THE PROFESSIONALS' ACADEMY OF COMMERCE

Advanced TAXATION

Mock Exam Summer-2015 | **May 18, 2015**
Module : F (Additional reading time - 15 minutes) **100 marks – 3 hours**

Q-1 Usaid a registered person under the Sales Tax is engaged in the business of manufacture and supply of various taxable and exempt goods. During the month of May 2015 it carried out the following transactions:

(i). During the month of May 2015, Usaid purchased raw material worth Rs. 200,000 for manufacturing of taxable goods. He utilized raw material worth Rs. 125,000 for production whereas material worth Rs. 25,000 was lying in the inventory. Balance raw material of Rs. 50,000 was destroyed by fire. Usaid received an insurance claim of Rs. 40,000 in respect of goods destroyed by fire.

(ii). An amount of Rs. 500,000 was paid to his custom agent on import of raw material used.

(iii). He purchased storage batteries worth Rs. 150,000 from a wholesaler. Batteries are employed in the electric system used in the factory.

(iv). Usaid under misapprehension collected additional sales tax of Rs. 100,000 from one of its customers. 65% of the goods on which additional sales tax was collected are still lying with the customer as unsold stock.

(v). Usaid paid franchise fee of Rs. 400,000 to Mr. Brain Lara in West Indies in lieu of right to use certain items in its production process, Rs. 200,000 to bank against L/C opening charges and Rs. 30,000 to insurance company against fire and theft insurance.

(vi). Usaid sold goods worth Rs. 1,000,000 to Mr. Inzamam-Ul- Haq on April 2014 and related sales tax was paid to the exchequer in the same month. In January 2015 Inzamam became bankrupt. In May 2015 after making several unsuccessful attempts to recover the debt, Usaid recognized the said amount of Rs. 1,000,000 as bad debt in its books of accounts.

(vii). Usaid launched incentive scheme for its customers. Under the said scheme, goods worth Rs. 100 are provided free of cost on the cumulative purchase of goods worth Rs. 2,000.

(viii). Usaid sold vehicles used for business purpose and furniture and fittings to non-registered person for Rs. 1,000,000 and Rs. 500,000 respectively. Furniture and fittings were held by Usaid as stock in trade.

(ix). He imported 10 samples of taxable product A from its associate in USA. Value of samples determined by custom authorities amounted to Rs. 1,000,000.Three of such samples amounting to Rs. 200,000 were distributed to local customers free of cost, whereas one sample amounting to Rs. 100,000 was gifted by Usaid to his uncle.

(x). Solar Torches were exported by Usaid to UAE. Solar Torches are included in the list of exempted goods under section 13 read with 6^{th} Schedule of the Sales Tax Act, 1990.

Required:
In the light of the provisions of the Sales Tax Act, 1990 read with Sales Tax Rules, 2005 advice Usaid as to the chargeability/adjustment of sales tax in respect of each of the above transactions.

(15)

Q.2 Aizah Pakistan Limited (APL) 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:

	Product A	**Product B**	**Product C**
Source of Product	**Manufactured**	**Manufactured**	**Imported**
Listed under 3rd Schedule of Sales Tax	Yes	No	Yes
Federal Excise Duty- rate - Basis	10% Retail Price	10% Value of supply as defined under Sales Tax Act, 1990	Exempt
Retail price per unit (inclusive all taxes and duties)	107	150	200
Retail price per unit (excluding all taxes and duties)			140
Price to distributor (excluding all taxes and duties)	80	125	122

Following information is also available:

(a). The import value of Product C under the Customs Act, 1969 is Rs. 100 and the rate of custom duty is 10%

(b). All the Distributors of the APL are companies as defined under the Companies Ordinance, 2001 and registered with FBR for sales tax and income tax purpose.

