

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

| SUBJECT | SESSION |
|-------------------|-------------|
| Advanced Taxation | Summer 2007 |

Overall Feedback

Overall performance of the candidates was poor. It was observed that instead of explaining what the law has prescribed, the students formulated their answers according to their general understanding of the subject. For example, many students believed that since the liability of shareholders of a private limited company is limited, they shall not be required to contribute anything if the company is unable to pay its tax liability. Further, many students tried to stretch the answer by providing irrelevant details and explanations. The students are once again advised that marks are only awarded for the portion of answer which is relevant and it is a waste of time to display knowledge of other irrelevant areas.

Question-wise Comments

Q.1 (a) This part related to a private limited company which had been wound up. The students were expected to discuss the following two issues:

- Legality of the notice issued to a shareholder of the company to recover tax which the company was unable to pay.
- Extent of the shareholder's liability

While discussing the legality of the notice, the students were expected to cover two aspects as follows:

- Only shareholders with 10% or more shareholding can be called upon to pay such tax.
- The above condition shall apply to such individuals who held more than 10% shares at any time during the related tax year.

While discussing the extent of Mr. Green's liability, majority was able to answer correctly that he shall be liable to pay the full amount but very few could mention that he was entitled to recover any amount paid by him from other shareholders meeting the above criteria, in proportion to their shareholdings.

Many candidates did not give any reason and simply answered either in the affirmative or otherwise. Few others were of the view that notice may only be issued to shareholders with more than 25% shareholding. Very few were able to point out the second point mentioned above.

(b) It was a straight forward question and many candidates correctly mentioned the rules discussed in Section 147 of the ITO-2001. Some of the common mistakes are elaborated below:

- The students wasted their time in explaining the method of computing the advance tax liability for each quarter, as the same was not required.
- Many candidates did not mention that own estimate may be filed at any time during the year but before the last installment becomes due.
- Many candidates were not aware of the recent changes made in the ITO-2001 wherein the Companies are required to file their own estimate of Income even if the liability for the year is more than the last assessed liability.
- Few candidates mentioned that penalty shall be payable if the estimated liability is less than 90% of the actual liability but failed to specify how the penalty will be calculated i.e. 12% of the amount of difference between estimated liability and 90% of actual liability.

Q.2 (a) In this question two independent situations were given. Very few candidates were able to give proper answers. The common mistakes were as under:

- (i) The candidates had no or very little knowledge of the concept of prescribed person as explained in Section 153 of the ITO-2001.
- (ii) Many candidates incorrectly mentioned that if the firm pays the amount of tax on its own and the same is not deducted by Mr. Ghalib, it would be considered as final tax. They failed to comprehend that Mr. Ghalib being an individual was not covered in the definition of a "prescribed person" and hence the question of finality of tax did not arise.
- (iii) Many candidates failed to explain that the advance payments received from XYZ (Private) Limited, (who in this case can be classified as a prescribed person) fall under FTR and the tax deducted thereon shall be full and final discharge of tax liability irrespective of whether any work had been performed or not.

(b) The candidates were required to state the conditions as given in Section 148 and the relevant circular, under which a manufacturer can obtain exemption certificate from the Commissioner with regard to payment of tax at the import stage. Response to this question was average.

Q.3 The tax computation of a public limited company was given in this question and the students were required to give their comments in respect of the computation and other information disclosed in the computation. Many candidates were able to correctly explain the tax implication of the transactions discussed in the question. However, following deficiencies were observed in the answers:

- A large number of candidates wasted their time in working out the revised calculations despite the clear instructions given in the question that these were not required.

