The Institute of Chartered Accountants of Pakistan

Certified Finance and Accounting Professional Stage Examination

10 June 2017
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Taxation

Q.1 Bismil Limited (BL) is a listed company engaged in the business of manufacturing and supply of multiple products across the country. Following information has been extracted from BL's records for the year ended 31 December 2016.

	Rupees
Sales	160,000,000
Cost of sales	(112,000,000)
Gross profit	48,000,000
Administrative and selling expenses	(20,000,000)
Financial charges	(5,000,000)
Other income	2,000,000
Profit before taxation	25,000,000

Additional information:

Sales include:

(i) An amount of Rs. 15,000,000 received net of withholding tax at the rate of 4% of the gross value of sales against sale of electric motors to a person registered under the Sales Tax Act, 1990.

(ii) Sale of a product to an associated company for Rs. 250,000. The fair market value of the product was Rs. 200,000.

Administrative and selling expenses include:

(i) Rs. 900,000 paid to Shams Associates in respect of financial due diligence of a company which BL is planning to acquire.

(ii) An amount of Rs. 425,000 in respect of write off of an old machine which is no longer used by BL in its business operations. The accounting and tax written down values of the machine were the same. The machine is expected to fetch Rs. 5,000 if sold in the open market.

(iii) A penalty of Rs. 150,000 imposed by the Commissioner for short payment of tax in the year 2015.

(iv) An amount of Rs. 385,000 incurred on entertainment of CEO's guests at a hotel in Karachi.

(v) Rs. 125,000 incurred on account of industrial training of Murad, a Pakistani citizen working at BL's competitors in connection with a scheme approved by the Federal Board of Revenue. Murad is also the nephew of BL's CEO.

Financial charges include:

(i) Profit on debt of Rs. 3,230,000 paid to non-resident persons in China. BL had issued securities in China for the purpose of raising loan to be used for its business in Pakistan. These securities were approved by the Federal Board of Revenue. BL did not deduct withholding tax from the payment.

Other income includes:

(i) A monetary award of Rs. 1,000,000 granted by the President of Pakistan for best corporate practices in the year 2016. Besides, an amount of Rs. 300,000 was conferred by the Governor of Sindh for BL's contribution in rural development.

(ii) Rs. 500,000 on account of service charges charged and kept by BL out of tax withheld from suppliers.

(iii) Rs. 120,000 received in respect of inter-corporate dividend from a subsidiary within the group. BL owns 75% interest in the subsidiary. No withholding tax was deducted by the subsidiary.

Further information:

(i) Tax paid by BL u/s 147 amounted to Rs. 5,300,000.

(ii) Assume that tax depreciation on all assets is the same as their accounting depreciation.

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 BL for the tax year 2017. **(16)**

Note:
- ***Your computation should commence with the profit before tax figure of Rs. 25,000 K.***
- ***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 (a) Under the provisions of the Income Tax Ordinance, 2001 compute the amount of deduction to be allowed in computing 'Income from business' in each of the following independent cases. Also give brief reason(s) for treatment of items in (iii) and (iv) below:

(i) Alpine Pharmaceuticals Limited incurred advertisement and sales promotion expenses of Rs. 1,300,000 and exceeded its target of annual turnover of Rs. 20,000,000 by 7%. **(02)**

(ii) Sigma (Pvt) Limited (SPL) incurred interest expense of Rs. 7.5 million on a debt of US$ 1.06 million (equivalent to PKR 113 million) obtained during the year from Big Inc., a company incorporated in USA. SPL is 85% owned by Big Inc. The debt was obtained to finance a project approved by the Federal Government and the repayment of the principal was to commence after two years. At the end of the year, SPL had total assets of Rs. 350 million, total liabilities of Rs. 190 million and it earned a net profit after taxation of Rs. 120 million during the year. **(06)**

(iii) Raja Limited purchased items of promotional give-aways from the website of a company in China for Rs. 300,000. Raja Limited did not deduct withholding tax from the payment. **(02)**

(iv) Neo Limited (NL) purchased raw materials of Rs. 700,000 during the year from Duo Limited (DL). NL paid the amount by way of online transfer of funds from its business bank account to the bank account of one of DL's directors without deducting withholding tax of Rs. 28,000. **(03)**

(b) What do you understand by 'Pledge call transaction'? Briefly describe the tax treatment of a pledge call transaction under the Income Tax Rules, 2002. **(05)**

(c) In determining the income of a person from a transaction with an associate the Commissioner shall apply arm's length standard. Under the provisions of the Income Tax Rules, 2002 list the methods which the Commissioner may apply for the purposes of determining an arm's length result. **(02)**

Q.3 Under the provisions of the Federal Excise Act, 2005 and Rules made thereunder, explain the following:

(a) Franchise and Franchiser **(05)**

(b) Circumstances under which adjustment of excise duty on input goods may be admissible for determining net liability of duty in respect of any goods manufactured **(03)**

(c) Conditions under which the Board may grant drawback of duty to a taxpayer **(03)**

Q.4 For the purpose of this question, **assume that the date today is 15 August 2017**.

