THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2008

June 5, 2008

ADVANCED TAXATION (MARKS 100)

Module F (3 hours)

Q.1 Mr. Jehangir Ahmad (JA) worked as Head of I.T. Division in Sutlej Pakistan Limited (SPL) for last ten years. From July to September 2007 he earned a basic salary of Rs. 900,000. He was also provided with rent free furnished accommodation, in respect of which SPL paid a rent of Rs. 35,000 per month. He resigned with effect from October 1, 2007 .

In July 2004, JA was granted an option to acquire 1000 shares of SPL's Parent Company, which is listed in a foreign country. The option was exercisable on completion of three years' employment with the Company. He paid an amount equivalent of Rs. 100,000 to acquire the option whereas the fair market value of such option at that time was Rs. 150,000. On July 4, 2007 he paid a sum equivalent of Rs. 200,000 to acquire the said shares which were issued to him on July 21, 2007 when the market value of the shares was equivalent of Rs. 350 per share. JA disposed off the shares on October 1, 2007. The net sales proceeds received in Pakistan amounted to Rs. 344,000 i.e. after adjustment of income tax deducted by the foreign government amounting to Rs. 20,000, brokerage commission of Rs. 6,500 and bank charges of Rs. 2,500.

JA has also been carrying out a software business in the ground floor of a house owned by his wife, since many years. On March 31, 2008 he converted the business into a limited company. The company took over the assets of the business at their fair value of Rs. 2.6 million and in consideration thereof, 260,000 shares of Rs. 10 each were issued, in the name of JA. The book value of the assets taken over on the date of transfer was Rs. 2.2 million.

The company has entered into a large contract for supply of software to a renowned Japanese firm over a period of two years. In view of limited resources, the company is not considering offers from other clients.

The office in which the business was being carried out has been rented to the company at Rs. 50,000 per month whereas the prevailing market rate is Rs. 35,000 per month. The profit of the company up to June 30, 2008, excluding the rent, is expected to be Rs. 350,000.

JA has earned an income of Rs. 850,000 from the business, before the assets were transferred to the company. His wife has no other income except dividend income of Rs. 50,000 on which tax has been deducted at source.

Required:
Compute the taxable income of Mr. Jehangir, his wife and the company, for the Tax Year 2008. Give reasons for the treatment made by you, wherever necessary. **(15)**

Q.2. Crown Enterprises, a branch of a company incorporated in Singapore, intends to dispose off one of its business segment to Trend Setters Limited (TSL), a company listed on the Karachi Stock Exchange, for a lump sump consideration of Rs. 500 million. The net assets of the business segment are separately identifiable. The consideration was agreed keeping in view the fair market value of net assets, earning potential of the underlying assets and the brand name of the products. Under a separate agreement Crown Enterprises has agreed to refrain from competing in the same business for a period of five years and in consideration thereof TSL has agreed to pay an additional amount of Rs. 50 million.

The break-up of net assets related to the business segment is given below:

	Net book value	**Fair market value**
	------- Rs. in million -------	
Plant and machinery	150	180
Land	60	80
Building (costing Rs. 50 million)	40	70
Inventory	90	90
Other current assets including receivables	85	85
	425	505
Less: Current liabilities	125	125
	300	380

The cost of building to the company is Rs. 50 million and tax WDV is equal to the accounting WDV of Rs. 40 million.

Required:

(a) Compute the amount that will be included in the taxable income of Crown Enterprises, as a result of the above transaction. Give appropriate reasons under the Income Tax Ordinance, 2001, to support your calculations.

(b) Describe the withholding tax obligations of TSL in respect of payments to be made to Crown Enterprises. **(08)**

Q.3 Holdings Limited, a public listed company is engaged in the manufacturing and supply of consumer products. Its profit and loss account for the year ended March 31, 2008 is given below:

	Rs. in million
Sales (local)	30,000
Cost of sales	21,000
Gross profit	9,000
Selling and administration expenses	3,000
	6,000
Finance cost	1,200
Other expenses	900
	3,900
Other income	1,500
Net profit before taxation	5,400

The following information is available in respect of the above.

(a) Sales are net of sales tax and the break-up is as under:

Manufactured products	70%
Imported products	17%
Locally purchased products	13%

20% of all sales are made to limited companies. Imported products are sold at a profit of 40% of sales whereas locally purchased goods are sold at a mark-up of 25% above cost.

(b) The cost of development of a new manufacturing process was capitalized as an intangible asset in 2003. The product has a life of approximately 15 years. The amortization thereon amounting to Rs. 4 million is included in the cost of sales.

(c) Selling and administration expenses include bad debts of Rs. 6 million. Opening and closing balance of provision for bad debt account is Rs. 20.8 and 18.4 million respectively.

(d) Other expenses include an amount of Rs. 20 million paid to a commodity exchange to settle a transaction which was carried out as a hedge against fluctuation in prices of one of the raw materials used by the company.

