THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final/Professional Examination Summer 2003

June 04, 2003

ADVANCED TAXATION (MARKS 100)
[Module 'F' Paper F-20] & [PE-2 Paper 3] (3 hours)

Q.1 Briefly explain the significant changes in the procedure of determination of taxable income brought about by the Income Tax Ordinance, 2001. Review the same with reference to Section 122 of the Income Tax Ordinance, 2001. **(10)**

Q.2 You are Finance Manager of an unlisted public limited company engaged in textiles manufacturing. The company does not have a provident fund scheme and instead maintains an unfunded unapproved gratuity scheme whereby one salary is contributed annually by the company as provision for staff gratuity for each year of completed service of an employee. The balance sheet of the company shows the provision for staff gratuity at Rs. 25 million. Since past few years you have been pursuing the management to have gratuity fund approved by the Commissioner of Income Tax in accordance with the rules made under Part III of the Sixth Schedule to the Income Tax Ordinance, 2001. Your contention is that both the employees and the company are at a disadvantage by not having the gratuity fund approved as aforesaid. The Chief Executive of the company has asked you to prepare a paper which should explain separately and precisely the tax benefits that will accrue to the employees and the company if the desired fund is established. The paper is to be presented in the forthcoming meeting of the Board of Directors.

Required:
Please prepare the position paper for presentation to the Board of Directors. **(08)**

Q.3 A private limited company, engaged in manufacturing activities, has been assessed to income tax as under:

	Sales	Income declared	Income assessed
	(Rupees in million)		
June 30, 2000	250	8	10
June 30, 2001	230	9	11
June 30, 2002	240	10	12.5

Sales have been projected at Rs. 250 million and Rs. 260 million for the years ending on June 30, 2003 and 2004 respectively. Due to decrease in the prices of the imported raw materials since December 2002, the profitability of the company has increased. The gross profit has increased from 15% in 2002 to 27% currently and the company is expected to make taxable income of about Rs. 30 million during the year ending on June 30, 2003. While considering the quarterly accounts in April 2003, the Board of Directors (BOD) of the company considered a proposal to avail the presumptive tax regime for the current year. The tax to be withheld on the projected sales will be Rs. 8.75 million while the tax @ 43% on the returned income under the normal law works out to be Rs. 12.9 million.
The BOD has also been informed that the reduction in prices of the raw materials in the international market is temporary and that the old prices will prevail from July 2003. The BOD has requested the chief executive to seek advice from the company's tax advisors.

Required:

Please write to the Chief Executive, as tax advisors, a letter about the validity or otherwise of the company's proposal to avail the presumptive tax regime for the tax year 2003 in the light of the provisions of the Income Tax Ordinance, 2001. **(08)**

Q.4 The Income Tax Ordinance, 2001 has an "overriding effect over the other laws". Sections 3 and 54 of the said Ordinance specify such provisions. Discuss the effect of these provisions of law with practical examples. **(08)**

Q.5 The following data is available in respect of a Foreign-Controlled Resident Company engaged in manufacturing activities:

	(Rupees in million)
Issued, subscribed & paid up capital:	
Held by the foreign controller	400
Held by the local shareholders	200
	600
Accumulated profits – at the beginning of the year	100
Share premium - do -	100
Assets revaluation reserve - do -	100
	300
Debt owed to foreign controller	2,400
Interest paid on above debt @ 10% included in P & L account	240

Required:

Work out disallowance, if any, under 'Thin Capitalization' provisions contained in section 106 of the Income Tax Ordinance, 2001. **(09)**

Q.6 Standard Carpet Industries Limited is a company engaged in the manufacture and sale of carpets. Its Profit and Loss Account for the tax year 2003 is as under:

	Rupees
Sales – Local	92,400,000
- Exports	15,000,000
	107,400,000
Less: Sales Tax	12,400,000
	95,000,000
Cost of Goods Sold	57,000,000
	38,000,000
Selling & Administration expenses	20,000,000
Operating Income	18,000,000
Other Income	2,000,000
	20,000,000
Financial Charges	12,000,000
Profit before taxation	8,000,000

Extracts from his balance sheet are as follows

	Current Year	Last Year
Trade debts – considered good	7,000,000	6,000,000
Trade debts – considered doubtful	1,200,000	1,000,000
	8,200,000	7,000,000
Provision for doubtful debts	1,200,000	1,000,000
	7,000,000	6,000,000
Provision for Gratuity	0	3,000,000

The following further information is available:

(a) Sales tax payments include Rs.300,000 in respect of prior years plus additional tax of Rs.100,000 thereon. The amount was determined at the time of sales tax audit carried during the year.

