Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

7 December 2019
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 You are a tax partner in a local firm of Chartered Accountants. You have been approached by some of the clients for opinion on the possible tax implication/treatment of certain matters. 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) Zodiac Limited (ZL) wrote off a debt amounting to Rs. 600,000 in September 2016 after making all possible efforts for the recovery of the debt. ZL was allowed a deduction of Rs. 410,000 in tax year 2017. In tax year 2020, the case which was filed in the Court, for the recovery of the debt was decided in ZL's favour. Now, ZL is expecting to recover any of the following two amounts against the debt:

(i) Recovers Rs. 240,000
(ii) Recovers Rs. 160,000 **(04)**

(b) Firdous held 6,000 shares in Delta Limited (DL) which he had acquired on 1 July 2018 at Rs. 25 each. DL subsequently merged into Bravo Limited (BL) through a scheme approved by the High Court. BL issued 2 shares for every 4 shares held in DL. **(03)**

(c) On 31 July 2019 Noble (Pvt) Limited (NPL) received a notice from Officer of Inland Revenue asking it to deposit withholding tax of Rs. 3,750,000 in respect of a loan of Rs. 25,000,000 which was provided by NPL to one of its shareholders on 31 December 2018. NPL's accumulated profits at the time of provision of loan amounted to Rs. 20,000,000. **(03)**

(d) Kamran Malik, a non-salaried individual, declared taxable income of Rs. 9,585,000 for tax year 2019. However, due to unavoidable circumstances he failed to file his return of income on due date. Upon application, the Commissioner allowed him an extension of 15 days for furnishing his return of income. Kamran Malik did not file the return within the extended time as he was out of the country for twenty days. Now he intends to file his return of income on 01 December 2019 and pay the tax liability of Rs. 2,474,750 on his declared income. **(08)**

(e) On 01 September 2016 Mega (Pvt) Limited (MPL), engaged in the business of manufacturing plastic bottles, had obtained a machinery on finance lease. For the year ended 30 September 2019 MPL charged interest of Rs. 228,000 to the profit and loss account on account of such finance lease. Total lease rentals paid during the year amounted to Rs. 475,000. At the end of the lease term which expired on 31 August 2019, the machinery was transferred to MPL at a residual value of Rs. 764,000. The market value of the machinery on the date of its transfer amounted to Rs. 868,000. **(03)**

Q.2 Sahulaat Limited (SL) is engaged in various businesses across Pakistan and is registered as a manufacturer cum commercial importer and service provider with the Federal and Provincial Sales Tax Authorities. Besides carrying on various trading businesses, SL is primarily engaged in the business of manufacturing and supply of household electrical and gas appliances, covered under third schedule of the Sales Tax Act, 1990. Following data has been extracted from SL's records for the month of November 2019:

(i) Raw materials of Rs. 3,650,000 were purchased from an un-registered AOP for the manufacture of gas appliances.

(ii) Packing materials of Rs. 2,350,000 were purchased from registered distributors for the packing of electrical appliances. The distributor did not file his return under section 26 by the due date for September 2019 and October 2019.

(iii) 1,700 litres of paint, covered under Third Schedule, were imported from Belgium without retail packing at Rs. 892,500. SL paid custom duty at the rate of 20% at the time of import.

800 litres of paint were sold to a dealer at a special discounted price of Rs. 565 per litre (the discount was duly shown on the invoice); 600 litres were sold to a wholesaler at a price of Rs. 575 per litre and 300 litres to a company in Export Processing Zone at a retail price of Rs. 625 per litre.

(iv) 5 kilograms of un-worked silver, covered under Serial No. 61 of the Eight Schedule, was imported from Dubai at Rs. 486,000. The silver was sold in the same condition as it was when imported to a local bullion dealer at Rs. 558,000.

(v) Preservatives of Rs. 690,000 were purchased from a cottage industry for onward sale to the producers of fruit juices.

(vi) Tiles measuring 625 square meters were purchased in June 2019 from a local manufacturer at Rs. 665,000. Extra tax was charged by the manufacturer at the time of purchase. These tiles were sold to un-registered contractors at a wholesale price of Rs. 1,264 per square meter for use in construction projects. The tiles are normally sold in the retail market at a price of Rs. 1,364 per square meter.

