Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

8 December 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 August 2019**.

Ali Mir has sought your advice for filing his tax return for the year ended 30 June 2019 and has provided following information for tax year 2019:

	Rupees
Income from salary	1,493,200
Income from business	725,000
Income from property	960,000
Income from other sources	1,050,000

Additional information:

(i) Income from business includes the following:

- a consideration of Rs. 120,000 for vacating the possession of a building acquired on rent in 2015. Ali Mir had paid Rs. 60,000 to the land lord for acquiring the possession of that building.
- deemed income of Rs. 92,000 in respect of a loan received through a bearer cheque.
- a loss of Rs. 430,000 from speculation business.
- a gain of Rs. 125,000 on sale of derivative products.

(ii) Income from property includes Rs. 180,000 received in respect of services of a watchman provided by Ali Mir to his tenant. The salary paid by Ali Mir to the watchman amounted to Rs. 168,000. Ali Mir also incurred following expenses in respect of the property: Ground rent Rs. 8,000, Rent collection charges Rs. 3,000 and Repair expenses Rs. 22,000. These expenses have not been considered in computing the income from property.

(iii) Income from other sources includes a loss of Rs. 65,000 incurred on sale of agricultural produce to a foreign NGO operating in rural areas of Sindh.

Other information: ***(not included in the incomes mentioned above)***

(i) Income from foreign speculation business amounted to Rs. 500,000.

(ii) Earned Rs. 175,000 as return on investment in sukuks from a public company.

(iii) Ali Mir also served as a visiting faculty member for four months at a business school in Karachi. He earned Rs. 380,000 from the school and incurred an expenditure of Rs. 20,000 for providing the service. Withholding tax deducted by the school amounted to Rs. 17,800.

(iv) Loss on sale of shares in a listed company brought forward from tax year 2018 amounted to Rs. 45,000.

(v) Ali Mir paid tuition fees of Rs. 900,000 for his three children.

Required:
Under the provisions of the Income Tax Ordinance, 2001 compute under the correct head of income, the total income and taxable income of Ali Mir for tax year 2019. **(15)**

Notes:
- ***Show all relevant exemptions, exclusions and disallowances.***
- ***Computation of income under correct head of income and total income carry marks.***

Q.2 For the purpose of this question, **assume that the date today is 31 December 2019**.

Empress Limited (EL), an un-listed public company resident in Pakistan is engaged in the business of manufacture and sale of children garments and onyx products both locally and in international markets. EL has two foreign branches situated in Jordan and Morocco. EL is 72% owned by Tulip S.A. a company incorporated in Belgium and 20% by a Sweden based company, Rose Inc. Following information is available from EL's records for the year ended 30 June 2019.

	Pakistan operation		**Foreign branches**	
	Local	**Export**	**Jordan**	**Morocco**
	------------------------- **Rupees** -------------------------			
Sales	49,000,000	3,850,000	11,600,000	19,500,000
Profit before tax	2,200,000	1,925,000	3,248,000	5,850,000
Taxes paid during the year	(770,000)	(38,500)	(876,000)	(1,872,000)

Additional information:

The profit before tax from local operation has been arrived after considering the following:

(i) Profit on debt of Rs. 5,680,000 incurred on a debt of US$ 1,250,000 (equivalent to Rs. 162,500,000). The debt was obtained during the year from Tulip S.A. and is repayable after three years. It was obtained for a project in Sindh and is duly approved by the Federal Government for the purpose of Second Schedule.

(ii) Profit on debt of Rs. 3,200,000 incurred on a debt of US$ 820,500 (equivalent to Rs. 106,665,000). The debt was obtained on 1 January 2019 from Rose Inc. for working capital. The principal repayment would commence from 1 January 2020.

(iii) An amount of Rs. 290,000 written back against excess provision made for bad debts in tax year 2018.

(iv) Cost of Rs. 325,000 in respect of a ramp built at EL's customer care department for providing access to disabled customers.

EL's equity at 30 June 2019 amounted to Rs. 190,000,000 (2018: Rs. 59,133,500).

Required:
Under the provisions of the Income Tax Ordinance, 2001 compute the taxable income and net tax payable by or refundable to EL for tax year 2019. Give brief reason(s) for the treatment of the items which do not appear in your computation. **(12)**
Note: EL's tax rate for tax year 2019 is 29%.

Q.3 Briefly describe the **five** fundamental principles of ethics for tax practitioners. **(05)**

Q.4 (a) Massive (Pvt) Limited (ML) is engaged in the business of manufacturing and selling consumer durables. ML's income year ends on 30 September each year. Due to unavoidable circumstances, the return of income u/s 114 for tax year 2018 was filed on 5 December 2018. Following information has been extracted from ML's return for tax year 2018:

	Rupees
Total income	12,500,000
Donation paid to Al-Shifa Trust under Second Schedule	500,000
Advance tax paid u/s 147	3,200,000

The tax rate applicable to tax year 2018 is 30%.

