Certified Finance and Accounting Professional Stage Examination

The Institute of
Chartered Accountants
of Pakistan

11 June 2022
3 hours – 100 marks
Additional reading time – 15 minutes

Tax Planning and Practices

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

Q.1 Khalida and Nasreen have been the income tax filers for the last many years. They are currently considering launching a business to manufacture beauty soaps and detergents with the capital of Rs. 60 million. Khalida and Nasreen intend to make investment and share the profits in the ratio of 70:30 respectively.

They are, however, not certain whether the business venture should be in the form of an association of persons or a limited liability company.

Following is the expected profit or loss statement of their first year operations:

	Rs. in million
Sales	163
Cost of sales	(85)
Gross profit	78
Operating expenses	(37)
Interest expenses	(6)
Profit before donations and tax	35
Donations	(7)
Profit before tax	**28**

Additional information:
(i) Operating expenses include:
- salary of Rs. 5 million payable to Nasreen.
- rent of Rs. 3 million payable to Khalida for letting out her property on lease for office purposes. The fair market value of the rent is estimated at Rs. 4 million.

(ii) Interest expenses represent amount payable to Khalida on a loan utilized for business under an agreement.
(iii) Donations represent 20% of the profit to a charitable educational institute, included in the Thirteenth schedule of the Income Tax Ordinance, 2001.
(iv) The remaining profit for the year would be distributed to owners.

You may assume that Khalida and Nasreen have no other source of income except mentioned above.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, advise which of the following forms of business would be tax beneficial for the business as well as its owners:
- Association of persons
- Limited liability company **(22)**

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

Q.2 Khushi Limited (KL), a public unlisted company, is primarily engaged in the business of manufacturing and sale of auto parts.

50% of KL's shares are owned by a UAE company, Hafiz LLC (HL) whereas remaining 50% shares are owned by a local group. Break-up of KL's equity and long term liabilities as on 1 January 2021 and 31 December 2021 are as follows:

	1 Jan 2021	**31 Dec 2021**
	------Rs. in million ------	
Equity:		
Share capital (Rs. 10 each)	500	500
Reserves	160	280
Revaluation surplus	40	50
Long term liabilities:		
15% bank loan, payable in 2024	200	300
12% loan from HL, payable in 2026	800	1,200

On 1 January 2021, KL acquired 80% shareholdings in Roshni Limited (RL), an unlisted company. RL is engaged in the business of manufacturing car batteries. KL has no other subsidiaries.

KL's finance manager is in the process of finalizing income tax return for the tax year 2022 and has presented the following information alongwith supporting notes for the year ended 31 December 2021.

Income from business	**Note**	**Rs. in million**
Profit before tax	(i)	222
Adjustments:		
Accounting depreciation		86
Tax depreciation	(ii)	(142)
Income from rendering of maintenance services	(iii)	(16)
Taxable income before setting off losses		**150**
Less: RL's brought forward business losses	(iv)	(90)
Less: RL's business loss for the year 2021	(iv)	(28)
Taxable income		**32**

Notes to the computations:

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

- Expense of Rs. 14 million paid to Qurban Limited on account of rental of building alongwith plant and machinery. No withholding tax was deducted at the time of payment.
- Expense of Rs. 5 million paid to Karachi branch of a UAE based consultancy firm, for carrying out due diligence for acquisition of RL. No withholding tax was deducted at the time of payment.
- Expense of Rs. 15 million paid to an IT company, for development of computer software. Although the software was available for use from 1 October 2021, KL's management decided to implement the software from 1 January 2022.
- Interest expenses of Rs. 38 million and Rs. 120 million on bank loan and loan from HL respectively.
- Interest income of Rs. 12 million on investment in Pakistan Investment Bond.

(ii) It includes following depreciation amount:

- Rs. 3 million on delivery vehicle which was purchased on 1 January 2021 at a cost of Rs. 20 million.
- Rs. 0.78 million being 5th year depreciation on car which was in use of KL's CEO. The car was provided to the CEO for official purpose. On 1 December 2021, this car was sold to the CEO at a book value of Rs. 2 million after the expiry of its useful life of 5 years. The cost and market value of the car at the time of disposal were Rs. 10 million and Rs. 6 million respectively.

(iii) These services were rendered to a manufacturer namely Kamran & Co. whose annual turnover was less than Rs. 40 million in preceding tax years. The finance manager considers that this income is subject to minimum tax.

