THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Winter 2009

December 10, 2009

ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 Ms. Saima is a telecommunication engineer working with a leading GSM operator as their chief technical officer for the last many years. She has provided you with the following information relating to her assessment for the year ended June 30, 2009.

(i) Monthly salary of Rs. 500,000 was paid to her by the company consisting of the following:

	Rupees
Basic Salary	400,000
Medical allowance	40,000
Conveyance allowance	60,000

The salary was credited to her bank account on the 25th of every month. She incurred actual medical expenses of Rs. 100,000 during the year. These expenses were reimbursed to her by the company in accordance with the terms of her employment.

(ii) She received a bonus of Rs. 1.0 million. Employer also agreed to pay tax on such bonus to the extent of Rs. 200,000.

(iii) Apart from her employment with a GSM operator, she also served as a visiting faculty member at a local engineering university and received a total of Rs. 470,000. Ms. Saima incurred an expenditure of Rs. 70,000 towards this service. Withholding tax was deducted from the payments made by the university.

(iv) In August 2008, she participated and won a quiz competition arranged by Pakistan Urdu Academy. The prize money of Rs. 200,000 was paid to her after deduction of a tax of Rs. 40,000.

(v) She inherited a plot of land from her father on his death in July 2000. On October 1, 2008 she entered into a contract of sale with Mr. Moin for a consideration of Rs. 50.0 million. Mr. Moin paid a deposit of Rs. 1.0 million and agreed to pay the balance within one month of the date of contract. On due date, Mr. Moin defaulted in making the payment upon which Ms. Saima forfeited the deposit in accordance with the terms of the contract. Later on, the plot was sold to Mr. Parkash at a price of Rs. 50.0 million.

(vi) Ms. Saima purchased another plot of land for a consideration of Rs. 56 million. She borrowed Rs. 5.0 million from her sister for the purchase of this plot. The amount was received in cash.

(vii) Ms. Saima also inherited a painting from her father. The painting was valued at Rs. 500,000. On April 1, 2009 she gifted the painting to her brother who came from Canada after five years. He went back to Canada after staying in Pakistan for a period of two months. The value of the painting was Rs. 1.0 million when it was gifted.

Required:
Compute the taxable income of Ms. Saima for the tax year 2009. Give brief reasons under the Income Tax Ordinance, 2001 in support of your treatment of each of the above items. **(18)**

Q.2 Supreme Limited (SL), a registered importer, exporter and manufacturer, is primarily engaged in the manufacture and export of a wide range of consumer durables, falling under the third schedule to the Sales Tax Act, 1990. Following activities were carried out by the company during the year:

(i) In view of the high cost of manufacturing the product locally, SL imported certain finished beauty products from France. In addition to the normal sales tax, value addition tax of 2% was levied by the collector of customs on the value of imports. Tax credit was not claimed by the company on the value addition tax.
(ii) A number of raw materials were imported for in-house consumption in various manufacturing processes. Sales tax on account of minimum value addition was not paid at the import stage. The management is now considering paying it with the monthly returns.
(iii) At the time of preparing sales tax return for the month of January 2009, it was found that an input tax credit pertaining to June 2008 inadvertently remained unclaimed. An adjustment was, therefore, claimed in January 2009 without any intimation to the sales tax authorities.
(iv) In June 2009, SL acquired a new plant for the manufacture of beauty soaps. Sales tax of Rs. 1.2 million paid at the time of purchase was claimed as an input tax in the monthly return for June 2009.
(v) Electricity bill of Rs. 100,000 for June 2009 was paid in cash. The company however, did not claim the related input tax credit as cash transactions exceeding Rs 50,000 are inadmissible.
(vi) Sales tax paid on advertisements in electronic media was not claimed as it was paid under the Punjab Sales Tax Ordinance, 2000.
(vii) The company acquired an existing manufacturing business of textile products from Sun Textiles (ST) as an ongoing concern. ST is registered under the Sales Tax Act, 1990.

Required:
In the light of the provisions of Sales Tax Act, 1990 advise the management of the company as to the chargeability/ adjustment of sales tax in each of the above situations. **(11)**

Q.3 Plasma Pakistan (Pvt.) Limited (PPL) is engaged in the manufacture and sale of pharmaceutical products. During 2009, it started a new business related to aerated water. After scrutiny of the tax return filed by the company for the tax year 2009, the Additional Commissioner has issued a notice under section 122(5A) in which he has raised the following issues:

(i) The parent company reimbursed 60% of the expenses, incurred by PPL in 2007, on marketing a new product imported from Germany. The commissioner wants to add the recouped expenditure to the taxable income of the company.
(ii) Expenses incurred under the account head “Travel fare” aggregating to Rs. 500,000 were paid in cash and should be added back.
(iii) The commissioner wants to disallow an expense of Rs. 90.0 million, incurred by PPL on the promotion of a vaccine which is expected to generate revenue for three years.