Required:
Under the provisions of the Income Tax Ordinance, 2001 compute the amount of tax, default surcharge and penalty payable by ML, if any, to the tax authorities. **(07)**

(b) For the purpose of this part of question, **assume that the date today is 31 August 2019**.

Ali Murad holds 10,000 shares in Tit Limited (TL). He acquired these shares on 30 June 2016 at Rs. 49.50 per share. On 1 August 2018, consequent to High Court's order, TL de-merged and split into two companies: Tit Limited and Bit Limited (BL). TL's shareholding was also divided into shares of TL and BL. Consequently, Ali Murad's holding in TL was reduced to 6,000 shares in his CDC account and 9,000 new shares in BL were recognized in his account. On the date of de-merger, the market values of each share of TL and BL were Rs. 20 and Rs. 50 respectively.

On 1 December 2018 Ali Murad sold 2,000 shares in TL at Rs. 30 each and 5,000 shares in BL at Rs. 60 each.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute taxable income and tax payable by Ali Murad at the time of de-merger and upon sale of shares, for tax year 2019. **(06)**
Note: Tax rates are given on the last page.

(c) Karam Din is working as Director Finance in Cherokee Limited (CL). On 30 June 2016, when CL's shares were priced at Rs. 30 each in the market, Karam Din received 12,000 shares in CL under an employee share scheme with a restriction not to transfer the shares before 1 June 2017. On 1 June 2017 the market value of CL's shares was Rs. 40 per share. On 30 April 2018 Karam Din sold all the shares in CL at Rs. 42 per share.

Required:
Under the provisions of the Income Tax Ordinance, 2001 compute under the correct head of income, the amount to be included in Karam Din's taxable income for the tax years 2016, 2017 and 2018. **(04)**

Q.5 (a) Spring Fields Limited (SFL) is engaged in the business of producing flavoured aerated waters for five star hotels. SFL buys various flavours from local suppliers. These flavours are used in the production of aerated waters.

Required:
Under the provisions of the Federal Excise Act, 2005 explain how SFL would determine the net liability of duty in respect of aerated waters. Specify necessary conditions, if any, to be fulfilled in this regard. **(05)**

(b) Under the provisions of the Federal Excise Act, 2005 briefly describe the tax treatment in each of the following independent cases:

(i) Frenzy Bottles Limited paid excise duty on concentrates used in the manufacture of aerated beverages. The beverages were exported to U.A.E. **(2.5)**

(ii) Invincible Limited supplied edible olive oil for consumption on board a Chinese aircraft proceeding from Karachi to Peshawar. **(2.5)**

Q.6 Under the provisions of the Income Tax Ordinance, 2001 discuss the tax treatment in each of the following independent cases for tax year 2019:

(a) In tax year 2018, Shock Limited had exported woollen carpets to its parent company in Spain and had incurred expenses of Rs. 300,000 in relation to the export. In tax year 2019, parent company reimbursed 65% of the expenses to Shock Limited. **(03)**

(b) Ink Limited (IL), a resident company, paid Rs. 460,000 to a non-resident debtor upon settlement of a disputed claim lodged on account of supply of defective products. IL also paid Rs. 100,000 to a non-resident lawyer for making the settlement. IL did not deduct withholding tax while making the above payments. **(05)**

Q.7 Droplet Limited (DL) is engaged in variety of businesses across Pakistan. Various divisions of DL are registered with federal and provincial sales tax authorities as manufacturer, importer, wholesaler-cum-retailer and service provider. Following information has been extracted from DL's records for the month of November 2018.

	Rupees
Purchases	
From registered suppliers	4,350,000
From un-registered suppliers	2,280,000
Imports	2,935,000
Supplies	
Taxable supplies to registered persons	7,500,000
Taxable supplies to un-registered persons	3,050,000

Additional information:

(i) Purchases from registered suppliers include the following:
- semi manufactured goods worth Rs. 520,000. These goods are used in the manufacture of product Zee which is exempt from tax.
- packing material worth Rs. 350,000 purchased by DL's textile division for use in packing of textile products covered under S.R.O 1125(I)/2011 dated 31 December 2011.
- storage batteries worth Rs. 970,000 purchased from a manufacturer for in-house consumption by DL's car manufacturing division. These batteries are designated as specified goods under Chapter XIII of the Sales Tax Special Procedure Rules, 2007.
- cooking ranges worth Rs. 240,000 purchased by DL's wholesale-cum-retail division directly from a manufacturer. These cooking ranges are designated as specified goods under Chapter XIII of the Sales Tax Special Procedure Rules, 2007.
- goods worth Rs. 210,000 purchased under DTRE scheme.

