Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

9 June 2018
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Taxation

Q.1 For the purpose of this question, **assume that the date today is 31 December 2018**.

Rozgar (Pvt) Limited (RPL) was incorporated in Pakistan with a paid-up capital of Rs. 55 million. It is a 70% owned subsidiary of Alpha Plc. (a British company controlled and regulated by the British Government). RPL is engaged in the business of manufacturing various products. Following information has been extracted from RPL's records for the year ended 31 March 2018.

	Rupees
Gross sales	215,000,000
Cost of goods sold	(184,425,000)
Gross profit	30,575,000
Administrative and selling expenses	(10,425,000)
Financial charges	(3,220,000)
Other income	5,975,000
Profit before taxation	22,905,000
Taxation	(4,228,938)
Profit after taxation	18,676,062

Additional information:

(i) **Gross sales includes** sale of milled limestone and marble of Rs. 85,000,000 to various oil and gas companies in Europe. 80% of the sale proceeds were realized during the year after deduction of 1% withholding tax.

(ii) **Cost of goods sold includes** purchase of raw material of Rs. 3,500,000 from a grower of agricultural produce. No tax was deducted from payments made to the grower. RPL received prescribed certificate from the grower under Part IV of the Second Schedule.

(iii) **Administrative and selling expenses include:**
- Bad debt of Rs. 175,000 being the write off of a loan granted in 2016 to one of RPL's shareholders.
- Penalty of Rs. 75,000 against non-payment of sales tax in time. The amount was paid in cash.
- Rs. 5,150,000 spent on the construction of a library building for an educational institution established by the Local Government in Mardan under RPL's CSR scheme.

(iv) **Financial charges include** Rs. 50,000 incurred on securing overdraft facilities for working capital requirement.

(v) **Other income includes:**
- Rs. 1,800,000 on account of export of IT services, as defined in Part I of the Second Schedule, to a company in Sri Lanka. 70% of the export proceeds were brought into Pakistan in foreign exchange through normal banking channels whereas balance was adjusted against technical assistance received with regard to RPL's manufacturing processes. Tax deductible on receipt of technical assistance at the rate of 15% was paid by RPL and is included in administrative expenses. The debtor balance relating to the above technical assistance remained un-adjusted at the end of financial year.
- Rs. 2,600,000 in respect of unrealized gain arising on revaluation of foreign currency debtors.

- Dividend-in-specie received on 1 July 2017 in the form of 25,000 listed shares in Freeze Limited (FL). The dividend income was recorded by RPL at Rs. 35 per share. Tax of Rs. 131,250 was collected from RPL in respect of dividend-in-specie.
  On 1 March 2018 RPL sold 10,000 shares in FL at a negotiated price of Rs. 38 per share to a local institutional investor. The market value of these shares at the time of sale was Rs. 36 per share. The gain on sale amounting to Rs. 30,000 is included in other income.
- Rs. 300,000 earned on trading of borrowed shares. RPL borrowed 15,000 shares of a listed company from Beta Limited (BL) for four months. The agreed value of the borrowed shares was Rs. 120 per share on which mark-up for four months was to be paid by RPL @ 10% per annum. RPL sold such borrowed shares at Rs. 125 per share and subsequently on the agreed date of return of shares, RPL re-purchased 15,000 shares at Rs. 105 per share. At the time of settlement, RPL also paid the mark up on borrowed shares as agreed. The mark-up is included in financial charges.

(vi) For tax year 2018, RPL declared and paid 10% dividend to its shareholders.
(vii) RPL has filed an option u/s 154 to opt out of the final tax regime (FTR).
(viii) Tax paid by RPL u/s 147 amounted to Rs. 2,860,000.
(ix) Accounting depreciation charged during the year is the same as tax 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 RPL for tax year 2018. **(19)**

Note:
- ***Your computation should commence with the profit before tax figure of Rs. 22,905K.***
- ***Ignore WWF, WPPF, Minimum tax u/s 113, 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 briefly describe the following:
(i) when a revised return filed by a person u/s 114 shall be treated as an invalid return. **(04)**
(ii) the circumstances in which a taxpayer, filing a revised return, is not required to pay the penalty. **(03)**

(b) Under the provisions of the Income Tax Rules, 2002 describe the term 'MNE group' in relation to the country-by-country reporting requirement. **(04)**

(c) Paragon (Pvt) Limited (PPL) owns a piece of agricultural land in Sehwan. On 1 January 2017, PPL rented out the land for poultry farming on commercial basis to one of its associates, Hen Enterprises, at a monthly rent of Rs. 200,000. However, the annual letting value of similar land in the area is estimated at Rs. 2,880,000. PPL also received a non-adjustable deposit of Rs. 800,000 from Hen Enterprises.

