Certified Finance and Accounting Professional Stage Examinations

The Institute of Chartered Accountants of Pakistan

10 December 2016
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Taxation

Q.1 Multi-Tasking Limited (MTL) is a listed company engaged in the business of manufacturing, export and supply of various products and services. Following information has been extracted from MTL's records for the year ended 30 September 2016.

	Rupees
Gross sales:	
▪ Goods	17,000,000
▪ Services	10,000,000
	27,000,000
Cost of goods sold and services rendered	(18,400,000)
Gross profit	8,600,000
Administrative and selling expenses	(4,900,000)
Financial charges	(2,100,000)
Other income	3,700,000
Profit before taxation	5,300,000

Additional information:

Gross sales includes:

(i) Sale of beverages of Rs. 9,000,000 to one of the distributors. MTL did not collect advance tax at the rate of 0.1% at the time of sale to distributors.

(ii) Rs. 1,500,000 in respect of interior decoration services provided to Lulu Enterprises. Withholding tax deducted from the payment u/s 153 amounted to Rs. 120,000. MTL earned a net profit of Rs. 400,000 on this sale.

Cost of goods sold and services rendered includes:

(i) Purchase of imported beverages of Rs. 6,900,000 from Bali Enterprises (BE), which is a permanent establishment in Pakistan of a non-resident manufacturer in Iran. BE sold 60% of the beverages in the same condition as they were imported whereas 40% of the beverages were sold after adding special preservatives to suit the local conditions. MTL made full payment without deduction of withholding tax at the rate of 4.5% of the gross amount payable to BE.

(ii) A donation of Rs. 350,000 paid to the Citizens Foundation, listed in the Second Schedule of the Income Tax Ordinance, 2001.

Administrative and selling expenses include:

(i) Annual listing fee of Rs. 182,500 paid to Pakistan Stock Exchange Limited.

(ii) Bad debt of Rs. 200,000 written off against a loan provided to one of MTL's previous directors for the construction of a dwelling house.

(iii) Loss of Rs. 1,000,000 sustained by MTL on discontinuance of its print media business in July 2015.

(iv) Computer software of Rs. 2,800,000. The software was acquired on 25 February 2016 with an estimated useful life of 4 years.

Financial charges include:

(i) Lease rentals of Rs. 900,000 paid to an approved Modaraba company in respect of a car obtained on finance lease for marketing manager. The car was used 70% for business and 30% for personal purposes.

(ii) Profit on debt of Rs. 680,000 paid to International Finance Corporation (IFC), a non-resident, established under the IFC Act, 1956 and mentioned in the Second Schedule. MTL did not withhold tax from the payment.

Other income includes:

(i) Rent of Rs. 1,170,000 received on account of machinery provided on hire to Bhola Limited. The rent was received after deduction of withholding tax of Rs. 130,000. MTL did not incur any expenditure on letting out the machinery to Bhola Limited.

(ii) Rs. 2,500,000 in respect of export of web hosting services to a company in Malaysia. 82% of the export proceeds have been received in Pakistan in foreign exchange, equivalent to MYR 89,100 through normal banking channel.

Further information:

(i) During the year, MTL purchased computer hardware for Rs. 575,000, professional books for Rs. 400,000 and furniture and fixtures for Rs. 625,000. These assets remained in use for 146 days during the year ended 30 September 2016. MTL did not charge any depreciation on these assets.

(ii) MTL has filed an option to opt out of the final tax regime (FTR).

(iii) Tax paid by MTL u/s 147 amounted to Rs. 1,530,000.

(iv) Assume that accounting depreciation charged during the year, on assets which existed on 1 October 2015, is the same as their tax depreciation and that no common expenses were incurred by MTL during the year.

