Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

12 December 2020
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Taxation

Instructions to examinees:
(i) Answer all **SEVEN** questions.
(ii) Answer in **black** pen only.

Q.1 Pagoda Limited (PL) is primarily engaged in the business of manufacturing and sale of consumer products. PL also provides toll manufacturing services to sportswear exporters in Faisalabad. Following information has been extracted from PL's records for the year ended 30 September 2020:

	Rs. in '000
Sales	45,068
Cost of sales	(21,250)
Gross profit	23,818
Administrative and selling expenses	(6,200)
Financial charges	(400)
Profit before taxation	17,218

Additional information:

(i) **Sales include:**
- goods worth Rs. 11,300,000 (net of foreign withholding tax of Rs. 1,832,000) exported to customers in Thailand and Malaysia.
- toll manufacturing services of Rs. 4,690,000. Tax withheld by exporters amounted to Rs. 46,900.
- local sales of Rs. 29,078,000.

(ii) **Administrative and selling expenses include:**
- online payment of Rs. 450,000 on purchase of professional books relating to PL's production processes from the website of a company in USA. No withholding tax was deducted/collected from the payment.
- salary of Rs. 1,060,000 paid to five newly hired staff members. The appointees are alumni of the class of 2018 of a well-recognized Federal Government university. They were hired on 1 June 2020 at a monthly emolument of Rs. 53,000 each. On 30 September 2020, PL had a total of 20 employees on its payroll.

(iii) Accounting depreciation charged to cost of sales and administrative and selling expenses amounted to Rs. 2,050,000 and Rs. 1,543,000 respectively.

Other information:

(i) On 1 September 2020, PL purchased a specialized machinery for Rs. 1,040,000 from a cottage industry in Lahore. The payment was made through a bearer cheque as per supplier's instructions. The accounting depreciation on machinery charged at the rate of 15% is included in cost of sales.

(ii) Total tax depreciation, including tax depreciation on specialized machinery, amounted to Rs. 2,925,000.

(iii) Tax paid u/s 147 amounted to Rs. 2,450,000 whereas tax deducted u/s 154 from export proceeds amounted to Rs. 113,000.

(iv) All the expenses, except cost of sales, are related only to PL's local sales.

(v) The shareholders' equity as at 30 September 2020 was Rs. 42,500,000.

Required:
Under the provisions of Income Tax Ordinance, 2001 and Rules made thereunder, compute taxable income and net tax payable for the tax year 2021. **(12)**

Note: ***Ignore WWF, WPPF, Minimum tax u/s 113, Alternative Corporate Tax and default surcharge, if any.***

Q.2 Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, discuss the tax implication/treatment in each of the following independent cases:

(a) On 30 November 2020 Jamila, a non-filer, gifted a cash cheque of Rs. 100,000 and a gold necklace to her daughter Anjum, who was visiting Pakistan on three months' vacation after a period of five years. Jamila had bought this necklace in 2017 for Rs. 325,000. Anjum sold the necklace on the same day at a jewellery shop for Rs. 475,000. **(07)**

Note: For the purpose of part (b) and (c), **assume that the date today is 31 December 2021**.

(b) Nasir Brothers (NB) is an AOP engaged in the business of trading consumer goods. On 1 June 2021 NB acquired a vehicle on lease from an NBFC for Rs. 2.75 million. However, due to serious illness of NB's managing partner, the accountant has failed to file the return of income u/s 114 for tax year 2021 and an updated taxpayer's profile for tax year 2020 until now. **(08)**

(c) Sunflower Limited (SL) is engaged in the business of production and supply of edible oils. On 1 June 2021 SL sold one of its office buildings to a commercial bank in Mardan for Rs. 130 million. This property was purchased by SL for Rs. 100 million. The accounting and tax written down value of the property at the time of disposal was Rs. 85 million. SL recorded the gain of Rs. 45 million in its audited financial statements. However, the gain was not offered to tax in the return of income for tax year 2021. SL has received a notice u/s 122(5A) from the Commissioner asking to add the gain of Rs. 45 million to SL's taxable income for tax year 2021. **(03)**

Q.3 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.