Required:

In respect of all the three products above calculate the following:

(a). Sales tax and Federal Excise duty payable by APL

(b). Income tax to be deducted by distributors ***(15)***

Q.3(a) The Chief Financial Officer of Gilchrist (Pvt.) Ltd (GPL) furnished you with the following information on 28 July 2014:

- GPL is a non-resident company incorporated under the laws of Australia
- GPL closes its accounts on 30 June of each year
- GPL is engaged in providing construction and related supervisory activities to Federal Government in Pakistan.
- The budgeted figures for the Net receipts (after tax deduction by Federal Government) and the taxable income (i.e. adjusted for tax purposes of GPL) are as follows:

Tax Year	**Net receipts(net of tax)**	**Taxable income**
2015	9,400,000	2,500,000
2016	11,280,000	2,920,000
2017	13,160,000	3,380,000

- In the tax year 2018, GPL plans to expand its business which would entail the purchase of new plant and machinery. The cost of the new plant is estimated to be Rs.10 million. The plant is expected to be commissioned for use in September 2017.
- For the tax year 2018, the company's net receipts (after tax deduction) from contract is estimated to be Rs.15,040,000 and the taxable profit to be 18% of the Gross receipts. The estimated profit has been adjusted for tax purposes except that no adjustments have been made for purchase of new plant and machinery.

Required:

(a). Keeping in view provisions of Income Tax Ordinance, 2001 explain whether income of GPL will be assessed under Final or normal tax regime. **(04)**

(b). Advice on the basis of the information furnished, whether or not it would be beneficial from a tax viewpoint for GPL to opt for assessment on the final tax basis or normal tax basis for the tax years 2015, 2016, 2017 and 2018. **(09)**

(b) McCullum Limited a non-resident company based in New Zealand wants to set up a wind power plant in Pakistan in collaboration with Pakistan based company namely, Javed Miandad (Pvt.) Limited.

McCullum Ltd is not sure about the income tax implications in respect of machinery to be imported for this purpose.

Required:

(i) State how McCullum Limited can obtain a ruling of the Federal Board of Revenue in advance on the proposed transaction. **(01)**

(ii) Explain whether the ruling will be binding on the taxpayer and the Commissioner. ***(1.5)***

(iii) State the status of the ruling if inconsistency is found between a circular and an advance ruling given by FBR. ***(01)***

Q.4(a) A person who holds an asset shall be treated as having made a disposal of the asset at the time the person parts with the ownership of the asset.

Required:

Briefly explain how you would determine the amount of the consideration received by a person in respect of an asset which the person has transferred to another person by reason of a gift. ***(02)***

(b) In the light of the provisions of the Income Tax Ordinance, 2001 define Securitization and Special Purpose Vehicle. Explain provisions of the Income Tax Ordinance, 2001 regarding taxability of income, deductibility of expenses and withholding tax obligations of Special Purpose Vehicle. ***(06)***

(c) A company formed for establishing and operating a new industrial undertaking for manufacturing in Pakistan is allowed a tax credit equal to 100% of the tax payable on the taxable income arising from such industrial undertaking for a period of five years from the date of setting up or commencement of commercial production, whichever is later.

Required:

Specify the conditions which must be satisfied for availing the above tax credit. ***(05)***

(d) State the provision regarding taxation of petroleum products as per section 156A of the Income Tax Ordinance, 2001 ***(02)***

(e) M/s. Cotton Limited, a holding company of five companies is engaged in the business of cotton farming, ginning, spinning, weaving and trading. Approximately 60% of the output of each company is consumed by the next follower. The remaining 40% is being sold in the open market through the trading company out of which 60% is exported and 40% is sold in the local market. Mr. Zaidi, Director Finance of the group of companies has received a notice from tax department regarding applicability of section 108 of the Income Tax Ordinance, 2001 transactions between associates. Mr. Zaidi approached you to seek advice about the following:

(i). What are the methods which may be applied to determine arm's length results under the Income Tax Rules, 2002? **(02)**

(ii). Which method will be used where the arm's length results cannot be reliably determined under any of the methods as mentioned at (i) above **(01)**

