured	10,338,700
Administrative expenses	4,756,300
Distribution and marketing expenses	2,141,200

(ix) Information relating to provisions and right-offs, included in administration expenses, is as under:

Provision for slow moving stock	6,200,966
Provision for bad debts	227,425
Stock written off	366,131
Bad debts written off	38,186

Required:
You are required to compute the company's taxable income and tax liability (gross) for the tax year 2008. **(20)**

Q.4 Akhter is evaluating the possibility of starting a large scale import and retail business of consumer goods through a chain of stores supplying to wholesale as well as general body of consumers.

Required:

(a) Advise him about the payment of advance tax at the import stage and the treatment thereof, under the Income Tax Ordinance, 2001.

(b) With reference to Sales Tax Act 1990, advise him on the following:

(i) Whether he will be required to obtain separate registration for each outlet?

(ii) Will he be classified as a retailer specially with reference to the supplies made other than to the general body of consumers?

(iii) Can he claim input tax on his purchases? Assume that 30% of all sales will be collected in cash. **(11)**

Q.5 XYZ Limited, a listed company, has made the following payments without deduction of withholding tax:

(i) Reimbursement of boarding, lodging and incidental expenses incurred by non-executive directors of the Company for attending the Board's quarterly meeting held in Dubai.

(ii) Payment to a non-resident debtor on account of out of court settlement of a dispute and payment of fee to the lawyer for handling such settlement. The lawyer was also a non-resident.

(iii) Payment to a resident company as consideration for obtaining a right to manufacture certain goods.

(iv) Reimbursement made to a foreign associate in respect of salary of the Director Finance of XYZ Limited. The Director Finance is a foreign national and receives part payment of his salary in his home country. The foreign associate had not deducted any tax from the payment made by it to the Director Finance.

Required:

Comment on the above transactions in the light of Income Tax Ordinance, 2001. **(10)**

Q.6 (a) Describe the rule related to adjustments of duties of excise, for the purpose of determining the net liability under the Federal Excise Act, 2005. **(06)**

(b) Explain the following with reference to Income Tax Ordinance, 2001:

(i) Capital assets

(ii) Valuation of capital assets

(iii) Capital gains

(iv) Adjustment of capital loss against capital gains **(08)**

Q.7 Mr. Bilal, a sole proprietor, had been filing his income tax returns and wealth statements for the last many years. He was not satisfied with his tax advisor and has appointed you as his consultant. He has asked you to review his returns for the past five years also.

Your assistant had reviewed the records and observed the following:

(i) During tax year 2003, Mr. Bilal purchased an immovable property at a market price of Rs. 5 million. At the time of purchase, the property was rented to a tenant who was paying Rs. 50 thousand per month. The property had not been declared in the wealth statements filed by Mr. Bilal, over this period.

(ii) On review of the wealth reconciliation for tax year 2004, it was noticed that Mr. Bilal borrowed Rs. 1 million from his friend who is a foreign national. The amount was received in cash while his friend was on a visit to Pakistan and is still outstanding.

(iii) In tax year 2005, Mr. Bilal's father who was settled in Dubai had sent an amount of US$ 10,000 through banking channel which was encashed into Pak rupees @ 60.15. This receipt was disclosed in his wealth statement but no explanation has been given to the authorities so far.

Required:
Advise Bilal about the tax implications, in each of the above situations. **(08)**

Q.8 Zeta Pakistan Ltd is principally engaged in the purchase, manufacture and supply of taxable goods and is registered under the Sales Tax Act, 1990. During the usual course of business, it also carried out the following transactions during the year:

(i) Use of taxable goods for internal testing, training and evaluation purposes. The goods included own manufactured as well as locally procured goods.
(ii) Free replacement of faulty parts of goods which had been sold under warranty.
(iii) Destruction of damaged goods.
(iv) Payment of sales tax on diesel purchased and used in generation of electricity. The electricity produced is mainly used in production. However, part of it is also used in finished goods warehouses and workers canteen.
(v) An amount of Rs 300,000 was paid to the company's customs agent on import of raw material used.

Required:
Comment on the chargeability of sales tax in the above situations. **(12)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2008

June 5, 2008

ADVANCED TAXATION **(MARKS 100)**

Module F **(3 hours)**

Q.1 Mr. Jehangir Ahmad (JA) worked as Head of I.T. Division in Sutlej Pakistan Limited (SPL) for last ten years. From July to September 2007 he earned a basic salary of Rs. 900,000. He was also provided with rent free furnished accommodation, in respect of which SPL paid a rent of Rs. 35,000 per month. He resigned with effect from October 1, 2007 .

In July 2004, JA was granted an option to acquire 1000 shares of SPL's Parent Company, which is listed in a foreign country. The option was exercisable on completion of three years' employment with the Company. He paid an amount equivalent of Rs. 100,000 to acquire the option whereas the fair market value of such option at that time was Rs. 150,000. On July 4, 2007 he paid a sum equivalent of Rs. 200,000 to acquire the said shares which were issued to him on July 21, 2007 when the market value of the shares was equivalent of Rs. 350 per share. JA disposed off the shares on October 1, 2007. The net sales proceeds received in Pakistan amounted to Rs. 344,000 i.e. after adjustment of income tax deducted by the foreign government amounting to Rs. 20,000, brokerage commission of Rs. 6,500 and bank charges of Rs. 2,500.

JA has also been carrying out a software business in the ground floor of a house owned by his wife, since many years. On March 31, 2008 he converted the business into a limited company. The company took over the assets of the business at their fair value of Rs. 2.6 million and in consideration thereof, 260,000 shares of Rs. 10 each were issued, in the name of JA. The book value of the assets taken over on the date of transfer was Rs. 2.2 million.

The company has entered into a large contract for supply of software to a renowned Japanese firm over a period of two years. In view of limited resources, the company is not considering offers from other clients.

The office in which the business was being carried out has been rented to the company at Rs. 50,000 per month whereas the prevailing market rate is Rs. 35,000 per month. The profit of the company up to June 30, 2008, excluding the rent, is expected to be Rs. 350,000.

JA has earned an income of Rs. 850,000 from the business, before the assets were transferred to the company. His wife has no other income except dividend income of Rs. 50,000 on which tax has been deducted at source.

Required:
Compute the taxable income of Mr. Jehangir, his wife and the company, for the Tax Year 2008. Give reasons for the treatment made by you, wherever necessary. **(15)**

Q.2. Crown Enterprises, a branch of a company incorporated in Singapore, intends to dispose off one of its business segment to Trend Setters Limited (TSL), a company listed on the Karachi Stock Exchange, for a lump sump consideration of Rs. 500 million. The net assets of the business segment are separately identifiable. The consideration was agreed keeping in view the fair market value of net assets, earning potential of the underlying assets and the brand name of the products. Under a separate agreement Crown Enterprises has agreed to refrain from competing in the same business for a period of five years and in consideration thereof TSL has agreed to pay an additional amount of Rs. 50 million.