(a) Firdous Limited (FL) is engaged in the manufacturing and sale of plastic toys. FL's accountant is in the process of preparing sales tax return for the month of November 2020. While gathering information for the return, he has come across an insurance claim of Rs. 1,500,000 which was received in full against the raw materials destroyed by fire. The raw materials were purchased from a registered supplier in October 2020. FL adjusted the input tax paid on the lost materials in its return for October 2020. The accountant is perplexed whether FL is required to obtain a permission to adjust output tax of Rs. 255,000 on the amount of claim received from the insurance company in its November 2020 return. **(05)**

(b) Sohrab (Pvt) Limited (SPL), a registered person, is engaged in the business of manufacture and sale of foam and spring mattresses covered in Third Schedule. In November 2020 SPL imported 1,600 square meters of high quality packing foam worth Rs. 2,000,000 from Germany and supplied it to a renowned packaging industry in Punjab at a special price of Rs. 1,475 per square meter. However, such foam is usually sold in the local market at a retail price of Rs. 1,525 per square meter. **(04)**

(c) Masala (Pvt) Limited (MPL) is engaged in the business of production and sale of spices in retail packing and is registered for sales tax purposes. On 22 November 2020 the regional sales manager requested MPL's tax department to issue a credit note to one of MPL's customers in Sargodha who had purchased 5,000 packets of spices from MPL on 26 May 2020. The tax department issued the credit note on 24 November 2020. The tax department intends to adjust the amount of MPL's output tax in relation to the above credit note in its November 2020 return. **(04)**

Q.4 Zeenat Limited (ZL) is engaged in multiple businesses across Pakistan. ZL is registered as a manufacturer, importer and distributor with sales tax authorities in Karachi. Following information has been extracted from ZL's records for the month of November 2020.

(i) Vegetable ghee of Rs. 995,000 was purchased from a registered distributor in Multan.

(ii) On 15 November 2020, ZL acquired a machinery from a registered supplier under hire purchase agreement. Payment was to be made in thirty equal monthly instalments of Rs. 80,000 starting from December 2020. The fair value of the machinery was estimated at Rs. 2,000,000.

(iii) On 23 October 2020 ZL entered into a contract with BM Associates (BMA), a registered supplier, for the purchase of taxable goods worth Rs. 920,000. ZL paid 25% of the price on the date of the contract and agreed to pay the balance in November 2020. The goods were made available to ZL on the contract date. However, due to shortage of storage capacity, ZL removed the goods from BMA's warehouse on 23 November 2020 and paid the balance to BMA on the same day.

(iv) 2,800 kg of raw tea, covered under Third Schedule, was imported from Kenya in bulk packing. The value of tea, assessed at import stage by customs authorities, amounted to Rs. 400 per kg. The value was inclusive of all applicable taxes and charges, excluding sales tax. ZL was in compliance with all the requirements relating to import of raw tea.

(v) Consultancy charges of Rs. 480,000 was paid to a non-resident foreign consultant for conducting market research for the launch of ZL's new product in overseas market.

(vi) Halal ready-to-cook lamb-meat worth Rs. 1,632,000 was sold in retail packing under a brand name 'Taza' to large departmental stores in Peshawar. ZL also supplied meat offal worth Rs. 485,000 to some of the famous food chains in Lahore. These products are covered under Sixth/Eight Schedules.

(vii) Taxable goods worth Rs. 365,000 were sold to a 250 beds teaching hospital, run by a statutory university in Nawabshah. The goods were purchased in finished condition for Rs. 256,000 from a registered manufacturer in September 2020.

(viii) 11,400 litres of lubricating oils worth Rs. 1,482,000 were sold in retail packing to a dealer in Karachi. Sales tax collected on the supply amounted to Rs. 230,000.

(ix) Following products were sold to an unregistered wholesaler at a trade discount of 5%. The discount was duly reflected on the invoice.
- Rice flour worth Rs. 1,675,000 (Gross value). It was sold in retail packing under a brand name.
- Meslin flour worth Rs. 488,000 (Gross value).

The above products are covered under Sixth/Eight Schedules.

(x) 5,000 toothbrushes were supplied to a creditor in final settlement of his dues of Rs. 245,000. The toothbrushes are sold in the market at a price of Rs. 52 each. ZL also supplied 1,800 tubes of toothpaste to an unregistered wholesaler at Rs. 112 per unit. The toothbrushes and toothpastes were purchased at a cost of Rs. 45 and Rs. 98 per unit respectively.