Following expenses were incurred by PPL in respect of the land during the year ended 31 December 2017:
(i) Ground levelling expenses Rs. 50,000.
(ii) Property tax Rs. 150,000.
(iii) Rent collection charges Rs. 12,000.
(iv) Interest accrued on mortgage of land Rs. 75,000.
(v) Insurance premium against the risk of water logging Rs. 30,000.

Required:
Under the provisions of the Income Tax Ordinance, 2001 calculate PPL's taxable income for tax year 2018. **(06)**
Note: Show all relevant exemptions, exclusions and disallowances.

Q.3 AB Limited (AB) is an un-listed public company engaged in the business of manufacturing consumer durables. AB is member of a group of five companies, with HL (Pvt) Limited (HL) being the holding company. Except AB, all other companies in the group were incorporated as private limited companies. HL is engaged in the processing of dairy milk in Punjab and owns 70% shares in AB.

AB's assessed loss for the year ended 30 September 2017 is Rs. 9,800,000 which is inclusive of a loss of Rs. 500,000 on account of sale of shares of an un-listed public company and a loss of Rs. 80,000 incurred on sale of delivery truck. AB also sustained a loss of Rs. 200,000 on sale of a rare manuscript held for decoration purposes. This loss is however not included in the assessed loss for the year. AB has a brought forward assessed loss of Rs. 2,500,000 from tax year 2017 and intends to surrender its losses in favour of HL.

During the year ended 31 December 2017 HL earned a profit before tax of Rs. 11,000,000 which includes:

(i) royalty of Rs. 950,000 received from a foreign enterprise in consideration for the use of a formula outside Pakistan, which is covered under 2nd Schedule.
(ii) profit on debt of Rs. 100,000.
(iii) rent of Rs. 600,000 from a land used for agricultural purposes.
(iv) gain on disposal of immoveable property of Rs. 450,000. The immoveable property was allotted to HL by the Provincial Government in April 2017 for the promotion of cattle farming in Punjab.

Tax paid by HL u/s 151 and u/s 153 amounted to Rs. 10,000 and Rs. 2,440,000 respectively.

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

(a) Compute taxable income under correct head of income and the amount of tax payable by or refundable to HL for tax year 2018. Also give reason(s) for your treatment of losses to be surrendered by AB in favour of HL. **(08)**
(b) What would be your answer in (a) above if HL had 98% shares in AB? Also state the amount of cash, if any, which HL may be required to transfer to AB with the approval of the board of directors. **(08)**

Note:
- ***Show all relevant exemptions, exclusions and disallowances.***
- ***Ignore WWF, WPPF, Minimum tax u/s 113, Alternative Corporate Tax, and default surcharge.***
- ***Tax rates are given on the last page.***

Q.4 (a) Under the provisions of the Sales Tax Act, 1990 identify the persons who may be allowed to import goods or a class of goods without payment of the whole or any part of the tax payable thereon and the authority who may grant such approval(s). **(03)**

(b) Under the provisions of the Sales Tax Special Procedure (Withholding) Rules, 2007 identify the persons who may be regarded as withholding agents, for the purpose of deduction and deposit of sales tax. **(03)**

(c) Under the provisions of the Sales Tax Rules, 2006 for the purpose of selection of cases for audit on parametric basis, who shall determine the risk parameters to be used for balloting? State the factors on which audit selection parameters may be based. **(05)**

(d) Under the provisions of **any one** of the Provincial Sales Tax on Services Acts, briefly describe the following:

(i) when a taxable service shall be considered to have been provided in the tax period. **(02)**
(ii) possible actions the Board/Authority is required to take if the suspension of a person's registration is not withdrawn within sixty days. **(03)**

Q.5 Rahmate Ramzan Limited (RRL) is a company registered as manufacturer, importer and distributor with the Inland Revenue Department for sales tax purposes. Following information is available from RRL's records for the month of May 2018:

	Rupees
Purchases	
From registered suppliers	5,000,000
From un-registered suppliers	2,345,000
Imports	1,850,000
Supplies	
Taxable supplies to registered persons	9,000,000
Taxable supplies to un-registered persons	4,350,000

Additional information:

(i) Purchases from registered suppliers include the following:
- raw material worth Rs. 200,000. The material was used as a constituent in the manufacture of taxable goods destroyed in semi manufactured condition during a manufacturing process.
- electric bulbs and telephone sets worth Rs. 2,800,000. These items are designated as specified goods under Chapter XIII of the Sales Tax Special Procedure Rules, 2007 and were purchased in cash from Dunhill Stores, which is registered as a wholesaler-cum-retailer.

