



## 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 Nauman has been working as manager finance in Dua Limited (DL), a public listed company, for many years. He received following monthly emoluments from DL during the year ended 30 June 2021:

	Rupees
Basic salary	120,000
Medical allowance	20,000
House rent allowance	60,000

In addition to the above, the employer also provided him the following benefits:

- (i) Company maintained car for both official and personal use. The car was purchased on 1 July 2016 at the cost of Rs. 1,400,000. As per company policy, Nauman purchased this car at its book value of Rs. 450,000 on completion of five years i.e. 30 June 2021. Fair market value of this car on the date of sale to Nauman was Rs. 1,000,000.
- (ii) Provident fund contribution of Rs. 18,000 per month to a recognized provident fund. An equal amount was also contributed by Nauman to the fund. Interest income of Rs. 540,000 at the rate of 18% of accumulated balance of the fund was credited to Nauman's account.
- (iii) On 1 July 2020, he was transferred to Lahore and was paid relocation allowance of Rs. 300,000.
- (iv) HR Committee approved a performance bonus for the year ended 30 June 2021 for all employees. Nauman received Rs. 400,000 as performance bonus on 15 July 2021.
- (v) On 1 April 2021, Nauman obtained a loan of Rs. 5,000,000 @ 6% per annum from DL to purchase a new house for his own use. First instalment of the loan was paid on 30 June 2021. He incurred legal expenses of Rs. 20,000 for obtaining the loan.

### Other information relevant to tax year 2021:

- (i) During the year, Nauman received interest income of Rs. 510,000 on his investments in defence savings certificates. The amount was net of withholding income tax at the rate of 15% and Zakat of Rs. 200,000 was deducted under the Zakat and Usher Ordinance, 1980.
- (ii) On 1 October 2020, Nauman received advance rent of Rs. 1,200,000 for 12 months for renting office premises. This amount includes Rs. 400,000 for utilities, cleaning and security. During the tax year 2021, Nauman incurred following expenditures in relation to the premises:

	Rupees
Repair and maintenance	70,000
Insurance premium	50,000
Administration and collection charges of rent	30,000
Utility, cleaning and security	250,000

Nauman has opted normal tax regime for chargeability of tax on income from property.

**Required:**

Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute total income and taxable income of Nauman for the tax year 2021. *Show all relevant exemptions, exclusions and disallowances.* (13)

- Q.2 (a) Mukhtar, a resident individual, is in process of finalization of his wealth statement for the tax year 2021. He has provided you the following information:
- (i) During the tax year 2021, Mukhtar received share of profit of Rs. 1,400,000 from an AOP. As on 30 June 2020, his total investment in the AOP was Rs. 5,300,000. He was also provided a car worth Rs. 2,500,000 by the AOP for office use only.
  - (ii) In 2014, he had purchased 10 tola gold for Rs. 500,000. At 30 June 2021, the market value of the gold was Rs. 107,000 per tola.
  - (iii) During the tax year 2021, he sold his personal car for Rs. 1,876,000. The car was purchased in 2019 for Rs. 1,700,000.
  - (iv) During the tax year 2021, he paid Rs. 600,000 against outstanding interest free loan of Rs. 1,000,000. The loan was obtained in tax year 2020.

**Required:**

Under the provisions of the Income Tax Ordinance, 2001 advise Mukhtar that how the above matters would be dealt with in his wealth statement and its reconciliation for the tax year 2021. (04)

- (b) Following information pertains to Ms. Ayesha for the tax year 2021:

	Rs. in million
Income from non-speculation business	15.0
Income from property	3.0
Gain on sale of jewellery	2.5
Gain on sale of listed securities	4.0
Loss from speculation business	(4.5)
Loss on sale of shares of a private company	(3.6)
Loss on sale of antique	(1.6)
Loss on sale of listed securities	(6.0)
Loss from agriculture	(8.0)
Loss from other sources	(19.0)

**Required:**

Under the Income Tax Ordinance, 2001, discuss how the above losses can be set off against her aforesaid incomes. Also discuss the amount of losses that can be carried forward for adjustment against her future incomes. (08)

- Q.3 (a) State the provisions of the Income Tax Ordinance, 2001 relating to each of the following:
- (i) Change of tax year from special to normal (02)
  - (ii) Change in the method of accounting for income chargeable to tax under the head 'income from business' (03)
- (b) Aoun has discovered an error in his annual income tax return which was submitted on the due date. Now he intends to file a revised return voluntarily.