(vii) Accessories and spare parts worth Rs. 500,000 were purchased for delivery vans.

(viii) SL also purchased a fiscal electronic cash register and office equipment from a corporate supplier at a price of Rs. 735,000 and Rs. 495,000 respectively. These items were purchased on 30 days' credit.

(ix) Cooking oil, covered under Serial No. 24 of the Sixth Schedule, was purchased from a registered manufacturer in October 2019 at Rs. 632,000. Excise duty was collected by the manufacturer in VAT mode. SL sold the cooking oil to distributors from its retail outlet at Rs. 758,000.

(x) Electrical appliances worth Rs. 1,200,000 were supplied to a large departmental store in Islamabad. SL received the payment in four equal instalments with the last payment received on 31 October 2019.

(xi) SL's services division provided cold storage facilities worth Rs. 392,000 to various merchants for storing fruits and vegetables at their storage facility in Lahore.

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 SL and the amount of input tax to be carried forward, if any, for the tax period November 2019. Also compute withholding tax, wherever applicable. **(19)**
Note: Show all relevant exemptions, exclusions and disallowances.

Q.3 In the light of ICAP's Code of Ethics, discuss each of the following independent situations with regard to the breach of the fundamental principles of ethics:

(i) Ali Ahmad, a tax practitioner, failed to include rental income on a tax return he filed for his client, Zaheer Associates (ZA). The omitted income was from a recently acquired property. The property was duly disclosed in ZA's wealth statement. **(02)**

(ii) Mateen is a sole practicing chartered accountant. During the year, one of his clients, Taiz Enterprises (TE), opened a new division in Middle East. Mateen has no experience in international tax and would not be able to give TE the kind of tax advice needed for the new division. TE is a long-time client and Mateen does not want to lose it. Mateen decided to remain silent about his lack of knowledge in the area and would deal the situation on need basis. **(03)**

Q.4 (a) Muneer Enterprises (ME) is an AOP and is engaged in various businesses in the province of Sindh. ME is registered under the Federal Excise Act, 2005. Following information has been extracted for the month of November 2019 from ME's records.

(i) Received Rs. 875,000 in respect of services provided to Big Cargo Limited against inland carriage of goods by air.
(ii) Paid Rs. 200,000 for charges on hiring chartered flights for the purpose of inland carriage of goods by air.
(iii) Sold 26,000 bottles of aerated waters under the brand name of 'Surchashma' to Bayaab Associates at a discounted price of Rs. 95 per bottle. The retail price of each bottle in the market is Rs. 112.
(iv) Received 2,000 litres of concentrates in syrup form worth Rs. 90,000 from a local supplier on two months' credit. Concentrates are used in the manufacture of aerated waters.
(v) Paid Rs. 80,000 on account of newspaper advertisement for boosting sales of aerated waters in Hyderabad. No services tax was paid to Sindh Revenue Board (SRB) in this regard.
(vi) Received Rs. 150,000 in respect of franchise fee from Himalaya Enterprises. ME granted them the right to sell "Surchashma" in Malir. ME also paid services tax of Rs. 19,500 on the franchise fee to SRB.

All the above figures are **exclusive of excise duty**, wherever applicable. Payments were made/received through banking channels, unless mentioned otherwise.

Required:
In the light of the provisions of the Federal Excise Act, 2005 and Rules made thereunder, compute the amount of net duty payable by or refundable to ME for November 2019. **(06)**
Note: Show all relevant exemptions, exclusions and disallowances.

(b) Dexo Corporation (DC), is engaged in the business of manufacture and sale of aerated waters to shopping centres and cinema houses in Lahore. DC buys fruit juices from a local supplier which are directly used in the manufacturing process. In November 2019 DC bought 600 litres of fruit juices at a retail price of Rs. 330 per litre and exported 10,000 bottles of aerated waters to a customer in Dubai at a wholesale price of Rs. 590 per bottle. It also sold 1,500 bottles of aerated waters to a shopping centre at a retail price of Rs. 680 per bottle.