The break-up of net assets related to the business segment is given below:

	Net book value	**Fair market value**
	------- Rs. in million -------	
Plant and machinery	150	180
Land	60	80
Building (costing Rs. 50 million)	40	70
Inventory	90	90
Other current assets including receivables	85	85
	425	505
Less: Current liabilities	125	125
	300	380

The cost of building to the company is Rs. 50 million and tax WDV is equal to the accounting WDV of Rs. 40 million.

Required:

(a) Compute the amount that will be included in the taxable income of Crown Enterprises, as a result of the above transaction. Give appropriate reasons under the Income Tax Ordinance, 2001, to support your calculations.

(b) Describe the withholding tax obligations of TSL in respect of payments to be made to Crown Enterprises. **(08)**

Q.3 Holdings Limited, a public listed company is engaged in the manufacturing and supply of consumer products. Its profit and loss account for the year ended March 31, 2008 is given below:

	Rs. in million
Sales (local)	30,000
Cost of sales	21,000
Gross profit	9,000
Selling and administration expenses	3,000
	6,000
Finance cost	1,200
Other expenses	900
	3,900
Other income	1,500
Net profit before taxation	5,400

The following information is available in respect of the above.

(a) Sales are net of sales tax and the break-up is as under:

Manufactured products	70%
Imported products	17%
Locally purchased products	13%

20% of all sales are made to limited companies. Imported products are sold at a profit of 40% of sales whereas locally purchased goods are sold at a mark-up of 25% above cost.

(b) The cost of development of a new manufacturing process was capitalized as an intangible asset in 2003. The product has a life of approximately 15 years. The amortization thereon amounting to Rs. 4 million is included in the cost of sales.

(c) Selling and administration expenses include bad debts of Rs. 6 million. Opening and closing balance of provision for bad debt account is Rs. 20.8 and 18.4 million respectively.

(d) Other expenses include an amount of Rs. 20 million paid to a commodity exchange to settle a transaction which was carried out as a hedge against fluctuation in prices of one of the raw materials used by the company.

(e) Other income includes the following:
- Share of income received from an AOP amounting to Rs. 60 million. The company's share in the AOP is 40% and the amount has been distributed by the AOP after paying income tax at the rate of 25%. The income tax authorities have added back an amount of Rs. 20 million while assessing the income of the AOP.
- Indenting Commission of Rs. 11.16 million, received from a party in a foreign country where withholding tax of 40% was deducted at source. Withholding tax of 5% and bank charges of 2% were deducted by the bank in Pakistan before the above amount was credited in the company's account.

(f) The details of tax deducted and paid are as follows:

	Million
Imports	153.0
Deducted by corporate clients (Rs. 147 million on sale of manufactured goods)	174.3
Advance tax under section 147	1,200

(g) Tax rate applicable to the company is 35%.

Required:
Compute the income tax liability of the company for the tax year 2008. Support your answer with appropriate calculations and comments. **(26)**

Q.4 The Commissioner of Income Tax – Appeals (CIT) stayed the tax demand of Mr. Bashir until disposal of his appeal. While deciding appeal the CIT reduced tax demand to 60%. Subsequently, the Income Tax Department issued an order asking Mr. Bashir to pay additional tax on the whole amount, for the period during which the demand was stayed.

Explain whether the order issued by the Tax Department is justified. **(04)**

Q.5 With effect from January 1, 2009, a Scheduled Bank intends to launch an unlisted Unit Trust by establishing an Asset Management Company. The income of the Unit Trust will be in the form of dividend, capital gains and profit on debt.

Required:
Advise the management of the Bank on the following:
(a) Taxability of the Unit Trust;
(b) Taxability of the asset management company; and
(c) Taxability of unit-holders including the Scheduled Bank, in respect of
- dividend received from Unit Trust;
- capital gain on sale/redemption of units. **(10)**

Q.6 Hashmi Limited purchased a machine for Rs. 20 million on July 1, 2005, when it was enjoying tax holiday. The tax holiday period expired on June 30, 2006. The machine remained in the company's use till March 31, 2008 when it was shipped to an associated company in Indonesia for sale, on behalf of Hashmi Limited.

Required:
(a) Compute the amount of depreciation which the company could claim in tax year 2007 and 2008. (Assume that the rates of initial and normal depreciation during this period was 50% and 10% respectively).
(b) How should the company determine the sale price of the machine for computing gain/loss on sale, under the Income Tax Ordinance, 2008? **(06)**

Q.7 Shahid Limited (SL) is engaged in the import, export and distribution of various consumer goods. SL has recently expanded its business by setting up a manufacturing unit for various consumer goods. The manufacturing unit will start production in June 2008.

Following transactions were carried out during May 2008:

(i) SL purchased 5,000 bottles of locally manufactured shampoo at a cost of Rs. 100 per bottle. The retail price of each bottle is Rs. 110. During the month, SL sold all bottles to the retailers at Rs. 105 per bottle. (Shampoo is included in the items listed on third schedule to the Sales Tax Act, 1990).

(ii) The company imported 10,000 bottles of hair oil at import value of Rs. 400 per bottle (exclusive of custom duty and sales tax). Custom duty was paid at the rate of Rs. 20 per bottle. 500 bottles were re-exported to Azerbaijan at Rs 3,000 per bottle whereas 6,000 bottles were sold in the local market at Rs 350 per bottle.

(iii) New plant including ancillary equipment was acquired for the manufacturing unit at Rs. 200 million on which sales tax of Rs. 30 million was paid.

(iv) SL paid sales tax of Rs 50,000 on foods and beverages used for the entertainment of the Company's employees.

(v) Sales tax of Rs 150,000 was paid under Provincial Sales Tax Ordinance on services provided by customs agents for clearance of imported goods.

Required:
Compute the sales tax payable by Shahid Limited for the month of May 2008. Give proper comments where any given information has not been utilized in the computation. **(13)**

Q.8 Through Finance Act 2007, Government departments, autonomous bodies and public sector organizations have been notified as withholding agents for the purpose of collection of sales tax.

Briefly discuss responsibilities of a withholding agent as enumerated in the Sales Tax Special Procedure (Withholding) Rules, 2007. **(04)**

Q.9 Zohaib & Co., a partnership firm, plans to purchase raw material from Mr. Salman Ahmed (SA) who has the reputation of evading sales tax. Mr. Khalid, the managing partner of the firm, however is of the view that failure to deposit sales tax by SA would not have any bearing for his firm.

