Certificate in Accounting and Finance Stage Examination

The Institute of Chartered Accountants of Pakistan

21 September 2020
3 hours – 100 marks
Additional reading time – 15 minutes

Principles of Taxation

Instructions to examinees:

(i) Answer all **EIGHT** questions.
(ii) Answer in **black** pen only.
(iii) Tax rates are given on the last page.

Q.1 Sageer, a resident individual, is working as a full time professor at Knowledge Institute (KI) which is a non-profit education and research institution and is duly recognized by Higher Education Commission. KI is entirely owned and funded by Zinger Limited (ZL), a company listed on the Pakistan Stock Exchange.

Details of his monthly remuneration during the year ended 30 June 2020 are given below:

	Rupees
Basic salary	200,000
Medical allowance	20,000
Fair market rent of accommodation	100,000

In addition to the above, he was also provided the following:

- Health insurance for Sageer and his dependents as per the terms of employment. For this purpose, KI is paying annual insurance premium of Rs. 40,000.
- Provident fund contribution of Rs. 15,000 per month to a recognized provident fund. An equal amount was also contributed by Sageer to the fund.

Additional information

(i) On 1 July 2019, Sageer was granted an option to acquire 10,000 shares in ZL at a price of Rs. 105 per share under an employee share scheme. Sageer bought the option on the same date by paying Rs. 175,000 to KI when the fair market value of the option was Rs. 200,000. He exercised the option on 30 September 2019 when the fair market value was Rs. 130 per share.

As per the scheme, he was not allowed to sell or transfer the shares before 31 December 2019. On 31 December 2019, the fair market value of ZL's shares was Rs. 142. On 30 May 2020, he sold 5,000 of these shares at Rs. 135 per share.

(ii) On 1 July 2019, Sageer obtained an interest free loan of Rs. 1,500,000 from KI in exchange for which he agreed to waive the interest receivable on his provident fund balance maintained with KI. Interest provided on provident fund balance for the year was 8%. The prescribed benchmark rate is 10%.

(iii) On 31 August 2019, he received leave encashment of Rs. 100,000 relating to previous year.

(iv) During the year, tax of Rs. 160,000 was deducted at source by KI.

Other information relevant to tax year 2020:

(i) On 15 January 2020, he sold a shop situated in Karachi for Rs. 15,000,000. He had purchased this shop in 2018 for Rs. 19,000,000 out of which Rs. 5,000,000 was paid in cash.
(ii) On 1 March 2020, he sold a residential plot situated in Faisalabad for Rs. 18,000,000. The plot was inherited from his father in 2014. Fair market value of the plot at the time of inheritance was Rs. 7,000,000.

(iii) In June 2020, Sageer independently developed learning courses for sale through a web based marketplace managed by a company situated outside Pakistan. On 25 June 2020, he received USD 4,260 into his dollar account from sale of these courses. Withholding income tax @ 8% was deducted from the receipt as per the income tax laws of the foreign country.

Relevant exchange rates were as follows:

25 June 2020	USD 1 = PKR 168
30 June 2020	USD 1 = PKR 169
Average exchange rate for June 2020	USD 1 = PKR 168.5

(iv) On 1 June 2020, Sageer paid Rs. 2,500,000 as donation to a non-profit organization listed in the Second Schedule of the Income Tax Ordinance, 2001.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute the taxable income and net tax payable by or refundable to Sageer for the year ended 30 June 2020. ***Show all relevant exemptions, exclusions and disallowances.*** **(19)**

Q.2 Libas & Co. is an association of persons (AOP) with three members, Saba, Junaid and Akram, sharing profit and loss in the ratio of 1:1:2 respectively.

During the year, AOP earned profit before tax of Rs. 8,500,000 from its principal business i.e. trading of garments. In addition, AOP is also involved in purchase and sale of following securities listed on the Pakistan Stock Exchange:

Name of investee company	Details of purchase			Details of sale		
	Date	**No. of shares**	**Price per share (Rs.)**	**Date**	**No. of shares**	**Price per share (Rs.)**
XOK Limited	1 Oct 2016	200,000	200	29 June 2020 **[Note A]**	200,000	225
PBB Limited	18 Aug 2017	55,000	145	20 Dec 2019	100,000	180
	10 Jan 2018	100,000	150			
OOI Limited	15 Feb 2020 **[Note B]**	150,000	86	15 March 2020	150,000	78

Note A: Sale proceed from disposal of these shares was credited to the AOP's bank account on 2 July 2020.

