
Answers

- 1 (a) A public company for Pakistan tax purposes, inter-alia, means a company in which not less than 50% of the shares are held by a foreign government [s.2(47)(ab)]. Since 50% of the shares in Wheels Pakistan Limited (WPL) are held by the Government of Kuwait, WPL is a public company for tax purposes. Marks
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(b) **Wheels Pakistan Limited**
Accounting year ended 30 June 2007
Tax year 2007

Computation of taxable income	Rupees	Rupees	
Income from business			
Accounting profit		20,000,000	
<i>Add:</i> Accounting depreciation (Note 1)	6,000,000		0.5
Tax collected by the Collector of Customs (Note 2)	11,000,000		1
Donation to a relief fund (Note 3)	700,000		1
Major renovations to plant (Note 4)	3,000,000		1
Plant installation expenses (Note 5)	500,000		1
Unpaid liability (Note 6)	400,000		1
Tax profit on the sale of the building (Note 7)	3,000,000		2
		24,600,000	
<i>Less:</i> Accounting profit on the sale of the building (Note 8)	6,000,000		0.5
Bonus shares received (Note 9)	500,000		2
Dividend income (Note 10)	95,000		1
Recovery of a debt previously written off (Note 11)	175,000		1
Initial allowance (Note 12)	2,000,000		1
Depreciation (Note 13)	3,345,500		4
		(12,115,500)	
		32,484,500	
Income from other sources			
Temporary advance received in cash for working capital (Note 14)		1,000,000	2
Taxable income		33,484,500	

The relevant notes will be considered in allocating marks against each item. In addition, specific marks will be awarded for the explanations of the treatment of items not included in the computation of income [1 mark each for items (i), (ii) and (iii) and 2 marks for item (iv)] as follows.

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Items not included in the computation of taxable income

- (1) No adjustment is required in the computation of income for Rs. 2,000,000 transferred to the general reserve account, since the transfer is after determination of the profit of Rs. 20,000,000.
- (2) The net income of Rs. 5,000,000 (adjusted for tax purposes), on the sale of the imported cars in CBU condition, is income chargeable to tax, since the tax of Rs. 11,000,000 collected at the customs stage is not the final tax [s.148(7)(c)]. No adjustment is, therefore, required for the Rs. 5,000,000 in the computation of income.
- (3) An advance received by a person from another person (not being a banking company or a financial institution) which is not paid by a crossed cheque or through a banking channel from a person holding a national tax number, is treated as the income of the recipient chargeable to tax in the year of receipt under the head 'Income from other sources' [s.39(3)]. However, the provisions of s.39(3) does not apply to an advance payment for the sale of goods or supply of services [s.39(4)]. No adjustment is, therefore, required in the computation of income for the Rs. 4,000,000 received in cash from Carsales Associates as an advance payment for the sale of cars.
- (4) Under the provisions of group relief (s-59B), a subsidiary of a public company can surrender its assessed loss for the year in favour of its holding company provided certain conditions are fulfilled, one of which is that the holding company should be a public company listed on a registered stock exchange in Pakistan. As Wheels Pakistan Limited is not listed on any stock exchange in Pakistan, Radiators Pakistan Limited cannot surrender its tax loss of Rs. 1,750,000 to Wheels Pakistan Limited and therefore, the Rs. 1,750,000 cannot be set off by Wheels Pakistan Limited against its taxable income.

(c) Computation of tax payable	Rupees	Marks
Tax on taxable income of Rs. 33,484,500 at 35%	11,719,575	0.5
Tax credit on donation (Note A)	(245,000)	2.5
	<hr/>	
	11,474,575	
Tax collected by the Collector of Customs	(11,000,000)	1
	<hr/>	
Balance of tax payable	474,575	<hr/>
	<hr/>	4
		<hr/>
		30
		<hr/>

Note (A)

As the donation is to a relief fund established in Pakistan by the Federal Government, a tax credit is allowed at the average rate of tax (before allowance of any tax credit) on the lower of the amount of the donation paid or 15% of the taxable income [s.61(1)(b) and (2)].