Required:
Offer your comments on the views expressed by Mr. Khalid. **(03)**

Q.10 A consignment imported by ABC worth Rs. 10 million was damaged while in transit from the port. Due to a limiting clause in the Insurance policy, the claim received from the insurance company was restricted to an amount of Rs. 6.4 million.

Required:

(a) Explain whether the sales tax paid on import can be claimed as input tax.

(b) Explain whether the delivery of goods to the insurance company against insurance claim, constitute a taxable supply **(05)**

Q.11 The Federal Government is empowered to levy special excise duty (SED) on certain goods. The rate of SED is 1% of the value of such goods.

Required:
Explain the provisions laid down in the Federal Excise Act, 2005 for determining the value of following goods:

(i) Imported goods. **(02)**

(ii) Goods chargeable to SED on the basis of retail price. **(04)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations   Winter 2007

December 6, 2007

ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 A Pakistani company has engaged a foreign contractor to upgrade its production facility. The agreement with the foreign contractor specifies that:

- The foreign contractor would acquire the required plant and machinery and design it in accordance with the requirements of the Pakistani company.
- Plant and machinery will be assembled and installed at Pakistani company's location by a sub-contractor in Pakistan. The sub-contractor would be engaged by the foreign contractor and would work under the supervision of the foreign contractor's personnel who would also come to Pakistan for a certain period.
- Foreign contractor would also procure some parts of plant and machinery locally from the sub-contractor.
- On request of the foreign contractor, the Pakistani company will pay for local service and procurements cost of the sub-contractor directly to the sub-contractor. Payments to the sub-contractor totaling Rs.35 million will be deducted from the total contract price of Rs. 200 million. The net contract price of Rs. 165 million will be remitted outside Pakistan to the foreign contractor.

You are required to mention the critical points to determine the tax implications of the above contract with reference to the taxability of the foreign contractor as well as the sub-contractor. **(08)**

Q. 2 Mr. Kashif Ahmad, a Pakistani National, left the Pakistani subsidiary of a multinational company and was employed in the role of Commercial Director Middle East for the Group company with effect from January 1, 2007. Due to certain visa issues, he could not travel immediately and remained in Pakistan till February 28, 2007. While in Pakistan, he continued to work for the Middle East region and received payment from the Group company.

Mr. Kashif is required to return to Pakistan for sorting out certain issues on behalf of the group company and will be staying in Pakistan for about two months. On his return to Pakistan he will continue to be employed and paid by the Group company. The Group company deducts tax @ 20 % of the gross salary.

Required:
Briefly explain the Pakistan tax implications to Mr. Kashif for the tax years 2007 and 2008 in respect of the following:

(a) Salary earned while he was present in Pakistan from January 1, 2007 to February 28, 2007.
(b) If he returns to Pakistan before June 30, 2007.
(c) If he returns to Pakistan after June 30, 2007. **(10)**

Q. 3 RA (Pvt.) Limited, is a highly profitable company and is engaged in manufacturing activities. It has recently started a consultancy business through a newly formed company RA Consultancy (Pvt.) Limited, whose structure of shareholding is as follows:

RA (Pvt.) Ltd	60 %
Mr. Rashid	20 %
Mr. Arshad	20 %

RA Consultancy (Pvt.) Limited is suffering losses due to heavy expenditures on marketing and set-up of infrastructure. It is expected to continue incurring losses during the next few years.

Mr. Rashid and Mr. Arshad are also the Directors and majority shareholders of RA (Pvt.) Limited. They want to claim the tax losses of the subsidiary against the income of RA (Pvt.) Limited and have approached you, as their tax advisor for advice.

Required:
Advise your clients about the necessary steps which should be undertaken to avail the maximum benefit under the Income Tax Ordinance, 2001. **(09)**

Q. 4 Your company has filed return of income for tax year 2007 on September 30, 2007 according to which income tax amounting to Rs. 50 million was refundable. The Director Finance of the company is worried about the refund and has consulted you for advice.
Required:
Please advise the Director Finance in respect of the following:

(i) Procedure for claiming the refund.
(ii) Time frame within which cheque must be issued by the tax authorities.
(iii) Compensation allowed if refund cheque is not issued in time. **(07)**

Q. 5 A foreign Group is contemplating to start business in Pakistan. The Group Finance Director is analyzing options to establish either a branch or a locally incorporated company.

Required:
Briefly analyse the rules relating to computation of income and tax liability under each of the above options as regards the following:

(a) Business income.
(b) Head office expenses.
(c) Payment of royalty or fees for technical services to head office.
(d) Interest payments on loan given by the parent company.
(e) Remittance of profits. **(12)**

Q. 6 Mr. Aslam, a sole proprietor carrying on the business of trading died on January 1, 2007. He had the following assets at the time of his death:

Stock in trade	Rs. 5,000,000 at cost
Property	Rs. 1,200,000 at cost
Shares	200,000 shares of TMC Pakistan Ltd.

The stock in trade was sold by his legal representative on February 1, 2007 at a price of Rs. 7.0 million. Out of this amount Rs. 1 million has been utilized by him for personal expenditures. The property and the shares were however retained and were in possession of the legal representative on May 31, 2007.

On May 31, 2007 the legal representative received a notice for recovery of arrears of Mr. Aslam's income tax of Rs. 15 million.

The market value of Mr. Aslam's assets is given below:

	On January 1	On May 31
	---------Rs. in million---------	
Stocks	5.50	N/A
Property	1.50	2.5
Shares	1.40	3.0

The legal representative has also received rent of Rs. 10,000 and dividends amounting to Rs. 40,000 from the above assets, after Mr. Aslam's death.

Required:
Compute the amount which the taxation authorities can recover from the legal representative alongwith necessary explanations. **(05)**

Q. 7 Jabbar and Company Limited carries on business in Pakistan as well as abroad. Sales revenue from business activity in Pakistan and abroad are separately identified. Some of the business expenditures relate exclusively to business activity outside Pakistan. The business expenditure incurred inside Pakistan relates to both and is allocated on the basis of revenue earned from each type of activities.

The following information is available in respect of the tax year 2007:

	Operations inside Pakistan	Operations outside Pakistan
	------------Rs. in thousand------------	
Sales revenue	105,000	35,000
Allowable business expenses	136,000	12,000
Brought forward business losses	Nil	5,000
Taxes paid in foreign countries	Nil	1,000

The company has also paid advance tax in Pakistan amounting to Rs. 0.5 million.

