The Institute of Chartered Accountants of Pakistan

Certified Finance and Accounting Professional Stage Examination

15 June 2019
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Taxation

Q.1 Sober Limited (SL) is an unlisted public company engaged in the business of import, manufacturing and supply of multiple products. SL commenced its business operations, with a paid-up capital of Rs. 51 million. On 1 April 2018, SL signed an agreement with a renowned multinational company for the distribution of its popular brand of beverages to various wholesalers and departmental stores across the country.

Following information has been extracted from SL's records for the year ended 31 March 2019:

	Rupees
Sales	156,777,000
Cost of goods sold	(105,250,000)
Gross profit	51,527,000
Administrative and selling expenses	(42,555,000)
Financial charges	(1,950,000)
Profit before taxation	7,022,000

Additional information:

(i) **Sales include:**

- sale of durable goods of Rs. 105,327,000 to local customers across Pakistan. These goods were manufactured by SL. Withholding tax deducted by customers amounted to Rs. 4,212,000. Raw material consumed and other manufacturing costs incurred for the manufacture of durable goods amounted to Rs. 53,200,000 and Rs. 9,700,000 respectively.
- sale of beverages of Rs. 32,500,000 to departmental stores in Sindh. These beverages were purchased at the cost of Rs. 28,150,000. Applicable advance/withholding taxes were duly collected/deducted at the time of purchase and sale of beverages. Beverages are covered under fast moving consumer goods.
- sale of paint of Rs. 9,594,000 (inclusive of sales tax at the rate of 17%). It was locally purchased at a wholesale price of Rs. 6,900,000 from a commercial importer in Lahore. This product was sold to registered retailers, in the same condition as they were when purchased. The retailers are registered under the Sales Tax Act, 1990. No withholding tax was collected/deducted, at the time of purchase and sale of paint.
- sale of canned food items of Rs. 7,000,000 to the canteens of large corporate houses in KPK. Applicable taxes were duly deducted by respective corporate houses at the time of payment. SL purchased vegetables, live fowls, eggs and fresh milk, for processing canned food, from a farm in Balochistan. These items were purchased at Rs. 5,400,000. The other processing costs incurred in this regard amounted to Rs. 1,900,000. SL made full payment without deduction of withholding tax.
- receipt of Rs. 3,750,000 in respect of remote monitoring of canning process for the preservation of food for a company in Mexico. The entire amount was received in USD in Pakistan through normal banking channel. Expenditure incurred on remote monitoring of the canning process amounted to Rs. 1,200,000 and was booked as part of administrative expenses. No other expenditure was incurred by SL in this regard.

(ii) **Administrative and selling expenses include:**

- Rs. 28,985,000 in respect of salaries, wages and other benefits. Of these, cash payments of Rs. 3,492,000 were paid to daily wage workers, engaged in the manufacture of durable goods, at the rate of Rs. 450 per day and Rs. 1,725,000 were paid to 5 salesmen in equal proportion who are engaged with the sale of paint and beverages.
- Rs. 2,850,000 paid to Press (Pakistan) Limited for acquiring a right to use latest food canning technology. Withholding tax was not deducted from the payment.

(iii) Financial charges include profit on debt of Rs. 1,900,000 which was incurred on a loan obtained for the purchase of specialized machinery for durable goods.

(iv) On 1 February 2019, SL declared 5% dividend as dividend-in-specie. On 15 February 2019, SL credited 30,000 shares in Mubarak Textiles Limited (MTL) as dividend-in-specie to the respective shareholders' account. MTL is 63% owned by the Sindh Government. At the time of declaration of dividend, the market value of each share of MTL was Rs. 78 whereas at the time of credit to shareholders' account its value increased to Rs. 82. On 30 June 2016, SL had acquired 60,000 shares in MTL at a value of Rs. 75 per share.

