THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final and Professional Examinations Winter 2003

December 03, 2003

ADVANCED TAXATION **(MARKS 100)**
Module F and PE-2 **(3 hours)**

Q.1 (a) Explain the concept of "Permanent Establishment" (PE) as laid down in Section 2 of the Income Tax Ordinance, 2001. **(04)**

(b) Explain the principles determining "geographical source of income" under Section 101 of the Income Tax Ordinance, 2001. **(06)**

(c) Determine the circumstances and manner in which "Business Income" of a PE of a non-resident may be equated with a resident in Pakistan for tax purposes under the provisions of Section 101 of the Income Tax Ordinance, 2001. **(06)**

Q.2 The charge to tax is based on substance of a transaction rather than its form. Explain with reference to Section 109 of the Income Tax Ordinance 2001 the provisions under which an income or deduction could be "recharacterized" by the tax authority for the purposes of taxation. **(12)**

Q.3 Explain the common principles for acquisition and disposal of asset including depreciable assets under the Income Tax Ordinance 2001. Is there any concept of recoupment of tax depreciation on disposal/transfer of asset. **(12)**

Q.4 ABC Limited is engaged in manufacturing activities. Accounting profit after charging WPPF and WWF for the year ended June 2003 was Rs. 6,000,000. The following are some additional information which requires consideration:

(i) Two new machines valuing Rs. 6 million were added on August 31, 2002. One machine valuing Rs. 3 million was returned to the supplier after failure during the trial runs. The same was replaced after incurring freight charges Rs. 100,000 and was put to production from April 1, 2003. Both the machines worked double shift during the last month. The accounting depreciation on these machines is Rs. 600,000.

(ii) Trial run expenses referred to in paragraph (i) above amounting to Rs.200,000 as reduced by the sale of the trial production Rs. 50,000 have been included in the trading account. These expenses need to be included under proper head of account keeping in view the provisions of Income Tax Ordinance, 2001.

(iii) Cost of the new factory land purchased during the year include land development charges Rs. 250,000. These represent cost of making a small road for Rs. 200,000, landscaping along side the road Rs. 25,000 and a canal waterway Rs. 25,000.

(iv) Legal and professional charges include cost of computer accounting software purchased for Rs. 200,000 and installed on 15-08-2002.

(v) On March 25, 2003 the company received an assessment order u/s 62 of Income Tax Ordinance, 1979 for the assessment year 2002-2003. A refund of Rs. 125,000 was determined in this order after setting off company's tax liability of Rs. 1,575,000 Under Section 62 for the assessment year 2002-2003.

(vi) Stocks have been valued at lower of cost and net realizable value. The net realizable value of a particular segment of stocks in trade is Rs. 200,000 less than its cost.

(vii) The company opened a branch from April 1, 2003. Rent of branch office is Rs. 60,000 (Rs. 20,000 per month).

The following are the monthly salaries of the newly recruited staff for the above branch from the date of its opening except for the Branch Manager who was appointed at the head office from February 1, 2003. These salaries were negotiated without any perquisites and allowances.

Branch Manager	Rs. 20,000 per month
Admin. Assistant	Rs. 6,000 -do-
Cashier	Rs. 4,000 -do-

The above salaries were paid in cash except for Branch Manager whose salary has been transferred to his bank account. Income tax has not been withheld from the above salaries and the rent paid for branch office.

(viii) During financial year ended June 2003 the company had suffered tax deductions amounting to Rs. 1,600,000 u/s 153 of Income Tax Ordinance, 2001. No tax was deducted after June 20, 2003 u/s 153.

(ix) On June 15, 2003 the company entered into a sale and lease back agreement with XYZ leasing company for Rs. 2,800,000. regarding one of it's machine costing Rs. 2,500,000. Depreciation charged for the year Rs. 225,000 on this machine. The book value amounting to Rs. 2,025,000 has been transferred from operating fixed assets to assets subject to finance lease. The tax WDV of the same at the beginning of the year was Rs. 2,250,000. The leasing company has paid cheque of Rs. 2,425,900 after deduction of 10% as security and Rs. 94,100 for the first lease rental.

(x) One vehicle leased by the company for Rs. 600,000 has been sold at a gain of Rs. 100,000 on maturity of the lease. The unamortised value of the vehicle in the books stood at Rs. 400,000 on the date of disposal.

(xi) No accounting transaction has been recorded at the receipt of the following bonus shares of :

15,000 ordinary shares of nominal value of Rs. 10 per share of a public quoted company

(xii) The profit declared by the company include Rs. 350,000 as share of profit from an AOP in which company is 50% partner both in capital and profits and losses of AOP. AOP has paid income tax amounting to Rs. 119,000 equivalent to its tax liability.

(xiii) The company paid its tax liability u/s 147 of Income Tax Ordinance, 2001 on June 21, 2003 after adjustment of refund determined for assessment year 2002-2003 and tax deducted u/s 153.

Required:

You are required to calculate, after considering all the above, taxable income, income tax liability and tax payable, if any, under Section 137 of Income Tax Ordinance, 2001 to enable the company to file it's income tax return for tax year 2003.

(21)

Q.5 Beena Ltd. is registered under the Sales Tax Act 1990. They have provided you with the following data for the month of November 2003.

	Rupees
<u>Import Purchases</u>	
- Value of documents retired during the period.	20,000
- Goods in bond increased during the period.	5,500
- Sales tax on clearing agent bill.	250
- Rate of Customs duty.	20%
<u>Local Purchases</u>	
- Local purchases from registered suppliers	50,000
- Advance paid to suppliers during the period not yet adjusted.	20,000
- Purchases prior to August 2003 still appearing in creditors	15,000

During the period the Beena Ltd. imported certain furniture and furnishings for the factory amounting to Rs. 50,000 and metering and testing apparatus Rs. 100,000.

Sales tax paid on office electricity bill	525
<u>Sales</u>	
- Sales to Registered persons.	70,000
- Sales to Unregistered persons.	10,000
- Sales under international tender.	15,000
- Sales to registered person for items covered under sixth schedule.	5,000
- Advance received from customers during the period not yet adjusted.	10,000
- Sales to employees.	5,000
- Sales to associated company located in KEPZ made during the period at a special discount of 20 percent.	40,000
- Sales to enrolled persons.	5,000

Sales tax return for the month of October 2003 showed a refundable balance of Rs. 4,250.

Required:
You are required to compute the sales tax liability of Beena LTD. for the month of November 2003. **(10)**

Q.6 Explain the sales tax treatment of the following transactions:
(a) Toll Manufacturing.
(b) Fork lifting vehicle imported by a trading concern.
(c) Supply of CNG to customers by a CNG Station. **(09)**

Q.7 Ravi Ltd is engaged in the manufacture and sale of pharmaceutical products a well as the sale of imported diagnostic equipments. It has recently set up a cogeneration plant for the generation of electrical energy from oil and fuel to be used in the factory. Further the Company has also purchased a boiler for use in the cogeneration plant. You are the tax advisor of the Company.

Required:
Write a letter to the Finance Director explaining the sales tax implication of the above transaction. **(10)**

Q.8 The Sales Tax Act, 1990 specifies the principle for determining the tax liability whereby the eligible input tax is deducted from the output tax on taxable supplies of a registered person. Does the law specify any departure from the said principle relating to the levy of tax on taxable supplies? Please discuss by narrating the relevant provisions of law. **(06)**

Q.9 Explain the requirements for charge of CED on retail price on goods chargeable to such duty. **(04)**

(THE END)