THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Winter 2008

December 4, 2008

ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 Styles & Styles, Inc. (SSI) is the parent company of a leading foreign group involved in the manufacturing and sales of consumer products all around the world. They are considering an option to enter into the Pakistani market. Based on data obtained through a market survey, they are in the process of preparing financial projections for a proposed local subsidiary in Pakistan, Styles & Styles Pakistan (Pvt) Limited (SSPL).

Under the proposed business model, business of SSPL is likely to be set-up as under:-

(i) SSPL would be incorporated with a share capital of Rs 100 million to be wholly owned through a UAE based group company Styles & Styles FZE. The investment in SSPL would be financed by the UAE company through an interest bearing loan agreement with SSI;
(ii) SSPL would be involved in commercial imports as well as local manufacturing of certain products for which the raw material would be imported from group companies;
(iii) To set up the manufacturing plant in Pakistan, certain second-hand plant and machinery will be imported from an unrelated supplier outside Pakistan. To save bank charges/commission etc. it was agreed that LC would not be opened and the payment will be remitted directly through bank, 30 days after the import of plant. The supplier is insisting that payment be made without deduction of withholding tax;
(iv) Construction of factory building is likely to be carried out by a leading Pakistani engineering company. A contract in this regard would be signed shortly after the incorporation of SSPL and thereafter a mobilization advance of Rs 50 million will be paid; and
(v) A foreign currency loan of US $ 75 million would also be provided by SSI, directly to SSPL. The loan would be payable over a period of five years carrying an arm’s length interest rate.

Required:
The group wants to determine Pakistan tax implications, if any, and have requested you to advise on the following issues:

(a) Treatment of income tax paid at the import stage.
(b) Tax depreciation on the plant.
(c) Deduction of tax on interest paid by SSPL to SSI.
(d) Taxability of interest received by SSI. **(15)**

Q.2 The concept of representatives has recently been introduced in the Sales Tax Act, 1990 through the Finance Act, 2008. You are required to explain the following:

(a) Who can be treated as the representative of a non-resident person?
(b) Under what circumstances, a representative may become personally liable for the payment of any tax due by the non-resident? **(10)**

Q.3 PSK is a public listed company engaged in manufacturing and sale of goods. Extracts from the financial statements of the company for tax year 2008 are given below:

	Rupees
Sales:	
- local sales out of manufactured/packed goods	924,306,539
- local sales of imported finished goods	127,721,264
- export sales	25,157,641
Cost of goods sold	665,875,300
Administration expenses	169,453,900
Distribution and marketing cost	37,024,600
Other income	4,628,780
Financial charges	909,500

Following further information is available

(i) All exports were made through confirmed LCs except export to Afghanistan amounting to Rs. 1,610,000 which was received in Pak Rupees and no tax was deducted by the Banks.

(ii) Certain goods imported from Dubai were later exported to Malaysia, at a price of Rs. 752,100. Tax deducted on such goods at the import stage amounted to Rs. 25,000 whereas tax deducted from export proceeds amounted to Rs. 7,521. The transaction is included in export sales.

(iii) Imported goods are sold without any further processing, at a mark-up of 15% of cost.

(iv) Cost of export sales is Rs. 14,645,500.

(v) Distribution and marketing costs relate to local sales only.

(vi) Other income consists of the following:

	Rupees
Return on Pakistan Investment Bonds (PIBs)	3,480,000
Gain on sale of scrap	972,400
Duty drawback on exports	149,280
Bad debts previously written off, now reversed	27,100

(vii) Financial charges include amortization of premium on PIBs amounting to Rs. 70,900.

