THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2006

June 08, 2006

ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 (a) Tipu Sultan (Pvt.) Ltd., a fast growing IT solution provider, a wholly owned subsidiary of a listed company, commenced its operations in 1999. The details of tax losses incurred by the subsidiary company are as follows:

Accounting year	Assessment / tax year	Losses as per return	Assessed losses
		Rupees	Rupees
June 30, 2001	2001 - 02	5,750,000	4,500,000
June 30, 2002	2002 - 03	4,800,000	3,782,500
June 30, 2003	2003	4,200,000	3,500,100
June 30, 2004	2004	3,711,800	3,050,000
June 30, 2005	2005	2,750,800	2,200,000

One of the directors is of the view that the holding company can set off the losses of its subsidiary.

As a Tax Consultant, you are required to advise on the following:

(i) What are the pre-requisites for claiming the losses of the subsidiary?
(ii) How much amount can the holding company claim against the subsidiary's losses? **(10)**

(b) Dividends are generally chargeable to tax under the head "income from other sources". Briefly explain the exception to this rule. **(03)**

Q.2 (a) Shah Jahan Ltd. has acquired plant and machinery which was partly financed through a loan denominated in a foreign currency. The financial details along with repayment schedule and exchange rates are given below:

Cost of plant and machinery acquired in January 2002	Rs.15,000,000
Grant paid by the Federal Government directly to the supplier of plant and machinery	Rs. 750,000
Foreign currency debt obtained to finance the purchase of plant and machinery on January 1, 2002	USD 200,000

Repayment schedule:

– January 1, 2003	USD 60,000
– January 1, 2004	USD 60,000
– January 1, 2005	USD 80,000

Exchange rates of US$ to Rupee had been as follows:

	Rupees
– January 1, 2002	Rs. 57.00
– June 30, 2002	Rs. 57.25
– January 1, 2003	Rs. 56.95
– June 30, 2003	Rs. 57.50
– January 1, 2004	Rs. 58.00
– June 30, 2004	Rs. 57.00
– January 1, 2005	Rs. 58.50
– June 30, 2005	Rs. 59.00

Required:

Compute the depreciation allowable for the tax years 2002, 2003, 2004 and 2005. **(09)**

Note : Rate of Depreciation for plant and machinery are as follows:
Initial = 50%
Normal = 10%

(b) Akbar Limited, a listed company, has offered buy back of shares to its shareholders. The following information is available:

Paid up capital: 10,000,000 shares @ Rs. 10 each	Rs. 100,000,000
Accumulated reserves	Rs. 350,000,000
Market value at the time of offer for buy back	Rs. 35
Offer price for buy back	Rs. 40

The company intends to delist before the end of tax year.

Advise the company about its obligations under the Income Tax Ordinance, 2001 in respect of the above stated buy back transaction. **(04)**

Q.3 (a) Humayun Limited has entered into a contract for supply of goods to Lodhi Limited on April 20, 2006. At the time of entering into contract, the goods were exempt from tax. As per the contractual terms, supplier was required to deliver the goods at buyer's premises at an agreed price.

With effect from April 25, 2006 the Federal Government withdrew the exemption of sales tax on such goods.

Advise the company on the chargeability of sales tax under the Sales Tax Act, 1990 in each of the following situations:

(i) 50 per cent payment was made on April 26, 2006 when goods were delivered and remaining 50 per cent payment was made on April 28, 2006

(ii) The company paid 100 per cent advance on April 23, 2006 and goods were delivered on April 28, 2006

(iii) The company paid 50 per cent advance on April 23, 2006 and the remaining payment was made when goods were delivered on April 28, 2006. **(06)**

(b) Mr. Babar, a registered person, purchased 1000 kgs of raw material for production of taxable finished goods. During the month, he utilized 70% of raw material for production whereas 20% raw material was still lying in the inventory. The remaining raw material was destroyed in fire.

Explain with reasons, to what extent Mr. Babar is entitled to adjust input tax against output tax liability for the month. **(05)**

Q.4 (a) Discuss allowability of the following against output duty payable on manufactured goods under the Federal Excise Act, 2005:

(i) Duty paid on material used for plant expansion project.
(ii) Excise duty paid on import of raw material. **(05)**

(b) A person, who is registered under the Sales Tax Act, 1990, is engaged in the supply of products which are also subject to excise duty.

Discuss briefly what additional steps, if any, the said person will take for the purpose of registration under the Federal Excise Act, 2005 and for issuing invoices under the said Act. **(03)**

(c) Under the Federal Excise Act 2005, what is the due date for payment of Federal Excise Duty and filing of return, by a person who is engaged in providing excisable services? **(03)**

Q.5 (a) Jahangir Bank (JB) seeks your legal advice regarding withholding tax obligations in respect of the following issues:

(i) Remittance to non-resident for repairs of special purpose hardware, carried out in U.S.A.
(ii) Payments of commission to non resident person having no permanent establishment in Pakistan. **(06)**

(b) Explain whether losses incurred during the exemption period can be set off against income of post exemption period. **(03)**

(c) Mr. Pasha is managing a fast growing chain of garment shops which sell readymade ethnic and fashion garments. He has a turnover of Rs. 40 million during the last year.

