Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

Model paper
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Taxation

Q.1 You are the tax manager in a firm of chartered accountants, responsible for providing tax related services to Sample Limited (SL) for tax year 20X9. SL is a listed company engaged in the business of manufacturing and supply of various consumer products across Pakistan. SL's accounting year ends on 31 December each year.

Before submitting the income tax return for tax year 20X9, SL's finance department has provided you the following tax computation along with some supporting notes:

	Supporting notes	Rupees
Income from business:		
Profit before taxation	(i)	25,000,000
Add/(less): Inadmissible expenses/(income)		
Profit on foreign debt	(ii)	3,230,000
Difference of accounting and tax depreciation		1,780,000
Forfeiture of security deposit	(iii)	700,000
Dividend received from a subsidiary – FTR	(iv)	(5,200,000)
Total income		**25,510,000**
Less: Donation to a non-profit organization		(7,000,000)
Taxable income		**18,510,000**
Computation of net tax liability:		
Tax on taxable income [18,510,000 @ 30%]		5,553,000
Less: Advance tax paid u/s 147		(5,300,000)
Net tax payable		**253,000**

SUPPORTING NOTES

(i) Profit before tax was arrived after considering the following:

- Share of profit of Rs. 13 million received from an industrial undertaking set up on 1 June 20X6 for operating cold chain facilities for storage of agricultural produce. The industrial undertaking was set up by SL at a cost of Rs. 165,000,000. 50% of the cost of project including working capital was financed through equity investment from an investor in China.
- Sale of a product to an associated company for Rs. 250,000. The fair market value of the product was Rs. 200,000.
- Rs. 5 million being the cost of a right to use a formula for the development of a new chemical compound. SL obtained the rights on 1 March 20X8 from High Tec Inc. USA for twelve years.
- Impairment loss of Rs. 200,000 on SL's investment in Temporary (Pvt.) Limited. The loss occurred due to decrease in the breakup value of these shares as compared to their book value.

(ii) Profit on foreign debt of Rs. 3,230,000 was paid to non-resident persons in China. SL had issued securities in China for the purpose of raising loan to be used for its business in Pakistan. These securities were approved by the Federal Board of Revenue. SL did not deduct withholding tax.

(iii) The forfeiture of security deposit was made on account of breach of contract by one of the suppliers, Twist Limited (TL). TL is owned by the spouse of one of your partners in the firm. TL is a major supplier of SL.

(iv) SL received dividend of Rs. 5,200,000 from its subsidiary within the group. SL owns 75% interest in the subsidiary. No withholding tax was deducted by the subsidiary.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder:

(a) comment on the computation of total income, taxable income and tax liability by SL's finance department and give your suggestion(s), where required. **(19)**

(b) compute the revised tax payable by SL, if any. **(04)**

Q.2 Under the provisions of Income Tax Ordinance, 2001 discuss the tax treatment in case of each of the following independent situations.

(a) Khalq Limited (KL) is engaged in the manufacture and supply of polio vaccines. In order to meet the increasing demand for vaccines, KL expanded its manufacturing facilities in July 20X8. This expansion project involved a capital expenditure of Rs. 75 million including a cost of Rs. 50 million which was spent on the acquisition of new plant and machinery.

The Federal Government, realizing the importance of the project, voluntarily paid a grant of Rs. 20 million to KL towards the cost of new machinery. KL accounted for the amount of grant as capital reserve in its financial statements for the year ended 31 March 20X9. The management is of the view that Rs. 20 million should be claimed as exempt from tax in the return of income for tax year 20X9. **(05)**

(b) Moon Limited (ML), an unlisted public company, engaged in the manufacture of sports goods, remitted US $ 30,000 to JH Hospital in Boston, USA for the medical treatment of its CEO. According to the terms of his employment, the CEO is entitled to free provision of medical treatment and hospitalization. The amount was remitted on 1 March 20X9 in compliance with the regulations of the State Bank of Pakistan. The management of ML is not clear as to whether the expenditure would be allowed as a deductible expense in tax year 20X9 as no tax was withheld from the payment to JH Hospital in Boston, USA. **(06)**