	Rupees
Tax credit is calculated as under:	
Tax on taxable income before tax credit	(A) 11,719,575
Taxable income for the year	(B) 33,484,500
The lesser of the amount of the donation (Rs. 700,000) or 15% of taxable income (15% of Rs. 33,484,500 = Rs. 5,022,675)	(C) 700,000
A/B × C	
Rs. 11,719,575/Rs. 33,484,500 × Rs. 700,000	245,000

Notes referred to in the computation of taxable income and tax payable

- Note (1) Accounting depreciation is not a deductible charge. Depreciation calculated at the rates prescribed in the Third Schedule is a deductible charge.
- Note (2) The tax of Rs. 11,000,000 collected by the Collector of Customs is not a deductible charge. It is also not the final tax on the income derived from the sale of the imported cars in CBU condition [s.148(7)(c)]. The Rs. 11,000,000 collected as tax is available to Wheels Pakistan Limited as a tax credit.
- Note (3) Rs. 700,000 paid as a donation is not deductible but Wheels Pakistan Limited is entitled to a tax credit calculated under a prescribed formula [s.61(1)(b)].
- Note (4) Rs. 3,000,000 expended on upgrading the assembly line is capital expenditure, since the expenditure incurred has increased the capacity of the assembly plant – it has added value to a depreciable asset. For tax purposes the written down value of plant and machinery has been increased by Rs. 3,000,000 (Note 13).
- Note (5) Rs. 500,000 spent on the installation of the item of plant imported from Japan is not an expenditure for the carrying on of the business, but is capital expenditure. The cost of the plant has been increased by Rs. 500,000 (Note 12).
- Note (6) The unpaid amount of Rs. 400,000 for profit on debt (included in sundry creditors) was allowed as a deduction in the tax year 2003 (accounting year ended 30 June 2003). As the amount has remained unpaid for three years from the end of the tax year in which the deduction was allowed, the Rs. 400,000 is chargeable to tax in the tax year 2007 (i.e. the first tax year following the end of the said three years).
- Note (7) The tax profit or loss on the disposal of a depreciable asset is the difference between the consideration received and the tax written down value of the asset [s.22(8)]. However, in the case of immovable property (other than land) where the consideration received on the disposal exceeds the cost of the immovable property, the consideration received is to be treated as the cost of the property for calculating the tax profit or loss on the disposal of the immovable property [s.22(13)(d)].

As the consideration received (Rs. 15,000,000) for the sale of the building is more than the cost of the building (Rs. 10,000,000), Rs. 15,000,000 is treated as the cost of the building (deemed cost) for working out the tax profit/loss on the sale of the building.

The tax profit on the disposal of the building is worked out as under:

	Rupees
Sale consideration	15,000,000
Less: Tax written down value	
Deemed cost	15,000,000
Depreciation allowed (actual cost Rs. 10,000,000 less tax written down value Rs. 7,000,000)	(3,000,000)
	<u>12,000,000</u>
Tax profit	<u>3,000,000</u>

Note (8) The accounting profit or loss on the disposal of a depreciable asset is not to be considered in the determination of taxable income. It is the tax profit or loss that is chargeable to tax or allowed as a deduction. The accounting profit of Rs. 6,000,000 is, therefore, not chargeable to tax.

Note (9) Rs. 500,000 representing the face value of bonus shares issued to Wheels Pakistan Limited is not income chargeable to tax. For tax purposes 'income' does not include, in the case of a shareholder of a company, the face value of any bonus shares issued by the said company to its shareholders [s.2(29)].

Note (10) Dividends received by a public company (for tax purposes) are taxed at 5% of the gross amount of the dividends irrespective of whether the dividends are received from a public or private company.

	Rupees
Net amount of dividend received from Poshcars (Private) Ltd after deduction of tax	95,000
Gross amount of dividend	100,000
Tax deducted at source	5,000

Rs. 5,000 being the tax deducted at source is the final tax on the dividend income

Note (11) A recovery of a debt previously written off and allowed as a deductible charge is income chargeable to tax. However, as the debt of Rs. 175,000 written off in the tax year 2006, was not allowed as a deductible charge, the receipt of the Rs. 175,000 is not income chargeable to tax.

