

**Mock Exam, Spring–2013**  
**Taxation (Solution)**

Answer to Q.1

**Mr. Waqar Anwar**  
**Tax year 2013**  
**Computation of Taxable Income and Tax Liability**  
**(01 mark for format)**

<u>Salary</u>		<u>Pak Rupee</u>
Basic Salary		3,780,000(01 mark)
Medical Allowance	607,500	
Less: Exempt (10% of B.S)	<u>378,000</u>	229,500(01 mark)
Utility Allowance		607,500
Rent free Accommodation	<u>1,620,000</u>	(01 mark)
45% of Basic Salary	<u>1,701,000</u>	
Whichever is higher		1,701,000
Others		337,500(02 marks)
Gratuity	4,000,000	
Less exempt up to 50% or Rs 75,000 whichever is lower	<u>75,000</u>	3,925,000(02 marks)
Pension @ Rs 70,000 per month		<u>EXEMPT(01 mark)</u>
<b>Taxable Salary</b>		<b><u>10,351,000</u></b>
<b><u>Income from Property</u></b>		
Rent Received		3,600,000(01 mark)
<b><u>Capital Gain</u></b>		
Loss on sale of Manuscript	not allowed	(01 mark)
Residential plot (Note-1)		Exempt
<b><u>Tax Liability</u></b>		
Since the salary is more than 50% of total income, the case should be treated as salaried case(01 mark)		
Tax up to Rs 2,500,000	420,000	
Tax @ 20% on Rs 7,851,000	<u>1,570,200</u>	1,990,200(01 mark)
Less <b>Tax Credits</b>		
Donation made to University	500,000	
Mark up to HBFC	<u>300,000</u>	
	<b><u>800,000</u></b>	
Tax Credit (1,990,200/ 10,351,000) * 800,000		<u>153,817(02 mark)</u>
		1,836,383
Tax on Income from Property		
Tax up to Rs 1,000,000	57,500	
10% on Rs 2,600,000	<u>260,000</u>	<u>317,500(01 mark)</u>
<b>Total Tax Liability</b>		<b><u>2,153,883</u></b>

**Note 01:** Residential plot is not taxable as holding period is more than 2year. (01 mark)

**Note 02:** Mr. Anwar is 62 years; however, his income exceeds Rs 1.0 Million so senior citizen tax relief shall not be allowed. (01 mark)

**Note 03:** Pension from one employer is exempt. (01 mark)

**Answer to Q.2**

The provisions of Income tax Ordinance shall not apply to a payment on account of payments made to non-residents in respect of tax deduction;

(a) an import of goods where title to the goods passes outside Pakistan and is supported by import documents, except an import that is part of an overall arrangement for the supply of goods, their installation, and any commission and guarantees in respect of the supply where –

- (i) the supply is made by the head office outside Pakistan of a person to a permanent establishment of the person in Pakistan; **(1.5 marks)**
- (ii) the supply is made by a permanent establishment of the person outside Pakistan to a permanent establishment of the person in Pakistan; **(1.5 marks)**
- (iii) the supply is made between associates; or **(1.5 marks)**
- (iv) the supply is made by a resident person or a Pakistan permanent establishment of a non-resident person; or **(1.5 marks)**

(b) Educational and medical expenses remitted in accordance. **(02 marks)**

**Answer to Q.3**

- (i) No Capital loss is recognized on sculpture or on an antique. **(02 marks)**
- (ii) Where salary is received by an employee in arrears and as a result the employee is chargeable at higher rate of tax, by notice in writing to the commissioner, elect for the amount to be taxed at the tax that would have been applicable if the salary had been paid to the employee in the tax year in which the services were rendered. **(02 mark)**
- (iii) Arm's Length transaction means a transaction between two parties who are;
  - Not related
  - Not on close terms
  - Not involved in a confidential relationship
  - Presumed to have roughly equal bargaining power
  - Knowledgeable about the deal
  - Willing to undertake the deal

**(01 mark)**

In the case given, Mr. C concerns are genuine as the transactions are made between the related parties and also have close terms in terms of relationship of one of the partner with the other party. **(01 mark)**

(iv) Following is the correct tax treatment;

Cost of the car		<u>Rs 3,000,000</u>	
Cost used for Tax purposes		Rs 2,500,000	
<u>Depreciation</u>			
Tax year 2010	Rs 375,000		
Tax year 2011	Rs 318,750		
Tax year 2012	<u>Rs 270,938</u>	<b>Rs 964,688</b>	<b>(01 mark)</b>
WDV of Motor Vehicle		Rs 1,535,313	
<u>Sale proceed for Tax purpose</u>			
(2,500,000/3,000,000) * 2,600,000		Rs 2,166,667	
Taxable Gain on disposal		<b>Rs 631,354</b>	<b>(01 mark)</b>

- (v) According to the provision of Income Tax Ordinance, a person who owns immovable property of 250 Sq yards or more or a flat in urban area is required to file Return of income, however, this provision is not applicable to;
- i. A non-resident person
  - ii. A widow
  - iii. An orphan below the age of 25 years
  - iv. A disable person

**(01 mark)**

In this case, notice of one month is valid and MsAsma needs to respond within the said notice period.

