Fundamentals Level – Skills Module

Taxation (Pakistan)

Monday 3 December 2007

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.
Tax rates and allowances are on page 3.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper F6 (PKN)

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The question paper begins on page 3.

SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need only be made to the nearest rupee.
2. All apportionments should be made to the nearest month.
3. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates and allowances are to be used in answering the questions.

A. Tax rates for individuals where salary income exceeds 50% of taxable income for the tax year 2007.

Taxable income	Rate of tax
Up to Rs. 150,000	0%
Rs. 150,001 – Rs. 200,000	0.25%
Rs. 200,001 – Rs. 250,000	0.50%
Rs. 250,001 – Rs. 300,000	0.75%
Rs. 300,001 – Rs. 350,000	1.50%
Rs. 350,001 – Rs. 400,000	2.50%
Rs. 400,001 – Rs. 500,000	3.50%
Rs. 500,001 – Rs. 600,000	4.50%
Rs. 600,001 – Rs. 700,000	6.00%
Rs. 700,001 – Rs. 850,000	7.50%
Rs. 850,001 – Rs. 950,000	9.00%
Rs. 950,001 – Rs. 1,050,000	10.00%
Rs. 1,050,001 – Rs. 1,200,000	11.00%
Rs. 1,200,001 – Rs. 1,500,000	12.50%
Rs. 1,500,001 – Rs. 1,700,000	14.00%
Rs. 1,700,001 – Rs. 2,000,000	15.00%
Rs. 2,000,001 – Rs. 3,150,000	16.00%
Rs. 3,150,001 – Rs. 3,700,000	17.50%
Rs. 3,700,001 – Rs. 4,450,000	18.50%
Rs. 4,450,001 – Rs. 8,400,000	19.00%
Rs. 8,400,001 and over	20.00%

* For a woman taxpayer where salary income exceeds 50% of taxable income for the tax year 2007, no tax is chargeable if taxable income does not exceed Rs. 200,000

B. Tax rates for companies

Tax year	Public company	Private company	Small company
2007	35%	35%	20%

C. Rates of advance collection or deduction of tax

For rent of immovable property (including rent of furniture and fixtures and amounts for services relating to such property)	5% of gross rent paid

D. Tax rates on dividends received from companies

Received by a public company or any other resident company	5% of the gross amount of the dividend
In any other case	10% of the gross amount of the dividend

E. Capital allowances

Depreciation		
Buildings (all types)	10%	of the tax written down value
Furniture and fittings	15%	of the tax written down value
Plant and machinery (not otherwise specified)	15%	of the tax written down value
Motor vehicles (all types)	15%	of the tax written down value
Computer hardware	30%	of the tax written down value
Initial allowance	50% of cost	

ALL FIVE questions are compulsory and MUST be attempted

1 Wheels Pakistan Limited (WPL), an industrial undertaking, is engaged in the manufacture of motor cars. The following information is available for the accounting year ended 30 June 2007.

(1) WPL is a public company under the Companies Ordinance, 1984. 40% of its shares are held by the Federal Government, 50% by the Government of Kuwait and 10% by individuals. WPL is not listed on any stock exchange in Pakistan

(2) WPL's accounting profit for the year ended 30 June 2007 before the transfer of Rs. 2,000,000 to the general reserve account is Rs. 20,000,000

(3) Deductions charged in the accounts include:

		Rupees
(i)	Accounting depreciation	6,000,000
(ii)	Tax collected by the Collector of Customs on the import of motor cars in CBU (completely built unit) condition	11,000,000
(iii)	Donation to a relief fund established in Pakistan by the Federal Government	700,000
(iv)	Major renovations to upgrade the assembly line to meet the increasing demand for deluxe cars	3,000,000

(4) Income shown in the accounts includes:

(i)	Accounting profit on the sale of a building	6,000,000
(ii)	The face value of bonus shares received from Gears Limited, a public company not listed on any stock exchange in Pakistan. WPL holds shares in Gears Limited as an investment	500,000
(iii)	Dividends (net of tax) received from Poshcars (Private) Ltd, a company incorporated under the Companies Ordinance, 1984	95,000
(iv)	Received against a debt written off in the tax year 2006, which write off was then not allowed as a deduction against taxable income	175,000
(v)	Net income (adjusted for tax purposes) on the sale of the imported cars in CBU condition (as in 3(ii) above)	5,000,000