Note (12) Initial allowance

	Rupees
Cost of second-hand item of plant	3,500,000
Add: Installation cost	500,000
	<u>4,000,000</u>
Initial allowance at 50%	<u>2,000,000</u>

A second hand plant which has not previously been used in Pakistan is entitled to the initial allowance [s.23(1) and (5)(c)]

Note (13) Depreciation

	Plant and machinery	Buildings	Motor vehicles	Furniture	Total depreciation
Rate of depreciation	15%	10%	15%	15%	
	Rs.	Rs.	Rs.	Rs.	Rs.
Written down value	2,700,000	13,800,000	2,500,000	1,570,000	
Disposal		(7,000,000)			
Renovation cost	3,000,000				
	<u>5,700,000</u>	<u>6,800,000</u>	<u>2,500,000</u>	<u>1,570,000</u>	
Depreciation	855,000	680,000	375,000	235,500	2,145,500
Additions	4,000,000		6,000,000		
Initial allowance	2,000,000		*		
Written down value	<u>2,000,000</u>		<u>6,000,000</u>		
Depreciation	300,000		900,000		1,200,000
					<u>3,345,500</u>

* Road transport vehicles not plying for hire are not eligible for initial allowance

Note (14) Any advance received in cash otherwise than as an advance payment for the goods or supply of services is treated as the income of the recipient chargeable to tax as 'Income from other sources' [s.39(3) and (4)]. As the temporary advance of Rs. 1,000,000 from a director of the company was received in cash, the said Rs. 1,000,000 is chargeable to tax under the head 'Income from other sources'.

2 (a)

Mr Cyrus Banaji
Accounting year ended 30 June 2007
Tax year 2007

Computation of taxable income	Rupees	Rupees	
Salary			
From ABC			
Consideration for agreeing to a restrictive covenant (Note 1)	4,000,000		1.5
Gratuity (Note 2)	925,000		2
Basic salary – Rs. 250,000 × 6 months (1 July 2006 to 31 December 2006)	1,500,000		0.5
Cash allowances			
– Utilities - Rs. 25,000 × 6 months (Note 3)	150,000		0.5
– House rent – Rs. 45,000 × 6 months (Note 3)	270,000		0.5
– Medical – Rs. 150,000 – exempt from tax (Note 4)	–		1
Benefit of company maintained car (Note 5)	50,000		1
Benefit on purchase of car (Note 6)	150,000		1
Pension exempt from tax (Note 7)	–		1
Arrears of salary (Note 8)	65,000		1
	7,110,000		
Income from business			
Share of profit from the partnership firm – Rs. 1,250,000 exempt from tax (Note 9)		–	2
Income from other sources			
Income from the Korangi property (Note 10)		330,000	4
		7,440,000	
Taxable income			

The relevant notes will be considered in allocating marks against each item. In addition, specific marks will be awarded for the explanation of the treatment of items not included in the computation of income or tax payable (1 mark for item (1) and 2 marks each for items (2) and (3)).

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Items not included in the computation of taxable income

- (1) The accumulated balance due and becoming payable to an employee participating in a recognised provident fund is exempt from tax (clause 23 of Part 1 of the Second Schedule).
- (2) A tax is imposed at prescribed rates on every person who receives a dividend from a company. The tax imposed is computed by applying the relevant rate of tax on the gross amount of the dividend (s-5). Dividend income received by an individual is taxed at the rate of 10% of the gross amount of the dividend, irrespective of the status of the company from which the dividend is received. Rs. 6,000, being the tax deducted at source [10% of the gross dividend of Rs. 60,000 (s.150)], is the final tax on the dividend income and it is, therefore, not included in the computation of taxable income or tax payable.

As tax at 10% is imposed on the gross amount (Rs. 60,000) of the dividend received, the question of any deductible charges does not arise. The Rs. 10,000 profit paid by Cyrus on the loan obtained to acquire the shares in XYZ Ltd is, therefore, not deductible.
- (3) Every 'prescribed person' making a payment on account of the rent of immovable property (including the rent of furniture and fixtures and amounts for services relating to the property) is required to deduct tax at the rate of 5% of the gross rent paid [s.155(1)]. The tax so deducted is the final tax on the income from property. A company is one of the categories included in the definition of a 'prescribed person' [s.155(3)(iv)]. Gulab (Private) Ltd being a company is a prescribed person and is, therefore, required to deduct tax on the rent paid to Cyrus.