Q.5(a) Alpha Private Limited (OPL) wanted to adjust the Federal Excise duty paid on the raw materials purchased against the account of duty required to pay on its finished products. Under section 6 of the Federal Excise Act, 2005 explain the conditions which OPL is required to fulfill for the adjustments of duty? **(02)**

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

(i). Non-fund banking services

(ii). Non-tariff area

(iii). Narrate any two goods on which Federal Excise duty is collected under sales tax mode

(03)

(c) Under the provisions of the Sales Tax Act, 1990 and rules made there under, briefly explain whether the person under each of the following situations are required to be registered with Inland Revenue Department:

(i). A commercial exporter who intends to claim sales tax refund

(ii). A retailer whose annual turnover during the last twelve months is Rs. 3,000,000.

(iii). A commercial importer whose value of supplies during the last twelve months is below Rs. 5 million

(iv). A distributor whose annual turnover during the last twelve months is Rs. 13,000,000.

(v). A Wholesaler making exempt supplies ***(2.5)***

(e) Explain the provisions of the Sales Tax Rules, 2006 regarding cancellation of multiple registrations. ***(03)***

Q.6 Atif and Azhar are partners of a firm FEROZI, resident in Pakistan, carrying on the business of providing corporate, accounting and taxation services to various local and foreign clients. Atif also works as an employee in XYZ Ltd. Both partners share the profit and loss of the firm in the ratio of 50:50. For the tax year 2015, the results of the operations of the firm are as follows:

Particulars	**Rupees**
Revenue	10,000,000

Cost of sales	(6,000,000)
Gross Profit	4,000,000
Administrative and selling expenses	(2,000,000)
Financial charges	(1,000,000)
Other income	500,000
Profit before tax	1,500,000

Following further information is available from firm's record:

(i). During the period firm provided consultancy services to various corporate clients. Tax deducted at source @ 10% amounted to Rs. 100,000.

(ii). During the month of April 2015, Ricky Ponting Inc. a company based in Australia appointed FEROZI under an agreement to technically assist the company in preparing a feasibility study for its new project to be set up in Sydney Australia. Mr. Atif visited Australia and stayed there for completion of the assignment till 15 June 2015. Ricky Ponting Inc. paid a sum of Rs. 2,000,000 to FEROZI for this assignment. The amount was transferred through proper banking channel in the bank account of FEROZI maintained in Gulberg, Lahore. No tax was deducted either in our outside Pakistan.

(iii). Cost of sales include the following:

(a). Payment of compensation of Rs. 100,000 to a client for failure to provide the consultancy services within the time stipulated in the contract.

(b). Expense of Rs. 200,000 in connection with an infringement of a trade mark of wholly owned subsidiary of FEROZI.

(c). Reimbursement of Rs. 300,000 to the promoter of FEROZI for expenditure incurred in taking legal advice on certain matters raised by the law authorities at the time of the incorporation of FEROZI.

(iv). Administrative and selling expenses include:

(a). Free distribution of budget commentary and tax software to various corporate and non-corporate clients in line with the practice in the industry. The combined market value of the software and cost of preparation of budget commentary is Rs. 100,000.

(b). Payment of Rs. 50,000 to Faletti's Hotel Lahore for holding the annual eid-milan party for the employees and their families.

(v). Depreciation has been charged to the accounts according to the rates prescribed in the Income Tax Ordinance, 2001 except for one vehicle, used by a non-partner marketing employee of the FEROZI, details of which are given below:

Particulars	**Rupees**
Cost of the vehicle Date of purchase	3,300,000 Rs. 1 January 2015
Depreciation claimed	20% of cost using the straight line method

(vi). Financial charges include:

(a). Profit on debt of Rs. 200,000 paid to Singapore bank on a US Dollar loan. The loan was used by FEROZI for its business in Pakistan. No tax was deducted from payment of profit on debt on the contention that the profit was not chargeable to tax in Pakistan since

Singapore bank has no permanent establishment in Pakistan and profit on debt has been received by the Singapore Bank outside Pakistan.