(5) Fixed assets

(i) The tax written down values of WPL's fixed assets on 1 July 2006 were:

Buildings	13,800,000
Furniture and fitting	1,570,000
Plant and machinery	2,700,000
Motor vehicles	2,500,000

(ii) A deluxe motor car was purchased on 1 January 2007 for Rs. 6,000,000, for the Chief Executive

(iii) One of the buildings (cost Rs. 10,000,000 and tax written down value Rs. 7,000,000) was sold on 30 June 2007 for Rs. 15,000,000

(iv) An item of second-hand plant, not previously used in Pakistan, was imported from Japan at a cost of Rs. 3,500,000. Rs. 500,000 was incurred on the installation of the plant, which was commissioned for use on 1 January 2007. The Rs. 500,000 installation cost has been shown as revenue expenditure in the accounts.

(6) Creditors include:

(i) Rs. 3,000,000 payable in respect of a loan taken out for business purposes in the accounting year ended 30 June 2003. The Rs. 3,000,000 includes an amount of Rs. 400,000 profit payable on the loan, which amount was allowed as a deduction in the accounting year ended 30 June 2003.

(ii) Rs. 1,000,000 received in cash from a director as a temporary advance to meet working capital requirements.

(iii) Rs. 4,000,000 received in cash from Carsales Associates, a customer, as an advance payment for the sale of cars.

Radiators Pakistan Limited (RPL), an industrial undertaking, which is the 100 per cent subsidiary of WPL, furnished its complete return of income for the tax year 2007 to the tax department on 1 October 2007, declaring a tax loss for its accounting year ended 30 June 2007 (other than brought forward losses) of Rs. 1,750,000. The said loss was surrendered by RPL in favour of its holding company WPL. The Chief Financial Officer of WPL wants you to set-off the surrendered loss of Rs. 1,750,000 against the taxable income of WPL.

Required:

(a) Briefly state, with reasons, whether or not Wheels Pakistan Limited (WPL) is a public company for tax purposes. (2 marks)

(b) Compute the taxable income of WPL for the relevant tax year under the appropriate heads of income. Your answer should give clear reasons/explanations for the inclusion or exclusion in the computation of taxable income of each of the items listed above. The reasons/explanations for the items not listed in the computation of taxable income should be shown separately. Specific marks are allocated for this part of the requirement. (24 marks)

(c) Calculate the tax payable by/refundable to WPL for the relevant tax year. (4 marks)

(30 marks)

2 The following information is furnished to you by Mr Cyrus Banaji for his accounting year ended 30 June 2007.

(1) On 31 December 2006, Cyrus, a citizen of Pakistan, retired from the employment of the Karachi branch of ABC Limited (ABC), a company incorporated under the law of a country outside Pakistan. Cyrus has been in the employment of ABC since 1 January 1990 and on retirement he received:

- Rs. 1,000,000 from ABC as a gratuity. The amount received was not from any gratuity fund approved by the Commissioner or a gratuity scheme approved by the Central Board of Revenue.
- Rs. 9,000,000 from the ABC Employees Provident Fund being the accumulated balance in his account of the fund. The fund has been recognised by the Commissioner.

(2) Cyrus was also eligible to receive a monthly pension of Rs. 50,000 from 1 January 2007. At the end of each month ABC transfers Rs. 50,000 to his bank account.

(3) On 1 June 2007 (on which date Cyrus was no longer in the employment of ABC), DEF Ltd Singapore transferred the equivalent of Rs. 4,000,000 in US Dollars to Cyrus's bank account in Singapore. The payment was 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. DEF Ltd Singapore is an associate company of ABC.

(4) The terms of employment of Cyrus with ABC provided for the following:

(i) A basic salary of Rs. 250,000 per month.

