

December 13, 2002

ADVANCED TAXATION
[PE-2 Paper 3] & [Module "F" Paper F-20]

(MARKS 100)
(3 hours)

Q.1 You are a director in Elastin (Private) Limited, a company incorporated under the Companies Ordinance 1984 where the liability of the members is limited by shares. You hold 5% shares in the paid up capital of the company. You are served with a demand notice from the DCIT holding jurisdiction on assessment of Elastin (Private) Limited for payment of tax demand outstanding against the company.

You feel that the demand notice issued by the DCIT is abinitio void however your tax advisor feels that the notice is valid.

Please explain why the tax advisor feels otherwise. In case the notice is also served on your brother who holds 8% shares in the company but is not a director in the company what would be your tax advisor's opinion.

Your reply should be in the form of a letter from the legal advisor. (06)

Q.2 (a) How does an individual person is said to have met the residency test. (02)
(b) Mr William De Niro signed a contract with Pakistan Television Corporation to assist PTV in making a film on the wild life sanctuaries in Pakistan. Under the terms of the contract Mr Niro was to stay in Pakistan for a period of 1 year 3 months and 21 days. He landed in Pakistan on 29 August 2001. According to the terms of employment Mr Niro was to be paid following emoluments:

- ◆ Basic Salary of Rs.150,000 per month
- ◆ Furnished accommodation on a piece of land measuring 1000 sq. yards.
- ◆ Chauffeur driven car having engine capacity of 2000 cc
- ◆ PTV spends Rs.15,000 per month for providing security to Mr. Niro
- ◆ Mr. Niro was entitled for utility allowance of Rs.40,000 p.m.
- ◆ Besides above PTV also pays US \$ 2500 p.m. in his home country for family subsistence. Mr. Niro is US national

Mr Niro was also responsible as part of his deal to provide training to PTV staff abroad and was responsible to finalize training course in Italy & France. Boarding and lodging, finalization of travelling schedule is also his responsibility.

The PTV crew left for offshore training on 15 December 2001 and the training started from 20 December 2001. Mr Niro returned to Pakistan with his crew on 14 April 2002.

(2)

Mr Niro also has other income in his home country.

- Rent from apartment in New York amounting to US \$ 15,000 per annum out of which he received US\$ 3,000 in Pakistan during the income year ending on 30 June 2002. The balance amount was retained in his bank account abroad.
- Mr Niro has a partnership in a production house with his wife in New Jersey. During the year he earned a profit of US \$ 50,000 which remained in US in his bank account.

During the offshore training, Mr Ashfaq an engineer specializing in visual effect entered into a contract for providing technical services to Xter, a production house based in France, and earned US \$ 3000. This amount was remitted by Mr Ashfaq to Pakistan through normal banking channel.

Mr Ashfaq is a regular employee of PTV and his monthly salary and other benefits comprised the following:

Basic Salary	40,000	
House Rent	16,000	
Utility	4,000	60,000

Besides above Mr Ashfaq Ahmed is also entitled to following:

- A 1000 cc company maintained car for private & official use
- Petrol allowance of Rs.2500 per month
- Medical allowance Rs.1500 per month

Please assume an exchange rate of Rs.60 = US \$ 1 for the purpose of above calculation.

You are also provided with following

- | | |
|--|-------------|
| (i) Value of unfurnished accommodation is | Rs.336,000 |
| (ii) Value to be adopted for vehicle provided by the employer used solely for business purposes if the engine capacity of vehicle is | |
| 1000 CC | Rs. 80,000 |
| 2000 CC | Rs. 200,000 |

For the purpose of calculating the tax liability you may ignore the provision of clause 1B of Part III of the Second Schedule to the Income Tax Ordinance 1979, relating to reduction in tax in case of salaried tax payer.

Following tax rates are applicable.

Where the income exceeds Rs.400,000 but does not exceed Rs.700,000	Rs.45,500 plus 15% of the amount exceeding Rs.400,000.
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Where the income exceeds Rs.700,000	Rs.120,500 plus 25% of the amount exceeding Rs.700,000
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Required:

- (i) On the basis of above information calculate the tax payable by Mr Niro and Mr Ashfaq for assessment year 2002-2003. (14)

(3)

- (ii) Briefly explain provisions of law on the basis of which exemptions have been claimed or an amount is included for computing the taxable income of Mr Niro and Mr Ashfaq as the case may be.

Q.3 You have received a notice from the Deputy Commissioner of Income Tax on 17 June 2002 who intend to reopen your assessment for year ended on 30 June 1996 the assessment in respect of which was finalized on 18 June 1997.

You feel that the issues raised by the Deputy Commissioner of Income Tax can at best be the subject of rectification but for the period of limitation no rectification could be made. You however feel that Deputy Commissioner of Income Tax has no authority to reopen the assessment.

