Certificate in Accounting and Finance Stage Examination

The Institute of Chartered Accountants of Pakistan

1 March 2021
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.

Q.1 (a) On 31 December 20X1, Dr. Jamal resigned from his employment with General Hospital Limited. In January 20X2, he received following amounts in final settlement:

- Rs. 600,000 as leave encashment.
- Rs. 8,510,000 from recognised provident fund.
- Rs. 1,300,000 and Rs. 1,700,000 as salary arrears relating to tax year 20W9 and 20X0 respectively.

Dr. Jamal had received a monthly salary of Rs. 500,000 from July 20X1 to December 20X1. His taxable income and tax liability during the preceding four tax years were as under:

Tax year	**20W8**	**20W9**	**20X0**	**20X1**
Total taxable income (Rs.)	2,800,000	3,200,000	3,800,000	4,800,000
Total tax paid (Rs.)	359,500	404,500	300,000	630,000

Required:
As a tax consultant, advise Dr. Jamal about the amount of income tax payable by him for the tax year 20X2, under the Income Tax Ordinance, 2001. **(07)**
(Tax rates are given on the last page)

(b) Dr. Jamal is planning to establish a hospital as a non-profit organization.

Required:
Discuss the conditions that should be complied with by Dr. Jamal, under the Income Tax Ordinance, 2001. **(03)**

Q.2 (a) What do you understand by the term 'Turnover' as provided in section 113 of the Income Tax Ordinance, 2001? List the persons who are required to pay minimum tax on the basis of turnover. **(08)**

(b) Gillani and Company (GC), a sole proprietor, is dealing in various consumer products in Pakistan. During the year ended 30 June 20X2, GC's taxable income for the year was Rs. 1.6 million.

Required:
Under the provisions of the Income Tax Ordinance, 2001 compute the amount of net income tax payable by GC and amount of income tax to be carried forward, if any, for the tax year 20X2, in each of the following situations:

(i) GC's sales were Rs. 12,500,000 inclusive of sales tax.
(ii) GC's sales were Rs. 11,000,000 inclusive of sales tax. **(05)**
(Tax rates are given on the last page)

Q.3 Muhammad Asghar owns an industrial undertaking under the name and style of Asghar & Company (AC) which is engaged in the business of manufacturing pharmaceutical products. Following information is available for the year ended 31 December 20X1:

	Rs. in '000
Turnover	324,850
Cost of goods sold	(217,197)
Gross profit	107,653
Administrative and distribution expenses	(88,980)
Marketing expenses	(19,765)
Other income	3,560
Profit before tax	**2,468**

Additional information:

(i) Cost of goods sold includes:

- raw materials of Rs. 7,800,000. No withholding tax was deducted at the time of payment.
- accounting depreciation of Rs. 2,100,000 on plant and machinery.
- provision for slow moving inventory of Rs. 1,800,000.

(ii) Administrative and distribution expenses include:

- Rs. 676,500 paid to a local hotel for holding annual Eid-Milan party for the employees and their families.
- Rs. 1,235,000 paid as penalty to a customer in settlement of his claim for damages under a contract for the supply of a batch of vaccines. Laboratory tests and in-house investigations revealed that the level of impurities in the vaccines exceeded the acceptable level as agreed in the contract.
- Rs. 2,300,000 paid as donation to a hospital established by the local government.

(iii) Marketing expenses include a reward of Rs 500,000. The reward was paid in cash to one of the salesmen for exceeding his sales target.

(iv) Other income includes:

- dividend of Rs. 174,000. This amount was received from a listed company after deduction of income tax at the rate of 15% and Zakat of Rs. 30,000 deducted under the Zakat and Usher Ordinance, 1980.
- gain of Rs. 660,000 on sale of shares in Akash (Pvt) Limited (APL) in November 20X1. 60% of the shares in APL are owned by the Federal Government. AC purchased these shares in June 20X0.

Other information:

(i) A second hand plant was imported from France at a cost of Rs. 2,500,000. Withholding tax of Rs. 150,000 was deducted at import stage. The plant was installed in the month of September 20X1. AC incurred Rs. 375,000 on the installation of plant which is included in administrative and distribution expenses.

(ii) Pre-commencement expenditures of Rs. 3,400,000 were charged to accounting profit and loss for the year ended 31 December 20X0. However, for tax purposes, it has to be amortized over the period of five years.

(iii) Tax depreciation other than imported plant amounted to Rs. 1,900,000.

(iv) Income tax deducted by the customers u/s 153 and advance income tax paid u/s 147 during the year amounted to Rs. 1,400,000 and Rs. 200,000 respectively.

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 AC for the tax year 20X2. **(19)**

Note:
- ***Your computation should commence with profit before tax figure of Rs. 2,468K.***
- ***Ignore minimum tax under section 113.***
- ***Show all relevant exemptions, exclusions and disallowances.***
- ***Tax rates are given on the last page.***

Q.4 (a) On 1 July 20X1, Mrs. Ahmed separated from her spouse and decided to live apart with her six years old son. Below are the extracts of clauses from the agreement to live apart:

(i) Mr. Ahmed will pay Rs. 50,000 in cash every month to his spouse.
(ii) Mr. Ahmed will continue to pay his son's monthly school fee of Rs. 10,000.
(iii) Mr. Ahmed will transfer the ownership of a shop in her spouse's name. The shop was already in use by a tenant at a monthly rent of Rs. 88,000. Mrs. Ahmed will be entitled to receive the rent from the date of transfer of ownership in her name.