(ii) Monthly cash allowances of:
- Rs. 25,000 for utilities
- Rs. 25,000 for medical treatment
- Rs. 45,000 for house rent assistance

(iii) A company maintained car (purchased for Rs. 2,000,000 on 1 January 2003) for Cyrus's personal and business use.

(iv) No entitlement to free medical treatment or hospitalisation or reimbursement of such expenses.

(5) Under the ABC car policy, a retiring employee, with at least three years service, has the option to purchase the company maintained car used by that employee at the accounting written down value (WDV) of the car. Cyrus exercised this option and purchased the car at its WDV of Rs. 100,000 on 30 December 2006. He sold the car on 1 January 2007 for Rs. 250,000.

(6) Tax deducted at source by ABC from Cyrus' salary income for the relevant tax year was Rs. 1,200,000

(7) Cyrus and his friend Sorab entered into a partnership agreement on 1 January 2006, to carry on business as manufacturers of washing machines under the name of Sorab Associates. The partnership agreement provides that profits or losses in the business are to be shared equally. The taxable income of the partnership for the year ended 31 December 2006 [Special tax year 2007] was Rs. 2,500,000 and the tax paid by the partnership on this Rs. 2,500,000 was Rs. 625,000.

(8) On 15 December 2006, Cyrus purchased a building which had previously been used as a factory in the Korangi Industrial Estate for Rs. 4,000,000 and installed in the building an item of second-hand plant previously used in Pakistan, for the preparation of bakery products, costing Rs. 2,000,000. Cyrus leased the Korangi property consisting of the building together with the plant on 1 January 2007 to Mr Double Roti, for a composite rent of Rs. 200,000 per month payable in advance.

Cyrus is also the owner of a residential building in Gulshan which was let to Gulab (Private) Limited on 1 July 2006, for a monthly rental of Rs. 150,000. Rent for the year ended 30 June 2007 was received in advance on 1 July 2006 after deduction of tax at the prescribed rate.

The following expenditure was incurred by Cyrus on the two properties for the tax year 2007:

	Korangi property Rs.	Gulshan building Rs.
Repairs to building	80,000	50,000
Repairs to plant	50,000	–
Ground rent	2,000	2,000
Insurance	38,000	10,000
	170,000	62,000

(9) Cyrus has also furnished you with the following information in respect of amounts received by him in the accounting year ended 30 June 2007:

(i) Rs. 54,000 as a dividend on his shareholding in XYZ Ltd, a company listed on the Karachi Stock Exchange. He wants to claim, as a deductible charge against this dividend income, Rs. 10,000 paid as profit on a loan obtained to acquire the shares in XYZ Ltd.

(ii) Rs. 65,000 as arrears of salary for the year ended 30 June 2006 received from ABC on 21 March 2007. He does not want to include this Rs. 65,000 in the computation of income for the year ended 30 June 2007 since:

– he was not an employee of ABC on 21 March 2007 and therefore the Rs. 65,000 can not be treated as received from any employment; and

– the receipt of the Rs. 65,000 pertains to the year ended 30 June 2006 and is not his taxable income for the year ended 30 June 2007.

Required:

(a) Compute the taxable income of Mr Cyrus Banaji for the relevant tax year under the appropriate heads of income. Your answer should give clear reasons/explanations for the inclusion or exclusion in the computation of taxable income of each of the items listed above. The reasons/explanations for the items not listed in the computation of taxable income should be shown separately. Specific marks have been allocated for this part of the requirement. (21 marks)

(b) Calculate the tax payable by/refundable to Mr Cyrus Banaji for the relevant tax year. (4 marks)

(25 marks)

3 **(a)** Mr Murad, a resident for Pakistan tax purposes, is preparing his return of income for the accounting year ended 30 June 2007 and the following information is furnished to you:

(1) On 1 July 2006, Murad became a member of the Karachi Stock Exchange (KSE) by purchasing from Mr Govind one share in Karachi Stock Exchange (Guarantee) Ltd (KSEG) for Rs. 30,000,000. He also acquired from Govind the occupancy rights of a room in the stock exchange building for Rs. 800,000.

