The Institute of Chartered Accountants of Pakistan

Advanced Taxation

Final Examinations
Module F – Summer 2011

Reading time – 15 minutes

June 9, 2011
100 marks – 3 hours

Q.1 Mr. Khan has been working for a listed company Turtle Limited (TL) for the last many years. The details of his emoluments during the tax year ended June 30, 20X4 are as under:

	Rupees
Basic salary (per month)	350,000
Conveyance allowance (per month)	50,000

In addition to the above cash emoluments, Mr. Khan was also provided with the following:

(a) A rent free furnished accommodation with a fair market rent of Rs. 100,000 per month.
(b) An 1800cc company maintained car, both for business and private use. The car was purchased by TL on July 1, 20X1 at a fair market value of Rs. 2,000,000.
(c) On July 1, 20X3 he was provided with an interest free loan of Rs. 2,500,000 which is repayable in lumpsum in December 20X4. The prescribed benchmark rate is 13% per annum. On December 1, 20X3 Mr. Khan utilized 60% of the amount of loan for purchasing a double storey bungalow. The total cost of the bungalow was Rs. 25,000,000. The bungalow, on its ground floor, also had a suitable space for opening a departmental store.

In order to increase its operational efficiency, TL announced a redundancy scheme to its employees. Mr. Khan opting for the scheme resigned from TL with effect from January 1, 20X4. Upon resignation, 25% of his outstanding loan balance was waived by TL and the remaining loan amount was adjusted from his final settlement. He received the following payments from TL:

	Rupees
Compensation under the redundancy scheme	4,000,000
Gratuity under unapproved scheme	2,000,000

Following further information is also available:

(i) Tax of Rs. 1,837,000 was withheld by TL from the above payments.
(ii) Mr. Khan was allowed to purchase the 1800cc car at an accounting book value of Rs. 1,000,000 which he sold in the open market at a price of Rs. 1,500,000.
(iii) On March 1, 20X4 Mr. Khan rented out the ground floor of his bungalow to Mr. Riaz, for establishing a departmental store, at a monthly rent of Rs. 137,500. Due to the strategic location of the store, he also received adjustable and non-adjustable deposits of Rs. 600,000 and Rs. 500,000 respectively.
(iv) On April 1, 20X4 he rented out the residential portion of the bungalow to a Commercial Bank for their marketing executive. He received gross amount of Rs. 2,400,000 as two year's advance rent. The Bank deducted tax of Rs. 197,500 from such payment.
(v) A donation of Rs. 500,000 was made to an un-approved trust for the construction of mosque.
(vi) In July 20X1, Mr. Khan was issued shares in TL. The fair market value of shares at the time of issue was Rs. 500,000. He disposed off these shares in June 20X4 at a gain of Rs. 500,000.

Required:
Compute the taxable income, tax liability and tax payable/ refundable, if any, to Mr. Khan for the tax year 20X4. The average rate of tax of Mr. Khan for the last three years was **18%**. ***(20 marks)***

Note: *Show all exemptions, exclusions and disallowances where relevant. Tax rates are given on the last page.*

Q.2 Ms. Hina started her business on January 12, 2011 at a kiosk, located at Karachi Airport. She sells an exclusive blend of coffee imported from Kenya and packed dates purchased from a company in Khairpur. Ms. Hina though not registered with Inland Revenue Department, paid sales tax on all taxable purchases.

In order to increase the efficiency and profit margin of her business, she decided to get herself registered with the sales tax authorities enabling her to reclaim the input tax on her purchases. She made an application for voluntary registration under the Sales Tax Act, 1990 on April 25, 2011 and was registered with effect from May 2, 2011. Following was the position of her unsold stock of coffee and dates at April 25, 2011:

S. No.	Description	Date of purchase	Sales Tax paid (Rs.)
(i)	25 kg of coffee imported	January 15, 2011	23,750
(ii)	125 packets of dates purchased	February 2, 2011	12,325
(iii)	42 kg of coffee imported	February 25, 2011	39,900
(iv)	458 packets of dates purchased	March 28, 2011	41,325

Required:
In the light of the provisions of Sales Tax Act, 1990.
(a) Explain whether and under what circumstances Ms. Hina could reclaim the amount of tax paid on the unsold stock acquired before registration.
(b) Calculate the amount of input tax, if any, which she can reclaim with her sales tax return for the month of May 2011. ***(07 marks)***

Q.3 Beetle Limited (BL), an industrial undertaking, is engaged in the manufacture and supply of pesticides. The company manufactures its products from the raw material imported from Malaysia. BL also imports certain pesticides from Dubai, which are supplied to the local distributors without any further processing.