(v) In March 2018, SL wrote off a debt relating to sale of durable goods of Rs. 330,000 and filed a suit against the defaulting party for the recovery of the debt. SL was allowed a deduction of Rs. 220,000 in tax year 2018. In January 2019, the case was decided by the Court in SL's favour and an amount of Rs. 130,000 was received in final settlement.

(vi) Taxes paid by SL u/s 147 amounted to Rs. 860,000.

(vii) Accounting depreciation charged during the year is 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 SL for tax year 2019. **(20)**

Note:

- ***In your computation, show all figures in thousand.***
- ***Ignore WWF, WPPF, Minimum tax u/s 113, Alternative Corporate Tax and default surcharge, if any.***
- ***Show all relevant exemptions, exclusions and disallowances.***

Q.2 (a) Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, briefly advise the tax treatment in each of the following independent cases. Also compute the amount of tax, wherever applicable:

(i) Sigma Limited, a person registered with sales tax authority as a manufacturer, purchased taxable goods worth Rs. 1,520,000 from an unregistered distributor. **(02)**

(ii) Clove Limited (CL) while preparing sales tax return for the period of May 2019 discovered that an input tax credit of Rs. 905,000 pertaining to October 2018 has inadvertently remained unclaimed. CL now wants to claim it in its May 2019 return. **(05)**

(b) On 1 January 2019, Ginger Limited (GL), a sales tax registered person, supplied taxable goods worth Rs. 1,287,000 to one of its associates in Multan at a concessional price of Rs. 965,250. GL inadvertently failed to levy sales tax nor issued sales tax invoice with regard to the supply. On 1 June 2019, the Assistant Commissioner Inland Revenue served a notice requiring GL to show cause for the non-payment of amount specified in the notice. After having an opportunity of being heard, GL finally deposited the required amount of sales tax with the Inland Revenue Department on 10 June 2019.

Required:
Under the provisions of the Sales Tax Act, 1990:

(i) compute the amount of default which GL may have deposited with the tax authorities. **(05)**

(ii) briefly describe the circumstances in which GL would have been absolved from payment of any default as computed in (i) above. **(03)**

Q.3 (a) Broad (Pvt.) Limited (BPL) is engaged in the business of providing web designing and web hosting services to corporate clients in Lahore. BPL has a paid-up capital of Rs. 30 million and undistributed reserves of Rs. 15 million. Due to constantly increasing volume of work, BPL had to appoint Alpine Financials (AF), a debt collection agency, against 2% service charges for the recovery of debts. During tax year 2019, AF recovered Rs. 9,660,000 which was after deduction of 8% withholding tax by various clients. AF retained 2% services charges and remitted Rs. 9,466,800 to BPL. Following information is also available from BPL's records for tax year 2019:

	Rupees
Gross turnover	43,500,000
Taxable income	2,745,000

BPL had furnished an irrevocable undertaking by November 2018, for presenting its accounts to the Commissioner. BPL has no other source of income.

Required:
In the light of Income Tax Ordinance, 2001 advise BPL as regards the following:

(i) Withholding tax implications **(02)**

(ii) Tax liability **(03)**

(iii) Amount of tax to be carried forward, if any. **(02)**

(b) Day Light Limited (DLL), an investment finance services company, provided consumer loans to various customers during tax years 2018 and 2019. Following information is available from DLL's records for the two tax years:

	2019	**2018**
	Rs. in million	
Interest earned on consumer loans	58	50
Provision for bad debts	2.1	3.2

Required:
In the light of Income Tax Ordinance, 2001 discuss the tax treatment of provision for bad debts for tax year 2019. **(05)**

(c) Under the provisions of Income Tax Ordinance, 2001 and Rules made thereunder, explain the tax treatment in each of the following independent cases:

(i) Jamal Nasir held 30,000 shares in Galaxy Pharma Limited (GPL) which he had acquired on 1 May 2016 at Rs. 85 each. GPL subsequently merged into East Pharma Limited (EPL) through a scheme approved by the High Court. EPL issued 3 shares for every 5 shares held in GPL. **(03)**