Required:

Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute, under the correct head of income, the total income, taxable income and net tax payable by or refundable to MTL for the tax year 2017. **(15)**

Note:
- ***Your computation should commence with the profit before tax figure of Rs. 5,300K.***
- ***Ignore WWF, WPPF, Minimum tax, Alternative Corporate Tax and default surcharge.***
- ***Show all relevant exemptions, exclusions and disallowances.***
- ***Tax rates are given on the last page.***

Q.2 Briefly describe **five** fundamental principles of ethics for tax practitioners. **(05)**

Q.3 (a) 'Every person deriving income from business chargeable to tax, who has been issued a National Tax Number (NTN), shall display his NTN at a conspicuous place at every place of his business'.

Under the provisions of the Income Tax Rules, 2002 list the circumstances in which the above persons are also required to quote their NTN. **(04)**

(b) In view of the provisions of the Income Tax Ordinance, 2001 describe the circumstances in which the Commissioner may recharacterise or disregard a transaction. **(03)**

(c) With reference to the relevant provisions of the Income Tax Ordinance, 2001 briefly discuss the tax treatment of transactions in each of the following independent cases:

(i) On 1 June 2016, Wajahat received a loan of Rs. 600,000 from his brother in cash for the purchase of a new car. Wajahat repaid the loan on 1 August 2016. **(02)**

(ii) On 31 May 2016 Wahab sold securities of the face value of Rs. 350,000 to his friend Naeem with the condition to acquire them back on 15 July 2016. The profit accrued on the securities amounted to Rs. 52,500. On 30 June 2016 Naeem received the profit on securities. On 15 July 2016 Wahab re-acquired the same securities from Naeem. **(03)**

(iii) Moiz transferred his warehouse situated in Malir to Arif by way of a revocable deed. Arif derives annual income of Rs. 800,000 from the warehouse. **(02)**

(iv) After incurring losses of Rs. 1,000,000 and Rs. 2,500,000 in tax years 2014 and 2015 respectively, the Directors of Gama Limited made a strategic decision and changed 80% of the underlying ownership of Gama Limited. The new management discontinued company's old business and earned a profit before tax of Rs. 4,000,000 for the year ended 30 June 2016. **(04)**

Q.4 Arzu Limited (AL) is engaged in multiple businesses in Karachi and is registered with Inland Revenue Department for sales tax purposes. Following information has been extracted from AL's records for the month of November 2016:

(i) Purchase of raw material of Rs. 5,000,000 from persons registered under the Sales Tax Act, 1990 as adapted in Azad Jammu and Kashmir.
(ii) Purchase of raw materials of Rs. 2,750,000 from un-registered suppliers.
(iii) Import of finished goods worth Rs. 2,500,000 from Berlin. The goods declaration statement shows that only 60% of the amount of duty and sales tax has been paid to Custom authorities against such import.
(iv) Purchase of agricultural equipment, covered under Eight Schedule, at Rs. 150,000. The equipment is chargeable to sales tax at the rate of 7%.
(v) A debit note of Rs. 325,000 was received from one of the suppliers. AL has not yet issued the corresponding credit note.
(vi) Sale of taxable goods of Rs. 2,300,000 and Rs. 1,350,000 to registered and un-registered customers respectively.
(vii) A consignment of chemical worth Rs. 1,800,000 was supplied to registered manufacturers belonging to five major export sectors, as specified in the Sales Tax Act, 1990.
(viii) Free distribution of 2,000 boxes of biscuits at an annual prize distribution ceremony of an un-registered school in Hyderabad. The biscuits were manufactured at AL's confectionery factory and are sold in the market at Rs. 70 per box. The biscuits are designated as specified goods under Chapter XIII of the Sales Tax Special Procedures Rules, 2007.

