THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

**Final Examinations Winter 2006**

**December 7, 2006**

# ADVANCED TAXATION (MARKS 100)

**Module F** **(3 hours)**

Q.1 (a) GPM Textiles Limited and GAK Pakistan (Pvt) Limited are wholly owned subsidiaries of GYK Pakistan Limited. As a part of Corporate restructuring, it is being considered to transfer the plant and machinery from GPM to GAK at accounting written down value.

In the Board meeting, it was pointed out by one of the directors that under the provisions of the Income Tax Ordinance, 2001 the tax gain / loss will have to be worked out by taking into account the fair market value of the assets being transferred. The Director Finance has, however, contended that there is a provision in the Ordinance whereby no gain or loss is recognised in case of disposal of assets between subsidiary companies.

**Required:**
Explain to the management of the company about the conditions to be satisfied for non-recognition of gain / loss on disposal of assets between subsidiary companies of the same group. **(05)**

(b) GM Limited is considering an option to issue Term Finance Certificates (TFC) outside Pakistan for the purpose of raising funds for use in its business activities in Pakistan. To induce the investors for acquiring TFCs of the Company, it intends to advertise that the income on the same will not be taxable in Pakistan.

**Required:**
List down the conditions to be fulfilled for claiming exemption on profit on debt payable on TFCs being issued by the Company. **(05)**

Q.2 (a) Under the Income Tax Ordinance, 2001, entertainment expenditure shall be limited to the expenses incurred by a person that satisfy certain conditions.

**Required:**
Specify the conditions as explained in the Income Tax Rules, 2002 for the allowability of entertainment expenditure. **(05)**

(b) ZAB Manufacturing (Pvt.) Ltd., one of your clients, has been involved in the manufacturing of leather products. With effect from January 1, 2006 they have also started exporting approximately 30% of its manufactured goods. Consistent with their past practice, they are deducting tax from the payments against purchase of goods.

One of their suppliers has raised an objection on their practice by contending that by virtue of becoming manufacturer-cum-exporter, they are no more required to withhold tax from payments against purchase of goods.

**Required:**
Advise your client whether it should withhold tax from payment for purchase of goods. **(04)**

(c) An employer having established approved superannuation and approved gratuity fund is required to contribute annually to the funds on a reasonable basis. There are, however, limits set in the Income Tax Rules, 2002 on the initial and annual contributions to the aforesaid funds.

**Required:**
Specify those limits and the procedure for payment of contribution beyond the specified limits. **(04)**

Q.3 (a) As a tax consultant of Mirza Textile Mill Limited, you filed its return of income for tax year 2007 on November 30, 2006. Subsequently, you were informed by the Chief Financial Officer that he forgot to claim credit for certain taxes deducted and paid by the company's customers.

**Required:**
Explain the requirements for filing of revised return under the given circumstances. What would be the impact of filing a revised return on the assessment treated to have been made on filing the original return of income? **(04)**

(b) An appeal filed by FAL (Pvt) Limited against the order passed by the Commissioner of Income Tax – Appeals is pending before the Income Tax Appellate Tribunal (ITAT). Meanwhile, on the application filed by the Company, Central Board of Revenue (CBR) has appointed a committee for the resolution of dispute. On the recommendations of the Committee, the CBR has passed an order whereby the Company's tax liability has been reduced by 50%.

**Required:**
Explain to the management of the Company that in case they decide to make payment of tax in accordance with the CBR's order, what would be the affect on:

(i) existing orders, decisions, etc. and
(ii) appeal proceedings pending before the ITAT. **(04)**

(c) The Commissioner of Income Tax selected GZH Pakistan (Pvt.) Limited to verify its compliance with withholding tax regime. For this purpose, the transactions undertaken after July 1, 2006 were selected and on the basis of the audit, following transactions were identified where no tax was withheld by the Company:

(i) As part of company's scheme launched for promotion of sale, a car was given as a prize to Mr. C.F. Elahi.
(ii) Rent includes payment on account of furniture and fixtures provided by the landlord.
(iii) Purchase of goods from an importer.
(iv) Profit on debt paid to Pakistan branch of a non-resident bank under a loan agreement.

**Required:**
Explain with reasons as to whether or not the Company was required to withhold tax from payments mentioned in (i) to (iv) above. Also explain, what action can be taken by the tax authorities if it is established that the Company has failed to deduct tax from any of the above payments. **(09)**

Q.4 GIK Pakistan Limited is a Public limited company, whose shares are listed on all the stock exchanges of Pakistan. GIK Inc. USA holds 55% of the shares of the company. The Company is engaged in the trading of a wide range of electrical appliances, which comprise of the following:

(i) Import in finished form.
(ii) Manufactured in Pakistan from components imported mainly from GIK Inc. USA.

With effect from July 1, 2006, the Company has also established a software house at Lahore which is involved in export of computer software to GIK Inc., USA under a separate agreement entered in this behalf.

Following information has been extracted from the profit and loss account of the company for the year ended December 31, 2006:

| | **Rs in '000'** |
|---|---|
| Revenue | 500,000 |
| Direct costs | 302,000 |
| Administrative & marketing expenses | 100,000 |
| Other revenues | 50,000 |
| Financial charges | 10,000 |

Notes to the accounts revealed the following additional information:

(i) The revenue consists of sale of locally manufactured goods amounting to Rs. 300,000 and sale of imported finished goods amounting to Rs. 200,000.