(2) On 31 May 2007 Murad and Govind formed a partnership firm under the name of Murind Associates. On 1 June 2007 Murad gave up his membership rights in KSE and transferred to Murind Associates the one share in KSEG for Rs. 40,000,000 and the occupancy rights of the room in the stock exchange for Rs. 800,000.

Murad is of the view that there are no tax implications of the transaction relating to the transfer of the one share in KSEG and the occupancy rights in the room in the stock exchange, due to a specific exemption from tax for such transactions available under a clause in Part I of the Second Schedule.

Required:

State, giving reasons, whether or not Mr Murad's contention is correct. (3 marks)

(b) The following information is furnished to you by Mr Noman relating to his accounting year ended 30 June 2007.

(1) As an employee of the Karachi branch of Winners Bank plc (WBP), Noman, prior to his retirement from WBP, had participated in the Winners Employee Share Scheme (Scheme), the details of which are as follows:

- Under the Scheme, a participant has the free right to transfer the shares acquired only after a minimum holding period of six months, unless permission is granted by the custodian of the Scheme for the transfer of the shares before the expiry of the holding period.
- On 1 July 2006, Noman was granted the right to purchase 2,000 shares in WBP at the exercise price of £10 per share. The £10 was inclusive of a consideration of £1 for the right to acquire the shares. Noman accepted the right offered and made a payment of £2,000.
- On 31 July 2006 Noman disposed of the right relating to 1,000 shares for Rs. 150,000.
- On 1 August 2006 Noman exercised the right to acquire the balance of 1,000 shares in WBP and made a payment of £9 per share, having already paid £1 per share at the time of accepting the right. On 1 August 2006 the price quoted for one share in WBP on a stock exchange in the United Kingdom (UK) was £12.
- On 1 February 2007 (i.e. the end of the minimum holding period of six months for the shares acquired under the Scheme) the price of one share in WBP quoted on a stock exchange in the UK was £14.
- On 15 June 2007, Noman sold 500 shares in WBP for Rs. 1,200,000.
- The rate of exchange is to be taken as £1 = Rs. 100 on all relevant dates.

(2) On 31 May 2007 Noman sold some shares all of which had been acquired by him on 30 April 2006. The details of the gain or loss on the sale of these shares is as under:

- Gain of Rs. 100,000 on the sale of shares in Lowlands (Private) Limited.
- Gain of Rs. 40,000 on the sale of shares in Highlands Ltd a company incorporated under the Companies Ordinance, 1984, in which 50% of the shares are held by a company incorporated in Saudi Arabia which is wholly owned by the Kingdom of Saudi Arabia. Highlands Ltd is not listed on any stock exchange in Pakistan.
- Loss of Rs. 60,000 on the sale of shares in Fibres Ltd a company whose shares were traded on the Lahore Stock Exchange in the tax year 2007 and which remained listed on that exchange on 30 June 2007.

(3) On 31 May 2007 Noman sold agricultural land for Rs. 700,000, which he had purchased in April 2007 for Rs. 500,000.

(4) On 15 June 2007, Noman sold personal jewellery for Rs. 1,200,000. The jewellery had been gifted to him at the time of his marriage on 1 January 2006, on which date it had been valued by a reputed firm of jewellers at Rs. 900,000.

(5) In the accounting year ended 30 June 2007, Noman paid Rs. 50,000 as zakat under the Zakat and Ushr Ordinance, 1980.

Required:

Compute the total income and the taxable income of Noman under the appropriate heads of income for the relevant tax year, giving clear reasons/explanations for the inclusion or exclusion of each of the items listed above. The reasons/explanations for the items not included in the computation of total/taxable income should be shown separately. Specific marks are allocated for this part of the requirement. (17 marks)

(20 marks)

4 Jasmine Pharmaceuticals Company (JPC), a partnership firm, registered under the Partnership Act 1938, is in the business of manufacturing pharmaceuticals. The assessment of JPC for the tax year 2007 (accounting year ended 30 June 2007) was selected for audit under s.177 of the Income Tax Ordinance, 2001.