(c) Gadget Limited (GL) is a public company engaged in the manufacture and sale of electrical appliances. During tax year 20X9, GL launched an advertising campaign for the promotion of a new product. An Iranian artist was hired for making a TV commercial at an agreed remuneration of Rs. 10 million. GL's management is of the view that in order to claim the expense as deductible, payment of Rs. 10 million should be made through normal banking channel and no tax should be deducted from the payment as the entire advertisement was produced in Iran. **(06)**

Q.3 Desi (Pvt.) Limited (DPL), a resident company, is 70% owned by Mega Inc. USA (MI). On 15 March 20X8 DPL received a loan of US$ 3.0 million (equivalent to PKR 315.0 million) from MI with interest at the rate of 11% per annum. Interest is to be paid half yearly in arrears. Repayment of the principal would commence from January 20X9. The loan was received to finance a rural development project in Punjab duly approved by the Federal Government.

On 1 June 20X8 DPL received another loan of US$ 1.6 million (equivalent to PKR 168 million) from MI with interest at the rate of 6% per annum. Interest on this loan is to be paid monthly in arrears. This loan was received for the construction of a new factory building. The principal repayment would commence from November 20X9.

On 31 August 20X8 DPL wrote-off Rs. 1.0 million in respect of a debt owed by one of MI's associates who was based in Australia. The outstanding debt balance in DPL's books at the end of 30 September 20X8 was Rs. 4.0 million.

Following information has been extracted from DPL's records for the year ended 30 September 20X8:

	Rs. in million
Assets (including the above outstanding debt of Rs. 4.0 million)	3,500
Liabilities	2,870
Net profit after taxation for the year	350
Amount credited during the year to asset revaluation reserve	150

Required:
Under the provisions of the Income Tax Ordinance, 2001 compute the amount of interest on debt that shall be allowed as expense, for tax year 20X9. **(13)**

Q.4 Quick Fox Limited (QFL) is a multinational company and is registered as a manufacturer, importer, wholesaler and retailer with the Regional Tax Office of Inland Revenue Department in Karachi. Following information has been extracted from QFL's records for the month of March 2019:

	Rupees
Purchases from registered suppliers	3,900,000
Purchases from un-registered suppliers	1,058,000
Advance from customers	117,000
Taxable supplies to registered persons	3,105,000
Taxable supplies to un-registered persons	1,210,000
Imports	852,000
Other income	215,000

Additional information:

(i) Purchases from registered suppliers include the following:
- lubricating oil worth Rs. 380,000 purchased from an oil marketing company for in-house consumption.
- raw material of Rs. 390,000 and Rs. 225,000 purchased from SL on 6 March 2019 and 20 March 2019 respectively. On 15 March 2019 the Commissioner suspended SL's registration for claiming fraudulent refunds.
- goods covered under Third Schedule, worth Rs. 285,000 purchased from Nayab Associates (NA). QFL, upon instructions from NA, directly deposited cash amounting to Rs. 285,000 into its bank account.

(ii) Purchases from un-registered suppliers consist of the following:
- packing material of Rs. 358,000 which was purchased from a supplier who was liable to be registered with sales tax authorities.
- edible fruits of Rs. 700,000.

(iii) Taxable supplies to registered persons include the following:
- goods worth Rs. 435,000 supplied to a manufacturer for onward sale to an exporter holding concessions under DTRE scheme.
- tyres worth Rs. 660,000. These tyres were purchased from a local manufacturer, which was a cottage industry, in February 2019.

(iv) Taxable supplies to un-registered persons consist of the following:
- sale of 150 bicycles to un-registered dealers in Multan for Rs. 900,000. The bicycles were purchased in December 2018.
- sale of goods worth Rs. 310,000 to end consumers.

(v) Imports comprise of air conditioners worth Rs. 852,000. These were imported by QFL's wholesale-cum-retail division for sale through its own outlets.

(vi) Other income includes gain on disposal of a truck of Rs. 105,000. The truck was sold to an active tax payer for Rs. 1,205,000. No sales tax was recorded on this transaction.