Note B: Due to shortage of funds for making this purchase, AOP borrowed Rs. 5,000,000 in cash from Imran, who is in the business of lending money at 15% per annum.

Other information related to Saba:

(i) During the year, she earned Rs. 1,500,000 by working as a freelance photographer.

(ii) On 1 April 2020, Saba received Rs. 1,100,000 from Zafar in full settlement of a loan. The loan was provided on 1 April 2019 at 10% per annum interest through proper banking channel.

Required:
Under the provisions of the Income Tax Ordinance, 2001, compute taxable income and tax liability of AOP and Saba for the tax year 2020. **(13)**

Q.3 (a) On 2 July 2019, Rubina received a show cause notice u/s 122 from the Commissioner Inland Revenue (CIR) for amendment of the assessment order for tax year 2018. Due to lack of knowledge about tax matters, she did not respond to it.

On 1 August 2019, she received a demand notice under which she was required to pay Rs. 610,000 within 30 days on account of undeclared income and an amended assessment order for tax year 2018 under section 122 from the CIR.

Rubina is dissatisfied with the order issued by the CIR and wants to file an appeal to the Commissioner (Appeals) because payment of this amount will cause hardship to her.

Required:
Under the provisions of the Income Tax Ordinance, 2001:

(i) state the time period within which an appeal may be filed by Rubina to the Commissioner (Appeals). **(01)**

(ii) discuss different types of orders that the Commissioner (Appeals) may make for disposing of an appeal. **(02)**

(iii) explain what action(s) the Commissioner (Appeals) may take for ensuring that no undue hardship will be caused to Rubina because of the payment of this demand. **(03)**

(iv) discuss the option(s) available to Rubina for defending her case, if the Commissioner (Appeals) issues an order confirming the amended assessment order issued by the CIR. **(02)**

(b) Differentiate between deductible allowances and admissible deductions. Give **three** examples of each. **(06)**

Q.4 (a) Farheen is a resident filer and has provided following information pertaining to tax year 2020:

(i) She owns a bungalow situated in Multan which was given on rent to Abbas under a rental agreement of five years which expired on 31 March 2020. Details of payments received as per the rent agreement are given below.

Rent	Rs. 175,000 per month
Security guards' salaries	Rs. 50,000 per month
Non-adjustable security deposit	Rs. 2,500,000

On expiry of the rental agreement, Farheen refunded the security deposit to Abbas and rented out the bungalow to a new tenant Zafar on the same terms and conditions.

Farheen pays Rs. 40,000 per month to a security services company which provides security guards at the bungalow.

(ii) She owns a residential plot in Karachi. On 1 March 2020, she decided to sell the plot to Mehreen for Rs. 2,200,000 and received a deposit of Rs. 220,000. On 1 June 2020, she forfeited the deposit on refusal of Mehreen to purchase the plot.

(iii) On 1 December 2017, she had acquired a furnished office on monthly rent of Rs. 5,000 for her own use and had paid a non-refundable amount of Rs. 2,000,000 to the previous tenant for vacating the office. During the year, she received an offer of Rs. 2,400,000 from Shehroz to vacate this office which she accepted and received the amount on 1 March 2020.

(iv) On 1 October 2019, she inherited a factory with plant and machinery from her father and let it out on 1 December 2019 at a monthly rent of Rs. 500,000.

(v) Legal and professional charges of Rs. 40,000 were paid for preparation of rental agreements.