**(01 mark)**

- (vi) According to provision of Income Tax Ordinance, any payment by a private company by way of advance or loan to its shareholder to the extent to which the company possesses accumulated profit shall be considered as dividend in the hands of recipient. Therefore, SAGA Company Private limited would consider loan payment to MrJamshed as dividend and deduct tax @ 10% of the amount paid. This tax deducted would be final discharge of liability in respect of such payment in the hands of MrJamshed.**(02 marks)**

**Answer to Q.4 (a)**

- i. A public company having the prescribed amount of paid up capital, a trust or a body corporate may be registered as SPV with SECP for the purpose of Securitization under the Companies (Assets Backed Securitization) Rules, 1999. **(01 mark)**
- ii. An Originator including a leasing company and modaraba may transfer its receivables to SPV in consideration of a mutually agreed payment by SPV who is entitled to collect the receivables. **(01 mark)**
- iii. Lease rentals of assets, used by a lessee for his taxable business income, to SPV on behalf of an originator is allowable tax expense for the lessees (section 28). **(01 mark)**
- iv. Financial cost of securitization of receivables by an originator in respect of SPV is an allowable tax expense. **(01 mark)**
- v. Payment by SPV to an originator in respect of securitization of receivables shall not be subject to tax deduction. **(01 mark)**
- vi. According to Clause 136 part I of 2nd Schedule, income of SPV is exempt. However, if there is any income arises in the accounts of SPV after the completion of securitization process, the same shall be returned to originator in the next income year and such income shall be taxable in the hands of originator. **(01 mark)**
- vii. If a person deducts tax from payment to SPV on behalf of originator, the originator is entitled to get credit of such tax. **(01 mark)**

**Answer to Q.4 (b)**

Small Company means a company registered on or after the first day of July, 2005, under the Companies Ordinance, 1984 (XLVII) of 1984, which,— **(01 mark)**

- i. has paid up capital plus undistributed reserves not exceeding twenty-five million rupees; **(1.5 marks)**
- ii. has employees not exceeding two hundred and fifty any time during the year; **(1.5 marks)**
- iii. has annual turnover not exceeding two hundred and fifty million rupees; and **(1.5 marks)**
- iv. is not formed by the splitting up or the reconstitution of business already in existence; **(1.5 marks)**

**Answer to Q.4 (c)**

On disposal of the capital assets, a capital gain or loss is realized according to Income Tax provisions; however, there is certain exception of this rule. Following are the capital assets on which, capital loss shall not be recognized; **(07 marks)**

- A painting, sculpture, drawing or other work of art.
- An antique
- A coin or medallion
- A postage stamp or first day cover
- A rare manuscript, folio or book
- A jewellery

**Answer to Q.5**

**Calculation of tax liability**

*(2 marks)*

Output tax			2,608,000
Less: Input tax (lower of)			
- Actual input tax		797,261	
- 90% of output	(2,608,000 x 90%)	2,347,200	(797,261)
Payable			<u><u>1,810,739</u></u>

Refundable against exports	(1,076,058 + 1,379,310)	2,455,368
----------------------------	-------------------------	-----------

**Calculation of output tax**

*(04 marks)*

Taxable local supplies		
Sales to registered persons (10,000,000-200,000+400,000)		10,200,000
Goods given to CEO		100,000
Sales to un-registered persons		6,000,000
		<u>16,300,000</u>
<b>Rate</b>		<u>16%</u>
		<u><u>2,608,000</u></u>

**Calculation of input tax**

*(05 marks)*

**Common input**

Raw material	(15,000,000/116*16)	2,068,966
--------------	---------------------	-----------

**Specific input - exports**

Fixed assets	(10,000,000/116*16)	1,379,310
--------------	---------------------	-----------

**Apportionment of input tax**

	<b>Turnover</b>	<b>Common Input</b>	<b>Input fixed assets</b>
Taxable local supplies (as above)	16,300,000	797,261	-
Exports	22,000,000	1,076,058	1,379,310
Exempt	4,000,000	195,647	-
	<u><u>42,300,000</u></u>	<u><u>2,068,966</u></u>	

**Notes**

**(03marks)**

1. The free replacement of defective parts (open market value of Rs. 500,000) during the warranty period is considered as equivalent to the value of the original sale and not a separate sale. As through this transaction previous sale will be cancelled and new sale will be recorded so its net impact is nil.