The Finance Act 2005 introduced a scheme for the retailers under which retailers will be fully discharged from their income tax and sales tax obligations on payment of fixed percentage of tax on supplies.

Prepare a memorandum explaining the conditions and requirements of the scheme. **(03)**

Q.6 (a) Mr. Saleem is the Finance Manager of the subsidiary of a multinational company registered in Pakistan. He has been granted share options of parent company as follows:

- Option was granted at Rs. 20 per option, to acquire 5000 shares after 2 years, on payment of Rs. 30 per share.
- Fair market value of option at the time it was granted was Rs. 65 per option.

Two year period was completed in the tax year 2005 and Mr. Saleem decided to utilize the share options as follows:

- 2000 options were sold in international market at Rs. 110 per option.
- 3000 shares options were exercised by making additional payment of Rs. 30 per option. After two months, these shares were sold in international market at Rs. 150 per share. At the time of exercise of option, market value of share was Rs. 135.

Work out the tax liability of Mr. Saleem in respect of above transaction, in the year in which the options were granted as well as in the year 2005. Also specify the heads of income in which it shall be classified. **(10)**

(b) Aurangzeb Ltd. is engaged in the supply of canned fruit juices and is considering to launch an incentive scheme for its customers. For this purpose it has planned to offer an additional fruit juice can on the purchase of two.

Advise the management of Aurangzeb Ltd. on the sales tax implication in respect of the above scheme. **(04)**

Q.7 Hania Industries Limited (HIL) is in the business of manufacturing and sale of chocolates and sweets and is listed on Karachi Stock Exchange. It sells goods through distributors appointed in each major city. During the last two years, it has extended its business and have been involved in export and import also.

The exports are mostly made to SAFA countries. Imports are mostly made from Europe. These consist of premier quality sweets and biscuits which are sold directly to large super markets in Karachi, Lahore and Islamabad.

Extracts from the profit and loss account of the company for the tax year 2006 are as under:

	Rs. in '000'
Sales	196,500
Cost of sales (material & labour)	134,500
Gross profit	62,000
Administrative and selling expenses	
Salaries	22,000
Depreciation	15,000
Others	20,000
	57,000
Operating profit	5,000
Other income	1,000
Other charges	(3,210)
Net profit before tax	2,790

Following information are also available:

a) Break-up of the sales for the year are as follows:

	Rs. in '000'
Local sale of own manufactured goods	152,000
Local sale of imported goods	32,500
Exports	12,000

b) Imports worth Rs.2.0 million were re-exported to Sri Lanka at a C & F price of $64,000. The sale proceeds thereof are included in the export of Rs. 12 million. The bank deducted a tax of 0.5% from the sale proceeds.

c) Cost of imports were as follow:

	Rs. in '000'
C & F (US$ 250,000 @ 60)	15,000
Custom duty	3,000
Sales tax	2,700
Income tax	1,242
Other direct expenses	1,058
	23,000

d) Cost of raw material consumed as charged to cost of sales during the year was Rs. 80 million. About 8% of the raw material is lost during production mainly on account of evaporation and other unavoidable wastages. 60% of the raw material is imported from countries with which we have treaties for avoidance of double taxation. Remaining raw material is produced locally. The raw material used for exports is normally the same except certain high quality ingredients. The cost of such ingredients used during the current year were Rs. 0.5 million.

e) The rates of custom duty, sales tax and income tax and the ratio of other direct expenses is the same for raw material as well as finished goods.

f) The company's machinery has been acquired on lease. The rental paid for the year amounted to Rs.1.5 million. The company has recorded it as a finance lease. 60% of the amount paid was in repayment of principal. Accounting depreciation charged on the same amounted to Rs.1.2 million. The rate of accounting depreciation is 10%.

g) The delivery vans used for distribution were acquired two years ago at a price of Rs. 5.0 million from the holding company which is listed on the Karachi Stock Exchange. The fair value of these vans at the date of acquisition was Rs. 4.0 million. The rate of accounting depreciation is Rs. 25% on straight line method.

h) The details of tax deducted / paid are as under:

	Rs. in '000'
− Tax deducted by distributors of locally manufactured goods	1,000
− Tax deducted by super stores against imported goods	200
− Tax paid on import of raw materials	3,100
− Tax deducted on export proceeds	70

i) During the year the company has introduced a new product for which a trial run was carried out. Expenses of Rs. 150,000 were incurred on the trial. Rs. 50,000 was recovered from the sale of trial production. The net amount was charged to costs of sales.

j) The details of other charges are as under

	Rs. in '000'
Financial charges	3,000
WPPF	150
WWF	60
	3,210

k) Other income includes rental income of Rs. 300,000. The expenses related to the property and included in the profit and loss account of the company are as follows:

	Rs. in '000'
− Property taxes	15
− Depreciation	90
− Other expenses on collection	25

l) Accounting depreciation, other than mentioned above, is approximate to tax depreciation.

m) The rate of tax applicable to the company is 35%.

Compute the taxable income of the company and the tax payable thereon. **(20)**

Q.8 What are the sales tax implications, in case of:

(i) termination of taxable activity;
(ii) Sale or transfer of ownership of taxable activity to unregistered person.
(iii) Sale or transfer of ownership of taxable activity to another registered person as an ongoing concern. **(06)**

(THE END)