You have consulted your tax advisor who feel that Deputy Commissioner of Income Tax does have power to reopen the assessment, by way of additional assessment, on certain issues however in respect of most of the issues the Deputy Commissioner of Income Tax does not have a valid case. Following issues are interalia raised by Deputy Commissioner of Income Tax on the basis of which he intends to make additional assessment:

- (i) Depreciation on freehold land is wrongly allowed @ 10% of land cost.
(ii) Sale amounting to Rs.100,000 were inadvertently not recorded in the disclosed sales. The Deputy Commissioner of Income Tax came to know about this sale from verification of withholding tax statement of Mr B to whom this sale was made.

Please note that all legal formalities were duly completed by tax authorities before issuance of notice.

You have requested your tax advisor to apprise you about legal position where an assessment could be rectified or an additional assessment could be made by Deputy Commissioner of Income Tax. Please reproduce the letter from your tax advisor as an answer to this question.

(12)

- Q.4 (a) List the Income Tax authorities in order of hierarchy. Please exclude Director General for various services from this list. List them separately.
(b) You have just been served with a show cause notice on non compliance with certain instructions issued as clarification by CBR on a contentions issue. You feel that you have valid reason for not complying with such instructions.

Please draft your reply to show cause notice after taking into account the legal position considering that you were:

- (i) an assessing officer (ii) a Commissioner of Income Tax (appeals) (12)

Q.5 Explorators Limited signed a concession agreement with Pakistan for oil exploration in District Dadu.

You are provided with the following data and are requested to compute tax.

- (i) Explorators Ltd incurred expenditure Rs.200,000 on oil exploration however no commercial production commenced during year 1. Further no exploration was either abandoned or the area was surrendered by explerator during the first year.

(4)

- (ii) During year 2 expenditure on exploration were incurred to the tune of Rs.1,000,000. The commercial production this year again could not commenced but the company decided to abandon one of the dry holes. The expenditure attributable to dry hole was Rs.400,000.
- (iii) The company commenced commercial production during year 3. The expenditure at commencement of commercial production amounted to Rs.1,000,000. This includes expenditure of Rs.600,000 incurred upto year 2 and also includes Rs.200,000 represented by physical asset 'in use' at the time of commencement of commercial production.

You are provided with following further information

- (i) Expenditure amounting to Rs.400,000 incurred after the commercial production also includes Rs.100,000 which represent physical assets in use.
- (ii) The gross revenue from sale of crude oil was Rs.1,200,000
- (iii) Royalty @ 12.5% was payable.

Required:

On the basis of foregoing information please compute

- (i) Taxable income (ii) Tax payable
- (iii) Royalty refundable or capable of being carried forward.

(16)

Q.6 Bashir Corporation (Pvt) Limited is engaged in commercial as well as manufacturing activities. Primarily related to lubricating oil and grease, it is registered under single registration with sales tax department as manufacturer, importer, exporter and distributor. The grease manufactured by the company is subject to Sale Tax as well as Central Excise Duty (CED) is applicable @ Rs.7.35 per litre. Company also makes supply of specialized lubricants to cargo ships proceeding for a voyage to Dubai.

You are provided with following data to enable you to compute sales tax liability on the supplies made for the tax period ended on 31 May 2002. All data given below relates to same tax period:

- (i) Imported finished lubricating oil and grease amounting to Rs.1,000,000 and manufactured 1000 litre of grease at a cost of Rs.100,000. The company makes profit of 25% of cost on both these products.
- (ii) The company sold lubricating oil amounting to Rs. 900,000 and grease worth Rs.90,000 during the tax period.
- (iii) The buyers returned lubricating oil worth Rs.10,000 which was found to be contaminated with certain chemical which render the oil unfit for its intended use.
- (iv) The quality assurance department of Bashir Corporation after chemical examination agreed with buyers and recommended that the goods be destroyed. The management decided to destroy the goods.
- (v) Out of the total supply lubricating oil amounting to Rs.50,000 was supplied to cargo ships.
- (vi) Lubricating oil, worth Rs.50,000 was supplied to units located in special industrial zone which was provided complete immunity from custom duty, sales tax and excise duty. The company however do not expect to make any further supply to units located in this zone.

Required:

On the basis of foregoing please compute sales tax liability, sales tax refund or amount carried forward for the tax period on supply of

- (a) lubricating oil (b) grease

Please also explain the procedure to be adopted by Bashir Corporation for destroying the

(5)

- Q.7 Your client, a private limited company, is engaged in the business of running and managing a restaurant in Karachi. It has purchased/imported electronic cash registers, cooking equipments and other storage equipments which are used in the preparation and production of taxable supplies in which it is engaged in and has paid sales tax on such purchases/imports.

You are required to write a note discussing the principles underlying adjustment of input tax with output tax with particular reference to restaurant business.

(06)

- Q.8 Your client, a company whose country of origin is UAE, is a TV channel owner of International standing and repute. Your client is contemplating advertising sales in Pakistan whereby the invoices will be raised abroad but the consideration will be received by an agent in Pakistan for deposit in an escrow account pending its remittance abroad.

You are required to advise the client whether the contemplated arrangement has any sales tax implications in Pakistan.

(07)

(THE END)