(vi) On 15 November 2019, she received income tax refund of Rs. 180,000 related to tax year 2017. This amount included Rs. 30,000 being additional payment on delayed refund.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute the total income of Farheen under appropriate heads of income for the tax year 2020. **(07)**

(b) Ahmed has completed his MBA from a university in USA. He had been living there since August 2013 for his education and came to Pakistan only once in 2017 i.e. from 10 March 2017 to 30 September 2017 and then went back to USA to complete his MBA. Along with his studies, he was also doing a part time job at a restaurant in USA till November 2019. He returned to Pakistan on 1 December 2019 and commenced a trading business from 1 January 2020.

Below is the computation for taxable income/loss for the tax year 2020:

	Pakistan source income	**Foreign source income**	**Total**
Income from Salary	------------------	Rupees	------------------
Salary from restaurant in USA		840,000	840,000
Income from business			
Revenue	4,000,000		4,000,000
Less: Deductions			
Cost of goods sold	(2,200,000)		(2,200,000)
Selling and administrative expenses **[Note A]**	(2,820,000)		(2,820,000)
Donation **[Note B]**	(600,000)	(250,000)	(850,000)
Taxable income/(loss)	**(1,620,000)**	**590,000**	**(1,030,000)**

Note A: Selling and administrative expenses include the following:

(i) Salaries of Rs. 840,000 paid to two employees equally in cash. Withholding income tax was deducted as required under Income Tax Ordinance, 2001.

(ii) Rs. 600,000 in respect of the feasibility study which was conducted before commencement of the business.

Note B: Donation of Rs. 600,000 was paid to a charitable hospital in Pakistan and Rs. 250,000 was paid to a non-profit organization in USA.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, comment on the above tax computation for tax year 2020. Give suggestion(s) wherever required. **(08)**
Note: Revised computation is not required.

Q.5 Sun Associates (SA) has recently been registered with the Inland Revenue Department under the Sales Tax Act, 1990.

Required:
Under the Sales Tax Act, 1990 and Rules made thereunder,

(a) identify the documents which SA may require for claiming/adjusting the input tax relating to the following activities:

(i) supply of taxable goods **(01)**
(ii) import of goods into Pakistan **(02)**
(iii) goods purchased in an auction **(02)**

(b) state the requirements relating to retention of records and documents that SA should comply with. **(02)**

Q.6 Rapid Associates (RA) has been registered under the Sales Tax Act, 1990 since 2014. During the month of June 2020, RA issued fake sales tax invoices amounting to Rs. 5 million to one of its customers. Apart from this, RA has always been in compliance with all the regulations of the Sales Tax Act, 1990.

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, discuss the consequences which RA may have to face due to issuance of fake invoices. **(06)**

Q.7 JF Associates (JFA) is registered under the Sales Tax Act, 1990 as a manufacturer. Following information has been provided by JFA for the month of August 2020:

	Rupees
Supplies	
Taxable goods to registered persons	7,500,000
Taxable goods to unregistered persons	1,300,000
Exempt goods to unregistered persons	1,000,000
Exports to Saudi Arabia	500,000
Purchases	
Taxable goods from registered persons	7,400,000
Taxable goods from unregistered persons	1,100,000
Fixed assets (machines) from a registered supplier	2,500,000

Additional information:

(i) Supplies of taxable goods to registered persons include:

- goods worth Rs. 560,000 sold to a new customer at discount of 20%. JFA normally allows discount of 10% to its customers.
- an invoice issued to Qasim erroneously for Rs. 590,000 whereas the correct amount of invoice was Rs. 950,000.

(ii) Supplies of taxable goods to unregistered persons include sales of Rs. 28,500 to end consumers.

(iii) Exempt supplies of Rs. 50,000 were returned by the unregistered customers during the period.

(iv) Two machines A and B costing Rs. 1,500,000 and Rs. 1,000,000 respectively were acquired and commissioned into operation in August 2020. Machine A has been used for the manufacture of taxable (local) as well as exempt supplies whereas Machine B has been used only for manufacture of export supplies.

(v) Input tax on an invoice of Rs. 1,200,000 was paid on 15 March 2020 but inadvertently it could not be claimed in the return for March 2020 and thereafter.

(vi) Electricity bill of Rs. 859,950 was paid in cash. The bill was inclusive of sales tax of Rs. 124,950.

(vii) Sales tax credit brought forward from previous month amounted to Rs. 425,000.