After scrutiny of the tax return filed by BL for the tax year 20X4, the Additional Commissioner has issued a notice under section 122(5A) in which he has raised the following issues:

(i) Tax collected on the import of certain plant and machinery installed at BL's factory has been claimed as an adjustment in the return. The Commissioner is of the view that such tax should instead be treated as a final tax.
(ii) While computing the taxable income, BL has not apportioned the "Cost of goods manufactured" between its income from sale of manufactured products and income from sale of commercial imports. The Commissioner wants such costs to be apportioned between the two revenue streams.
(iii) The audited financial statements show a gain of Rs. 50 million on the disposal of an immovable property comprising office in a commercial building. This property was purchased by the company for Rs. 90 million and was sold for Rs. 120 million. Its tax written down value at the time of disposal was Rs. 70 million. The gain has not been offered to tax by BL. The Commissioner wants to add the amount of Rs. 50 million to the company's taxable income.
(iv) The financial statements also disclose an outstanding liability on account of royalty of Rs. 250 million. This amount payable to BL Dubai Plc. is outstanding for the last four years, pending approval from the State Bank of Pakistan. The expense was claimed by BL in the tax year 20X0. The Commissioner wants to add back the amount to the taxable income of BL.
(v) Bad debts written off during the year include an amount of Rs. 10 million which was provided to a distributor as a loan who has now been declared insolvent. The Commissioner wants to add this amount to the taxable income of BL.

Required:
Under the provisions of Income Tax Ordinance, 2001 explain, giving reasons, as to whether or not the Commissioner's contention with regard to each of the above situation is valid. ***(12 marks)***

Q.4 Gadget Limited (GL) is registered at the Large Taxpayer Unit (LTU) of Inland Revenue Department, Islamabad. It is engaged in the manufacture and supply of electrical appliances. Following information has been extracted from GL's records for the month of May 2011.

	Rupees
Purchases:	
Steel sheets, copper wire, aluminum and allied raw materials	2,500,000
Lubricants, spare parts and stores (include cash purchases of Rs. 900,000)	5,400,000
Gift items for customers - carpets, fancy watches etc.	700,000
Supplies:	
Electric switch-gears and electric motors to diplomatic mission in Islamabad	1,900,000
Air Coolers to customers based in Lahore, Islamabad and Faisalabad	7,000,000
Electric air coolers to customers in Spain and Zanzibar	3,800,000

Following information is also available:

(i) Technical fee of Rs. 1,400,000 was paid to Mr. Michael in Finland for the grant of right, under a contract, to use the latest Humidifier Process for the production of air coolers.
(ii) Rs. 700,000 was paid against bill board advertisement to Z Inc. which is registered with LTU.
(iii) Motors and switches of Rs. 650,000 were supplied for consumption on board a container ship with gross tonnage of 150 LDT. The ship was proceeding to the port of Antwerp.
(iv) Printed stationery of Rs. 500,000 was purchased from registered suppliers for the maintenance of factory records. These suppliers are however not registered with LTU.
(v) Rs. 500,000 was paid to bank on account of L/C opening charges and Rs. 100,000 on account of safe custody fees.
(vi) Sub-standard supplies of Rs. 900,000 were returned to vendors. Proper debit/credit notes were raised in this regard.

All payments for the purchase of goods and services have been made through crossed cheque or crossed pay order/credit card except as otherwise indicated. Sales tax is payable at the rate of **17%**. All the above figures are **exclusive of federal excise duty (FED) and sales tax** wherever applicable. The goods manufactured by GL are not subject to duty under the Federal Excise Act, 2005.

Required:
In the light of the provisions of Sales Tax Act, 1990 and Federal Excise Act, 2005 compute the following for filing the sales tax-cum-federal excise return for the tax period May 2011.