(e) Other income includes the following:
- Share of income received from an AOP amounting to Rs. 60 million. The company's share in the AOP is 40% and the amount has been distributed by the AOP after paying income tax at the rate of 25%. The income tax authorities have added back an amount of Rs. 20 million while assessing the income of the AOP.
- Indenting Commission of Rs. 11.16 million, received from a party in a foreign country where withholding tax of 40% was deducted at source. Withholding tax of 5% and bank charges of 2% were deducted by the bank in Pakistan before the above amount was credited in the company's account.

(f) The details of tax deducted and paid are as follows:

	Million
Imports	153.0
Deducted by corporate clients (Rs. 147 million on sale of manufactured goods)	174.3
Advance tax under section 147	1,200

(g) Tax rate applicable to the company is 35%.

Required:
Compute the income tax liability of the company for the tax year 2008. Support your answer with appropriate calculations and comments. **(26)**

Q.4 The Commissioner of Income Tax – Appeals (CIT) stayed the tax demand of Mr. Bashir until disposal of his appeal. While deciding appeal the CIT reduced tax demand to 60%. Subsequently, the Income Tax Department issued an order asking Mr. Bashir to pay additional tax on the whole amount, for the period during which the demand was stayed.

Explain whether the order issued by the Tax Department is justified. **(04)**

Q.5 With effect from January 1, 2009, a Scheduled Bank intends to launch an unlisted Unit Trust by establishing an Asset Management Company. The income of the Unit Trust will be in the form of dividend, capital gains and profit on debt.

Required:
Advise the management of the Bank on the following:
(a) Taxability of the Unit Trust;
(b) Taxability of the asset management company; and
(c) Taxability of unit-holders including the Scheduled Bank, in respect of
- dividend received from Unit Trust;
- capital gain on sale/redemption of units. **(10)**

Q.6 Hashmi Limited purchased a machine for Rs. 20 million on July 1, 2005, when it was enjoying tax holiday. The tax holiday period expired on June 30, 2006. The machine remained in the company's use till March 31, 2008 when it was shipped to an associated company in Indonesia for sale, on behalf of Hashmi Limited.
Required:
(a) Compute the amount of depreciation which the company could claim in tax year 2007 and 2008. (Assume that the rates of initial and normal depreciation during this period was 50% and 10% respectively).
(b) How should the company determine the sale price of the machine for computing gain/loss on sale, under the Income Tax Ordinance, 2008? **(06)**

Q.7 Shahid Limited (SL) is engaged in the import, export and distribution of various consumer goods. SL has recently expanded its business by setting up a manufacturing unit for various consumer goods. The manufacturing unit will start production in June 2008.

Following transactions were carried out during May 2008:

(i) SL purchased 5,000 bottles of locally manufactured shampoo at a cost of Rs. 100 per bottle. The retail price of each bottle is Rs. 110. During the month, SL sold all bottles to the retailers at Rs. 105 per bottle. (Shampoo is included in the items listed on third schedule to the Sales Tax Act, 1990).

(ii) The company imported 10,000 bottles of hair oil at import value of Rs. 400 per bottle (exclusive of custom duty and sales tax). Custom duty was paid at the rate of Rs. 20 per bottle. 500 bottles were re-exported to Azerbaijan at Rs 3,000 per bottle whereas 6,000 bottles were sold in the local market at Rs 350 per bottle.

(iii) New plant including ancillary equipment was acquired for the manufacturing unit at Rs. 200 million on which sales tax of Rs. 30 million was paid.

(iv) SL paid sales tax of Rs 50,000 on foods and beverages used for the entertainment of the Company's employees.

(v) Sales tax of Rs 150,000 was paid under Provincial Sales Tax Ordinance on services provided by customs agents for clearance of imported goods.

Required:
Compute the sales tax payable by Shahid Limited for the month of May 2008. Give proper comments where any given information has not been utilized in the computation. **(13)**

Q.8 Through Finance Act 2007, Government departments, autonomous bodies and public sector organizations have been notified as withholding agents for the purpose of collection of sales tax.

Briefly discuss responsibilities of a withholding agent as enumerated in the Sales Tax Special Procedure (Withholding) Rules, 2007. **(04)**

Q.9 Zohaib & Co., a partnership firm, plans to purchase raw material from Mr. Salman Ahmed (SA) who has the reputation of evading sales tax. Mr. Khalid, the managing partner of the firm, however is of the view that failure to deposit sales tax by SA would not have any bearing for his firm.

Required:
Offer your comments on the views expressed by Mr. Khalid. **(03)**

Q.10 A consignment imported by ABC worth Rs. 10 million was damaged while in transit from the port. Due to a limiting clause in the Insurance policy, the claim received from the insurance company was restricted to an amount of Rs. 6.4 million.

Required:

(a) Explain whether the sales tax paid on import can be claimed as input tax.

(b) Explain whether the delivery of goods to the insurance company against insurance claim, constitute a taxable supply **(05)**

Q.11 The Federal Government is empowered to levy special excise duty (SED) on certain goods. The rate of SED is 1% of the value of such goods.

Required:
Explain the provisions laid down in the Federal Excise Act, 2005 for determining the value of following goods:

(i) Imported goods. **(02)**

(ii) Goods chargeable to SED on the basis of retail price. **(04)**

(THE END)