(xi) Goods worth Rs. 980,000 were sold to exporters under the Duty and Tax Remission Rules, 2001. These goods were purchased by ZL in finished condition from an unregistered supplier for Rs. 710,000.

(xii) Dyes and chemicals worth Rs. 1,320,000 were exported through Afghanistan to Central Asian Republic countries.

All payments were made through cross cheque/pay order except otherwise indicated. 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 ZL and the amount of input tax to be carried forward, if any, for the tax period November 2020. Also compute withholding tax, wherever applicable. **(19)**
Note: Show all relevant exemptions, exclusions and disallowances.

Q.5 For the purpose of this question, **assume that the date today is 31 December 2021**.

Multitasking Limited (ML) is engaged in the business of manufacturing and sale of various products. ML has several retail outlets within the country and two branches outside Pakistan situated each in Bahrain and Sharjah.

ML's Tax Manager is in the process of finalizing return of income for the tax year 2021 and has presented following information along with supporting notes for management's approval:

	Note	Rs. in '000
Profit before taxation	(i)	125,000
Add: inadmissible expense/admissible income		
Accounting depreciation		30,000
Accounting amortization - Trademark	(ii)	1,000
Gain on sale of shares in Prime Limited	(iii)	250
		31,250
Less: admissible expense		
Tax depreciation - normal	(iv)	(22,000)
Tax amortization - Trademark	(ii)	(200)
Bad debts actually written off	(v)	(2,750)
		(24,950)
Taxable income for the year		**131,300**

Computation of net tax liability:

Tax @ 29%	38,077
Less: Tax deducted/paid:	
advance tax paid under section 147	(34,300)
tax deducted on import of second hand equipment	(275)
income taxes paid in Bahrain	(975)
unadjusted foreign tax credit from tax year 2020	(100)
	(35,650)
Net tax payable	**2,427**

Notes to the Computation:

(i) The profit before taxation has been arrived at after inclusion/adjustment of the following:

- Profit of Rs. 3,200,000 of Bahrain branch and loss of Rs. 4,400,000 of Sharjah branch.
- Profit on debt of Rs. 1,800,000 paid on a working capital loan obtained from a non-resident bank in Netherlands. No withholding tax was deducted by ML while making payment of interest on loan, considering the bank does not have a permanent establishment in Pakistan. There is no double tax treaty between Pakistan and Netherlands.
- Rs. 450,000 paid to a law firm in Netherlands for arranging the above loan facility and completion of all legal formalities relating to the loan. No withholding tax was deducted on the ground that both the bank and the law firm were based outside Pakistan.
- Exchange loss of Rs. 120,000. The loss was incurred in relation to a machinery which ML acquired on 30 June 2020 from Canada through a foreign currency loan of CAD 36,000. The loan was repayable in three equal annual instalments of CAD 12,000 at the end of each year. The first instalment was paid on 30 June 2020 when the exchange rate parity was CAD 1 = PKR 110 While the second instalment was paid on 30 June 2021 when exchange rate parity was CAD 1 = PKR 115.

(ii) On 19 April 2021, ML acquired rights for use of trademark from a French company for a period of five years. The trademark is related to a machinery which ML is planning to introduce after 31 August 2021 through its major outlets across the country. For accounting purposes, the cost is to be amortized equally over the period of five years.

(iii) On 1 June 2021, ML sold 15,625 shares in Prime Limited at a negotiated price of Rs. 55 per share to a foreign investor. The market value of these shares at the time of sale was Rs. 58 per share. On 1 March 2020, ML received these shares by way of dividend-in-specie. Dividend income was recorded at Rs. 609,375 and tax withheld on such dividend amounted to Rs. 91,406.

(iv) During the year, ML imported a second hand equipment at a cost of Rs. 5,000,000. No initial depreciation allowance has been claimed as the equipment is second hand in nature.

(v) It includes write off of an interest free loan of Rs 1,350,000. The loan was provided to ML's branch in Sharjah for working capital requirement.

The opening and closing balances of provision for bad debt account were Rs. 2,530,000 and Rs. 3,625,000 respectively.