(b). Exchange loss of Rs. 100,000 on the payment of final installment and markup of a foreign currency loan, which had been utilized for the import of unit of plant in the tax year 2011. Exchange loss includes Rs. 25,000 on account of markup payment.

(vii). Other income includes:

Rs. 100,000 (net of tax) representing value of bonus shares received from Usaid Ltd, a company listed on Karachi Stock Exchange. FEROZI holds shares in Usaid Ltd as an investment.

(viii). Creditors include:

(a). Rs. 200,000 received from Mr. Rizwan in cash against corporate services to be provided in tax year 2016

(b). Rs. 500,000 payable against a loan taken in the accounting year ended 30 June 2010 from an associate.

Besides their share of income from AOP, Azhar and Atif also earned following incomes in tax year 2015:

(i). Atif received a dividend of Rs. 50,000 from a mutual fund which only invests in debt securities. No tax was deducted by the mutual fund.

(ii). Atif is engaged in the software business since 2008. During the tax year 2015, he converted the business into a limited company. The company took over all the assets at fair value of Rs. 2,000,000 and in consideration thereof 200,000 shares @Rs. 10 were issued in the name of Atif. Book value of the assets on the date of transfer was Rs. 1,500,000. The newly formed company will only be involved in export of software.

(iii). On 20 March 2015 Atif received Rs. 300,000 in cash on entering into an agreement to sell an antique for total consideration of Rs. 1,500,000. It was agreed that the antique would be handed over to the purchaser on 15 July 2015, subject to payment of the balancing amount on 05 July 2015 and confirmation of stated origin of the Antique from the relevant department. Atif has purchased the Antique for Rs. 200,000 on 23 September 2008.

(iv). During tax year 2015, Atif borrowed 5,000 shares of listed company from Rubina for a short term. The value of the borrowed shares was agreed at Rs. 100 per share. Atif agreed to pay, for the specified period, a mark-up of Rs. 2 per share to Rubina at the time of settlement. Atif 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.

(v). In July 2011, Atif was granted an option to acquire 1000 shares of Alpha (Pvt.) Limited (Parent Company of his employer XYZ Ltd). 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, 2014 he paid a sum equivalent of Rs. 200,000 to acquire the said shares which were issued to him on July 21, 2014 when the market value of the shares was equivalent of Rs. 350 per share. Atif disposed off the shares on June 21, 2015. The net sales proceeds received amounted to Rs. 375,000. During the retention period from July 21, 2014 to June 21, 2015 he also received dividend of Rs. 45,000(net of tax) from Alpha (Pvt.) Limited.

(vi). Atif and Azhar, jointly own a freehold house in Lahore which was let out during the whole tax year at monthly rental of US $1,000. The total rent was paid in advance on 01 July 2014 on which date the exchange rates were:

a. State Bank of Pakistan rate 1US$= Rs. 100
b. Open market rate 1US$= Rs. 102

Both have equal share in the property

Required:

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

(a). FEROZI
(b). Mr. Atif **(25)**

(The End)

Tax rates for every individual and association of persons except for salaried taxpayer

Sr. No.	Taxable Income (Rs.) From	To	Rate of Tax
1.	Up to 400,000		0%
2.	400,001	750,000	10% of the amount exceeding Rs. 400,000
3.	750,001	1,500,000	Rs.35,000 + 15% of the amount exceeding Rs.750,000
4.	1,500,001	2,500,000	Rs.147,500 + 20% of the amount exceeding Rs.1,500,000
5.	2,500,001	4,000,000	Rs.347,500 + 25% of the amount exceeding Rs.2,500,000
6.	4,000,001	6,000,000	Rs.722,500 + 30% of the amount exceeding Rs. 4,000,000
7.	Above 6,000,000		Rs.1,322,500 + 35% of the amount exceeding Rs.6,000,000