THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Winter 2005

December 08, 2005

ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 (a) Briefly discuss the concept of small company introduced by the Finance Act, 2005 and the concessions given to such small companies under Income Tax Ordinance, 2001. **(04)**

(b) Define the term 'consumer loan' in terms of the provision of the Income Tax Ordinance, 2001. Please also explain how the provision against consumer loan is allowed as deduction to a banking company. **(04)**

Q.2 Prosperity Bank Limited having an extensive branch network and significant client base in Pakistan has decided to acquire latest banking software from SES Corporation of Malaysia. The arrangements under 'Software End User License and Technical Support Agreement' entered into between Prosperity Bank and SES, include:

- Granting a non-exclusive license for use of the software and program documentation;
- Technical support for installation and use of software;
- Free of cost maintenance support up to June 2006. Such support will be provided by the combination of visit of technical staff and online connection;
- Copy right, trademark and intellectual property rights in the software will remain the property of SES;

In consideration, Prosperity Bank will pay the following:

(i) US$ 300,000, for delivery and implementation of software for the bank and the related technical support and services fee for a period of ten years.
(ii) 5% of the aforesaid fee as annual maintenance fee after expiry of free maintenance period.
(iii) US$ 50,000 for migration of existing data and for customization of reports.

Assume that Pakistan does not have an agreement for the avoidance of double taxation with Malaysia and SES does not have any office or fixed place of business in Pakistan.

Required:

(a) Explain how the payment for acquisition of software will be chargeable to tax under the Income Tax Ordinance, 2001.
(b) Explain withholding tax applicability on various payments under the arrangements.
(c) Discuss deductibility of cost to Prosperity Bank under the Income Tax Ordinance 2001 **(07)**

Q.3 Mr Sheryar, Chief Financial Officer of a manufacturing company, is analyzing the implications of long term foreign currency loan for company's modernization and expansion of manufacturing facility. You have been informed that no coverage is available to the company against foreign currency fluctuation. Write a letter to Mr Sheryar advising him the tax implications associated with the exchange fluctuation on foreign currency loan. **(05)**

Q.4 The CFO of a UK company has provided you the following information:

(i) The company is incorporated and established in UK.
(ii) The company has only one business unit, which is a branch operating in Pakistan for the last ten years. There is no other business activity of the company and its head office situated in UK is only a management place.
(iii) Pakistan branch has incurred business losses during last five years.
(iv) Sixty percent of the shares of the UK company are owned and held by a resident of UK.
(v) The UK resident shareholder is now considering to sell these shares to a resident of France.

You are required to explain:

(a) Pakistan tax implications on the capital gains, if any arising to the UK resident on sale of shares.
(b) Provisions relating to carry forward of business losses of Pakistan branch after change of ownership. **(08)**

Q.5 The Finance Act, 2005 has enlarged the scope of amalgamation of companies provided in the Income Tax Ordinance, 2001.

You are required to briefly discuss the following:

(a) Concept of amalgamation.
(b) Special dispensation provided by the Ordinance in respect of amalgamation of companies. **(06)**

Q.6 MM Securities Limited is a public limited company in Karachi incorporated under Companies Ordinance 1984. It acquired corporate membership of Karachi Stock Exchange in 2000 and got listed on Karachi, Lahore and Islamabad Stock Exchanges in 2001. The company is engaged in the business of investment advisory, financial consultancy, brokerage, underwriting, portfolio management and securities research. In the year 2002, the company obtained membership of National Commodity Exchange Limited.

The financial statements of the company have been prepared under the historical cost convention except investment in marketable securities, which are stated at fair value.

During the year 2004-5, the company changed its accounting policy relating to capitalization of assets whereby purchase of assets of value Rs.50,000 and below were charged to P&L account.

The following information has been extracted from the audited financial statements of the company for the year ended 30 June 2005:

	Rupees
Operating Revenues:	
Revenue from brokerage	220,000,000
Underwriting commission	3,000,000
Placement fee	2,000,000
Financial consultancy	7,000,000
Dividend Income	225,000,000
Return on Term Finance Certificate	1,500,000
	458,500,000
Capital gain on investment – Net	1,500,000,000
Gain/(Loss) arises on re-measurement on investment at fair value	
• Gain	25,000,000
• Loss	(30,000,000)
Operating expenses	145,000,000
Financial charges	35,000,000
Other charges	5,000,000
Other Income	
• Profit on PLS account	1,100,000
• Mark-up on loan to associated undertaking	5,000,000

Other information:

i. During the year the company purchased 10 computers for Rs.49,500 each and except for the above, there was no other addition in the fixed assets.

ii. An expense of Rs.4.5 million per month was incurred by department which is responsible for making investments in securities.

iii. Salary and commission paid to dealers amounted to Rs.12 million.