Following further information has been provided by AL's internal auditors on completion of sales tax audit during tax period November 2016:
(i) Unpaid sales tax invoices of Rs. 600,000 received against purchase of taxable goods have not been claimed by AL in any of its tax returns. These invoices pertain to tax period June 2016.
(ii) In June 2016 AL inadvertently charged output tax of Rs. 59,000 to one of its customers as against the actual amount of Rs. 95,000. After detection of error in November 2016, proper debit and credit notes were raised in this regard.
(iii) In September 2016, AL failed to collect federal excise duty on sale of imported cosmetics of Rs. 425,000 to Maldar Traders. The tax manager has accepted his negligence in this regard.
(iv) In October 2016 AL paid courier and shipping charges of Rs. 75,000 to Asan Agencies, a service provider registered under a Provincial Revenue Board, without withholding sales tax at the applicable rate of $1/5^{th}$ of the amount of sales tax.
(v) In October 2016, AL claimed input tax credit of Rs. 85,000 on purchase of taxable goods from Mahee Enterprises (ME). On 1 November 2016 ME was blacklisted by the Commissioner due to a tax fraud.
(vi) Withholding sales tax of Rs. 180,000, deducted by a customer was claimed by AL in October 2016 return. The MIS report of sales tax return however indicates that the customer has not yet accounted for the withheld amount in his sales tax return.
(vii) In October 2016 imported stationery of Rs. 125,000 was consumed by the son of AL's director. AL did not pay any output tax on such consumption.

All the above figures are **exclusive of excise duty and sales tax**, wherever applicable. Sales tax is payable at the rate of **17%**, except for items specified in Eight Schedule**,** whereas excise duty, if any, is payable at the rate of **16%**.

Required:
In the light of the provisions of the Sales Tax Act, 1990, Federal Excise Act, 2005 and Rules made thereunder, compute the amount of sales tax payable by or refundable to AL for the tax period November 2016. Also compute withholding tax, wherever applicable. **(19)**
Note: ***Show all relevant exemptions, exclusions and disallowances.***

Q.5 (a) In the light of the Federal Excise Act, 2005 briefly describe the provisions relating to the following:

(i) filing of a revised return **(02)**

(ii) filing of special return in respect of goods and services **(04)**

(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 November 2016, due to the death of one of AA's partners and subsequent closure of the firm for a period of 20 days, the October 2016 return could not be filed on time. The amount of duty due for October 2016 amounted to Rs. 600,000. The management has decided to file its October 2016 return and pay the duty due along with its November 2016 return on 15 December 2016. 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 October 2016. **(05)**

Q.6 For the purpose of this question, **assume that the date today is 15 August 2017**.

Noman is a resident person. He is a sole proprietor and is engaged in the business of providing embroidery services to various export houses in Punjab. Following information has been provided by Noman for the purpose of filing his tax return for the year ended 30 June 2017.

(i) On 1 July 2015 he purchased 15,000 shares in Zed Limited (ZL) for Rs. 375,000. On 1 July 2016 ZL granted letter of rights to its shareholders to acquire 2 shares in ZL for every 3 shares held at Rs. 20 per share. The rights were credited to the respective shareholders' account on 1 October 2016 when the market value of each share was Rs. 22. On 5 November 2016 Noman sold 10,000 shares in ZL for Rs. 230,000. On the same date he also sold the letter of rights for Rs. 50,000.

(ii) On 15 January 2017 Noman gave 5,000 shares in ZL to his son Obaid by way of a gift. Obaid was studying in Germany and had come to Pakistan after two years to visit his parents for a period of one month. The market value of each share at the time of gift was Rs. 28.

(iii) On 1 June 2017 Noman sold machinery relating to his embroidery business for Rs. 600,000. The machinery was purchased on 1 May 2016 at a special discounted price of Rs. 525,000 and was in use for providing stitching services to an export house in Multan. The book value of the machinery at the time of sale was Rs. 468,125.

(iv) For the year ended 30 June 2017 Noman received gross sales value of Rs. 2,000,000 from export houses through normal banking channel and paid withholding tax of Rs. 10,000 on such receipts. He earned a profit before tax of Rs. 300,000 during the year.

(v) On 15 June 2017 Noman sold a cow for Rs. 150,000. The cow was purchased on 1 January 2015 at a price of Rs. 100,000 for the use of his family.