Rs. 90,000 being the tax deducted at source (5% of the gross rent of Rs. 1,800,000) is the final tax [s.155(2)] on the income from the Gulshan building. The Rs. 1,800,000 is not chargeable to tax under any head of income in computing the taxable income of Cyrus and no deduction is allowable for the expenditure of Rs. 62,000 incurred by Cyrus in deriving the income from property [s.169(2)(a) and (b)].

(b) Computation of tax payable

The share of profit from the AOP received by Cyrus is exempt from tax and does not form part of his taxable income. However, for the purpose of determining the rate of tax that would be applicable to the taxable income (i.e. income other than the share of profit from the AOP), the share of profit from the AOP is included in Cyrus's taxable income as if the said profit was chargeable to tax.

	Rupees	
Tax at 20% on taxable income if the share of profit from the AOP were chargeable to tax [20% of Rs. 8,690,000 (Rs. 7,440,000 + Rs. 1,250,000)]	(A) 1,738,000	
Taxable income if the share of profit from the AOP were chargeable to tax [Rs. 7,440,000 + Rs. 1,250,000]	(B) 8,690,000	
Actual taxable income	(C) 7,440,000	
(A/B × C)		
Rs. 1,738,000/Rs. 8,690,000 × Rs. 7,440,000	1,488,000	3.5
Less: Tax deducted at source by ABC	(1,200,000)	0.5
	288,000	4
	288,000	4
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Notes referred to in the computation of taxable income and tax payable

Note (1) An amount paid, inter alia, by a past employer or an associate of the employer to a past employee, is treated as received by the employee from an employment [s.12(5)]. Furthermore any consideration paid for an employee's agreement to a restrictive covenant in respect of any past, present or future employment is a profit in lieu, or in addition to salary [s.12(2)(e)(v)].

The equivalent of Rs. 4,000,000 in US Dollars transferred to the bank account of Cyrus in Singapore by DEF Ltd Singapore, an associate company of ABC is considered to be a payment by ABC to Cyrus. This payment, being in consideration of Cyrus consenting to a restrictive covenant restraining him from entering into employment with any competitor company of ABC for a period of five years, is a profit in lieu of or in addition to salary and is chargeable to tax as the salary income of Cyrus.

Note (2) Under the provisions of clause (13) of Part I of the Second Schedule, any amount receivable as a gratuity by an employee on his retirement:

- (i) from any gratuity fund approved by the Commissioner under the applicable rules is exempt from tax;
- (ii) from an employer under a gratuity scheme of the employer applicable to all employees and approved by the Central Board of Revenue for the purposes of the said clause (13), a maximum of Rs. 200,000 is exempt from tax; and
- (iii) in any other case, 50% of the amount receivable from the employer or Rs. 75,000 whichever is the less, is exempt from tax.

As the gratuity received by Cyrus was neither from an approved gratuity fund nor from an approved gratuity scheme of ABC, item (iii) would be applicable:

	Rupees
Gratuity received	1,000,000
Exempt from tax	75,000
	925,000
	925,000

Note (3) The cash allowances for utilities and housing are fully taxable.

Note (4) A medical allowance received by an employee not exceeding 10% of the basic salary of the employee is exempt from tax, provided free medical treatment or hospitalisation charges is not provided for in the terms of employment [Clause 139(b) of Part I of the Second Schedule].

As the terms of employment of Cyrus state that he is not entitled to free medical treatment or hospitalisation, the entire amount of Rs. 150,000 (Rs. 25,000 x 6 months), being not more than 10% of his basic salary, is exempt from tax.

Note (5) As the company maintained car is used by Cyrus partly for his personal use, Rs. 50,000, being 5% of the cost of the car proportionate to the number of months the car was used by Cyrus, (5% of Rs. 2,000,000 × 6/12 = Rs. 50,000) is chargeable to tax as salary income [s.13(3) and Rule 5 of the Income Tax Rules].