**Required:**

Under the provisions of Income Tax Ordinance, 2001 state the conditions which Aoun must comply with for filing valid revised return. (04)

- Q.4 Abbas, a resident individual, is engaged in the business of manufacturing various consumer goods under the name and style of 'Kamyab Enterprises (KE)'. Following information has been extracted from KE's records for the year ended 30 June 2021:

	<b>Rupees</b>
Sales	43,089,000
Cost of sales	(26,042,000)
Gross profit	17,047,000
Administrative and selling expenses	(7,800,000)
Financial charges	(2,100,000)
Other income	5,560,000
<b>Profit before tax</b>	<b>12,707,000</b>

**Additional information:**

**Cost of sales includes:**

- (i) accounting depreciation of Rs. 1,200,000. The tax written down values of KE's fixed assets on 1 July 2020 were:

	<b>Rupees</b>
Plant and machinery	6,860,000
Computers and related products	800,000
Motor vehicles (80% for business purposes)	3,000,000

A new computer was purchased on 1 April 2021 for Rs. 150,000.

Motor vehicle which was purchased on 15 June 2019 at the cost of Rs. 1,000,000 was sold for Rs. 750,000 on 31 May 2021. Carrying value of this motor vehicle was equal to sale proceeds.

- (ii) an amount of Rs. 40,000 paid to factory supervisor on 23 March 2021 as advance salary for the month of April. Since he was in urgent need of the amount and the banks were closed on 23 March 2021 due to the Pakistan Day, he was paid in cash.

**Administrative and selling expenses include:**

- (i) expenditure on 'In-house scientific research' related to KE's business. It includes salaries of Rs. 880,000 paid to scientists, material of Rs. 230,000 used in the research and Rs. 700,000 paid to a company in China for supporting KE's scientists in the research work. This expenditure was not recorded as intangible asset as it could not provide an advantage for a period of more than one year.
- (ii) an expense of Rs. 650,000 paid as an instalment towards the purchase price of an industrial plot.
- (iii) purchase of goats worth Rs. 225,000 for sacrifice on Eid-ul-Azha. The payment was made through cross cheque.
- (iv) donations of Rs. 1,000,000 to approved non-profit organisations. 40% of this amount was donated to organisations listed on the Second Schedule of the Income Tax Ordinance, 2001. All donations were made through crossed cheques.
- (v) an insurance premium of Rs. 200,000 paid to a registered insurance company for health insurance of Abbas and his dependents.

**Other income includes:**

- (i) an amount of Rs. 720,000 received from income tax department on account of tax refund related to tax year 2018. This amount includes an additional payment of Rs. 80,000 due to delay in tax refund.
- (ii) capital gains of Rs. 430,000 and Rs. 250,000 on sale of investments in shares of Manzil Limited, a public unlisted company and Himmat Limited, a public listed company respectively on 20 June 2021. Both investments were made on 1 January 2019.

**Required:**

Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute total income, taxable income and net income tax payable by or refundable to Abbas for the tax year 2021. (18)

- Note:**
- *Your computation should commence with profit before tax figure of Rs. 12.707 million.*
  - *Ignore minimum tax under section 113.*
  - *Show all relevant exemptions, exclusions and disallowances.*

Q.5 Kamkaj & Co. is an association of persons (AOP) with three members namely Baqir, Omer and Sadabahar (Pvt.) Limited (SPL), sharing profit and loss in the ratio of 20:30:50 respectively.

Following information is available with regard to AOP and its members for the tax years 2020 and 2021:

(i) AOP's income for tax years 2020 and 2021:

	2020	2021
	----- Rupees -----	
Income from business*	(18,000,000)	25,000,000
Dividend income	-	4,000,000

\*Net of annual fixed commission of Rs. 7,000,000 to SPL

- (ii) On 1 February 2021, Baqir earned capital gain of Rs. 5,200,000 on sale of his property which was purchased on 1 January 2018.
- (iii) Omer also operates a sole proprietor business from which he earned profits of Rs. 6,000,000 and Rs. 2,500,000 in tax years 2020 and 2021 respectively.