(iv) These represent the entire taxable losses of its subsidiary i.e. RL.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, comment on the above computation of taxable income, prepared by the finance manager for tax year 2022. Also suggest the revised adjustment, if required. **(25)**

Note:
- ***Ignore discussion on tax liability.***
- ***Ignore WWF, WPPF, Minimum tax u/s 113 and Alternative Corporate Tax, if any.***

Q.3 Rahat & Co. is the distributor of imported home appliances. It imports the items in bulk quantity and supplies to retailers on wholesale basis as well as to the general public on retail basis.

On 1 April 2022, it sold 50 split air conditioners to Sukoon & Co. at a wholesale price of Rs. 150,000 per unit. The retail price of each unit is Rs. 200,000. Sukoon & Co. paid the billed amount on 15 April 2022. The air conditioners are covered under the Third Schedule of the Sales Tax Act, 1990.

All the above figures are exclusive of sales tax.

Required:
Under the provisions of Income Tax Ordinance, 2001 and Rules made thereunder:

(a) discuss the withholding tax implication of the above transaction on both Rahat & Co. and Sukoon & Co. **Assume that both entities have an annual turnover of more than Rs. 100 million.** **(06)**

(b) what are the consequences in case of failure to collect/deduct the withholding tax, if any, computed in part (a). **(02)**

Q.4 Rahman was a tax manager in a firm namely Salman Iqbal and Company, Chartered Accountants (the firm). He was responsible for filing monthly sales tax returns of various clients including Jamshed Limited (JL) and was reporting to Salman, the tax partner in the firm.

In May 2020, Rahman resigned from the firm and joined Kashif Limited, a competitor of JL, as the Head of Taxation. Salman handed over Rahman's work to Nawaz, who was a newly inducted chartered accountant in his team. Nawaz had no prior experience of working in the tax department.

While filing the sales tax return for the month of May 2022, Nawaz approached Salman for some assistance. However, due to an extremely busy work schedule, Salman requested Rahman to provide assistance to Nawaz and instructed Nawaz to share his working papers with Rahman and submit the sales tax return after Rahman's approval.

After reviewing the file, Rahman made some adjustments in sales tax working and finalized the sales tax return for the month of May 2022. Nawaz does not agree with the adjustment and believes that they are not in accordance with the sales tax laws.

Required:
Briefly discuss if Salman may be in breach of the fundamental principles of ICAP's Code of Ethics. Also state the potential threats that Nawaz may face in the above circumstances and how he should respond. **(06)**

Q.5 Medicon Pakistan Limited (MPL) is engaged in the business of manufacturing and supply of pharmaceutical products and medical equipment with its principal place of business in Karachi. It is registered as an importer, manufacturer and distributer with the Sales Tax Authorities. Following information has been extracted from MPL's records for the month of May 2022:

	Rs. in million
Purchases	
from registered suppliers	1,080
from un-registered suppliers	180
Imports	650
Supplies	
to registered persons	1,210
to unregistered persons	120

All medicines and drugs purchased and supplied, unless specified otherwise, by MPL are registered under the Drugs Act, 1976.

Additional information:

(i) Purchases from registered suppliers include:

- raw material worth Rs. 400 million comprising of pharmaceutical active ingredients of Rs. 300 million and artificial flavourings of Rs. 100 million.
- plastic bottles for packaging worth Rs. 160 million from a local supplier. During the month it was discovered that the supplier has only deposited 80% of the sales tax on these purchases with the government treasury.
- sugar syrup from an associated company at a concessional price of Rs. 192 million. The open market price of this syrup was Rs. 200 million.
- transportation charges of Rs. 40 million paid to a Karachi based transport company for delivering products to retailers. 70% of these charges pertained to Karachi and the remaining to Lahore.
- Rs. 20 million paid in advance to Karachi based trainers for conducting doctors' training programme in Karachi in July 2022.
- air tickets of Rs. 8 million, purchased from a travel agent in Karachi. These tickets were purchased for a team of 20 doctors to attend training sessions in London. 50% of the amount was paid during the current month whereas remaining 50% would be paid in next month.
- furniture of Rs. 80 million for MPL's office.
- Dextrose and Saline infusion giving sets (listed under Sixth Schedule of the Sales Tax Act, 1990) worth Rs. 110 million.
- over the counter medicines worth Rs. 70 million from a local manufacturer.

(ii) Purchases from unregistered suppliers consist of taxable supplies only.