On 1 September 20X1, the ownership of the shop was transferred in her name.

Required:
Under the provision of the Income Tax Ordinance, 2001 briefly explain the tax treatment of the above arrangement in the income tax return of Mrs. Ahmed for the tax year 20X2. Also specify the head of income under which each of the above receipts will be classified. **(04)**
(Computation is not required)

(b) Briefly explain the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder relating to:

(i) interest free loan provided by an employer to its employee for marriage of his/her daughter. **(02)**
(ii) requirement of books of account to be maintained by a manufacturer having turnover exceeding Rs. 2.5 million. **(04)**
(iii) order of application of various tax credits if a taxpayer is allowed more than one tax credit for a tax year. **(03)**

Q.5 Star Garments Limited (SGL) had filed its tax return for the tax year 2015 on 30 September 2015.

On 25 February 2021, the Commissioner of Income Tax, on the basis of definite information, issued a notice u/s 122 (5) to SGL for the audit of books of account for the tax year 2015.

The accountant informed the chief executive officer that tax audit for the tax year 2015 had already been conducted in 2019 and an amended assessment order u/s 122(5A) was issued by the Commissioner on 24 February 2020.

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

(a) explain the term 'Definite information'. **(02)**
(b) discuss whether the Commissioner is empowered to make further amendment in the assessment order issued on 24 February 2020. **(07)**

Q.6 Hadi Associates (HA), a sole proprietor business, is registered under the Sales Tax Act, 1990 as manufacturer cum importer and is engaged in the manufacturing and supply of consumer products. Following information has been extracted from HA's records for the month of February 2021:

	Rupees
Supplies	
Taxable goods to registered customers	2,750,000
Taxable goods to un-registered customers	1,050,000
Exports of taxable goods to Saudi Arabia	1,500,000
Purchases	
Taxable goods from registered suppliers	1,890,000
Taxable goods from un-registered suppliers	1,000,000
Packing material from un-registered suppliers	445,000

Additional information:

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

- goods worth Rs. 225,000 (net of special discount of Rs. 75,000). These goods were sold to an associated undertaking. The special discount was not reflected on the invoice.
- goods worth Rs. 120,000 supplied to a customer in Multan. HA had received full payment against the goods in November 2020.

(ii) Supplies of taxable goods to unregistered customers include sales of Rs. 130,000 to end consumers.

(iii) Purchases from registered suppliers include:

- goods worth Rs. 100,000 purchased from Haq Enterprises on 5 February 2021. On 20 February 2021, Haq Enterprises informed HA that with effect from 1 February 2021, its registration has been suspended by the Commissioner Inland Revenue.
- goods worth Rs. 85,000 purchased in cash.
- goods worth Rs. 50,000 purchased from AB Traders. The supplier did not declare the sale of these goods in its tax return for the month of February 2021.

(iv) Taxable goods worth Rs. 150,000 were used in the business meeting held for the promotion of HA's business.

(v) A machine costing Rs.2,500,000 was acquired and commissioned into operation in February 2021. The machine was used for both taxable and zero rated supplies.

(vi) Electricity bill of Rs. 90,000 for the month of September 2020 was paid in October 2020. However, related input tax of Rs. 13,000 has still inadvertently remained unclaimed.

(vii) The auditors have proposed to make a provision of 50% against obsolete and expired stock of Rs. 350,000. The goods are lying in warehouse since July 2017. Input tax relating to this stock was claimed in July 2017.

(viii) Sales tax credit of Rs. 415,000 has been brought forward from previous tax period.

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 HA and input tax to be carried forward, if any, for the tax period February 2021. **(16)**

Q.7 (a) Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, briefly explain the following:

(i) how and under what situations the Inland Revenue Department may recover the amount of sales tax from a person without issuing him a show cause notice. **(04)**

(ii) extra tax and capacity tax. **(05)**

(b) On 4 February 2021, it was revealed to Fahad that he inadvertently reported an output sales tax of Rs 27,000 in a tax invoice, issued on 5 July 2020, to a customer instead of Rs. 72,000 in his sales tax return for July 2020.

Required:
In the light of the Sales Tax Act, 1990 and Rules made thereunder, advise how Fahad can rectify this error after the expiry of 180 days. **(03)**

Q.8 (a) Taxes are primary revenue yielding tools of the Government of modern ages. State any **five** ways by which taxes can be used for the development of the country. **(05)**

(b) List **six** types of taxes which are covered within the legislative powers of Provinces. **(03)**

(THE END)

EXTRACTS FROM THE INCOME TAX ORDINANCE, 2001

Tax rates for salaried individuals

S. No.	Taxable income	Rate of tax
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
9.	Where taxable income exceeds Rs. 12,000,000 but does not exceed Rs. 30,000,000	Rs. 2,345,000 plus 27.5% of the amount exceeding Rs. 12,000,000

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 securities

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

Minimum tax under section 113

The minimum tax as percentage of the person’s turnover for the year is 1.5%.

Depreciation rates under Third Schedule

The depreciation plant and machinery is 15%

Initial allowance

The rate of initial allowance shall be 25% for plant and machinery.