(ii) On 1 November 2018, Kashif Abbas sold securities having face value of Rs. 4.5 million to his friend Ahad Iqbal with the condition to acquire them back on 15 January 2019. On 31 December 2018, Ahad Iqbal received profit of Rs. 112,500 on these securities. On 15 January 2019, Kashif Abbas re-acquired the same securities from Ahad Iqbal. **(03)**

Q.4 Caramel Limited (CL) is engaged in variety of businesses across Pakistan and is registered as manufacturer, importer and service provider with Federal and Provincial Sales Tax Authorities. Following information has been extracted from CL's records for the month of May 2019:

	Rupees
Purchases	
From registered suppliers	8,064,000
From un-registered suppliers	2,476,000
Imports	1,387,500
Supplies	
Taxable supplies to registered persons	10,882,000
Taxable supplies to un-registered persons	1,370,000

Additional information:

(i) Purchases from registered suppliers include the following:

- Raw material worth Rs. 2,564,000 purchased from a dealer, Moral Associates (MA) for the manufacture of auto parts and accessories. MA has received a notice u/s 114(4) of the Income Tax Ordinance, 2001 to file income tax return for the tax year 2018.
- Fork lifter worth Rs. 1,800,000 purchased for moving goods in CL's warehouse.

(ii) Purchases from un-registered suppliers include purchase of water worth Rs. 1,230,000 from a wholesaler. The water was acquired under the trade name of 'Healthy Life' and is used at CL's factory. The rest of the purchases were made from a cottage industry engaged in supply of taxable goods to manufacturers.

(iii) Import consists of 1500 boxes of food packaging material worth Rs. 1,387,500. These boxes were imported from Germany and are sold in the same condition as imported.

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

- Auto parts and accessories worth Rs. 3,205,000 sold to an original equipment manufacturer (OEM), Madras Motor Company Limited. Auto parts and accessories are designated as specified goods under Chapter XIII of the Sales Tax Special Procedure Rules, 2007.
- Rock phosphate worth Rs. 1,952,000 sold to fertilizer manufacturers. It was imported by CL in March 2019 for Rs. 1,366,000 and is covered under Eight Schedule.
- Parts and components for manufacturing LED bulbs worth Rs. 3,435,000 sold to manufacturers in Peshawar. These parts and components are covered under Sixth Schedule and were purchased from a commercial importer in April 2019 for Rs. 2,460,000.
- Fumigation services worth Rs. 1,290,000 provided to landlords in district Badin for the protection of their crops. The rate of tax applicable on such services under the Sindh Sales Tax on Services Act, 2011 is 13%.

(v) Taxable supplies to un-registered persons include the following:

- Supply of finished fabrics (SRO. 1125(I)/2011) worth Rs. 625,000 to Neil Associates, a distributor in Sialkot whose total turnover from exempt goods is Rs. 5,200,000.
- Sale of iron bars worth Rs. 238,000. These bars were recovered from the wreckage of CL's old factory building. The building was demolished due to its dilapidated condition.
- Sale of second hand and worn footwear of Rs. 175,000 to a dealer in Multan. Second hand worn footwear are covered under Eight Schedule.
- The rest of the sales were made to the retailers who are liable to pay sales tax through their electricity bill.

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

- Advance payment of Rs. 300,000 was made to Sanai Enterprise, an un-registered distributor, for the purchase of detergents, covered under Third Schedule.
- Life insurance premium of Rs. 200,000 was paid to a Karachi based insurance company for getting insurance cover for two of CL's directors.
- CL outsourced its share registration and transfer services to a Lahore based company, Zircon Limited, at a monthly fee of Rs. 700,000. The rate of tax applicable on such services under the Punjab Sales Tax on Services Act, 2012 is 16%.

All the above figures are **exclusive of sales tax**, wherever applicable.