(1) On completion of the audit, the Commissioner informs JPC that he intends to amend the assessment for the tax year 2007 to:

(i) Levy minimum tax of 0·5% on the firm's turnover of Rs. 9,000,000.

(ii) Disallow Rs. 1,530,000 out of travelling expenses, being the travel and hotel expenses for JPC's technical manager's visit to Japan.

(iii) Disallow Rs. 400,000 being the contribution paid by JPC to the unrecognised Jasmine Employees Provident Fund.

(iv) Disallow Rs. 75,600 expended on the annual Eid-Milan party for JPC's employees and their families.

(v) Disallow Rs. 500,000 being damages paid to JPC's sole distributor.

(vi) Disallow the donation of Rs. 1,000,000 paid to a hospital.

(vii) Disallow the Rs. 1,200,000 salary paid to Mr A.

The Commissioner has required JPC to furnish explanations/reasons as to why he should not amend the assessment on the lines indicated.

(2) The following information on the issues raised by the Commissioner is provided to you:

(i) Minimum tax
JPC was not aware of the concept of minimum tax payable.

(ii) Travelling expenses
The travel to Japan was entirely for business purposes. It was necessary for the firm's technical manager to travel to Japan for the purpose of selecting a second-hand mixing machine, so as to ensure that the machine was compatible with the company's existing plant.

(iii) Contribution to the unrecognised provident fund.
JPC, in its accounting system, has ensured that when any payment is made from the fund to an employee, tax would be deducted at source from the amount of the payment, if the amount is chargeable to tax as the salary income of the employee.

(iv) Eid-Milan party
The expenditure on the party was motivated by the purpose of maintaining cordial relations between the employees and the management.

(v) Damages paid to the sole distributor
Due to the failure to deliver supplies within the time stipulated in the contract, JPC had to pay damages to their sole distributor. The failure to deliver the supplies in time was due to the negligence of the despatch department of the firm and not due to the violation of any law.

(vi) Donation
The donation was not paid to any private hospital but to a hospital which was established in Pakistan by the Federal Government.

(vii) Salary paid to Mr A
Mr A is a partner in the firm of JPC. He is also the Chief Executive Officer (CEO) of the firm devoting his full time to managing the affairs of the firm. His salary was approved by the partners.

Mr A, as CEO of JPC, wants you to explain the relevant statutory tax provisions on the issues raised by the Commissioner.

Required:

State giving reasons whether or not in each case, the amendment proposed by the Commissioner is or is not in accordance with the provisions of the tax statute.

Note: the allocation of marks is as follows:
Item (iii), 3 marks; all of the other six items, 2 marks each.

(15 marks)

5 Mr Miskeen, a registered person for sales tax purposes, is engaged in the manufacture of electrical appliances in Gujranwala.

Miskeen's business transactions for the month of June 2007 are summarised as follows:

	Rupees
Purchases of raw materials from registered persons	2,500,000
Purchases of packing materials from unregistered persons	950,000
Sale of electrical appliances to:	
– registered persons	1,890,000
– unregistered persons	2,150,000
Sale of old model electric toasters to registered persons (Note 1)	422,800

Notes:

(1) Prior to the introduction of a new model of electric toasters, Miskeen sold his entire stock of the old model toasters, allowing a trade discount of 35% (shown on the face of the invoice). This trade discount given to the dealers is not in accordance with Miskeen's normal business practice. Had the old model toasters been sold at the normal discounted price, the sale proceeds would have been Rs. 650,000 as against the Rs. 422,800 actually received.

(2) All payments for purchases made are stated inclusive of sales tax at the rate of 15%, where applicable. All amounts for the sale of electric appliances are stated exclusive of sales tax.

Required:

(a) Calculate the sales tax payable by/refundable to Mr Miskeen for the month of June 2007. (5 marks)

(b) Give clear explanations of the treatment accorded to the following items in calculating the sales tax payable by/refundable to Mr Miskeen in part (a):

(i) The purchases of packing material from unregistered persons. (1 mark)

(ii) The supply of goods to unregistered persons. (1 mark)

(iii) The supply of goods to registered persons at a trade discount of 35%. (3 marks)

(10 marks)

End of Question Paper