Required:
Under the provisions of the Federal Excise Act, 2005 briefly describe the tax treatment in respect of the above situation. **(05)**

Q.5 For the purpose of this question, **assume that the date today is 30 September 2020**.

You have recently joined Jubilee (Pvt) Limited (JPL), as director taxation. JPL owns 85% ordinary shares in an unlisted public company Diamond Pharma Limited (DPL). Both the companies are engaged in the business of manufacturing and supply of pharmaceutical products.

DPL also owns 100% ordinary shares in Titanium (Pvt) Limited (TPL) for the last many years. TPL is engaged in the trading business. It supplies empty capsules to various pharmaceutical companies. The accounting year of all the above companies ends on 30 September each year. The manager taxation is in the process of finalizing income tax return for tax year 2020 and has provided you the following tax computation along with supporting notes for your approval:

		JPL	DPL	TPL
Income from business:		------ Rs. in '000 ------		
Profit/(loss) before taxation	[Note (i)]	6,600	(2,300)	2,050
Add: Inadmissible expenses				
Accounting depreciation for the year		1,945	1,085	160
Purchase of goods without withholding the tax	[Note (ii)]	1,200	-	-
Total business income/(loss) before depreciation		9,745	(1,215)	2,210
Less:				
Unabsorbed tax depreciation		(350)	(585)	(125)
Tax depreciation		(1,410)	(1,010)	(155)
		7,985	(2,810)	1,930
Less: Brought forward assessed business loss		(162)	(658)	(1,035)
Total business income/(loss) for the year		7,823	(3,468)	895
Less: Brought forward capital loss		(625)	(195)	(220)
Total taxable income before availing group relief		7,198	(3,663)	675
Less: Group Relief Scheme				
Loss surrendered by DPL in favour of JPL and TPL		(2,988)	3,663	(675)
Taxable income for the year		4,210	-	-
Business loss carried forward to next tax year		Nil	Nil	Nil
Unabsorbed depreciation carried forward to next tax year		Nil	Nil	Nil
Capital loss carried forward to next tax year		Nil	Nil	Nil
Computation of net tax liability:				
Tax regime		**NTR**	**NTR**	**NTR**
Tax on taxable income [@ 29%]	**(a)**	1,221	-	-
Turnover		30,000	9,800	5,500
Minimum tax u/s 113 [@ 1.5% of turnover]	**(b)**	450	147	83
Total tax liability [Higher of **(a)** or **(b)**]		1,221	147	83
Less: Tax deduction at source				
Advance tax paid u/s 147 and 153		(1,163)	(175)	(61)
Net tax payable/(refundable)		**58**	**(28)**	**22**

Supporting notes:

(i) The above profit/(loss) for each company has been arrived at after inclusion/adjustment of the following:

In case of JPL:

- Deemed income of Rs. 225,000 in respect of a loan received otherwise than by a crossed cheque.
- Rs. 1,500,000 paid in respect of improving the embodied features of production software.
- Advertisement and sales promotion expenses of Rs. 5,310,000 incurred on capturing the major market chunk for two of JPL's new vaccines.

In case of DPL:

- A loss of Rs. 600,000 on disposal of shares in a private company. These shares were acquired by DPL on 30 September 2017.
- A loss of Rs. 900,000 on discontinuance of one of its vaccine units in July 2018.
- A gain of Rs. 145,000 on sale of machinery to TPL. The cost of machinery was Rs. 400,000 and its tax written down value at the time of transfer to TPL was Rs. 255,000.

In case of TPL:

- Income of Rs. 475,000 on account of profit on debt.
- A gain of Rs. 500,000 on disposal of shares in a private company. These shares were acquired by TPL on 01 August 2016.

(ii) Goods worth Rs. 1,200,000 (inclusive of imported goods of Rs. 750,000) were purchased from Tetra Enterprises (TE), a permanent establishment in Pakistan of a non-resident company in Japan. TE sold the imported goods to JPL in the same condition as they were when imported. No withholding tax was deducted by JPL at the time of making payment for these goods.