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 CL and input tax to be carried forward, if any, for the tax period May 2019. Also compute withholding tax, wherever applicable. **(16)**
Note: Show all relevant exemptions, exclusions and disallowances.

Q.5 Salman Abbas, ACA is Manager Taxation at a large tax consultancy firm and reports to Bader Ali, FCA who is one of the partners of the firm.

Salman Abbas is presently engaged in the preparation of the income tax return of Digital Systems Limited (DSL), an IT company. During the review of the tax workings, he discovers that DSL has charged certain expenses against which no supporting documents are available. He brings this matter to the attention of Bader Ali who has responded him that since this is not an audit engagement, it is not our responsibility to highlight such matters.

Required:
Briefly discuss how Bader Ali may be in breach of the fundamental principles of ICAP's Code of Ethics. Also, state the potential threats that Salman Abbas may face in the above circumstances and how he should respond. **(05)**

Q.6 Under the provisions of the Federal Excise Act, 2005 briefly describe the tax treatment of each of the following independent transactions:

(i) Silver Light Limited (SLL) supplied cooking oil worth Rs. 263,000 to Golden Era Limited in export processing zone for the purpose of packing it into specialized tin packs. Input tax paid by SLL on the production of cooking oil amounted to Rs. 145,000. **(04)**

(ii) Almond Investment Limited (AIL) is registered with Balochistan Revenue Authority as stockbroker for sales tax purposes. In May 2019, AIL rendered brokerage services to one of its clients in Quetta and charged a fee of Rs. 284,000. AIL paid provincial sales tax of Rs. 42,600 on such services. **(03)**

(iii) Micro Limited (ML) sold 100 boxes of Cuban cigars at US$ 356 per box (equivalent to Rs. 51,620) on board of a Pakistan International Airlines flight chartered by tourists from USA. The tourists were traveling from Islamabad to Dubai. Input tax paid by ML at the time of import of cigars amounted to Rs. 1,423,460. ML repacked these cigars in special packing at its facility. All payments were received in foreign exchange. **(03)**

Q.7 For the purpose of this question, **assume that the date today is 31 December 2019**.

Vocational Training Foundation (VTF) is a non-profit organization engaged in running a project for providing women living in rural areas of Balochistan, the skills to achieve financial self-reliance. Launched in January 2015, the project is being run under partnership with various institutions. Following information has been extracted from VTF's records for the year ended 30 June 2019:

	Rupees
Receipts:	
donations, voluntary contributions, subscriptions	70,000,000
rent from house property	2,502,000
income from business	5,000,000
Expenses:	
administrative and management	12,900,000
project	35,000,000

Additional information:

(i) Rent from house property includes non-adjustable deposit of Rs. 204,000 received from the tenant.

(ii) Administrative and management expenses include the following in relation to house property:

- Insurance premium of Rs. 150,000 paid to insure the house property against the risk of damage or destruction.
- Ground rent of Rs. 53,000.
- Installation of fire alarm amounting to Rs. 140,000.
- Salaries of Rs. 60,000 paid to two watchmen at the property.

(iii) Taxes paid by VTF u/s 153 amounted to Rs. 345,000.

(iv) VTF is included in active taxpayers' list and is in full compliance with all tax regulations.

Required:

Under the provisions of the Income Tax Ordinance, 2001:

(a) Compute, under the correct head of income, the taxable income and amount of tax payable by VTF, if any, for tax year 2019. **(11)**

(b) What would be your answer in (a) above if VTF had received a further donation of Rs. 16,000,000 from a donner agency requiring them to deposit 30% of the amount into an endowment fund to be used for granting scholarships to women who intend to pursue formal education in the field of commerce. **(05)**

Note:
- ***Ignore WWF, WPPF, Alternative Corporate Tax and default surcharge, if any.***
- ***Show all relevant exemptions, exclusions and disallowances.***

(THE END)