- Many candidates correctly quoted the relevant sections with explanation but did not describe the impact thereof on the working given in the question.
 - The concept of addition of excess cost of perquisites has been withdrawn with effect from Tax Year 2007. Many candidates were not aware of this change and consequently lost marks.
 - The treatment of amortization on trade mark was correct but many examinees were of the view that amortization of intangible assets for tax purposes should commence from the year in which it was paid and therefore felt that it should not have been added back.
 - Many candidates failed to comment that the mark-up on working capital loan can not be allowed as an expense if tax has not been deducted at source.
 - Many examinees failed to explain that gain on disposal of old car should be calculated by restricting the sale proceeds to 66.66% of the fair value (because tax depreciation had also been allowed on 66.66% of the cost, as provided in the Third Schedule to the Income Tax Ordinance 2001). Further, some students surprisingly mentioned that actual sales proceeds should be considered instead of fair value.
 - According to the given computation, full amount of deferred expenditure had been claimed for tax purposes. Most of the students failed to identify that this was not allowed because any expenditure which provides benefit for a period of more than one year, has to be claimed proportionally over the said period.
 - Majority of the candidates correctly stated that since bad debts were not previously charged to taxpayer's business income, these should be added back to income and taxed accordingly.
 - Through Finance Act 2006, service revenue of all taxpayers **other than companies** came into the ambit of FTR. Being a public limited company, MNO Pakistan Limited was not entitled to treat services revenue under the Final Tax Regime. This point was missed by most of the candidates.
 - While discussing taxation of lease rentals many students failed to point out that financial charges of Rs. 500,000 should be added back.
- Q.4 (a) The question consisted of three situations. In each case candidates were required to comment on the taxability of the given transaction. Short comments in respect of transactions described in each sub-part are given below:
- (i) The mere payment of mark-up to a non-resident by a resident person does not result in the income of the non-resident being classified as Pakistan Source Income. Since the loan was utilized outside Pakistan the income of the non-resident will be a Foreign Source Income and will not be taxable in Pakistan.

- (ii) Many candidates got confused and treated the salary income of Mr. Black as fees from technical services and declared that the same was covered under FTR. Further, most of the candidates declared that the salary paid to him was a Foreign Source Income as the same was paid in Japan. They ignored the provision of section 101 of the ITO-2001 according to which the salary income earned in Pakistan is Pakistani Source Income irrespective of whether it is paid in or outside Pakistan.
- (iii) Most of the candidates attempted it correctly but few of them termed it as Foreign Source Income because the company was non-resident without giving regard to the provision contained in section 101 of the ITO-2001 according to which, any gain on disposal of shares of a company whose assets are mainly situated in Pakistan shall be considered as Pakistan Source Income.
- (b) The performance of the candidates was satisfactory in this part. However, few of them mentioned that the assessment order can only be amended within 3 years, instead of 5 years.
- Q.5 (a) Response to this question was very poor. Very few candidates knew that even if the principal place of business of the employer is outside Pakistan, the provident fund maintained by him may still be recognized, provided the number of employees employed outside Pakistan do not exceed 10%.
- (b) This was a simple and well attempted question and many candidates secured full marks. However, in certain cases the following types of errors were witnessed:
- Provision was taken at 5% instead of 3%.
 - The provision in excess of 3% was not carried forward to the next year.
- Q.6 (a) This was a straight forward question from Rule 21 and 22 of the Sales Tax Rules 2006 requiring the candidates to advise the procedure for adjustment of excess sales tax charged. The question was well attempted and many candidates secured good marks. However, following common mistakes were noted:
- Few candidates got confused and incorrectly mentioned that the company should issue the debit note and the distributor should issue the credit note.
 - Some candidates did not know that the distributor will also have to issue a debit note.
- (b) This was also a very simple question from section 59 of the Sales Tax Act 1990 and well attempted by most of the candidates.

- Q.7 (a) This question proved to be the most difficult one. It was a very practical question requiring the application of special procedures for determining the amount of sales tax payable by a commercial importer as explained in Chapter II of the Sales Tax Procedures Rules 2006. In general the response was very poor. A large number of students were totally ignorant of the rules and the basis of calculation. In few instances the answer was correctly explained in the form of narration but the working was either not provided or contained errors. Other deficiencies were as follows:
- Most of the candidates did not have any idea about the method of calculation.
 - Computation of output tax was based on retail price instead of sale price.
 - Surprisingly many candidates computed the custom duty on the basis of sales price.
 - Students failed to calculate the actual value addition and sales tax thereon.
- (b) Since most of the candidates were not able to correctly attempt part (a), they also failed to secure marks in this portion. This portion required working out the input tax forgone by GHI Limited. It could have been done by adding output tax to the amount payable on actual value addition (if any) and subtracting therefrom, input tax paid on import value and minimum value addition.
- Q.8 (a) This was a simple question from section 12(2) of the Federal Excise Act 2005 and was answered well by most of the candidates. However some of the candidates incorrectly commented that the services provided free of charge or at concessional rates are exempt from Excise Duty.
- (b) This question was well attempted by majority of the candidates.

(THE END)