(ii) Purchases from un-registered suppliers include goods worth Rs. 1,280,000 covered under Third Schedule whereas rest of the goods are covered under Sixth Schedule.

(iii) The imports consist of agricultural tractor of Rs. 1,017,500 and other agricultural equipment of Rs. 832,500 both imported from Holland. The import was against specific customer order and is covered under the Eight Schedule. Agricultural tractor is charged to tax at the rate of 5% whereas tax rate applicable to the agricultural equipment is 7%.

(iv) Taxable supplies to registered persons include the following:
- lubricating oil worth Rs. 1,500,000, covered under Chapter XIII of the Sales Tax Special Procedure Rules, 2007. It was supplied to Ormara Tractors Limited under a Morabaha arrangement. The oil was imported from Nigeria in March 2018.
- supply of 200 fans worth Rs. 700,000 to DB (Pvt) Limited (DB), situated in EPZ. RRL also supplied electronic components of Rs. 300,000 to DB for further manufacturing of goods. Both fans and components were acquired from a cottage industry in April 2018. Fans are designated as specified goods under Chapter XIII of the Sales Tax Special Procedure Rules, 2007.
- supply of an old packing machine to a courier company at Rs. 2,500,000. The machine was purchased in 2015 at a cost of Rs. 3,200,000. The courier company is registered with Balochistan Revenue Authority as a courier service provider.
- supply of stores worth Rs. 125,000 for consumption aboard a flight proceeding to Islamabad.

(v) Taxable supplies to un-registered persons include goods worth Rs. 875,000 which were supplied to an individual, Sarwat Kirmani, whose annual turnover from exempt sales amounted to Rs. 60,000,000 and his utility bills for the last twelve months amounted to Rs. 500,000. The rest of the supplies under this category were made to a cottage industry in Sialkot.

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

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 RRL and input tax to be carried forward, if any, for the tax period May 2018. Also compute withholding tax, wherever applicable. **(16)**

Note: Show all relevant exemptions, exclusions and disallowances.

Q.6 (a) Under the provisions of the Federal Excise Act, 2005 briefly describe the circumstances under which a person may be required to pay default surcharge. Identify the duration of time which may be considered as a period of default and the rate at which the default surcharge should be paid. **(05)**

(b) On 1 July 2014 Shahrukh supplied excisable goods to Mubarak Enterprise (ME) in Export Processing Zone. Shahrukh did not levy excise duty on these goods considering that these would be used for further manufacturing but ME used these goods for in-house consumption.

On 1 January 2018 Shahrukh was serviced with a notice from the Office of Inland Revenue requiring him to show cause for non-payment of duty on goods supplied to ME.

Required:
Under the provisions of the Federal Excise Act, 2005:
(i) Explain whether Officer Inland Revenue was justified in issuing the show cause notice to Shahrukh. **(03)**
(ii) Describe the period within which the Officer Inland Revenue must decide the above case. **(03)**

Q.7 Briefly describe the following:

(a) any **three** pillars of tax administration which help to safeguard the interest of the tax payers. **(03)**
(b) the terms 'Tax evasion' and 'Tax avoidance'. **(02)**

(THE END)

TAX RATES

Rates of Tax for Companies

1.	The rate of tax imposed on the taxable income of a public/private company shall be 30%.
2.	The rate of tax imposed on the taxable income of a small company shall be 25%.

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)	15% in cases other than mentioned in clauses (a) and (c);
(c)	12.5% in case of dividend received by a person from a mutual fund if the amount of dividend is above Rs. 2.5 million and 10% if the amount of dividend is less than or equal to Rs. 2.5 million.

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.	15%

Part I Division VIII
Capital Gains on disposal of Immovable Property

S.No.	Period	Rate of tax
For immovable property allotted to persons mentioned in sub-section (4) of section 236C		
1.	Immovable property is held irrespective of the holding period.	0%
For immovable property acquired on or after July 1, 2016, other than those mentioned against S. No. 1.		
2.	Where holding period of immovable property is up to one year.	10%
3.	Where holding period of immovable property is more than or equal to one year but less than two years.	7.5%