Required:
Compute the taxable income of the company for the tax year 2007 and the tax payable with the return. **(07)**

Q. 8 Sulpher Pakistan Limited (SPL) manufactures two products locally and is also engaged in the import of a product which is supplied to the distributors without any further processing. Some of the details are as under:

	Alpha	Bravo	Charlie
Source of product	manufactured	manufactured	imported
Listed under 3rd schedule of Sales Tax Act	Yes	No	Yes
Federal Excise Duty – rate	10%	10%	Exempt
– basis	retail price	wholesale cash price	-
Retail price-per unit *(including all taxes & duties)*	100	150	200
Retail price-per unit *(excluding all taxes & duties)*	-	-	140
Price to distributors *(excluding all taxes & duties)*	65	125	122

Following information is also available:

- Price to distributors may be assumed to be the Wholesale Cash Price.
- The import value of Charlie under the Customs Act, 1969 is Rs. 100 and the rate of custom duty is 10%.
- All the products are exempt from levy of Special Excise Duty.

Required:
In respect of each unit of the three products, calculate the following:
(a) Sales Tax and Federal Excise Duty payable by SPL.
(b) Withholding tax to be deducted by the distributors. **(15)**

Q. 9 (a) Sales Tax Act, 1990 places certain restrictions on adjustment of input tax. Please explain its provisions in respect of the following:

(i) Extent of restriction on admissibility of input tax;
(ii) The conditions under which the amount of input tax which had been so restricted, may subsequently be allowed;
(iii) Treatment of sales tax paid on acquisition of fixed assets. **(06)**

(b) XYZ Limited is a public listed company engaged in a wide range of business activities. You are required to advise them on the following issues:

(i) The procedure for claiming input tax if the claim is not made in the relevant month.
(ii) The proportion of sales tax that may be claimed as a drawback on re-export of imported goods and the conditions (if any) which must be complied with in this regard.
(iii) The admissibility of sales tax paid on courier services as input tax. **(07)**

Q. 10 Uzair is the senior incharge at the audit of Faysal Technologies Limited for the year ended June 30, 2007. He has developed serious differences with the management as regards the computation of the company's income tax liability. The following transactions are the subject of the dispute:

(a) Investment in a Pakistani subsidiary at a cost of Rs. 30 million was disposed off to an associated undertaking at an arm's length price of Rs. 20 million.
(b) FTL sold self-manufactured goods at a sale price of Rs.20 million to its customer, Alpha Pakistan Limited (APL). Due to certain financial constraints, APL could not discharge its liability in cash and instead, under an agreement with FTL, transferred its land and building on January 1, 2007 as final settlement of its liability. At the date of transfer, the assets had a tax written down value of Rs. 16 million, however, the fair market value of the assets was Rs 22 million. For claiming depreciation, FTL has valued the building at Rs. 15.0 million.
(c) Research & Development expenditure amount to Rs 2 Million. As a result of the expenditure, FTL has been able to develop a new design for its products, which will be used for business purposes from the next accounting year. However, the useful life of the design cannot be ascertained.
(d) FTL is in the process of establishing a subsidiary company in a foreign country, with the objective of setting up a plant. In order to ascertain the technical feasibility of establishing the plant, FTL sought consultancy services of a firm resident of that country and paid Rs. 1.0 million from Pakistan without deduction of withholding tax.

Required:
As tax manager in the firm you are required to give your views with regard to the tax treatment of each of the above transaction. **(14)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2007

June 7, 2007

ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 (a) Mr. Green held 25% shares of ABC (Private) Limited at the time of its winding up on June 30, 2005. He has now received a notice from the Commissioner of Income Tax requiring him to pay Rs 500,000 on account of tax payable by the Company for the tax year 2005.

Discuss the legality of the notice issued to Mr. Green and the extent of his liability, if any. **(05)**

(b) Discuss the rules relating to "own estimate" with reference to quarterly payment of advance tax under the Income Tax Ordinance, 2001. **(04)**

Q.2 (a) Red, Blue & Co. has recently started business as Construction Contractors. During the year ended December 31, 2006, they have undertaken the following transactions:

(i) They entered into a contract for construction of a housing scheme with Mr. Ghalib, a Pakistani citizen. The project is likely to take three years to complete. Upto December 31, 2006 payments aggregating to Rs 10,000,000 were received from Mr. Ghalib. No tax has been deducted from these payments.

(ii) The firm was also awarded a contract by XYZ (Private) Limited for construction of residential quarters for its factory workers. The work shall commence from January 15, 2007 and will be completed within six months. However, a mobilization advance amounting to Rs 1,000,000 was paid by XYZ (Private) Limited in December 2006, after deducting tax of Rs 60,000.

The firm's partners are not very sure about the impact of the above transactions on the firm's taxation for tax year 2007. They are of the view that:

– Payments received from Mr. Ghalib should have been subjected to final tax. However, as he has not deducted the tax, they want to discharge the tax liability on their own.
– Work on contract with XYZ (Private) Limited has not commenced upto December 31, 2006 and therefore, the advance received is not taxable. The tax deducted should, therefore, be claimed as refundable.

Required:
Explain to the partners, the basis of taxation of the above payments received by the firm. **(06)**

(b) Under the Income Tax Ordinance, 2001, every importer is required to pay tax on the value of goods at the prescribed rates. State the conditions under which a manufacturer can obtain exemption certificate from the Commissioner of Income Tax, with regard to payment of tax at the import stage. **(04)**

Q.3 MNO Pakistan Limited is a public limited company whose shares are listed on all the registered stock exchanges in Pakistan and remained so listed during the year ended December 31, 2006. The Company is involved in the following activities:

- Supply of telecommunication equipment. The equipments are assembled in Pakistan after importing the major components from EU countries.
- Providing consultancy services in Pakistan to companies operating in the telecommunication sector.

The Tax Manager of the Company has computed the taxable income for the Tax Year 2007, as under:

	Note	Rupees in "000"
Profit before tax as per Profit & Loss Account		100,000
Add: Accounting depreciation		20,000
Accounting amortization	(i)	6,000
Excess cost of perquisites to employees		1,000
Provision for bad debts		2,000
Profit on debt to a foreign bank	(ii)	5,000
Tax gain on disposal of fixed assets	(iii)	5,000
		39,000
Less: Tax depreciation - initial	(iv)	5,000
- normal		10,000
Deferred expenditure	(v)	1,333
Accounting gain on disposal of fixed assets	(iii)	7,000
Bad debts actually written off	(vi)	1,000
		24,333
Less: Income attributable to services' revenue subject to Final Tax Regime	(vii)	15,000
Taxable income for the year		99,667

Notes to the Computation:

(i) On December 29, 2006, the Company has acquired rights for use of trade mark owned by a US company for a period of three years. The trade mark will be used for the equipments to be sold after March 31, 2007. For accounting purposes, the cost is being amortized equally over the three-year period.

(ii) The Company obtained a working capital loan from a foreign bank, the proceeds of which were utilized during the year. The Company did not deduct tax while paying interest on the loan. The Company is of the view that interest is not taxable in Pakistan as the bank does not have a Permanent Establishment in Pakistan.