(b) Salaries and allowances include the following:
- Bonus paid to the Managing Director Rs.500,000.
- Payment of Rs.3,500,000 to the gratuity fund formed and approved by the Commissioner during the current year. The payment was made to cover the company's liability towards the fund based on an actuarial valuation carried out during the year.
- Provident fund payment of Rs. 0.6 million @ 12% of basic salary.

(c) Advertisement and publicity expenses include Rs.300,000 spent on the company's participation in a trade fair held in a foreign country where the company wishes to promote its export. Presently no export is made to that country.

(d) An amount of Rs.25,000 has been written off as the debtor has gone out of business. No legal claim has been filed against him as it is estimated that the expenses incurred on legal proceedings will far exceed the amount due, and specially in view of the fact that chances of any recovery are very slim.

(e) Other income include Rs.650,000 remitted by a branch in a foreign country. The gross income of the branch was equivalent to Rs. 1.0 million. After making provision for income tax of Rs.350,000, balance amount was remitted. However an amount equivalent to Rs.300,000 has only been paid upto the end of the year whereas amount equivalent to Rs.50,000 is the subject of an appeal for which the branch has only 10% chances of success. The appeal is normally decided in one year. There is no agreement for the Avoidance of Double Taxation with the foreign country where the branch is located.

(f) Other income also includes Rs.450,000 earned on the sale on one of its office premises. The income has been calculated as under

Sales Proceeds		1,000,000
Less: WDV		
Cost	800,000	
Depreciation	250,000	550,000
		450,000

Tax depreciation on the premises charged todate amount to Rs.300,000.

(g) Financial charges includes exchange loss of Rs.600,000 relating to a foreign currency loan obtained in the year 2000, for the purchase of plant and machinery.

(h) Additions to fixed assets include:

- Car purchased for an executive director of the company costing Rs.1.2 million. The car was purchased nine months prior to the close of the tax year. Depreciation rate is 20% on straight line basis.
- Plant & machinery costing Rs.5.0 million plus intallation costs of Rs.800,000 and costs incurred on a test run of Rs.200,000 which produced goods valuing Rs.120,000. According to available records the machine worked double shift on 30 days and triple shift on 20 days. The machine started commercial production exactly in the middle of the year. Depreciation rate is 10% on straight line basis.

The company has a policy of charging full years depreciation in the year of purchase.

(i) Due to oversight the payment of third installment of Advance Tax amounting to Rs.300,000 was delayed.
To compensate the same, the fourth installment was paid 30 days earlier than required and the amount of Rs.300,000 was paid at the same time.

(j) Assume that entire export proceeds were received during the year.

Required:

(a) Compute the taxable income. **(17)**

(b) Compute the tax payable considering the tax to be at 43% **(03)**

Q.7 A manufacturer of goods (not otherwise required to be registered compulsorily) opts for voluntary registration under the Sales Tax Act, 1990 and accordingly so applies on December 31, 2002. On that date he held verifiable unsold stocks costing Rs. 800,000 as under:

	Rupees
Stocks purchased from unregistered persons	110,000
Stocks purchased from registered persons at normal sales tax rate by fulfilling requirements of section 23	
On 25.11.2002	230,000
On 15.12.2002	345,000
Goods imported – Bill of Entry dated 2.8.2002 showing sales tax paid on import is available	115,000
	800,000

There is no unpaid liability in respect of above stocks and registered persons have been paid through crossed cheques.

Required:

Work out the input tax which can be available to him in respect of the above mentioned stocks, in the first sales tax return to be submitted after grant of registration. **(07)**

Q.8 (a) Explain the procedure for the admissibility of the input tax which is not claimed by omission in the relevant tax period. **(05)**

(b) Describe the procedure laid down in the Sales Tax Act 1990 with regard to the documentation of input and output tax under Section 73 of the Sales Tax Act 1990. **(10)**

(c) Distinguish the concept of Zero Rating with exemption from tax as laid down in the Sales Tax Act 1990. **(05)**

Q.9 A liability to pay sales tax falls on the person who makes a supply. This is the general rule under the Sales Tax Act, 1990. Please illustrate exceptions to this general rule. **(06)**

Q.10 The law of Central Excise levies the duty on excisable goods on the manufacture. What is the instant of time of payment of the CED? Is it possible to store such goods at a place other than the one declared to and approved by the Collector without payment of duty? If yes, how? **(04)**

(THE END)