**Required:**

Under the provisions of the Income Tax Ordinance, 2001 compute the following for the tax years 2020 and 2021:

- Taxable income of AOP
- Taxable income and tax liability of Baqir and Omer (10)

- Note:**
- *Show all relevant exemptions, exclusions and disallowances.*
  - *Tax rates for tax year 2020 are the same as tax year 2021.*
  - *Ignore minimum tax under section 113.*

Q.6 (a) In the light of the provisions of Sales Tax Act, 1990 and Rules made thereunder, briefly explain as to the chargeability/adjustment of sales tax in respect of each of the following independent matters:

- (i) Free provision of taxable goods to the company's CEO as per the terms of his employment.
- (ii) Free replacement of defective parts in the case of taxable goods, sold under warranty.
- (iii) Payment of machine fuel by one of the directors using his own credit card. The machine is used to manufacture taxable goods.
- (iv) Taxable goods sold on instalment to a customer at a price inclusive of mark up.
- (v) Advance payment received against taxable goods to be supplied to a registered person in next month.
- (vi) Local supplies of goods manufactured by a cottage industry.
- (vii) Material purchased for the construction of office building.
- (viii) Electronic cash register purchased for retail outlet. (08)

(b) Under the Sales Tax Act, 1990 and Rules made thereunder, briefly describe temporary sale tax registration. Also state the rights, obligations and responsibilities of a person holding temporary registration. (05)

- Q.7 Mehrban Associates (MA) is registered under the Sales Tax Act, 1990. MA is engaged in the business of manufacturing and supplying of various consumer goods. Following information is available from MA's records for the month of August 2021:

	Rupees
<b>Purchases</b>	
Taxable goods from registered persons	4,960,000
Taxable goods from unregistered persons	1,400,000
Exempt goods from unregistered persons	520,000
<b>Supplies</b>	
Taxable goods to registered persons	8,650,000
Taxable goods to unregistered persons	1,560,000
Exempt goods to local unregistered persons	1,740,000
Export of taxable goods to UAE	1,300,000
Export of exempt goods to UAE	1,900,000

**Additional information:**

- (i) Taxable goods from registered persons include:
- materials worth Rs. 296,000, which were exclusively used for manufacturing exempt supplies.
  - materials worth Rs. 675,000, which were exclusively used for manufacturing export related goods.
  - goods worth Rs. 150,000 which were purchased in cash from a supplier.
  - 500 kg of tea purchased at a cost of Rs. 360,000 in one kg packing, covered under Third Schedule. Retail price of tea per kg is Rs. 900. By end of August 2021, 300 kg were supplied to an unregistered wholesaler at a price of Rs. 790 per kg.
- (ii) Taxable goods supplied to unregistered persons include goods worth Rs. 320,000 which were sold to a customer who did not provide his CNIC or NTN details. These goods were purchased from a registered supplier for Rs. 275,000 during August 2021.
- (iii) Following fixed assets were purchased during the month of August 2021:

Fixed assets	Purchase cost (Rs.)	Usage
Machine A	2,000,000	To ensure quality standards of packing for exports
Machine B	3,000,000	To manufacture taxable (local) as well as exempt (local) goods
Furniture and fittings	1,000,000	To use in office premises

- (iv) Electricity bill of Rs. 959,450 was paid in cash. The bill was inclusive of sales tax of Rs. 154,250.
- (v) Sales tax credit brought forward from last month amounted to Rs. 1,137,580.
- (vi) Input tax of Rs. 186,000 pertaining to purchase made on 1 February 2021 was inadvertently remain unclaimed.

All the above figures are exclusive of sales tax, except where it is specified 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 MA and input tax to be carried forward, if any, for the tax period August 2021. (*Show all relevant exemptions, exclusions and disallowances*)

Q.8 (a) State **one** objective of tax laws in each of the following independent cases:

- (i) High tax rate on import of goods
- (ii) Zero rating under the Sales Tax Act, 1990
- (iii) Decrease in sales tax rate
- (iv) Tax on cash deposit/withdrawal by non-filer
- (v) Introduction of tax holiday period for construction related industries
- (vi) High tax rate on interest income
- (vii) Decrease in tax rate for online sales
- (viii) Tax credit to persons employing fresh graduates
- (ix) High tax rates on luxury items
- (x) Allow expenditure on research and development

(05)

(b) List the fundamental principles of ethics for tax practitioners. Also describe any **one** of the principles.

(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

#### Initial allowance

The rate of initial allowance u/s 23 shall be 25% for plant and machinery.

#### Depreciation rates

1.	Plant and machinery	15%
2.	Computer and IT products	30%
3.	Motor vehicles	15%

#### Tax on capital gains on disposal of securities

The rate of tax to be paid under section 37A shall be 15%.

#### Tax on capital gain on disposal of immovable property

S. No.	Amount of gain	Rate of tax
1.	Where the gain does not exceed Rs. 5 million	2.5%
2.	Where the gain exceeds Rs. 5 million but does not exceeds Rs. 10 million	5%
3.	Where the gain exceeds Rs. 10 million but does not exceeds Rs. 15 million	7.5%
4.	Where the gain exceeds Rs. 15 million	10%