(iii) Tax gains on disposal of fixed assets include a tax profit of Rs 60,000 on the sale of a car. It was acquired during the year ended December 31, 2004 at a cost of Rs 1,500,000. However, for the purpose of tax depreciation, the value was restricted at Rs 1,000,000. As a policy, the car was sold to the Managing Director of the Company for Rs 200,000. Tax gain represents the difference between fair market value i.e. Rs 700,000 and the tax written down value i.e. Rs 640,000.

(iv) During the year, the Company acquired second hand equipment at a cost of Rs 8,000,000. The Company is of the view that since the equipment was not used by the Company itself, it is entitled to claim initial depreciation allowance.

(v) The Company incurred an expenditure of Rs 2,000,000 on sales promotion. It has been estimated that the benefit of such expenditure will extend to three years and, therefore, the same is being amortized over a period of three years. However, for tax purposes, the whole of the expenditure has been claimed.

(vi) It includes a loan of Rs 500,000 to an associated undertaking. The amount has been written off because the borrower is in financial crisis and would not be able to discharge his debt.

(vii) The income attributable to services revenue has been excluded from the computation of taxable income. Tax deducted on such receipts was Rs 900,000.

(viii) The fixed assets of the Company include vehicles having fair market value of Rs 20,000,000 taken on finance lease from a scheduled bank. The tax depreciation has been computed at 15% of the FMV. Lease rentals paid during the year were Rs 2,000,000 including financial charges of Rs 500,000.

(ix) The Company disputes certain amounts invoiced by its suppliers. As a matter of prudence, it has provided such liabilities although the same are still under dispute. Year-wise breakup of such liabilities is as follows:

Year of Supply	Rupees in "000"
Tax Year 2003	790
Tax Year 2004	1,251
Tax Year 2005	1,244
Tax Year 2006	1,596
	4,881

Required:
Give your comments as regards the:
- tax treatment in the computation of taxable income with which you concur or disagree.
- implication for tax purposes of the information disclosed in the notes to the computation. **(24)**

Note: Restrict your answer to comments only. Revised computation is not required.

Q.4 (a) With reference to the concept of geographical source of income as enumerated in the Income Tax Ordinance, 2001, briefly comment on the taxability of income in each of the following situations separately:

(i) Profit on debt paid by STU (Private) Limited, a company incorporated in Pakistan, to a US bank against a short term loan, obtained to meet working capital requirements of the company's UK branch.

(ii) Mr. Black, a foreign national working as a General Manager for a Japanese company, is deputed in Pakistan to carry out market research for a product sold in Pakistan. His remuneration for the services rendered in Pakistan is transferred directly to his bank account in Japan.

(iii) Mr. White, a non resident, sold his shareholding in KLM Inc. and derived capital gains. A significant part (97%) of assets of KLM Inc. consists of the right to explore natural resources in Pakistan. **(06)**

(b) Mr. Blue had filed his return of income for tax year 2003 on September 30, 2003. Discuss the following in terms of the Income Tax Ordinance, 2001:

(i) by what date the Commissioner of Income Tax could make the first amendment of the assessment, if required?

(ii) by what date any further amendment can be made if the first amendment was made on September 29, 2006? **(04)**

Q.5 (a) To receive and retain recognition, a provident fund has to satisfy various conditions mentioned in the Sixth Schedule to the Income Tax Ordinance, 2001. Based on these conditions, comment on the legality of each of the following:

(i) The recognition can also be granted by the Commissioner of Income Tax to an employer whose principal place of business is not in Pakistan.

(ii) Employer does not have the power to recover any sum whatsoever from the employees' provident fund balance, under any circumstances. **(04)**

(b) During the tax year 2006 and 2007, a local bank provided various types of consumer loan facilities to its customers. Details of interest earned on consumer loans and bad debts provided against consumer loans are as follows:

	2006	**2007**
	Rupees in million	
Interest earned on consumer loans	300	370
Bad debt provision for the year	12	10

Required:
Compute the allowable bad debt provision on consumer loans in accordance with the Income Tax Ordinance, 2001 for tax years 2006 and 2007. **(06)**

Q.6 (a) DEF Limited supplied goods valuing Rs 1,000,000 to one of its distributor, Mr. Pink who is also registered for sales tax purposes. Sales tax invoice was issued for the said amount plus sales tax of Rs 150,000. The transaction was recorded in the monthly sales tax return for the month of January 2007.

In February 2007 the internal auditor of the Company observed that the accountant had applied incorrect selling prices. As a result, the Company will have to refund the excess amount to Mr. Pink.

Required:
Advise the procedure to be adopted by the Company and the distributor to adjust the excess amount of sales tax. **(05)**

(b) Mr. Lal, an unregistered person, is engaged in the supply of imported and locally purchased good. He has received a notice from a local registration office of the sales tax for compulsory registration.

Before submitting the application for registration, he wants to know whether he will be able to claim the input tax paid on the unsold stocks purchased before registration.

Required:
Explain the legal provisions of the Sales Tax Act, 1990 regarding tax paid on stocks before registration. **(06)**

Q.7 GHI Limited has been engaged in the import and supply of taxable goods which are listed in the Third Schedule to the Sales Tax Act, 1990. You have been provided the following quarterly information relating to the company's operations:

Rupees in million

	July–Sept 2006	**Oct–Dec 2006**	**Jan–Mar 2007**
Sales	35.00	28.00	26.00
Value of goods imported determined under section 25 of the Customs Act, 1969	20.00	22.00	19.00
Closing Stock	4.00	5.00	3.20

Following additional information is available:

(i) There was no opening stock as at July 1, 2006;
(ii) Custom duty is payable at the rate of 20%;
(iii) Minimum value addition on the goods is prescribed at 15% of import value;
(iv) Retail price of goods sold in first, second and third quarter amounted to Rs 45 million, Rs 37 million and Rs 32 million respectively.

Required:
(a) Compute the sales tax payable, if any, in respect of each of the three quarters;
(b) Work out the amount of input tax, foregone by the commercial importer, if any, in each of the three quarters. **(17)**

Q.8 (a) Explain the basis of determination of Federal Excise Duty in each of the following cases:
(i) Services provided free of charge; and
(ii) Goods liable to duty at a rate dependent on their value. **(06)**

(b) Explain the term "Franchise" and "Franchiser". **(03)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Winter 2006

December 7, 2006

ADVANCED TAXATION

(MARKS 100)

Module F

(3 hours)

Q.1 (a) GPM Textiles Limited and GAK Pakistan (Pvt) Limited are wholly owned subsidiaries of GYK Pakistan Limited. As a part of Corporate restructuring, it is being considered to transfer the plant and machinery from GPM to GAK at accounting written down value.