2. The value of a supply can be reduced by a trade discount only if:

- (i) the trade discount is in conformity with the normal business practices; and
- (ii) is shown on the sales tax invoices.

In the instant case the second condition is not fulfilled; therefore, the value of the supply is not reduced for the purposes of charging sales tax.

3. The input tax of Rs. 100,000 pertaining to the raw material purchased in November 2011 cannot be claimed in September 2012 as it is older than six months and so ineligible for adjustment. It could only have been claimed up to May 2012.

**Answer to Q.6**

The following persons engaged in making taxable supplies in the course of any taxable activity carried on by them are required to be registered namely;

- 1. A manufacturer whose annual turnover from taxable supplies during the last 12 months exceeds Rs 5.0 Million. **(01 mark)**
- 2. A retailer whose value of supplies (total supplies including exempt supplies) during the last 12 months exceeds Rs 5.0 Million. **(01 mark)**
- 3. An Importer **(01 mark)**
- 4. A wholesaler, dealer or distributor. **(01 mark)**
- 5. A person who is required under any Federal or provincial law to be registered for the purpose of any duty or tax collected or paid as if were a sales tax under this Act. **(01 mark)**

**Answer to Q.7 (a) The exception on deduction of WHT –**

- (a)** Sale of goods where – **(01 mark)**
  - (i)** The sale is made by the importer of the goods;
  - (ii)** The importer has paid tax under section 148 in respect of the goods; and
  - (iii)** The goods are sold in the same condition they were in when imported;
- (b)** A refund of any security deposit; **(01 mark)**
- (c)** A payment made by the Federal Government, a Provincial Government or a Local Government to a contractor for construction materials supplied to the contractor by the said Government or the authority: **(01 mark)**
- (d)** a cotton ginner who deposits in the Government Treasury, an amount equal to the amount of tax deductible on the payment being made to him, and evidence to this effect is provided to the —prescribed person; **(01 mark)**
- (e)** The purchase of an asset under a lease and buy back agreement by a Modarba, leasing company, banking company or financial institution; or **(01 mark)**
- (f)** Any payment for securitization of receivables by a Special Purpose Vehicle to the Originator. **(01 Mark)**

**Answer to Q.7 (b)**

A manufacturer as a withholding agent who made sales made to distributors, dealers and wholesalers shall be subjected to 1% of the gross sales amount. This tax will be adjustable against the Income of the distributor, dealer or wholesalers. *(02 marks)*

**Answer to Q.7 (c)**

Following are the exception of the rule, where business transaction can be made in excess of Rs 10,000 thru other than banking instrument; *(01 mark each)*

- i. Utility bills& Postage
- ii. Freight charges
- iii. Travel fare
- iv. Payment of taxes, duties, fines, fee, penalties and other statutory obligations

**Answer to Q.8 (a)**

The tax payable by a full time teacher or a researcher, employed in a non profit education or research institution duly recognized by Higher Education Commission, a Board of Education or a University recognized by the Higher Education Commission, including government training and research institution, shall be reduced by an amount equal to 75% of tax payable on his income from salary. However, in the given case, the institute is private and not recognized by Higher Education Commission, so no tax relief would be applied on tax liability. *(02 marks)*

**Answer to Q.8 (b)**

Where the taxable income other than income on which the deduction of tax is final, in a tax year, of a taxpayer aged 60 years or more on the first day of tax year does not exceed one million rupees, his tax liability on such income shall be reduced by 50%. In this case, the annual taxable income is Rs 1.2 Million so the reduction of tax shall not applied. *(02 marks)*

**Answer to Q.8 (c)**

Depreciation expenses can be carried forward for an unlimited time and there is no time bar in respect of Depreciation carry forward rule. *(02marks)*

**Answer to Q.8 (d)**

Donation to a recognized institute as mentioned in the Income Tax Ordinance shall only be allowed for either tax credit or reduction of tax liability if such is made thru cross banking instruments. However, bearer cheque is not a “Crossed Banking Instrument” and therefore, is not entitled for any such tax relief. *(02marks)*

**Answer to Q.8 (e)**

Since MsShazia joined the office on September 01, 2012, her total annual taxable salary would be Rs 400,000, so she will remain under the exemption limit. *(02marks)*

**(The End)**