(ii) Break-up of direct costs is as under:

| | **Rs in '000'** |
|---|---|
| Raw materials consumed | 50,000 |
| Work in progress | 25,000 |
| Finished goods – Imported (note ii(a)) | 106,000 |
| Labour cost (note ii(b)) | 80,000 |
| Freight charges (note ii(c)) | 20,000 |
| Accounting depreciation | 21,000 |
| | 302,000 |

(a) This includes tax collected by the Customs Authorities on import of finished goods amounting to Rs. 6,000,000.

(b) Labour is provided by Messrs. RT & Co. under a contract. All the payments are made in cash and no tax is withheld therefrom as the management feels that cash payments are outside the scope of withholding tax provisions.

(c) Payment for freight charges has been made in cash.

(iii) Administrative and marketing expenses include the following items:

| | **Rs in '000'** |
|---|---|
| Accounting depreciation | 20,000 |
| Salaries (note iii(a)) | 15,000 |
| Advertising expenses | 40,000 |
| Trade mark fee (note iii(b)) | 5,000 |
| Donations (note iii(c)) | 1,000 |
| Rent, rate & taxes (note iii(d)) | 4,000 |
| Accounting amortisation (note iii(e)) | 5,000 |
| Miscellaneous expenses | 10,000 |
| | 100,000 |

(a) It includes contributions of Rs 1,000,000 to unrecognised provident fund. However, effective arrangements are in place to ensure deduction of tax from payments made by the fund to employees.

(b) Under an agreement with GIK Inc., USA, a quarterly fee is paid by the company for use of trade marks and logos owned by GIK Inc. The company has not deducted any tax from the payments on the understanding that such fee is not taxable in Pakistan in the absence of GIK Inc.'s Permanent Establishment in Pakistan. Assume that there is no double tax treaty between Pakistan and USA.

(c) All donations were made to approved institutions mentioned in the Second Schedule of the Income Tax Ordinance, 2001.

(d) This includes an amount of Rs 500,000 being the taxes withheld in USA on payments received for export of computer software to GIK Inc., USA. The company intends to claim foreign tax credit, against the tax payable in Pakistan.

(e) On September 1, 2006, the company has acquired accounting software costing Rs 15,000,000, which has a useful life of three years. It is the company's accounting policy to take full amount of amortisation in the first year and no amortisation in the year of disposal.

(iv) Other revenues comprise the following:

| | **Rs in '000'** |
|---|---|
| Gross dividend received from listed companies | 5,000 |
| Accounting profit on disposal of building (note iv(a)) | 17,000 |
| Net income from export of computer software (note iv(b)) | 20,000 |
| Profit on bank deposits | 8,000 |
| | 50,000 |

(a) Calculation of accounting profit is based on the following information.

| | |
|---|---|
| Sale considerations | 57,000 |
| Costs of building | 50,000 |
| Accounting depreciation | 10,000 |
| Accounting profit on disposal of building | 17,000 |

(b) This represents net income after taking into account all direct and indirect expenses incurred by the Company in relation to export of computer software, except the financial charges.

(v) Financial charges include profit on debt amounting to Rs 2,000,000 paid on a loan exclusively utilised by the software house. Rest of the financial charges exclusively relate to the loan obtained for trading business.

(vi) The details of taxes deducted and paid during the year are as under:

| | **Rs in '000'** |
|---|---|
| Advance tax paid under section 147 | 20,000 |
| Tax paid on import of raw material | 2,000 |
| Tax deductions from dividends received | 250 |
| Tax deducted by customers on purchase of locally manufactured goods | 10,500 |
| | 32,750 |

(vii) Accounting depreciation is the same as tax depreciation.

(viii) The normal rate of tax applicable on listed companies is 35%.

**Required:**
Compute the taxable income of the company and tax payable thereon for the Tax Year 2007. Give proper comments where any given information has not been utilised in the computation. **(25)**

Q.5 (a) (i) Identify the types of registered tax payers who are required to file their sales tax return electronically? **(03)**

(ii) Describe the manner of payment of sales tax in case of electronic filing of sales tax returns? **(03)**

(b) Under the Sales Tax Act, 1990, adjustment for input tax on credit purchases is allowable only if payment is made within 180 days of issuance of tax invoice. However, the Central Board of Revenue has prescribed certain conditions for condonation of delay in meeting the time frame of 180 days.

**Required:**
Describe the conditions under which the delay has been condoned. **(06)**

Q.6 (a) S. A. Enterprises, a registered person, failed to file a return with the Sales Tax Department for last twelve months. They have now received an order from Assistant Collector requiring them to pay the minimum tax liability determined by the Sales Tax Department. The management of the company has never heard about this minimum tax liability. They have approached you and raised the following questions:

(i) How is this minimum tax liability determined?
(ii) What would be the company's position if:
- they opt to pay the determined amount; or
- they do not pay the demand raised by the Sales Tax Department

**Required:**
Draft a memorandum, as a Sales Tax Consultant, explaining the question raised by the management. **(10)**

(b) Explain the conditions under which sales tax is allowed to be refunded as draw back? **(04)**

Q.7 (a) The Finance Act, 2006 has brought certain financial services provided by banking companies into the Federal Excise Regime.

**Required:**
Describe the following in respect of the above:
(i) Types of services on which excise duty has been levied;
(ii) Due date for payment of duties and filing of returns; and
(iii) Invoicing requirements. **(07)**

(b) One of the instruments which are now subject to Federal Excise Duty is the pay order. You are required to explain the applicability of Federal Excise Duty if pay order is issued by one branch of banking company in favour of another branch of the same banking company. **(02)**

**(THE END)**