In the Board meeting, it was pointed out by one of the directors that under the provisions of the Income Tax Ordinance, 2001 the tax gain / loss will have to be worked out by taking into account the fair market value of the assets being transferred. The Director Finance has, however, contended that there is a provision in the Ordinance whereby no gain or loss is recognised in case of disposal of assets between subsidiary companies.

Required:
Explain to the management of the company about the conditions to be satisfied for non-recognition of gain / loss on disposal of assets between subsidiary companies of the same group. **(05)**

(b) GM Limited is considering an option to issue Term Finance Certificates (TFC) outside Pakistan for the purpose of raising funds for use in its business activities in Pakistan. To induce the investors for acquiring TFCs of the Company, it intends to advertise that the income on the same will not be taxable in Pakistan.

Required:
List down the conditions to be fulfilled for claiming exemption on profit on debt payable on TFCs being issued by the Company. **(05)**

Q.2 (a) Under the Income Tax Ordinance, 2001, entertainment expenditure shall be limited to the expenses incurred by a person that satisfy certain conditions.

Required:
Specify the conditions as explained in the Income Tax Rules, 2002 for the allowability of entertainment expenditure. **(05)**

(b) ZAB Manufacturing (Pvt.) Ltd., one of your clients, has been involved in the manufacturing of leather products. With effect from January 1, 2006 they have also started exporting approximately 30% of its manufactured goods. Consistent with their past practice, they are deducting tax from the payments against purchase of goods.

One of their suppliers has raised an objection on their practice by contending that by virtue of becoming manufacturer-cum-exporter, they are no more required to withhold tax from payments against purchase of goods.

Required:
Advise your client whether it should withhold tax from payment for purchase of goods. **(04)**

(c) An employer having established approved superannuation and approved gratuity fund is required to contribute annually to the funds on a reasonable basis. There are, however, limits set in the Income Tax Rules, 2002 on the initial and annual contributions to the aforesaid funds.

Required:
Specify those limits and the procedure for payment of contribution beyond the specified limits. **(04)**

Q.3 (a) As a tax consultant of Mirza Textile Mill Limited, you filed its return of income for tax year 2007 on November 30, 2006. Subsequently, you were informed by the Chief Financial Officer that he forgot to claim credit for certain taxes deducted and paid by the company's customers.

Required:
Explain the requirements for filing of revised return under the given circumstances. What would be the impact of filing a revised return on the assessment treated to have been made on filing the original return of income? **(04)**

(b) An appeal filed by FAL (Pvt) Limited against the order passed by the Commissioner of Income Tax – Appeals is pending before the Income Tax Appellate Tribunal (ITAT). Meanwhile, on the application filed by the Company, Central Board of Revenue (CBR) has appointed a committee for the resolution of dispute. On the recommendations of the Committee, the CBR has passed an order whereby the Company's tax liability has been reduced by 50%.

Required:
Explain to the management of the Company that in case they decide to make payment of tax in accordance with the CBR's order, what would be the affect on:

(i) existing orders, decisions, etc. and
(ii) appeal proceedings pending before the ITAT. **(04)**

(c) The Commissioner of Income Tax selected GZH Pakistan (Pvt.) Limited to verify its compliance with withholding tax regime. For this purpose, the transactions undertaken after July 1, 2006 were selected and on the basis of the audit, following transactions were identified where no tax was withheld by the Company:

(i) As part of company's scheme launched for promotion of sale, a car was given as a prize to Mr. C.F. Elahi.
(ii) Rent includes payment on account of furniture and fixtures provided by the landlord.
(iii) Purchase of goods from an importer.
(iv) Profit on debt paid to Pakistan branch of a non-resident bank under a loan agreement.

Required:
Explain with reasons as to whether or not the Company was required to withhold tax from payments mentioned in (i) to (iv) above. Also explain, what action can be taken by the tax authorities if it is established that the Company has failed to deduct tax from any of the above payments. **(09)**

Q.4 GIK Pakistan Limited is a Public limited company, whose shares are listed on all the stock exchanges of Pakistan. GIK Inc. USA holds 55% of the shares of the company. The Company is engaged in the trading of a wide range of electrical appliances, which comprise of the following:

(i) Import in finished form.
(ii) Manufactured in Pakistan from components imported mainly from GIK Inc. USA.

With effect from July 1, 2006, the Company has also established a software house at Lahore which is involved in export of computer software to GIK Inc., USA under a separate agreement entered in this behalf.

Following information has been extracted from the profit and loss account of the company for the year ended December 31, 2006:

	Rs in '000'
Revenue	500,000
Direct costs	302,000
Administrative & marketing expenses	100,000
Other revenues	50,000
Financial charges	10,000

Notes to the accounts revealed the following additional information:

(i) The revenue consists of sale of locally manufactured goods amounting to Rs. 300,000 and sale of imported finished goods amounting to Rs. 200,000.

(ii) Break-up of direct costs is as under:

	Rs in '000'
Raw materials consumed	50,000
Work in progress	25,000
Finished goods – Imported (note ii(a))	106,000
Labour cost (note ii(b))	80,000
Freight charges (note ii(c))	20,000
Accounting depreciation	21,000
	302,000

(a) This includes tax collected by the Customs Authorities on import of finished goods amounting to Rs. 6,000,000.

(b) Labour is provided by Messrs. RT & Co. under a contract. All the payments are made in cash and no tax is withheld therefrom as the management feels that cash payments are outside the scope of withholding tax provisions.

(c) Payment for freight charges has been made in cash.

(iii) Administrative and marketing expenses include the following items:

	Rs in '000'
Accounting depreciation	20,000
Salaries (note iii(a))	15,000
Advertising expenses	40,000
Trade mark fee (note iii(b))	5,000
Donations (note iii(c))	1,000
Rent, rate & taxes (note iii(d))	4,000
Accounting amortisation (note iii(e))	5,000
Miscellaneous expenses	10,000
	100,000

(a) It includes contributions of Rs 1,000,000 to unrecognised provident fund. However, effective arrangements are in place to ensure deduction of tax from payments made by the fund to employees.

(b) Under an agreement with GIK Inc., USA, a quarterly fee is paid by the company for use of trade marks and logos owned by GIK Inc. The company has not deducted any tax from the payments on the understanding that such fee is not taxable in Pakistan in the absence of GIK Inc.'s Permanent Establishment in Pakistan. Assume that there is no double tax treaty between Pakistan and USA.

(c) All donations were made to approved institutions mentioned in the Second Schedule of the Income Tax Ordinance, 2001.

(d) This includes an amount of Rs 500,000 being the taxes withheld in USA on payments received for export of computer software to GIK Inc., USA. The company intends to claim foreign tax credit, against the tax payable in Pakistan.

(e) On September 1, 2006, the company has acquired accounting software costing Rs 15,000,000, which has a useful life of three years. It is the company's accounting policy to take full amount of amortisation in the first year and no amortisation in the year of disposal.