(ii) Purchases from un-registered suppliers include goods worth Rs. 1,900,000 purchased from a distributor engaged in supply of taxable goods to manufacturers. Rest of the purchases were made from a manufacturer in Lahore, whose annual turnover does not exceed Rs. 3,500,000 and whose annual utility bills remain within Rs. 280,000.

(iii) The imports consist of compressor scrap of Rs. 1,200,000 and finished sports footwear of Rs. 1,735,000.

(iv) Taxable supplies to registered persons include the following:
- red chillies worth Rs. 435,000. These were sold to super markets in retail packing under DL's brand name. Red chillies are covered under Sixth Schedule.
- 350 kg of locally manufactured sugar worth Rs. 28,000. The sugar was sold to a local pharmaceutical company for use in production of cough syrup. DL purchased 500 kg sugar in August 2018 at the rate of Rs. 75 per kg.
- cooking ranges worth Rs. 285,000 sold to restaurants through DL's wholesale-cum retail outlets.

(v) Taxable supplies to un-registered persons include the following:
- foam worth Rs. 1,295,000 supplied to a manufacturer, other than a cottage industry, for onward processing.
- goods worth Rs. 686,800 supplied on four months' credit to a distributor in Sialkot. The price is inclusive of mark-up at 3% per annum.
- the rest of the goods were supplied to end consumers.

Following further information is also available: ***(not included in purchases and supplies mentioned above)***

- an invoice of Rs. 125,000 was received from a service provider in Sindh against provision of overhauling services for a printing machine used in DL's textile division. Sales tax was collected at the rate of 5% under the Sindh Sales Tax on Services Act, 2011.
- further tax of Rs. 162,000 was collected erroneously from a registered distributor in July 2018. The goods on which further tax was collected were sold by the distributor to a manufacturer in November 2018.

All the above figures are **exclusive of sales tax**, wherever applicable. Sales tax is payable at the rate of **17%**, except where specified 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 DL and input tax to be carried forward, if any, for the tax period November 2018. Also compute withholding tax, wherever applicable. **(18)**
Note: Show all relevant exemptions, exclusions and disallowances.

Q.8 (a) Khalil Mirza established a business of selling fruit and vegetable juices on 18 April 2018 at a fruit market in Saddar. He serves both online and walk-in customers. The fruit juices are usually imported from Iran and New Zealand whereas vegetable juices are procured locally from Punjab. Khalil Mirza is not registered with the sales tax authorities but he makes all purchases from registered suppliers.

Due to increase in cost of doing business, Khalil Mirza decided to get himself registered with the Inland Revenue Department enabling him to reclaim the input tax on his purchases. He made an application for voluntary registration under the Sales Tax Act, 1990 on 2 August 2018 and was registered with effect from 10 August 2018. Following was the position of his unsold stock of fruit and vegetable juices on 2 August 2018:

S.No.	Description	Date of purchase	Stock status	Sales tax paid (Rs.)
(i)	300 packets of imported fruit juices	1 May 2018	100% verifiable	2,550
(ii)	600 packets of imported fruit juices	10 May 2018	15% unverifiable	5,100
(iii)	500 packets of local vegetable juices	30 June 2018	10% unverifiable	1,700
(iv)	650 packets of local vegetable juices	5 July 2018	100% verifiable	2,210

Required:
Under the provisions of the Sales Tax Act, 1990 compute the amount of input tax, if any, which Khalil Mirza can claim with his sales tax return for the month of August 2018. ***(Show all relevant exclusions and disallowances)*** **(04)**

(b) Sluggish Limited (SL) purchased 80 tons of cement, covered under Third Schedule, from Iron Limited (IL) for one of its projects at a wholesale price of Rs. 10,000 per ton. The retail price of the cement in the market is Rs. 11,000 per ton. All the above prices are exclusive of federal excise duty of Rs. 1,500 per ton and sales tax at the rate of 17%. Due to financial constraints, SL has requested to settle the price by transferring a fork lifter having a market value of Rs. 800,000 and to pay Rs. 90,000 in final settlement along with the applicable sales tax by way of a cheque drawn in favour of IL.

Required:
In view of the provisions of the Sales Tax Act, 1990 determine the value of supply and the amount of sales tax payable by SL under the above circumstances. **(06)**
(Note: Give reason(s) for the exclusion of any item from your computation)

(c) Karim Bux is engaged in the business of providing courier and logistics services in Punjab and Sindh. His head office is located in Karachi and is registered with Sind Revenue Board (SRB) as well as Punjab Revenue Authority (PRA). He pays the sales tax in the province from where the parcels are sent. Recently he has received a notice from Punjab Revenue Authority (PRA) asking him to pay tax on invoices raised in respect of parcels sent from Sindh to Punjab.

Required:
Under the provisions of the Provincial Sales Tax on Services Acts, advise Karim Bux on the notice issued by PRA. **(05)**

(THE END)

EXTRACTS FROM THE INCOME TAX ORDINANCE, 2001

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, 2013.	7.5%