- Note (6) Where any asset is transferred by an employer to an employee, the amount chargeable to tax in the hands of the employee is the fair market value (FMV) of the asset on the date of its transfer as reduced by any payment made by the employee [s.13(11)]. The car purchased by Cyrus for Rs. 100,000 was sold by him within two days of its acquisition for Rs. 250,000. It is, therefore, reasonable to take the said Rs. 250,000 as the FMV of the car on the date of its transfer. Rs. 150,000 being the difference between the FMV (Rs. 250,000) and the payment made by Cyrus for the car (Rs. 100,000), is chargeable to tax as salary income.
- Note (7) Under clause (8) of Part I of the Second Schedule, any pension received by a citizen of Pakistan from a former employer is exempt from tax, unless the person continues to work for the employer or an associate of the employer. The pension received by Cyrus is exempt from tax since he fulfills the conditions of the said clause (8)
- Note (8) An amount is treated as received from an employment regardless of whether the amount is paid *inter-alia* by a past employer [s.12(5)(b)]. The Rs. 65,000 received from ABC (a past employer) is, therefore, income from employment (salary income). Furthermore, any income chargeable to tax under the head 'salary' is taxable on a receipt basis. Since the arrears of salary for the year ended 30 June 2006 were received in the accounting year ended 30 June 2007, the Rs. 65,000 is chargeable to tax as salary in the tax year 2007.
- Note (9) Sorab Associates (a partnership) is assessed to tax in the status of an association of persons (AOP) [s.80(2)(a)]. An AOP which is not a professional firm prohibited from incorporating by any law or the rules of the body regulating the profession, is taxed separately from its members and where the AOP has paid any tax, any amount received by a member out of the income of the AOP, is exempt from tax [s.92(l)]. As Sorab Associates has paid tax on its assessed income, the Rs. 1,250,000 received by Cyrus from the firm in his capacity as a member of the AOP, is exempt from tax.
- Note (10) A composite rent of Rs. 1,200,000 (Rs. 200,000 × 6 months) was received as consideration for the lease of the Korangi property consisting of the building together with the plant installed in the building. Such income after permissible deductions is chargeable to tax as 'Income from other sources' [s.39(1)(f)]. Permissible deductions allowable in computing such income are (a) any expenditure paid by the person in deriving income chargeable to tax other than expenditure of a capital nature [s.40(1)] (b), depreciation of any plant, machinery or building used to derive that income [s.40(3)(a)] and initial depreciation for any plant or machinery used to derive that income [s.40(3)(b)].

The taxable income of the Korangi property is computed as under:

		Rupees
Lease rent received (Rs. 200,000 × 6 months)		1,200,000
Less: Repairs to building	80,000	
Repairs to plant	50,000	
Ground rent	2,000	
Insurance	38,000	
Depreciation (see note)	700,000	
	<hr/>	870,000
Taxable income		<hr/> <hr/> 330,000

Note: Depreciation

	Building	Plant	Total depreciation
Rate of depreciation	10%	15%	
	Rs.	Rs.	Rs.
Cost	4,000,000	2,000,000	
Depreciation	400,000	300,000	700,000
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The initial allowance is not allowed on second-hand plant or machinery that has been used previously in Pakistan [s.23(5)(c)].

- 3 (a) The exemption clause referred to by Mr Murad is in respect of any income derived by an individual from the transfer of his membership rights or share in a stock exchange in Pakistan, along with a room in the stock exchange, to a company at any time between 1 July 2005 and 30 June 2007 [clause (133A) of Part I of the Second Schedule].

The exemption under the said clause (133A) is not available to Murad, since the transfer of his share in Karachi Stock Exchange (Guarantee) Ltd [KSEG] along with the occupancy rights of the room in the stock exchange was not to a company but to Murind Associates, a partnership firm which is treated as an 'association of persons' for tax purposes [s.80(2)(a)].