(iii) Imports include:

- glucose testing equipment (listed under Sixth Schedule of the Sales Tax Act, 1990) worth Rs. 150 million.
- protein bars worth Rs. 500 million. Protein bars are not registered under the Drug Act, 1976.

(iv) Supplies to registered persons include:

- medicines worth Rs. 700 million supplied to various pharmacies in Karachi and Lahore.
- imported protein bars of Rs. 300 million supplied to retailers at a trade discount of 5%. The discount is in conformity with the normal business practice and also reflected on the tax invoice.
- imported protein bars of Rs. 110 million supplied to online medical stores at a trade discount of 15% which is reflected on the tax invoice. The additional discount was given to promote online sales.
- hospital scrubs worth Rs. 100 million supplied to a hospital owned and managed by the Federal Government.

(v) Supplies to unregistered persons comprise of over the counter medicines sold to various pharmacies.

(vi) During the month, MPL paid royalty of Rs. 40 million to a non-resident company for using its intellectual property in the manufacture of medicines.

All the payments were made through cross cheque / pay order. All the above figures are **exclusive of federal excise duty (FED) and sales tax**, unless specified otherwise.

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 MPL and the amount of input tax to be carried forward, if any, for the tax period May 2022. Also compute withholding tax, wherever applicable. **(20)**

Note:
- ***Show all relevant exemptions, exclusions and disallowances.***
- ***All figures should be rounded off to two decimal places.***

Q.6 (a) Juicy Drinks (JD) is a shop located in Karachi which is famous for its peach flavoured drinks. JD purchases peach syrup, in one litre packaging, from a registered supplier in Swat (located in PATA) for use in peach flavoured drinks. The retail price per litre fixed for sale of this syrup in Swat and Karachi is Rs. 700 and Rs. 750 respectively.

During the period, JD purchased 200 litres of peach syrup from Swat.

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, comment on the chargeability of sales tax and withholding of sales tax on purchase of 200 litres of peach syrup from Swat. **(03)**

(b) Zain Fruit and Nuts (ZFN) is involved in the business of manufacturing dried fruit and fruit jam and is registered with the sales tax authorities. It recently started a factory in Baluchistan within the limits of Border Sustenance Markets.

During the month of May 2022, ZFN imported apricots and kiwi fruit from Iran. Apricots were fully consumed in the manufacture of apricot jam however 60% of the kiwi fruit was used in the manufacture of dried kiwi slices and the remaining was sold to a fruit jam manufacturer in Islamabad.

Apricot jam was sold to a retailer in Peshawar as well as a retailer within the limits of Border Sustenance Markets.

Required:
Under the provision of the Sales Tax Act, 1990 and Rules made thereunder, discuss the implications of sales tax on the above transactions. **(04)**

(c) Faiz Limited (FL) and Sehat Limited (SL) are associated companies registered with the sales tax authorities. FL and SL share the rented office space under an agreement. SL makes the rent payment and later charges FL for its share of the cost.

SL also purchases packaging material from FL and adjusts the cost of purchase against FL's share of rent. Since no actual payment is made, FL neither issues a tax invoice nor charges sales tax on it.

On 31 May 2022, FL received a notice from Officer Inland Revenue under the Sales Tax Act, 1990 for the recovery of sales tax on supply of packaging material to SL during the period from May 2015 to May 2022.

Required:
In the light of the Sales Tax Act, 1990, discuss how FL should respond to the show cause notice issued by the Officer Inland Revenue. Also discuss the penalties which may be imposed on FL for the non-compliance with the provisions of law. **(04)**

Q.7 Aftab Limited (AL) is engaged in the business of import and distribution of mobile phones in Pakistan. Mobile phones are imported in Completely Built Unit (CBU) condition and are sold to various retailers across the country.

AL is planning to set up an assembly plant in Karachi for the assembly of three categories of mobile phones. AL will import mobile phones under these categories in Semi Knocked Down (SKD) condition and assemble them locally for sale to retailers. Below are the details of the assessed values of these mobile phones in both CBU and SKD condition together with their demand.

Category	Demand of mobile phones	Per unit C&F value of mobile phones in	
		CBU condition	**SKD condition**
A	4,000 units	USD 45	USD 35
B	1,100 units	USD 450	USD 375
C	350 units	USD 750	USD 660

The applicable exchange rate of 1 USD to PKR is Rs. 195.

Required:
In the light of the provisions of the Income Tax Ordinance, 2001 and Sales Tax Act, 1990 discuss the tax implications at import stage of purchasing mobile phones in CBU condition as well as SKD condition. **(08)**

(THE END)