(iv) Other revenues comprise the following:

	Rs in '000'
Gross dividend received from listed companies	5,000
Accounting profit on disposal of building (note iv(a))	17,000
Net income from export of computer software (note iv(b))	20,000
Profit on bank deposits	8,000
	50,000

(a) Calculation of accounting profit is based on the following information.

Sale considerations	57,000
Costs of building	50,000
Accounting depreciation	10,000
Accounting profit on disposal of building	17,000

(b) This represents net income after taking into account all direct and indirect expenses incurred by the Company in relation to export of computer software, except the financial charges.

(v) Financial charges include profit on debt amounting to Rs 2,000,000 paid on a loan exclusively utilised by the software house. Rest of the financial charges exclusively relate to the loan obtained for trading business.

(vi) The details of taxes deducted and paid during the year are as under:

	Rs in '000'
Advance tax paid under section 147	20,000
Tax paid on import of raw material	2,000
Tax deductions from dividends received	250
Tax deducted by customers on purchase of locally manufactured goods	10,500
	32,750

(vii) Accounting depreciation is the same as tax depreciation.

(viii) The normal rate of tax applicable on listed companies is 35%.

Required:
Compute the taxable income of the company and tax payable thereon for the Tax Year 2007. Give proper comments where any given information has not been utilised in the computation. **(25)**

Q.5 (a) (i) Identify the types of registered tax payers who are required to file their sales tax return electronically? **(03)**

(ii) Describe the manner of payment of sales tax in case of electronic filing of sales tax returns? **(03)**

(b) Under the Sales Tax Act, 1990, adjustment for input tax on credit purchases is allowable only if payment is made within 180 days of issuance of tax invoice. However, the Central Board of Revenue has prescribed certain conditions for condonation of delay in meeting the time frame of 180 days.

Required:
Describe the conditions under which the delay has been condoned. **(06)**

Q.6 (a) S. A. Enterprises, a registered person, failed to file a return with the Sales Tax Department for last twelve months. They have now received an order from Assistant Collector requiring them to pay the minimum tax liability determined by the Sales Tax Department. The management of the company has never heard about this minimum tax liability. They have approached you and raised the following questions:

(i) How is this minimum tax liability determined?
(ii) What would be the company's position if:
- they opt to pay the determined amount; or
- they do not pay the demand raised by the Sales Tax Department

Required:
Draft a memorandum, as a Sales Tax Consultant, explaining the question raised by the management. **(10)**

(b) Explain the conditions under which sales tax is allowed to be refunded as draw back? **(04)**

Q.7 (a) The Finance Act, 2006 has brought certain financial services provided by banking companies into the Federal Excise Regime.

Required:
Describe the following in respect of the above:
(i) Types of services on which excise duty has been levied;
(ii) Due date for payment of duties and filing of returns; and
(iii) Invoicing requirements. **(07)**

(b) One of the instruments which are now subject to Federal Excise Duty is the pay order. You are required to explain the applicability of Federal Excise Duty if pay order is issued by one branch of banking company in favour of another branch of the same banking company. **(02)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2006

June 08, 2006

ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 (a) Tipu Sultan (Pvt.) Ltd., a fast growing IT solution provider, a wholly owned subsidiary of a listed company, commenced its operations in 1999. The details of tax losses incurred by the subsidiary company are as follows:

Accounting year	Assessment / tax year	Losses as per return	Assessed losses
		Rupees	Rupees
June 30, 2001	2001 - 02	5,750,000	4,500,000
June 30, 2002	2002 - 03	4,800,000	3,782,500
June 30, 2003	2003	4,200,000	3,500,100
June 30, 2004	2004	3,711,800	3,050,000
June 30, 2005	2005	2,750,800	2,200,000

One of the directors is of the view that the holding company can set off the losses of its subsidiary.

As a Tax Consultant, you are required to advise on the following:

(i) What are the pre-requisites for claiming the losses of the subsidiary?
(ii) How much amount can the holding company claim against the subsidiary's losses? **(10)**

(b) Dividends are generally chargeable to tax under the head "income from other sources". Briefly explain the exception to this rule. **(03)**

Q.2 (a) Shah Jahan Ltd. has acquired plant and machinery which was partly financed through a loan denominated in a foreign currency. The financial details along with repayment schedule and exchange rates are given below:

Cost of plant and machinery acquired in January 2002	Rs.15,000,000
Grant paid by the Federal Government directly to the supplier of plant and machinery	Rs. 750,000
Foreign currency debt obtained to finance the purchase of plant and machinery on January 1, 2002	USD 200,000

Repayment schedule:

– January 1, 2003	USD 60,000
– January 1, 2004	USD 60,000
– January 1, 2005	USD 80,000

Exchange rates of US$ to Rupee had been as follows:

	Rupees
– January 1, 2002	Rs. 57.00
– June 30, 2002	Rs. 57.25
– January 1, 2003	Rs. 56.95
– June 30, 2003	Rs. 57.50
– January 1, 2004	Rs. 58.00
– June 30, 2004	Rs. 57.00
– January 1, 2005	Rs. 58.50
– June 30, 2005	Rs. 59.00

Required:

Compute the depreciation allowable for the tax years 2002, 2003, 2004 and 2005. **(09)**

Note : Rate of Depreciation for plant and machinery are as follows:
Initial = 50%
Normal = 10%

(b) Akbar Limited, a listed company, has offered buy back of shares to its shareholders. The following information is available:

Paid up capital: 10,000,000 shares @ Rs. 10 each	Rs. 100,000,000
Accumulated reserves	Rs. 350,000,000
Market value at the time of offer for buy back	Rs. 35
Offer price for buy back	Rs. 40

The company intends to delist before the end of tax year.

Advise the company about its obligations under the Income Tax Ordinance, 2001 in respect of the above stated buy back transaction. **(04)**

Q.3 (a) Humayun Limited has entered into a contract for supply of goods to Lodhi Limited on April 20, 2006. At the time of entering into contract, the goods were exempt from tax. As per the contractual terms, supplier was required to deliver the goods at buyer's premises at an agreed price.

With effect from April 25, 2006 the Federal Government withdrew the exemption of sales tax on such goods.

Advise the company on the chargeability of sales tax under the Sales Tax Act, 1990 in each of the following situations:

(i) 50 per cent payment was made on April 26, 2006 when goods were delivered and remaining 50 per cent payment was made on April 28, 2006
(ii) The company paid 100 per cent advance on April 23, 2006 and goods were delivered on April 28, 2006
(iii) The company paid 50 per cent advance on April 23, 2006 and the remaining payment was made when goods were delivered on April 28, 2006. **(06)**

(b) Mr. Babar, a registered person, purchased 1000 kgs of raw material for production of taxable finished goods. During the month, he utilized 70% of raw material for production whereas 20% raw material was still lying in the inventory. The remaining raw material was destroyed in fire.