Further information:

(i) In December 2018, QFL's car rental division imported a wheel alignment machine for in-house use. 3% value addition tax of Rs. 18,000 was not paid at import stage.
(ii) In November 2018, QFL sold certain taxable goods worth Rs. 535,000 to an un-registered wholesaler at a wholesale price of Rs. 50 per pack and collected further tax at the rate of 2% of the value of supplies. In March 2019, the internal auditor pointed out that these goods were covered under Third Schedule. The retail price of these goods at the time of sale was Rs. 65 per pack.
(iii) In September 2018, QFL inadvertently collected sales tax of Rs. 45,000 from a customer as against the applicable tax of Rs. 54,015. QFL had applied to the Commissioner IR for the revision of the return however, no reply has so far been received in this regard.

All the above figures are **exclusive of sales tax**, except where it is implied otherwise. Sales tax is payable at the rate of **17%**.

Required:
In the light of the provisions of the Sales Tax Act, 1990 and Rules made thereunder, compute the amount of sales tax payable by or refundable to QFL and input tax to be carried forward, if any, for the tax period March 2019. Also compute withholding tax, wherever applicable. **(19)**
Note: Show all relevant exemptions, exclusions and disallowances. Ignore default surcharge.

Q.5 Zeta Pakistan Ltd is principally engaged in the purchase, manufacture and supply of taxable goods and is registered under the Sales Tax Act, 1990. During the usual course of business, it also carried out the following transactions during the year:

(i) Use of taxable goods for internal testing, training and evaluation purposes. The goods included own manufactured as well as locally procured goods.
(ii) Free replacement of faulty parts of goods which had been sold under warranty.
(iii) Destruction of damaged goods.
(iv) Payment of sales tax on diesel purchased and used in generation of electricity. The electricity produced is mainly used in production. However, part of it is also used in finished goods warehouses and workers canteen.
(v) An amount of Rs 300,000 was paid to the company's customs agent on import of raw material used.

Required:
Comment on the chargeability of sales tax in the above situations. **(12)**

Q.6 (a) On 1 July 20X8 Shahrukh supplied excisable goods to Mubarak Enterprise (ME) in Export Processing Zone. Shahrukh did not levy excise duty on these goods considering that these would be used for further manufacturing but ME used these goods for in-house consumption.

On 1 January 20X9 Shahrukh was serviced with a notice from the Office of Inland Revenue requiring him to show cause for non-payment of duty on the goods supplied to ME.

Required:
Under the provisions of the Federal Excise Act, 2005:

(i) explain whether Officer Inland Revenue was justified in issuing the show cause notice to Shahrukh. **(03)**
(ii) describe the period within which the Officer Inland Revenue must decide the above case. **(03)**

(b) Akram Associates (AA) always submits its monthly excise return in form STR-7 on due date and deposits the amount of duty due at the time of filing of return. On 10 March 2019, due to the death of one of AA's partners and subsequent closure of the firm for a period of 20 days, the February 2019 return could not be filed on time. The amount of duty due for February 2019 amounted to Rs. 600,000. The management has decided to file its February 2019 return and pay the duty due along with its March 2019 return on 15 April 2019. AA is also required to pay a penalty of Rs. 50,000 to the Sindh Revenue Board at KIBOR (KIBOR is 11%).

Required:
Under the provisions of the Federal Excise Act, 2005 compute the amount of **duty** payable for the month of February 2019. **(05)**

Q.7 Identify the possible ethical issues in respect of each of the following independent situations. Also describe the possible circumstances (if any) under which the ethical issues may not arise.

(i) Mr. Timber did not disclose rental income of Rs. 500,000 received by his wife from letting out of her ancestral building in his return of income for tax year 2019.

(ii) Raja Yaseen, a manufacturer of water purifiers, failed to deduct withholding tax of Rs. 25,000 from sale of water purifiers to a retailer, Malik Naz. The Commissioner, however, allowed Malik Naz to claim tax credit of Rs. 25,000 while computing his tax liability. **(05)**

(THE END)