Rahat and Musa are partners in RM Associates (RMA), a firm engaged in the business of providing consultancy and book keeping services to clients in Pakistan as well as abroad. Rahat and Musa share profits and losses in the ratio of 4:5 respectively. Following is an extract from RMA's profit and loss account for the year ended 30 June 2017:

	Rupees
Net revenue	36,500,000
Less:	
Salaries	(19,780,000)
Rent	(1,250,000)
Depreciation/amortization (accounting)	(1,680,000)
Software expense	(650,000)
Interest expense	(135,000)
Other expenses	(1,655,000)
Total expenses	(25,150,000)
Income before tax for the year	11,350,000

Additional information:

(i) Net revenue includes the following:
- Retainership fee of Rs. 19,710,000 from corporate clients. Withholding tax at the rate of 7% of the gross receipt was deducted by such clients and the amount is included in other expenses.
- An amount of Rs. 6,210,000 received under an agreement from a Doha based company, Isra Middle East, for providing technical services in Doha. The amount was brought into Pakistan in foreign exchange in compliance with the regulations of the State Bank. No tax was deducted from the receipt either in Doha or in Pakistan by the bank.
- Rs. 10,580,000 on account of on-line accounting services provided to various clients in Iran and Afghanistan. The amount was received in foreign exchange through normal banking channel. Withholding tax at the rate of 1% of the gross receipts was deducted by the collecting bank and the amount is included in other expenses.

(ii) Salaries include Rs. 290,000 and Rs. 355,000 respectively paid to Rahat and Musa per month.

(iii) The rent was paid in respect of office premises to Lalazar Limited. RMA did not deduct withholding tax from the payment.

(iv) Software expense represents purchase of a software on 1 January 2017.

(v) Interest expense was in relation to a vehicle obtained on finance lease. Lease rentals paid during the year amounted to Rs. 800,000. The lease term of the vehicle ended on 1 June 2017, on which date RMA acquired the vehicle at a residual value of Rs. 950,000. The market value of the vehicle at the date of its transfer to RMA was estimated at Rs. 1,150,000.

(vi) The tax written down values of RMA's assets on 1 July 2016 were as follows:

Assets	**Rupees**
Furniture and fixtures	1,700,000
Computers and laptops	840,000
Accounting software (remaining life of 5 years)	5,000,000

Required:

Under the provisions of the Income Tax Ordinance, 2001 compute the taxable income and net tax liability of RMA for the tax year 2017. **(16)**

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

Q.5 Pasdar Limited (PL) is engaged in the business of production, import and trading of variety of products and is registered with the Inland Revenue Department for sales tax purposes. Following information has been extracted from PL's records for the month of May 2017:

	Rupees
Purchases:	
Raw material:	
▪ from local registered suppliers	5,560,000
▪ from cottage industries	1,500,000
Import – finished goods	5,000,000
Supplies:	
▪ taxable supplies to registered persons	6,000,000
▪ taxable supplies to un-registered persons	1,760,000

Additional information:

(i) Raw material purchased from local registered suppliers includes packing material worth Rs. 850,000 purchased for textile products.

(ii) The imports include tyres of Rs. 800,000 which were used in PL's delivery vans. Tyres are designated as specified goods under Chapter XIII of the Sales Tax Special Procedure Rules, 2007.

(iii) Annexure C of the sales tax return for March 2017 shows that a sales tax invoice of Rs. 480,000 had not been claimed by the buyer. Upon scrutiny it was disclosed that goods were actually sold to an un-registered person however due to inadvertence the invoice was entered in the name of a registered person.

(iv) On 15 May 2017, PL received an invoice of Rs. 3,000,000 from Najib Brothers (NB), a specialized workshop for industrial machinery in Islamabad. NB provided overhauling services to PL and charged sales tax at the rate of 5% under the Islamabad Capital Territory (Tax on Services) Ordinance, 2001.

(v) On 20 May 2017, PL acquired the ownership of a taxable activity of Glaze Enterprises (GE), as an ongoing concern for Rs. 10,500,000. GE issued a sales tax invoice in the name of PL and received the entire amount of sale proceeds from PL.