Other information:
ML was in dispute with some of its suppliers with regard to the amounts invoiced to it. Year-wise breakup of the unpaid disputed liabilities is as follows:

Year of supply	Rs. in '000
Tax Year 2017	810
Tax Year 2018	950
Tax Year 2019	1,355
Tax Year 2020	1,630
	4,745

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, comment on the above tax computation prepared by the tax manager for tax year 2021. Give suggestion(s), wherever required. **(22)**

Note:
- ***Revised computation is not required.***
- ***Ignore WWF, WPPF, Minimum tax u/s 113, Alternative Corporate Tax and default surcharge, if any.***

Q.6 Majid, a tax partner in Arzo and Company, Chartered Accountants is representing AB Associates, an audit client of the firm, in a law suit filed by Takeover Company Limited (TCL) for wrong deduction of withholding tax of Rs. 2,000,000 u/s 153 of the Income Tax Ordinance, 2001. Majid's spouse is a director in TCL.

Required:
In the light of ICAP's Code of Ethics, identify the potential threat(s) and the fundamental principles of code of ethics which may be breached in the above situation. Also suggest corresponding safeguard(s) to minimize/mitigate the threat(s). **(05)**

Q.7 (a) Moon Light Limited (MLL) is engaged in the business of production and supply of crude vegetable oil. The oil is obtained from rapeseeds grown in southern Punjab. After washing the oil for removing any impurities and passing it through a process of adding antioxidants for increasing its shelf-life, the oil is sold to various dealers/retailers in the market. On 15 November 2020 MLL supplied 1,500 litres of oil to un-registered dealers in Islamabad for Rs. 324,000.

Required:
Under the provisions of the Federal Excise Act, 2005 advise the tax implication / treatment of the above to MLL. **(03)**

(b) Ujala Limited (UL) is engaged in the business of manufacturing and import of cigarettes and is registered under the Federal Excise Act, 2005. UL sells two different brands of cigarettes viz. **A** and **B** in retail packing. Following information is available from UL's records for the month of November 2020:

Brand A: Import of 195,000 packs of cigarettes from Greece. The value assessed by customs authorities at import stage amounted to Rs. 39,000,000. UL sold 160,000 packs at a wholesale price of Rs. 220 per pack to a large distributor in Lahore whereas the remaining packs were sold on one-month credit to a departmental store in Karachi at a retail price of Rs. 250 per pack of 10 cigarettes.

Brand B: Purchase of 3,900 kg of unmanufactured WP tobacco worth Rs. 323,700 from district Swabi. The tobacco was provided to an independent manufacturer, Parwaz Limited (PL), in Peshawar for the manufacture of brand B cigarettes. PL manufactured 390,000 packs of cigarettes and invoiced gross conversion charges of Rs. 7,800,000 to UL. All the packs were sold by UL to various stores at a retail price of Rs. 38 per pack of 10 cigarettes. UL paid the conversion charges on 2 December 2020.

Required:
Under the provisions of the Federal Excise Act, 2005 compute the amount of duty payable by or refundable to UL for tax period November 2020. **(04)**

(c) Mudeer Beverages Limited (MBL) registered under the Federal Excise Act, 2005 is planning to extend the area of its operations and supply aerated waters to retail outlets in Hyderabad. MBL currently supplies aerated waters to customers in Sukkur at a retail price of Rs. 351 per bottle. The price is inclusive of octroi charges of Rs. 6, transportation cost of Rs. 3 and sales tax at the rate of 17%. For Hyderabad, MBL has estimated to incur additional transportation cost of Rs. 2, insurance charges of Rs. 3 and advertisement expense of Rs. 4 per bottle whereas the retailers are estimated to incur warehousing cost of Rs. 1 and chilling cost of Rs. 2 per bottle. MBL has also agreed to allow a special discount of Rs. 1.5 per bottle to the retailers in Hyderabad. The consumer price of aerated waters in Hyderabad is Rs. 364.53.

Required:
Under the provisions of the Federal Excise Act, 2005 compute the amount of duty payable by MBL on supply of aerated waters to Hyderabad and Sukkur. The rate of duty on aerated waters is 13%. **(04)**

(THE END)