(viii) Data related to depreciation is as under:

Tax depreciation	51,281,569
Accounting depreciation:	
Cost of goods manufactured	10,338,700
Administrative expenses	4,756,300
Distribution and marketing expenses	2,141,200

(ix) Information relating to provisions and right-offs, included in administration expenses, is as under:

Provision for slow moving stock	6,200,966
Provision for bad debts	227,425
Stock written off	366,131
Bad debts written off	38,186

Required:
You are required to compute the company's taxable income and tax liability (gross) for the tax year 2008. **(20)**

Q.4 Akhter is evaluating the possibility of starting a large scale import and retail business of consumer goods through a chain of stores supplying to wholesale as well as general body of consumers.

Required:

(a) Advise him about the payment of advance tax at the import stage and the treatment thereof, under the Income Tax Ordinance, 2001.

(b) With reference to Sales Tax Act 1990, advise him on the following:

(i) Whether he will be required to obtain separate registration for each outlet?

(ii) Will he be classified as a retailer specially with reference to the supplies made other than to the general body of consumers?

(iii) Can he claim input tax on his purchases? Assume that 30% of all sales will be collected in cash. **(11)**

Q.5 XYZ Limited, a listed company, has made the following payments without deduction of withholding tax:

(i) Reimbursement of boarding, lodging and incidental expenses incurred by non-executive directors of the Company for attending the Board's quarterly meeting held in Dubai.

(ii) Payment to a non-resident debtor on account of out of court settlement of a dispute and payment of fee to the lawyer for handling such settlement. The lawyer was also a non-resident.

(iii) Payment to a resident company as consideration for obtaining a right to manufacture certain goods.

(iv) Reimbursement made to a foreign associate in respect of salary of the Director Finance of XYZ Limited. The Director Finance is a foreign national and receives part payment of his salary in his home country. The foreign associate had not deducted any tax from the payment made by it to the Director Finance.

Required:

Comment on the above transactions in the light of Income Tax Ordinance, 2001. **(10)**

Q.6 (a) Describe the rule related to adjustments of duties of excise, for the purpose of determining the net liability under the Federal Excise Act, 2005. **(06)**

(b) Explain the following with reference to Income Tax Ordinance, 2001:

(i) Capital assets

(ii) Valuation of capital assets

(iii) Capital gains

(iv) Adjustment of capital loss against capital gains **(08)**

Q.7 Mr. Bilal, a sole proprietor, had been filing his income tax returns and wealth statements for the last many years. He was not satisfied with his tax advisor and has appointed you as his consultant. He has asked you to review his returns for the past five years also.

Your assistant had reviewed the records and observed the following:

(i) During tax year 2003, Mr. Bilal purchased an immovable property at a market price of Rs. 5 million. At the time of purchase, the property was rented to a tenant who was paying Rs. 50 thousand per month. The property had not been declared in the wealth statements filed by Mr. Bilal, over this period.

(ii) On review of the wealth reconciliation for tax year 2004, it was noticed that Mr. Bilal borrowed Rs. 1 million from his friend who is a foreign national. The amount was received in cash while his friend was on a visit to Pakistan and is still outstanding.

(iii) In tax year 2005, Mr. Bilal's father who was settled in Dubai had sent an amount of US$ 10,000 through banking channel which was encashed into Pak rupees @ 60.15. This receipt was disclosed in his wealth statement but no explanation has been given to the authorities so far.

Required:
Advise Bilal about the tax implications, in each of the above situations. **(08)**

Q.8 Zeta Pakistan Ltd is principally engaged in the purchase, manufacture and supply of taxable goods and is registered under the Sales Tax Act, 1990. During the usual course of business, it also carried out the following transactions during the year:

(i) Use of taxable goods for internal testing, training and evaluation purposes. The goods included own manufactured as well as locally procured goods.

(ii) Free replacement of faulty parts of goods which had been sold under warranty.

(iii) Destruction of damaged goods.

(iv) Payment of sales tax on diesel purchased and used in generation of electricity. The electricity produced is mainly used in production. However, part of it is also used in finished goods warehouses and workers canteen.

(v) An amount of Rs 300,000 was paid to the company's customs agent on import of raw material used.

Required:
Comment on the chargeability of sales tax in the above situations. **(12)**

(THE END)