(vi) PL paid Sindh Sales Tax of Rs. 50,000, Punjab Sales Tax of Rs. 65,000 and Federal Excise Duty of Rs. 45,000 in respect of franchise fees to a non-resident franchisor.

(vii) Taxable supplies to registered persons include the following:

- Supply of Electric Irons worth Rs. 500,000 to a distributor in Hyderabad. Electric Irons are designated as specified goods under Chapter XIII of the Sales Tax Special Procedure Rules, 2007. The Irons were purchased from a commercial importer in March 2017.
- Supply of goods worth Rs. 2,700,000 to the Local Government. PL had imported these goods from China in April 2017 at Rs. 2,200,000 and had paid 3% value addition tax at the time of import.
- Rest of the goods were supplied to various dealers in Sindh and Punjab.

(viii) Taxable supplies to un-registered persons include second hand worn clothing of Rs. 200,000 which was supplied to a retail outlet in Okara. Second hand worn clothing falls under PCT heading 6309.0000 and is covered under Serial No. 3 Table-II of SRO 1125(I)/2011 and accordingly chargeable to sales tax at the rate of 5%.

(ix) On 25 May 2017, one of PL's finished goods warehouse was destroyed by fire and all the goods stored were burnt to ashes. The goods were insured and PL received Rs. 2,750,000 from the insurance company in settlement of its claim. PL had claimed input tax of Rs. 325,000 on these goods in the April 2017 return.

(x) PL distributed gift vouchers worth Rs. 450,000 among its customers. The vouchers were to be redeemed at any time between July to September 2017.

(xi) As part of a settlement deal with AB Bank Limited, PL agreed to set off its hypothecated stock of Rs. 750,000 against an overdue loan of Rs. 950,000. The open market price of the goods was estimated at Rs. 1,100,000.

(xii) PL received a notice from the Deputy Commissioner of Inland Revenue demanding sales tax on promotional give-aways worth Rs. 235,000 which were distributed in March 2017. The tax department however accepted PL's contention that the non-payment of sales tax was due to misconstruction on part of the company.

(xiii) PL's Wholesale-cum-Retail Outlet received Rs. 2,350,000 in cash against supply of lubricants to a registered person. The lubricants were purchased from a manufacturer in April 2017 who had charged sales tax and extra tax on such supplies.

All the above figures are **exclusive of sales tax**, wherever applicable. Sales tax is payable at the rate of **17%**.

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 PL for the tax period May 2017. Also compute withholding tax, wherever applicable. **(19)**
Note: ***Show all relevant exemptions, exclusions and disallowances.***

Q.6 'Apart from financing government's operational expenditures, taxation also assists in achieving non-revenue objectives of social and economic development in a country.' List any ***five*** non-revenue objectives of taxation. **(05)**

Q.7 (a) Under the provisions of the Sales Tax Withholding Rules, 2007 state the persons who may be regarded as withholding agents. **(03)**

(b) In the light of the provisions of the Sales Tax Act, 1990 and Rules made thereunder, fill in the following blanks with the appropriate answers:

(i) With regard to refund of input tax, where there is reason to believe that a person has claimed input tax credit or refund which was not admissible to him, the proceedings against him shall be completed within ___________. For the purpose of enquiry or audit or investigation regarding admissibility of the refund claim, the above period may be extended up to ___________ by an officer not below the rank of ___________ and the ___________ may, for reasons to be recorded in writing, extend the aforesaid period which shall in no case exceed ___________. **(2.5)**

(ii) In case of transfer of ownership of a taxable activity to a non-registered person, the possession of taxable goods by the registered person shall be deemed to be ___________. If the tax payable by such registered person remains unpaid, the amount of unpaid tax shall be ______________ of the business and shall be payable by the _____________ of the business. **(1.5)**

(iii) Jami, a registered exporter, purchased taxable goods worth Rs. 500,000 from Asif Enterprises (AE), an un-registered supplier who is liable to be registered under Chapter I of the Sales Tax Rules, 2006. Jami shall deduct sales tax of Rs. ____________ from the payment due to AE under the Sales Tax Special Procedure (Withholding) Rules, 2007. **(01)**

(c) Under the provisions of **any one** of the Provincial Sales Tax on Services Acts, describe the application of the principle of origin and reverse charge. **(05)**

(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 III
Rate of Dividend Tax

(a)	7.5% in the case of dividends declared or distributed by purchaser of a power project privatized by WAPDA or on shares of a company set up for power generation or on shares of a company, supplying coal exclusively to power generation project; and
(b)	12.5% in cases other than mentioned in clauses (a) and (c);
(c)	10% in case of dividend received by a person from a mutual fund.

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%.