iv. Excess of tax depreciation on assets appearing in audited accounts of the company over accounting depreciation was Rs.2,000,000.

v. Company sold 1,000,000 shares of ABC private limited for Rs.25 each, the cost price of each share was Rs.20 and the shares were acquired in January 2003.

vi. During the year the company purchased 500,000 shares of ADE Private Limited for Rs.50. These shares were disposed of before the year end for Rs.20 per share.

vii. Operating expenses include the following donations:

		Rupees
	• Donation to approved institutions	15,000,000
	• Donation to un-approved institutions	2,000,000
viii.	Tax deducted at source on dividend u/s 150	10,000,000
ix.	Tax paid, deducted or collected as advance tax under:	
	• Section 147	18,000,000
	• Section 151	140,000
	• Section 153	10,000
	• Section 233	5,000,000
	• Section 234	5,000
	• Section 236	50,000

x. Operating expenses include Rs.1,500,000 in respect of net loss on sale of [illegible] assets. Book value of the above assets was higher by Rs.2,500,000 as compared to the value determined under Third Schedule to the Income Tax Ordinance, 2001.

xi. The company has not incurred any expenditure on transactions involving the shares of private limited companies and except for the items given in (5) and (6) above, all capital gain relates to listed securities.

Required:

(a) Compute taxable income of the company for the tax year 2005.

(b) Determine the amount of tax liability payable along with the return of total income assuming corporate tax rate of 35% for the year. **(25)**

Q.7 Explain the remedies available to a tax payer against additions to income made by the Taxation Officer and confirmed by the CIT (Appeals).

Also explain the recourse available against recovery of tax demand confirmed by the CIT (Appeals). **(08)**

Q.8 Please discuss allowability of input tax against output tax in the following situations:

(a) Input tax related to taxable goods supplied to unregistered person. **(02)**

(b) Input tax related to taxable goods supplied to registered person who makes payment for supply of goods through:

- On line transfer from his business account
- Credit card **(03)**

Q.9 During the course of sales tax audit of MNC Corporation following observations were made by the sales tax auditor:

(a) Sales tax was collected @17.5% instead of statutory rate of 15% during the month of April 2004 from Ahmed Corporation. Ahmed Corporation never claimed excess sales tax recovered and the difference of tax @2.5% was retained by MNC Corporation.

(b) Sales tax was collected @17.5% from Bashir Corporation however, tax in excess of statutory rate was paid to Bashir Corporation during the same tax period.

(c) MNC Corporation carried out repairs on the PNSC ship which was proceeding to a destination outside Pakistan, MNC Corporation also replaced certain electrical equipments and applied zero tax rate on such supply.

(d) Terminated part of taxable activity and sold 3/4th of the stock to a registered person and the balance to an unregistered person.

The sales tax auditor is of the view that MNC Corporation has violated ce[rtain] provisions of the Sales Tax Act, 1990 and therefore sales tax is recoverable fro[m] them on account of alleged violations noted by the sales tax auditor.

Required:

You being their tax advisor are asked to apprise management whether MNC Corporation has violated any provision of the Sales Tax Act, 1990. Please write a letter to management explaining the legal provision. **(09)**

Q.10 A company registered under the Sales Tax Act, 1990 has following data for the year:

	Commercial import business	**Local trading business**	**Total**
	………………………	……**Rupees**……	……………………...
Sales	50,000,000	40,000,000	90,000,000
Opening stock	25,000,000	21,000,000	46,000,000
Imports	45,000,000	--	45,000,000
Domestic taxable purchases	--	17,000,000	17,000,000
Domestic exempt purchases	--	14,000,000	14,000,000
Closing stock	26,000,000	14,600,000	40,600,000
Operating profit	6,000,000	2,600,000	8,600,000
Other expenses	2,000,000	1,500,000	3,500,000
Net profit	4,000,000	1,100,000	5,100,000

Ratio of taxable supplies to exempt supplies relating to local trading business is 60:40. All customers of the company are corporate entities and registered under the Sales Tax Act, 1990. Commercial imports are subject to customs duty @ 10 percent.

The nature of local trading business requires receipt of advance from customers. All advances are received against taxable supplies. Movement of advances during the year is as follows:

	Rupees
• Opening advance	5,000,000
• Sales during the year against opening advance	5,500,000
• Closing balance of advance	6,000,000
• Sales subsequent to year against closing balance of advance	5,800,000

You are required to compute net sales tax liability for the year. For the sake of convenience net liability for sales tax has been required to be computed on yearly basis. Appropriate explanation of the treatment with relevant assumptions, if any, may be given. **(10)**

Q.11 (a) Please explain the valuation rules relating to levy of excise duty on the excisable goods and services under the Federal Excise Act, 2005 **(06)**

(b) State who is required to be registered under the Federal Excise Act, 2005 **(03)**

(THE END)