



Principles of Taxation

Instructions to examinees:

- (i) Answer all **EIGHT** questions.
- (ii) Answer in black pen only.

Q.1 For the purpose of this question, **assume that the date today is 31 August 2020.**

Shahid is engaged in the business of manufacturing and supplying of auto parts. Following is the extract of his profit or loss statement for the tax year 2020:

| | Rs. in '000 |
|--------------------|-------------|
| Sales | 29,058 |
| Cost of goods sold | (18,724) |
| Gross profit | 10,334 |
| Operating expenses | (3,137) |
| Financial charges | (2,030) |
| Other income | 1,260 |
| Profit before tax | 6,427 |

Additional information:

- (i) The above accounts have been prepared on cash basis and stock-in-trade has been valued on prime cost method. However, Shahid wants to change the method of accounting from cash basis to accrual basis. In this respect, following information has been gathered:

| | Opening balances | Closing balances |
|---|-------------------------|------------------|
| | ----- Rs. in '000 ----- | |
| Stock-in-trade using prime cost method | 1,800 | 2,800 |
| Stock-in-trade using absorption cost method | 2,300 | 3,200 |

- (ii) Cost of goods sold includes:
 - purchase of packing material of Rs. 440,000 from Nasir Traders. No withholding tax was deducted at the time of payment.
 - freight charges of Rs. 85,000. These were paid in cash for transporting goods from suppliers.
- (iii) Operating expenses include:
 - salary of Rs. 80,000 per month paid to Shahid's brother who handles administrative matters of the business.
 - expenditure of Rs. 950,000 incurred on the development of a product which is expected to generate revenue for five years.
 - penalty of Rs. 15,000 for late filing of income tax return.
- (iv) Financial charges include profit on debt of Rs. 450,000 earned on fixed deposit account maintained with a bank. The bank withheld income tax and Zakat amounting to Rs. 45,000 and Rs. 93,750 respectively.

- (v) Other income includes:
- capital gain of Rs. 45,000 received, net of withholding tax of Rs. 6,750, on sale of 20,000 shares in Metal Limited (ML) in November 2019. ML is listed on PSX. On 1 January 2018, Shahid purchased these shares for Rs. 200,000 at initial public offering. He had claimed a tax credit of Rs. 15,000 on such investment in tax year 2018.
 - rent of Rs. 980,000 received from an agriculture land in Badin. No withholding tax was deducted at the time of receipt.
- (vi) Tax depreciation for the year amounts to Rs. 680,000.
- (vii) Tax deducted at source by customers amounts to Rs. 875,000.
- (viii) The unabsorbed tax depreciation brought forward from tax year 2019 amounts to Rs. 568,000.

Required:

Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute total income, taxable income and net tax payable by or refundable to Shahid for the tax year 2020. *(Use accrual basis of accounting)*

(18)

- Note:**
- *Your computation should commence with profit before tax figure.*
 - *Ignore minimum tax under section 113.*
 - *Show all relevant exemptions, exclusions and disallowances.*
 - *Tax rates are given on the last page.*

- Q.2 Farhan, Kamran and Rehan are members of an association of persons (AOP) and share its profit and loss in the ratio of 2:2:1 respectively.

Following information is available with regard to AOP and its members for the tax year 2020:

- (i) During the year, AOP earned a profit before tax of Rs. 2,000,000 after making following payment to its members:

| | Farhan | Kamran | Rehan |
|---------------------|--------------------|---------|---------|
| | ----- Rupees ----- | | |
| Salary | 1,000,000 | 800,000 | 600,000 |
| Interest on capital | 500,000 | 400,000 | 300,000 |

- (ii) Kamran is running a business as a sole proprietor from which he earned Rs. 800,000. Kamran is also a member of another AOP where his share of profit or loss is 60%. During the year, the other AOP incurred a loss after tax of Rs. 350,000 and paid Rs. 150,000 on account of income tax.
- (iii) Rehan received net dividend of Rs. 102,000 from a listed company after deduction of withholding tax @ 15%.
- (iv) Farhan has no other source of income.

Required:

Under the provisions of the Income Tax Ordinance, 2001 compute taxable income and tax liability of AOP and each of its members for the tax year 2020.