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(b) **Mr Noman**
Accounting year ended 30 June 2007
Tax year 2007

	Rupees	Rupees	
Computation of total/taxable income			
Salary			
Employee share scheme			
– gain on the disposal of the right to acquire 1,000 shares (Note 1)	50,000		1.5
– benefit on the acquisition of 1,000 shares (Note 2)	400,000		3
	<hr/>	450,000	
Capital gains			
Gain on the sale of shares acquired under the employee share scheme (Note 3)	500,000		3
Gain on the sale of shares in Lowlands (Private) Limited (Note 4)	75,000		1.5
Gain on the sale of shares in Highlands Limited – exempt from tax (Note 5)	–		1.5
Gain on the sale of personal jewellery (Note 6)	225,000		2
	<hr/>	800,000	
Total income		1,250,000	
Zakat paid (Note 7)		(50,000)	0.5
		<hr/>	
Taxable income		1,200,000	
		<hr/> <hr/>	

The relevant notes will be considered in allocating marks against each item. In addition, specific marks will be awarded for the explanation of the treatment of items not included in the computation of income [2 marks for item (1) and 1 mark each for items (2) and (3)] as follows:

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Items not included in the computation of total/taxable income

- (1) In an employee share scheme, where shares issued to an employee are subject to a restriction on the transfer of the shares, no amount is chargeable to tax on the employee until the earlier of, the time the employee has the free right to transfer the shares or the time the employee disposes of the shares [s.14(3a)].

Noman acquired 1,000 shares in Winners plc on 1 August 2006 at the exercise price of £10 per share, when the price quoted on a stock exchange in the UK was £12. The benefit of £2 per share is not chargeable to tax since under the Winners Employee Share Scheme, there is a restriction on the transfer of the shares. There is a holding period of six months before Noman has the free right to transfer the shares.

- (2) A loss on the disposal of a capital asset is not deductible where a gain on the disposal of such an asset is not chargeable to tax [s.38(2)]. Fibres Ltd is a public company for tax purposes and any gain on the sale of its shares is exempt from tax up to the tax year ending on 30 June 2007 (clause 110 of Part 1 of the Second Schedule). Therefore, the loss of Rs. 60,000 incurred on the disposal of the shares in Fibres Ltd is not deductible.

- (3) A gain or loss under the head 'Capital gains' can only arise on the disposal of a 'capital asset'. Any immovable property is excluded from the definition of a capital asset and, therefore, any gain or loss on the disposal of an immovable property is outside the ambit of capital gains. The gain of Rs. 200,000 on the sale of the agricultural land is, therefore, not included in the computation of income.

Notes referred to in the computation of total/taxable income

Note (1) The gain on the disposal of a right or option to acquire shares under an employee share scheme is chargeable to tax under the head 'Salary' [s.14(5)]. The gain of Rs. 50,000 is made up as under:

	Rupees
Consideration received on the disposal of the right to acquire 1,000 shares in Winners Bank plc (WBP) under the Winners Employee Share Scheme (Scheme)	150,000
Consideration paid for the right to acquire the 1,000 shares [$£1 \times 1,000 = £1,000$ ($£1 = Rs. 100$)]	100,000
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Gain on disposal	50,000
	<hr/> <hr/>

Note (2) Where shares issued under an employee share scheme are subject to a restriction on the transfer of the shares the amount chargeable to tax on the employee under the head 'Salary' is the fair market value (FMV) of the shares at the earlier of the time the employee has the free right to transfer the shares or disposes of the shares, as reduced by the amount paid to acquire the shares including any amount paid for the grant of a right to acquire the shares [s.14(3) (a) and (b)].

On 1 August 2006, Noman exercised the right to purchase 1,000 shares in WBP under the Scheme for £10 per share. The 1,000 shares issued were subject to a restriction on their transfer as the shares could only be transferred after a minimum holding period of six months. On 1 February 2007 (i.e. six months after 1 August 2006) Noman had the free right to transfer the shares. The FMV of one share in WBP on 1 February 2007 was £14 being the price quoted on a stock exchange in the UK on that date. The benefit of Rs. 400,000 on the acquisition of the 1,000 shares in WBP under the Scheme is made up as under:

	Rupees
FMV of 1,000 shares in WBP [$£14 \times 1,000 = £14,000$ ($£1 = Rs. 100$)]	1,400,000
Consideration paid at the time of:	
– accepting the right to acquire the 1,000 shares [$£1 \times 1,000 = £1,000$ ($£1 = Rs. 100$)]	100,000
– exercising the right to acquire the 1,000 shares [$£9 \times 1,000 = £9,000$ ($£1 = Rs. 100$)]	900,000
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	1,000,000
Benefit on acquisition of the 1,000 shares	400,000
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Note (3) Gain on the disposal of 500 shares in WBP acquired under the Scheme.