Required:
With reference to the provisions of Income Tax Ordinance, 2001 advise the management about the tax implications in each of the above situations. **(06)**

Q.4 In the light of the provisions of Income Tax Rules, 2002 you are required to explain the following:

(a) Expenditures which can be described as entertainment expenditures and limitations as to the admissibility of such expenditures. **(05)**
(b) Meaning of the term “Common expenditure” and the rule relating to the apportionment of such expenditures. **(07)**

Q.5 Fresh Stream Limited (FSL) is engaged in the manufacturing and import of food & beverages. Following is the extract from the profit and loss account of FSL for the period ended June 30, 2009.

		Rs. in '000
Sales	(Note 1)	5,000,000
Cost of sales	(Note 2)	(3,000,000)
Gross profit		2,000,000
Administrative and selling expenses	(Note 3)	(750,000)
Finance cost	(Note 4)	(250,000)
Other income	(Note 5)	500,000
Profit before taxation		1,500,000
Provision for taxation		(200,000)
Profit after taxation		1,300,000

Following additional information is also available:

1. Sales:

Net exports to Afghanistan (self manufactured)	495,000
Tax deducted on export @ 1%	5,000
Local sales out of imports	1,000,000
Local sales of manufactured items	3,500,000
	5,000,000

2. Cost of sales:

Imported finished goods (C & F)	300,000
Raw materials consumed during the year	1,000,000
Electricity & gas (incurred in cash)	300,000
Salaries, wages and other benefits	800,000
Local freight charges (paid in cash)	100,000
Depreciation	500,000
Cost of goods manufactured during the year	2,700,000
	3,000,000

- Cost of imported finished goods includes withholding taxes paid on imports @ 3.5%. The value of goods for the purpose of advance tax deduction amounted to Rs. 280.0 million.
- 10% of the total salaries were paid in cash. Of these, Rs. 20.0 million were paid to daily wage employees @ Rs. 400 per day, whereas Rs. 60.0 million were paid to contract employees who earn a monthly salary of Rs. 20,000 each.

3. Administrative & selling expenses

Salaries and other benefits	200,000
Advertisement expenses	100,000
Insurance	85,000
Rent, rates and taxes	65,000
Entertainment expenditure	25,000
Contributions to approved retirement funds	100,000
Depreciation	75,000
Amortization	25,000
Penalties paid under Sales Tax Act	25,000
Miscellaneous expenses	50,000
	750,000

- Rent, rates & taxes include Rs. 0.5 million paid under a provincial tax law imposed on all beverage manufacturing companies having a manufacturing facility in the province of Punjab. The said tax was computed as 0.1% of the accounting profit before tax.

- On July 1, 2008, FSL acquired export quota from the Government of Pakistan by paying an amount of Rs. 375.0 million having useful life of 15 years. For accounting purposes, the cost of export quota has been amortized over the period of 15 years.
- Depreciation computed under the Income Tax Ordinance, 2001 on all depreciable assets is Rs 500.0 million.

4. **Finance cost** includes Rs 10.0 million paid to a scheduled bank on account of vehicles obtained on lease. Total lease rentals paid for such vehicles were Rs 100.0 million.

5. **Other income** includes a gain of Rs 10.0 million on disposal of shares of Alpine Limited, a company listed on Karachi Stock Exchange. These shares were acquired by the company in the year 2007 at a cost of Rs 5.0 million.

Required:
In the light of the provisions of Income Tax Ordinance, 2001, compute the taxable income and gross tax liability of FSL. The normal tax rate applicable to the company is 35%. **(21)**

Q.6 Alpha Limited (AL) is engaged in the trading and manufacture of detergents and toiletries. During the month of November 2009 following activities were carried out by the company:

	Rs. in '000
Purchases:	
▪ Import of raw material for in house consumption:	
• subject to sales tax only	10,000
• subject to federal excise duty only	4,000
▪ Import of finished products for sale	2,000
▪ Import of items governed under the third schedule	1,000
▪ Local items governed under third schedule (50,000 @ Rs.175 each)	8,750
Supplies:	
▪ Manufactured products:	
• subject to sales tax only	20,000
• subject to federal excise duty only	6,000
▪ Exempt items out of manufactured products	2,000
▪ Commercial imports	2,750
▪ Imported third schedule items	7,500
▪ Local third schedule items to wholesalers (30,000 @ Rs. 225 each)	6,750

Goods costing Rs. 3.0 million were returned by different customers. Out of these, Rs. 1.0 million worth of goods were subject to federal excise duty only. Proper debit/credit notes have been raised in this regard. Retail price of local third schedule items is Rs. 250 each.

Sales tax is payable at the rate of 16% whereas custom duty and federal excise duty are levied at the rate of 10% each. All the above amounts are exclusive of any duty and taxes.

Required:
In the light of the provisions of Sales Tax Act, 1990 and Federal Excise Act, 2005, compute the following for the tax period November 2009. Give brief reasons, wherever necessary.

(a) Net sales tax payable with return. **(12)**
(b) Net federal excise duty payable with return. **(03)**

Q.7 (a) Describe the provisions of Sales Tax Act, 1990 relating to the maintenance and keeping of records by a registered person making taxable supplies. **(07)**
(b) Explain the requirements of registration as specified in Federal Excise Act, 2005. **(04)**
(c) Explain the following with reference to the provisions of Federal Excise Act, 2005.
(i) Goods **(02)**
(ii) Wholesale dealer **(02)**
(iii) Adjudicating authority **(02)**

(THE END)