(11)

(Tax rates are given on the last page)

Q.3 Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, discuss:

- (a) the prescribed limits/conditions for the deduction of entertainment expenditure. (06)
- (b) who is required to file the foreign income and assets statement? Also state the particulars to be included in such statement. (05)
- (c) the concept of 'Concealed asset' and state the powers of the Commissioner relating to concealed asset of any person when it is impounded by the Federal Government. (05)

Q.4 Respond to the following independent situations, under the provisions of the Income Tax Ordinance, 2001:

- (a) During the tax year 2020, Sadiq received a flat as gift from his uncle, Mumtaz Alvi. The flat was located in posh area of Lahore and its fair market value at the time of gift was Rs. 4.5 million. *Discuss the tax treatment of the flat received by Sadiq.* (02)
- (b) On 1 July 2014, Ahmed purchased two sculptures for Rs. 410,000 and Rs. 475,000 respectively. On 30 November 2019, during the shifting of his house, he lost both the sculptures. On 15 January 2020, he received insurance claim of Rs. 940,000 in a single transaction against the loss of two sculptures. The fair market value of both the sculptures at the time of loss was estimated at Rs. 360,000 and Rs. 540,000 respectively. *Compute Ahmed's taxable income or loss for the above transaction.* (04)

Q.5 (a) Following are the incomes of three resident individuals A, B and C during the tax year 2020:

| Head of income | A | B | C |
|----------------------|--------------------|---------|-----------|
| | ----- Rupees ----- | | |
| Income from property | 200,000 | 150,000 | 4,100,000 |
| Income from business | - | 360,000 | 160,000 |

Required:

Discuss the tax treatment of income from property of each of the above individuals while computing the taxable income under the Income Tax Ordinance, 2001. (05)

(b) Sajid retired from Sun Chemicals Limited (SCL) as a marketing manager with effect from 31 December 2019. He received the following amounts in final settlement from SCL:

- (i) Leave encashment of Rs. 600,000.
- (ii) Rs. 4,000,000 from unapproved provident fund. 50% of this amount was contributed by Sajid.
- (iii) Un-approved gratuity of Rs. 2,500,000.

He also acquired the vehicle, provided to him by SCL, at accounting written down value of Rs. 500,000. The market value of the vehicle at the time of retirement was Rs. 2,000,000.

Required:

Under the Income Tax Ordinance, 2001 and Rules made thereunder, discuss the tax treatment of the above benefits received by Sajid on retirement. (04)

- Q.6 Following information has been extracted from the records of two different persons registered under the Sales Tax Act, 1990 for the month of February 2020:

| | Registered persons | |
|--|--------------------|------------|
| | Taha | Shan |
| | ----- Rupees ----- | |
| Purchases | | |
| Taxable supplies from registered persons | - | 11,000,000 |
| Taxable supplies from unregistered persons | 3,500,000 | - |
| Exempt goods | - | 3,000,000 |
| Fixed assets (machinery) from a registered supplier (Note A) | 5,000,000 | 6,000,000 |
| Supplies | | |
| Taxable supplies to registered persons | - | 10,000,000 |
| Taxable supplies to unregistered persons | 2,000,000 | - |
| Exempt supplies to registered persons | 3,800,000 | 5,500,000 |
| Zero rated supplies | 2,500,000 | - |

Note A:

- In case of Taha, the machinery has been used for exempt as well as zero rated supplies.
- In case of Shan, the machinery has been used for taxable supplies only.

All the above figures are **exclusive of sales tax**. 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 each of the above registered persons and input tax to be carried forward, if any, for the tax period February 2020. (13)

- Q.7 (a) Raheel, an unregistered person, runs a garment shop in the posh area of Karachi. He has received a notice from the Commissioner Inland Revenue requiring him to register with the sales tax authorities within 30 days.

Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, advise Raheel regarding the following:

- (i) Whether the Commissioner is justified in issuing the notice to him. (03)
(ii) Would it be necessary for him to respond to the notice. (04)

- (b) Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, discuss the following:

- (i) Difference between zero rated supplies and exempt supplies. (04)
(ii) How and under what circumstances the Inland Revenue Department may recover the amount of sales tax from a person without issuing him a show cause notice. (04)
(iii) Concept of provisional and final adjustments in relation to 'Apportionment of input tax'. (02)

- Q.8 (a) List any **seven** responsibilities of tax administrators arising from best ethical practices. (07)

- (b) State any **six** ethical issues which the administrators may face while discharging their duties. (03)

(THE END)

EXTRACTS FROM THE INCOME TAX ORDINANCE, 2001**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 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% | |

Rate for Profit on Debt

| S. No. | Profit on Debt | Rate of tax |
|---------------|--|--------------------|
| 1. | Where profit on debt does not exceed Rs. 5,000,000 | 15% |
| 2. | Where profit on debt exceeds Rs. 5,000,000 but does not exceed Rs. 25,000,000 | 17.5% |
| 3. | Where profit on debt exceeds Rs. 25,000,000 but does not exceed Rs. 36,000,000 | 20% |