The Institute of Chartered Accountants of Pakistan

Advanced Taxation

Final Examination	8 December 2011
Winter 2011	100 marks - 3 hours
Module F	Additional reading time – 15 minutes

Q.1 Mateen and Vaqas are planning to commence a business venture selling pesticides to the farmers. They are however, not certain whether the business venture should be in the form of a partnership or a limited liability company. They intend to make investment and share the profits in the following ratio:

- Mateen 60%
- Vaqas 40%

Further, in case of incorporation of a limited liability company they would distribute 60% of the after tax profits as dividends.

Following are the expected results of their twelve months' operation:

	Rupees
Sales	10,500,000
Cost of sales	(4,410,000)
Gross profit	6,090,000
Salaries and wages	(3,165,000)
Rent and rates	(582,000)
Travelling and entertainment	(273,000)
Depreciation	(975,000)
Profit before taxation	1,095,000

Salaries and wages include salaries of Rs. 1,100,000 and Rs. 970,000 to be paid to Mateen and Vaqas respectively.

Depreciation relates to delivery vehicles. In the first year tax depreciation allowance on these vehicles is estimated at Rs. 1,462,500.

Required:
Under the provisions of Income Tax Ordinance, 2001 advise Mateen and Vaqas on the preferable structure of their business, whether it should be a partnership or a limited liability company, in terms of the amount of tax payable, assuming that they have no other sources of income.
(For the purpose of your calculations, tax rates are given at the end of this paper.) ***(11 marks)***

Q.2 (a) Describe the powers of an officer of Inland Revenue with regard to the recovery of arrears of tax as enumerated under the Sales Tax Act, 1990. ***(10 marks)***

(b) In view of the provisions of Sales Tax Act, 1990 identify the persons who may be regarded as the representative of a non-resident person for a tax year. ***(04 marks)***

Q.3 Explain the following in the light of the provisions of Federal Excise Act, 2005.

(a) The persons who are liable to pay Federal Excise Duty. ***(05 marks)***

(b) The alternative sources on which duty may be levied and collected by the Board, in lieu of levying and collecting duties on goods and services. ***(02 marks)***

(c) The circumstances under which duty drawback may be allowed to a taxpayer. Also state the relevant authority who may grant such drawback. ***(04 marks)***

Q.4 Mega Limited (ML), an unlisted public company, owns an industrial undertaking which is engaged in the manufacturing and supply of specialized machinery to power projects.

Following is the extract from the profit and loss account of ML for the period ended 30 June 20X8:

	Rs. in '000
Sales	1,100,000
Cost of Sales	(792,000)
Gross Profit	308,000
Administrative and selling expenses	(135,000)
Financial charges	(110,000)
Other charges	(27,500)
Other income	117,000
Profit before taxation	152,500

Additional information:

(i) In July 20X7, ML purchased and installed plant and machinery for the purpose of balancing, modernization and replacement of existing plant and machinery from an Austrian based non-resident supplier at a cost of Rs. 52 million. The title in goods was transferred outside Pakistan. ML did not deduct any tax from payments made to the supplier. The plant is depreciated on a straight line basis over its useful life of ten years. The investment in plant was made with borrowed funds.

(ii) Cost of sales includes a penalty of Rs. 0.5 million paid in respect of breach of customs regulations.

(iii) Administrative expenses include amounts of Rs. 4.8 million, paid against purchase of industrial software having a useful life of three years and Rs. 5 million paid in cash for electricity expenses. The software was installed and used with effect from 01 April 20X8.

(iv) Other charges include a donation of Rs. 13 million paid to a university established under provincial law by the Government of Punjab.

(v) Other income includes the following:

- An amount of Rs. 27 million earned from consultancy services provided to the UAE Government. The gross receipts from such services were Rs. 90 million. No tax was paid by the company in UAE on such income.
- A royalty of Rs. 50 million which was received from Solar Pte Limited, a company based in Singapore, for providing scientific and commercial knowledge under an agreement. Withholding tax of Rs. 10 million was deducted by Solar Pte Limited from such payment. This amount is included in other charges.

The above amounts were brought into Pakistan in foreign exchange through normal banking channels in compliance with the foreign exchange regulations of the State Bank of Pakistan.

(vi) Unadjusted business loss, brought forward from tax year 20X1, amounted to Rs. 50 million. This loss is inclusive of an unabsorbed tax depreciation of Rs.11 million and amortisation of pre-commencement expenditure of Rs. 7.7 million.

(vii) Following taxes were deducted / paid by the company during the year:

	Rs. in '000
Advance tax paid under section 147	5,000
Paid on import of raw material	55
Paid on import of plant and machinery	1,560
Deducted by banks on profit on debt	250

(viii) Assume that tax depreciation on all assets acquired before July 20X7 is the same as their accounting depreciation.

Required:

(a) Under the provisions of Income Tax Ordinance, 2001 compute the taxable income and net tax liability of ML for the tax year 20X8. ***Tax rates are given on the last page***.
(*Show all exemptions, exclusions and disallowances where relevant.*) ***(21 marks)***

(b) Based on the computation of tax liability in (a) above, briefly explain whether the advance tax paid quarterly by ML under section 147 could result in any further tax liability to the company with reference to the provisions of Income Tax Ordinance, 2001. ***(05 marks)***

Q.5 Sunshine Limited (SL), a registered person under the Sales Tax Act, 1990 is engaged in the production and supply of three products Alpha, Beta and Gama. Beta is a by-product of Alpha and is governed under the third schedule. It is sold in the market at a retail price of Rs. 25 per unit.