	Rupees
Consideration received on the disposal of 500 shares	1,200,000
Cost of 500 shares to Noman (Note 3A)	700,000
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Gain on disposal	500,000
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As the shares were held for less than one year, the entire gain of Rs. 500,000 is chargeable to tax under the head 'Capital gains'.

Note (3A) The cost of the shares to an employee acquired under an employee share scheme is the sum of (i) the consideration, if any, paid by the employee for the right or option to acquire the shares, (ii) the consideration, if any, paid by the employee for the shares, and (iii) the amount chargeable to tax as the salary income of the employee on acquisition of the shares [s.14(4)].

	Rupees
(i) £1 paid on accepting the right to acquire 1,000 shares [$£1 \times 1,000 = £1,000$ ($£1 = Rs. 100$)]	100,000
(ii) £9 paid on the acquisition of 1,000 shares [$£9 \times 1,000 = £9,000$ ($£1 = Rs. 100$)]	900,000
(iii) Amount charged to tax as salary income on the acquisition of the shares (Note 2)	400,000
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Cost of 1,000 shares	1,400,000
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Cost of 500 shares ($1/2 \times 1,400,000$)	700,000
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Note (4) As the shares in Lowland (Private) Ltd were held by Noman for more than one year, only Rs. 75,000, being 75% of the gain of Rs. 100,000 is chargeable to tax.

Note (5) A gain on the disposal of shares in a company which is a 'public company' for tax purposes is exempt from tax up to the tax year ending on 30 June 2007 (clause 110 of Part 1 of the Second Schedule). Highlands Ltd is a 'public company' for tax purposes, since 50% of its shares are held by a company incorporated in Saudi Arabia (foreign company) which is wholly owned by the Kingdom of Saudi Arabia (foreign government) [s.2(47)(ab)]. Therefore, the gain of Rs. 40,000 on the disposal of the shares is exempt from tax.

Note (6) Gain on the sale of jewellery

A gain or loss under the head 'Capital gains' can only arise on the disposal of a 'capital asset'. Movable assets held for personal use (with certain exceptions) are excluded from the definition of a 'capital asset' and therefore, any gain or loss on the disposal of such movable assets (which are not in the list of the exceptions) is outside the ambit of capital gains. One of the exceptions to the above is jewellery. Any jewellery even if held for personal use is treated as a 'capital asset' and any gain on its disposal is chargeable to tax as income from capital gains [s.37(5)(d)].

For assets acquired by gift (there is no cost of acquisition for the person acquiring the asset), the FMV of that asset, on the date of its acquisition by the donee is treated as the cost of the asset [s.37(4A)]. The jewellery gifted to Noman on 1 January 2006 was valued by a reputed firm of jewellers to be worth Rs. 900,000, which can be taken to be the FMV of the jewellery at the time of its acquisition by Noman. Rs. 900,000 is accordingly treated as the cost of the jewellery.

	Rupees
Sale consideration of the jewellery	1,200,000
Cost being the FMV of the jewellery on 1 January 2006	900,000
Gain on sale	300,000
75% of the gain of Rs. 300,000 is chargeable to tax since the jewellery was held by Noman for more than a year [s.37(3)]	225,000

Note (7) A payment of zakat under the Zakat and Ushr Ordinance, 1980 is a deductible allowance from total income [s.9 and s.60].

4 (1) The following issues raised by the Commissioner are not in accordance with the provisions of the tax statute:

(i) Minimum tax

The concept of minimum tax shall apply only to a resident company [s.113(1)]. As Jasmine Pharmaceuticals Company (JPC) is a partnership firm, its tax status is that of an association of persons and therefore, the provisions relating to minimum tax payable are not applicable to JPC.