(a) Sales tax payable/refundable.
(b) FED payable, assuming the rate of duty is **10%** on all excisable items/ services. ***(18 marks)***

Q.5 (a) Describe the benefits available under the Income Tax Ordinance, 2001 to persons who are registered under the Sales Tax Act, 1990. Also state the conditions which such persons are required to fulfill in order to be eligible for claiming such benefits. ***(05 marks)***

(b) Skilled (Pvt.) Limited (SPL) wants to form a joint venture with Expert Consultants (Pvt.) Limited (ECPL) for providing disaster management services to corporate clients.

Required:
Under the provisions of Income Tax Ordinance, 2001 advise the CEO of the two companies about the tax treatment of the following:

(i) Income / loss derived by the joint venture; and
(ii) Share of venturer's profit / loss from such venture. ***(09 marks)***

(c) Who may be regarded as short-term resident individual under the Income Tax Ordinance, 2001? Discuss the provisions relating to the taxability of foreign source income of such individuals. ***(04 marks)***

Q.6 Al Maratib, a large group of companies is contemplating to avail the benefits of Group Taxation by offering it to be taxed as one fiscal unit.

Required:
In the light of the provisions of Income Tax Ordinance, 2001 explain the provisions of Group Taxation to the chairman of the group. ***(08 marks)***

Q.7 (a) Under the provisions of Sales Tax Act, 1990 and Rules made thereunder, certain restrictions have been placed on the adjustment of input tax. Explain those provisions in respect of each of the following situations.

(i) X Limited is registered with Inland Revenue Department. It purchased copper wires of Rs. 24 million on credit, for the manufacture of electric fans. The payment was made after 210 days of the issuance of tax invoice by way of a crossed pay order drawn on the business bank account of the company.
(ii) Mr. Baba is working with Y Limited as director procurement. He paid Rs. 698,456 on behalf of the company for the purchase of lubricants using his own credit card.
(iii) Z Limited acquired new machinery for its manufacturing department at a price of Rs. 150 million. Sales tax paid at the time of purchase amounted to Rs. 25.5 million.
(iv) Mr. Haq is registered as a wholesaler under the Sales Tax Act, 1990. He paid sales tax of Rs. 88,750 including extra tax of Rs. 3,750 on the purchase of certain specified electric appliances from a manufacturer in Lahore. ***(07 marks)***

(b) "The Commissioner may amend an assessment order for a tax year only on the basis of definite information acquired from an audit or otherwise". What do you understand by the term "Definite information" as described in the Income Tax Ordinance, 2001? ***(03 marks)***

Q.8 Explain the provisions of Federal Excise Act, 2005 with regard to the following:

(a) Excess duty collected from the customer. ***(05 marks)***
(b) Duty on services provided free of charge. ***(02 marks)***

(THE END)

EXTRACTS FROM THE FIRST SCHEDULE OF THE INCOME TAX ORDINANCE, 2001
Division I – Rate of Tax for Salaried Individuals

S. No.	Taxable Income	Rate of Tax
(1)	(2)	(3)
16.	Where the taxable income exceeds Rs. 2,850,000 but does not exceed Rs. 3,550,000,	17.50%
17.	Where the taxable income exceeds Rs. 3,550,000 but does not exceed Rs. 4,550,000,	18.50%
18.	Where the taxable income exceeds Rs. 4,550,000.	20.00%

Division VI – Income from property

S. No.	Gross amount of rent	Rates of tax
(1)	(2)	(3)
1.	Where the gross amount of rent does not exceed Rs. 150,000.	NIL
2.	Where the gross amount of rent exceeds Rs. 150,000 but does not exceed Rs. 400,000.	5 percent of the gross amount exceeding Rs. 150,000.
3.	Where the gross amount of rent exceeds Rs. 400,000 but does not exceed Rs. 1,000,000.	Rs. 12,500 plus 7.5 percent of the gross amount exceeding Rs. 400,000.
4.	Where the gross amount of rent exceeds Rs. 1,000,000.	Rs. 57,500 plus 10 percent of the gross amount exceeding Rs. 1,000,000.