Following information is available from SL's records for the month of November 2011:

Purchases:	**Rupees**
Raw material used in the production of Alpha	10,000,000
Raw material used in the production of Gama	15,000,000
Supplies:	
Local taxable supplies of Alpha to registered persons	15,000,000
Local taxable supplies of Alpha to un-registered persons	3,000,000
Local supplies of Gama to registered persons	18,000,000
Export of Gama to Turkey	7,000,000
Local taxable supplies of Beta to wholesalers (250,000 units @ Rs. 20 each)	5,000,000
Supply of 25,000 units of Beta to Export Processing Zone for further processing	625,000

Additional information:

(i) Supplies of Alpha to registered persons include sale of Rs. 2,000,000 to an associated company. The open market price of Alpha at the time of sale was Rs. 4,000,000.

(ii) Free replacement of defective units is made in the case of Alpha, which is sold under warranty. The market value of replacement units during the month of November 2011 was Rs. 1,000,000.

(iii) SL provided 50,000 units of Beta to its employees free of charge.

(iv) In November 2011 SL imported new machinery from Japan for the purpose of launching a new product Zeta. The production of Zeta is expected to commence from April 2012. Sales tax paid on this machinery amounted to Rs. 3,000,000.

(v) Input tax of Rs. 500,000 was inadvertently not adjusted in the return for the month of October 2011.

(vi) The local supplies of Gama are exempt from the charge of sales tax.

(vii) All purchases are from registered suppliers.

All the above figures are exclusive of sales tax, wherever applicable. Sales tax is payable at the rate of 16%. The above products are not subject to duty under the Federal Excise Act, 2005.

Required:
In the light of the provisions of Sales Tax Act, 1990 and Rules made thereunder, calculate the sales tax payable/refundable/carried forward, if any, for the tax period November 2011. ***(15 marks)***

Q.6 (a) In the light of the provisions of Income Tax Ordinance, 2001 explain the term "Tax avoidance scheme". Under what circumstances the Commissioner may exercise his powers to recharacterise or disregard a transaction? ***(05 marks)***

(b) A foreign company, for the purpose of executing construction contracts, intends to establish a branch office in Pakistan.

Required:
Under the provisions of Income Tax Ordinance, 2001 advise the company on the following:

(i) Circumstances under which taxes withheld from the payments made to a non resident person would be construed as final tax under the presumptive tax regime. ***(03 marks)***

(ii) The tax implication in each of the following cases while determining chargeable income of the branch office in Pakistan.
- Head office expenditure
- Compensation for management services performed by the branch
- Profit payable on debt to finance the operations of the branch ***(05 marks)***

Q.7 Rose Petal Limited (RPL) is engaged in the construction business for the past many years. In April 20X1, Sind Provincial Government awarded a contract of Rs. 9.0 million to RPL for the construction of 10 primary schools in the districts of Khairpur and Badin over a period of three years. The company expects to earn a profit of 25% of the contract value. The project was scheduled to start in July 20X1 and be completed on 30 June 20X4.

The amount received and costs incurred by RPL on the contract over the period of three years were as under:

Tax Year	Receipts	Costs
	Rupees	
20X2	3,000,000	3,105,000
20X3	3,000,000	2,632,500
20X4	3,000,000	1,012,500

Required:
Under the provisions of Income Tax Ordinance, 2001 calculate the taxable income for each of the above three tax years. ***(10 marks)***

(THE END)

EXTRACTS FROM THE FIRST SCHEDULE OF THE INCOME TAX ORDINANCE, 2001

Division I – Rate of Tax for Salaried Individuals

S. #	Taxable Income	Rate of Tax
(1)	(2)	(3)
8	Where the taxable income exceeds Rs. 900,000 but does not exceed Rs. 1,050,000,	9.00%
9	Where the taxable income exceeds Rs. 1,050,000 but does not exceed Rs. 1,200,000,	10.00%
10	Where the taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 1,450,000,	11.00%
11	Where the taxable income exceeds Rs. 1,450,000 but does not exceed Rs. 1.700,000,	12.50%
12	Where the taxable income exceeds Rs. 1,700,000 but does not exceed Rs. 1.950,000,	14.00%

Division IB
Rate of Tax for Association of Persons

The rate of tax imposed on the taxable income of Association of Persons shall be 25%.

Division II
Rates of Tax for Companies

1. The rate of tax imposed on the taxable income of public/private company shall be 35%.
2. The rate of tax imposed on the taxable income of a small company shall be 25%.

Division III
Rate of Dividend Tax

The rate of tax imposed on dividend received from a company shall be 10%.

The Third Schedule
Depreciation Rates

1.	Building (all types)	10%	2.	Furniture and fittings	15%
3.	Plant and machinery	15%	4.	Motor vehicles (all types)	15%
5.	Computer hardware	30%			

Initial Allowance and First Year Allowance

The rate of initial allowance for eligible depreciable assets shall be 50%.