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(ii) Contribution to the unrecognised provident fund

A contribution to a recognised provident fund is an allowable deduction. A contribution made to an unrecognised provident fund is also deductible provided the employer has made effective arrangements to ensure that tax would be deducted from any payments made by the fund in respect of which the recipient is chargeable to tax under the head 'Salary' [s.21(f)].

As JPC has made the aforesaid effective arrangements for deduction of tax from any payments made by the fund to an employee which is chargeable to tax as the employee's salary income, the contribution of Rs. 400,000 made to the fund is a deductible expenditure.

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(iii) Eid-Milan party

The expenditure of Rs. 75,600 is in the nature of an amenity provided to the employees motivated on the grounds of commercial expediency, since maintaining cordial and friendly relations with employees is an integral part of the profit earning process of any business. Expenditure incurred on the grounds of commercial expediency and in order to indirectly facilitate the carrying on of the business, is expenditure incurred wholly and exclusively for the purposes of the business and is a deductible expenditure.

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(iv) Damages paid

The Rs. 500,000 paid to the sole distributor as damages due to the failure to deliver supplies within the time stipulated in the contract, is an expense connected and incidental to the carrying on of the business of JPC. That the delay in the delivery of the goods was due to the negligence of JPC's despatch department is not relevant. The expenditure incurred is wholly and exclusively for the purpose of the business and is a deductible expenditure.

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- (2) The following issues raised by the Commissioner are in accordance with the provisions of the tax statute:
- (i) Travelling expenses
The expenditure of Rs. 1,530,000 incurred solely to secure the purchase of a mixing machine, is capital expenditure and is not deductible. Rs. 1,530,000 should be added to the cost of the mixing machine for tax purposes. 2
- (ii) Donation
The donation of Rs. 1,000,000 paid to a hospital run by the Federal Government is not a deductible expenditure. JPC is however entitled to a tax credit [s.61(l)(b) and (2)]. 2
- (iii) Salary paid to Mr A.
Any salary paid by an association of persons (AOP) to a member of the AOP is not a deductible expenditure [s.21(j)]. A partnership firm has the tax status of an AOP and is assessed to tax as an AOP. Mr A, being a partner in JPC, is thus a member of the AOP and therefore, the salary paid to him is not a deductible expenditure. 2

15

5 Mr Miskeen

	Rupees	
(a) Calculation of input tax		
Sales tax on:		
– purchases of raw materials from registered persons [Rs. 2,500,000 × 15/115]	326,087	1·0
– purchases of packing materials from unregistered persons ((b)(i))	–	1·0
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Admissible amount of input tax for June 2007	326,087	
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Calculation of output tax		
Sales tax on:		
– supply of goods to registered persons [Rs. 1,890,000 × 15%]	283,500	0·5
– supply of goods to unregistered persons [Rs. 2,150,000 × 15%] ((b)(ii))	322,500	1·0
– supply of goods at a trade discount of 35% [Rs. 650,000 × 15%] ((b)(iii))	97,500	1·0
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Admissible amount of output tax for June 2007	703,500	
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Sales tax payable for June 2007		
Output tax	703,500	
Input tax	326,087	
	<hr/>	
	377,413	0·5
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(b) (i) As unregistered persons do not charge sales tax and issue tax invoices the question of claiming input tax does not arise.		1
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(ii) As Miskeen is a registered person for sales tax purposes he is required to charge sales tax on making taxable supplies, irrespective of the fact that the supply has been made to an unregistered person.		1
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(iii) In the case of trade discounts the 'value of supplies' for the purpose of the levy of sales tax shall be the discounted price excluding the amount of tax, provided that the tax invoice shows the discounted price and the related tax and the discount allowed is in conformity with normal business practice.		
In respect of the sale of the old model toasters, the discounted price and related tax has been shown on the tax invoices. However, since the trade discount of 35% is not in conformity with normal business practice, the consideration of Rs. 422,800 received by Miskeen for the sale of the old model toasters, is not the 'value of supplies'. Rs. 650,000, which would have been received had the toasters been sold at their normal price, is considered as the 'value of supplies' on which sales tax must be charged, levied and paid.		3
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