(vi) On 30 June 2017 Noman received insurance claim of Rs. 830,000 in a single transaction against theft of two antique paintings. Painting-1 was purchased on 1 July 2016 at a cost of Rs. 445,000 whereas Painting-2 was purchased on 15 July 2016 at a cost of Rs. 403,000. The fair market value of Painting 1 and Painting 2 at the time of theft was estimated at Rs. 459,000 and 441,000 respectively.

Required:
Under the Income Tax Ordinance, 2001 and Rules made thereunder, compute, under the relevant head of income, the total income, taxable income and tax payable by or refundable to Noman for the year ended 30 June 2017. Give brief reasons for your treatment of the items in (ii), (iii) and (v) above. **(19)**

Note:
- ***Show all relevant exemptions, exclusions and disallowances.***
- ***Tax rates are given on the last page.***

Q.7 (a) Under the provisions of the Sales Tax Act, 1990 when an order is treated to be properly served under the following cases:

(i) resident individual other than in a representative capacity **(04)**
(ii) association of persons when dissolved **(02)**

(b) Under the provisions of the Sales Tax Special Procedures Rules, 2007 value addition tax is levied at import stage on imports of taxable goods. State the circumstances in which the value addition tax shall not be charged. **(03)**

(c) Under the provisions of the Provincial Sales Tax on Services Acts, briefly describe the following:
(i) 'provision of service' or 'providing of service' **(02)**
(ii) public relations services **(02)**

(THE END)

EXTRACTS FROM THE INCOME TAX ORDINANCE, 2001

The First Schedule
Part I Division I
Tax Rates for Every Individual and Association of Person Except for Salaried Taxpayer

S. No.	Taxable income	Rate of tax
1.	Upto Rs. 400,000	0%
2.	Exceeds Rs. 400,000 but does not exceed Rs. 500,000	7% of the amount exceeding Rs. 400,000
3.	Exceeds Rs. 500,000 but does not exceed Rs. 750,000	Rs. 7,000 + 10% of the amount exceeding Rs. 500,000
4.	Exceeds Rs. 750,000 but does not exceed Rs. 1,500,000	Rs. 32,000 + 15% of the amount exceeding Rs. 750,000
5.	Exceeds Rs. 1,500,000 but does not exceed Rs. 2,500,000	Rs. 144,500 + 20% of the amount exceeding Rs. 1,500,000
6.	Exceeds Rs. 2,500,000 but does not exceed Rs. 4,000,000	Rs. 344,500 + 25% of the amount exceeding Rs. 2,500,000
7.	Exceeds Rs. 4,000,000 but does not exceed Rs. 6,000,000	Rs. 719,500 + 30% of the amount exceeding Rs. 4,000,000
8.	Above Rs. 6,000,000	Rs. 1,319,500 + 35% of the amount exceeding Rs. 6,000,000

Part I Division II
Rates of Tax for Companies

1. The rate of tax imposed on the taxable income of a public/private company shall be 31%.
2. The rate of tax imposed on the taxable income of a small company shall be 25%.

Part I Division VII
Capital Gains on disposal of Securities

1.	Where holding period of a security is less than 12 months.	15%
2.	Where holding period of a security is 12 months or more but less than 24 months.	12.5%
3.	Where holding period of a security is 24 months or more but the security was acquired on or after 1st July, 2012.	7.5%

Part III Division II
Payments to non-residents

2. The rate of tax to be deducted from payments referred to in sub-section (2) of section 152 (including profit on debt) shall be 20% of the gross amount paid.

THE THIRD SCHEDULE
Part I
Depreciation Rates

1.	Building (all types)	10%	2.	Furniture and fittings	15%
3.	Plant and machinery	15%	4.	Motor vehicles (all types)	15%
5.	Computer hardware	30%			

Part II
Initial Allowance and First Year Allowance

The rate of initial allowance for eligible depreciable assets shall be 25%.