Explain with reasons, to what extent Mr. Babar is entitled to adjust input tax against output tax liability for the month. **(05)**

Q.4 (a) Discuss allowability of the following against output duty payable on manufactured goods under the Federal Excise Act, 2005:

(i) Duty paid on material used for plant expansion project.
(ii) Excise duty paid on import of raw material. **(05)**

(b) A person, who is registered under the Sales Tax Act, 1990, is engaged in the supply of products which are also subject to excise duty.

Discuss briefly what additional steps, if any, the said person will take for the purpose of registration under the Federal Excise Act, 2005 and for issuing invoices under the said Act. **(03)**

(c) Under the Federal Excise Act 2005, what is the due date for payment of Federal Excise Duty and filing of return, by a person who is engaged in providing excisable services? **(03)**

Q.5 (a) Jahangir Bank (JB) seeks your legal advice regarding withholding tax obligations in respect of the following issues:

(i) Remittance to non-resident for repairs of special purpose hardware, carried out in U.S.A.
(ii) Payments of commission to non resident person having no permanent establishment in Pakistan. **(06)**

(b) Explain whether losses incurred during the exemption period can be set off against income of post exemption period. **(03)**

(c) Mr. Pasha is managing a fast growing chain of garment shops which sell readymade ethnic and fashion garments. He has a turnover of Rs. 40 million during the last year.

The Finance Act 2005 introduced a scheme for the retailers under which retailers will be fully discharged from their income tax and sales tax obligations on payment of fixed percentage of tax on supplies.

Prepare a memorandum explaining the conditions and requirements of the scheme. **(03)**

Q.6 (a) Mr. Saleem is the Finance Manager of the subsidiary of a multinational company registered in Pakistan. He has been granted share options of parent company as follows:

- Option was granted at Rs. 20 per option, to acquire 5000 shares after 2 years, on payment of Rs. 30 per share.
- Fair market value of option at the time it was granted was Rs. 65 per option.

Two year period was completed in the tax year 2005 and Mr. Saleem decided to utilize the share options as follows:

- 2000 options were sold in international market at Rs. 110 per option.
- 3000 shares options were exercised by making additional payment of Rs. 30 per option. After two months, these shares were sold in international market at Rs. 150 per share. At the time of exercise of option, market value of share was Rs. 135.

Work out the tax liability of Mr. Saleem in respect of above transaction, in the year in which the options were granted as well as in the year 2005. Also specify the heads of income in which it shall be classified. **(10)**

(b) Aurangzeb Ltd. is engaged in the supply of canned fruit juices and is considering to launch an incentive scheme for its customers. For this purpose it has planned to offer an additional fruit juice can on the purchase of two.

Advise the management of Aurangzeb Ltd. on the sales tax implication in respect of the above scheme. **(04)**

Q.7 Hania Industries Limited (HIL) is in the business of manufacturing and sale of chocolates and sweets and is listed on Karachi Stock Exchange. It sells goods through distributors appointed in each major city. During the last two years, it has extended its business and have been involved in export and import also.

The exports are mostly made to SAFA countries. Imports are mostly made from Europe. These consist of premier quality sweets and biscuits which are sold directly to large super markets in Karachi, Lahore and Islamabad.

Extracts from the profit and loss account of the company for the tax year 2006 are as under:

	Rs. in '000'
Sales	196,500
Cost of sales (material & labour)	134,500
Gross profit	62,000
Administrative and selling expenses	
Salaries	22,000
Depreciation	15,000
Others	20,000
	57,000
Operating profit	5,000
Other income	1,000
Other charges	(3,210)
Net profit before tax	2,790

Following information are also available:

a) Break-up of the sales for the year are as follows:

	Rs. in '000'
Local sale of own manufactured goods	152,000
Local sale of imported goods	32,500
Exports	12,000

b) Imports worth Rs.2.0 million were re-exported to Sri Lanka at a C & F price of $64,000. The sale proceeds thereof are included in the export of Rs. 12 million. The bank deducted a tax of 0.5% from the sale proceeds.

c) Cost of imports were as follow:

	Rs. in '000'
C & F (US$ 250,000 @ 60)	15,000
Custom duty	3,000
Sales tax	2,700
Income tax	1,242
Other direct expenses	1,058
	23,000

d) Cost of raw material consumed as charged to cost of sales during the year was Rs. 80 million. About 8% of the raw material is lost during production mainly on account of evaporation and other unavoidable wastages. 60% of the raw material is imported from countries with which we have treaties for avoidance of double taxation. Remaining raw material is produced locally. The raw material used for exports is normally the same except certain high quality ingredients. The cost of such ingredients used during the current year were Rs. 0.5 million.

e) The rates of custom duty, sales tax and income tax and the ratio of other direct expenses is the same for raw material as well as finished goods.

f) The company's machinery has been acquired on lease. The rental paid for the year amounted to Rs.1.5 million. The company has recorded it as a finance lease. 60% of the amount paid was in repayment of principal. Accounting depreciation charged on the same amounted to Rs.1.2 million. The rate of accounting depreciation is 10%.

g) The delivery vans used for distribution were acquired two years ago at a price of Rs. 5.0 million from the holding company which is listed on the Karachi Stock Exchange. The fair value of these vans at the date of acquisition was Rs. 4.0 million. The rate of accounting depreciation is Rs. 25% on straight line method.

h) The details of tax deducted / paid are as under:

	Rs. in '000'
− Tax deducted by distributors of locally manufactured goods	1,000
− Tax deducted by super stores against imported goods	200
− Tax paid on import of raw materials	3,100
− Tax deducted on export proceeds	70

i) During the year the company has introduced a new product for which a trial run was carried out. Expenses of Rs. 150,000 were incurred on the trial. Rs. 50,000 was recovered from the sale of trial production. The net amount was charged to costs of sales.

j) The details of other charges are as under

	Rs. in '000'
Financial charges	3,000
WPPF	150
WWF	60
	3,210

k) Other income includes rental income of Rs. 300,000. The expenses related to the property and included in the profit and loss account of the company are as follows:

	Rs. in '000'
− Property taxes	15
− Depreciation	90
− Other expenses on collection	25

l) Accounting depreciation, other than mentioned above, is approximate to tax depreciation.

m) The rate of tax applicable to the company is 35%.

Compute the taxable income of the company and the tax payable thereon. **(20)**

Q.8 What are the sales tax implications, in case of:

(i) termination of taxable activity;
(ii) Sale or transfer of ownership of taxable activity to unregistered person.
(iii) Sale or transfer of ownership of taxable activity to another registered person as an ongoing concern. **(06)**

(THE END)