Except where otherwise specified, all figures are exclusive of sales tax. Rate of sales tax is **17%**. Proper debit/credit notes were issued within the specified time wherever required.

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 JFA and input tax to be carried forward, if any, for tax period August 2020. **(18)**

Q.8 (a) Identify any **four** powers of the Federal Board of Revenue (FBR) with respect to collection of tax. What consequences may be faced by taxpayer if such powers are misused by any officer(s) of FBR? **(03)**

(b) Briefly explain any **two** pillars of tax administration which may be helpful in safeguarding the interest of taxpayers and avoiding the abuse of powers by the tax administration. **(02)**

(c) List any **six** ethical issues which may be faced by tax administration authorities while discharging their duties under the four pillars of tax administration. **(03)**

(THE END)

EXTRACTS FROM THE INCOME TAX ORDINANCE, 2001

Tax rates for salaried individuals

S. No.	Taxable income	Rate of tax
3.	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 1,800,000	Rs. 30,000 plus 10% of the amount exceeding Rs. 1,200,000
4.	Where taxable income exceeds Rs. 1,800,000 but does not exceed Rs. 2,500,000	Rs. 90,000 plus 15% of the amount exceeding Rs. 1,800,000
5.	Where taxable income exceeds Rs. 2,500,000 but does not exceed Rs. 3,500,000	Rs. 195,000 plus 17.5% of the amount exceeding Rs. 2,500,000
6.	Where taxable income exceeds Rs. 3,500,000 but does not exceed Rs. 5,000,000	Rs. 370,000 plus 20% of the amount exceeding Rs. 3,500,000
7.	Where taxable income exceeds Rs. 5,000,000 but does not exceed Rs. 8,000,000	Rs. 670,000 plus 22.5% of the amount exceeding Rs. 5,000,000
8.	Where taxable income exceeds Rs. 8,000,000 but does not exceed Rs. 12,000,000	Rs. 1,345,000 plus 25% of the amount exceeding Rs. 8,000,000

Tax rates for non-salaried individuals and AOP

S. No.	Taxable income	Rate of tax
1.	Where taxable income does not exceed Rs. 400,000	0%
2.	Where taxable income exceeds Rs. 400,000 but does not exceed Rs. 600,000	5% of the amount exceeding Rs. 400,000
3.	Where taxable income exceeds Rs. 600,000 but does not exceed Rs. 1,200,000	Rs. 10,000 plus 10% of the amount exceeding Rs. 600,000
4.	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 2,400,000	Rs. 70,000 plus 15% of the amount exceeding Rs. 1,200,000
5.	Where taxable income exceeds Rs. 2,400,000 but does not exceed Rs. 3,000,000	Rs. 250,000 plus 20% of the amount exceeding Rs. 2,400,000
6.	Where taxable income exceeds Rs. 3,000,000 but does not exceed Rs. 4,000,000	Rs. 370,000 plus 25% of the amount exceeding Rs. 3,000,000
7.	Where taxable income exceeds Rs. 4,000,000 but does not exceed Rs. 6,000,000	Rs. 620,000 plus 30% of the amount exceeding Rs. 4,000,000
8.	Where taxable income exceeds Rs. 6,000,000	Rs. 1,220,000 plus 35% of the amount exceeding Rs. 6,000,000

Capital gains on disposal of immovable property

S. No.	Period	Rate of tax
1.	Where the gain does not exceed Rs. 5 million	5%
2.	Where the gain exceeds Rs. 5 million but does not exceed Rs. 10 million	10%
3.	Where the gain exceeds Rs. 10 million but does not exceed Rs. 15 million	15%
4.	Where the gain exceeds Rs. 15 million	20%

Capital gains on disposal of securities

The rate of tax to be paid under section 37A shall be as follows:

S. No.	Period	Securities acquired before 1 July 2016	Securities acquired after 1 July 2016
2.	Less than 12 months	15%	15%
3.	Equal or more than 12 months but less than 24 months	12.5%	
4.	Equal or more than 24 months but less than 48 months acquired on or after July 01, 2013	7.5%	