Required:

Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, comment on the above tax computation prepared by the manager taxation for tax year 2020. Give suggestion(s), wherever required. **(20)**

Note: Revised computation is not required.

Q.6 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 and compute the amount of tax, wherever applicable:

(a) Saltish Associates (SA) is a registered person, engaged in the business of supplying iodized salt, covered under Serial Number 29 of the Sixth Schedule. SA supplied 300 kg of iodized salt, in retail packing of 5 kg, under the brand name of 'Best' to an un-registered departmental store in Faisalabad at a wholesale price of Rs. 100 per pack. In October 2019 SA had purchased 500 kg of un-packed salt from a local supplier, TP Enterprises (TPE), at a price of Rs. 12 per kg. This salt is sold in the market at a retail price of Rs. 120 per pack. TPE declared the sale of salt to SA in its return for November 2019. **(05)**

(b) On 15 October 2019, Taj Saeed, a registered exporter for sales tax purposes, filed an application for refund of Rs. 186,000 on account of input tax paid on 18 October 2018 on raw material exported to Iran. The refund is expected to be received on 15 December 2019. Taj Saeed is also required to pay a default surcharge of Rs. 25,000 to the income tax department for late filing of his monthly withholding tax statement. The rate of KIBOR is 11%. **(05)**

(c) Decor Enterprises (DE) is engaged in the business of manufacturing and supply of water and soap dispensers to various corporate clients. DE placed 10 electric water dispensers worth Rs. 60,000 and 10 soap dispensers worth Rs. 20,000 at leading departmental stores for advertisement purposes. DE also received a security deposit of Rs. 60,000 against such placement. The Deputy Commissioner Inland Revenue has issued a show cause notice to DE asking them to pay Rs. 23,800 on account of sales tax on such dispensers and security deposit. **(03)**

Q.7 Moiz Bilgrami, a sole proprietor, is engaged in the business of processing and selling honey and honey based products to homeopathic clinics in Punjab under the name and style of Al Shifa Trading (AST). On 1 December 2019 Moiz Bilgrami decided to transfer his proprietary business, including all the assets and liabilities, to a private limited company Bee Honest (Pvt) Limited (BHPL). Following is the balance sheet of AST immediately before the disposal of business to BHPL:

Al Shifa Trading (AST)
Balance Sheet as at 30 November 2019

Capital and Liabilities	Rupees	Assets	Rupees
Owner's Capital	10,080,000	Fixed Assets (WDV)	6,048,000
Accumulated Profit	1,680,000	Patents (WDV)	2,240,000
	11,760,000	Stock in Trade	5,152,000
Short Term Loan	650,000	Debtors	3,360,000
Trade Creditors	7,840,000	Cash and Bank Balances	3,450,000
	20,250,000		**20,250,000**

Following information is available relating to the proposed scheme of transfer:

(i) The stock in trade as at 30 November 2019 is estimated to realize Rs. 4,480,000.

(ii) Rs. 1,120,000 recoverable from two large clinics in Multan against sale of honey products remains outstanding. All possible efforts have been made by AST for the recovery of debts, to no avail.

(iii) Following are the tax written down values (WDV) and fair market values (FMV) of AST's fixed assets and patents as at 30 November 2019:

	Cost	Tax WDV	FMV
	------------------ Rupees	------------------	
Fixed assets	7,840,000	3,630,000	5,800,000
Patents	5,600,000	2,800,000	2,570,000

(iv) BHPL has a paid-up capital of Rs. 50,000,000 consisting of ordinary shares of Rs. 10 each. Moiz Bilgrami beneficially owns all the issued shares in BHPL. The fair value of each share of BHPL as at 30 November 2019 was Rs. 20.

Assume all conditions necessary for the avoidance of any gain or loss on the disposal of all the assets of AST to BHPL have been duly complied with.

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

(a) number and value of shares to be received by Moiz Bilgrami from BHPL. **(06)**
(b) BHPL's cost of acquisition of assets. **(03)**
(c) Moiz Bilgrami's cost in respect of shares received by him as consideration. **(02)**

(THE END)