The Institute of Chartered Accountants of Pakistan

Certified Finance and Accounting Professional Stage Examination

12 June 2021
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 (a) Marhaba (Pvt.) Limited (MPL), a manufacturing concern, was selected by the Commissioner Inland Revenue for the verification of its compliance with withholding tax regime. After completion of the audit, following transactions were identified where no tax was withheld/collected by MPL:

(i) As part of MPL's sales promotion scheme, a car was given as a prize to Mr. Ikram Nabi.

(ii) Following amounts were paid to landlord in respect of office building:
- Rent of Rs. 6 million
- Un-adjustable deposit of Rs. 600,000
- Salaries of three security guards of Rs. 900,000. The security guards were provided by the landlord.

(iii) Goods purchased from an importer.

(iv) Profit on debt was paid, under a loan agreement, to a Pakistani bank.

(v) Pesticides of Rs. 9.12 million were sold to retailers in Multan after a discount of 5%. These pesticides were purchased in January 2021 from a distributor.

Required:
Explain with reasons as to whether or not MPL was required to withhold tax on the above transactions and identify the amount(s), if any, on which withholding was to be made. Also explain the consequences in case of MPL's failure to deduct tax from any of the above payments. **(10)**

(b) Turbo (Pvt.) Limited (TPL) has acquired a new factory building for the establishment of a coal processing plant at district Tharparkar. TPL has engaged a foreign contractor, Dynamics Limited (DL) at a total contract price of Rs. 180 million for the design and implementation of production system on the following terms and conditions:

(i) DL would design the production system and acquire the necessary machinery for TPL.
(ii) A sub-contractor would be appointed by DL in Pakistan for the implementation of production system and installation of machinery at TPL's factory. DL would send its staff for the supervision of entire process from abroad.
(iii) TPL would pay Rs. 30 million to the sub-contractor on DL's behalf in Pakistan and remit the balance of Rs. 150 million to DL outside Pakistan.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and the Rules made thereunder, discuss the tax implication/treatment in case of both DL and the sub-contractor. **(07)**

Q.2 For the purpose of this question, **assume that the date today is 30 September 2021.**

Badri Versatile Limited (BVL), a listed company, is engaged in the business of manufacturing and supply of various products.

Presently its tax manager is in the process of finalizing income tax return for tax year 2021 and has provided following tax computation along with supporting notes for your approval:

Income from Business:		**Note**	**Rupees**
Profit before taxation		(i)	95,000,000
Add/(Less): Inadmissible expenses/(income)			
Raw material purchased from TL		(ii)	900,000
Training expenses		(iii)	235,000
Inter-corporate dividend received from a subsidiary		(iv)	(160,000)
Government grant against cost of machinery		(v)	(25,000,000)
Total business income for the year	**A**		**70,975,000**
Exempt income:			
Inter-corporate dividend received from a subsidiary		(iv)	160,000
Government grant against cost of machinery		(v)	25,000,000
	B		**25,160,000**
Total income for the year	**(A+B)**		**96,135,000**
Less: Exempt income			
Inter-corporate dividend received from a subsidiary			(160,000)
Government grant against cost of machinery			(25,000,000)
			(25,160,000)
Taxable income for the year under NTR			**70,975,000**
Computation of net tax liability:			
Tax on taxable income [70,975,000 @ 29%]			20,582,750
Default surcharge @ 18% on the shortfall [20,582,750 – 14,400,000]			1,112,895
Gross tax payable			**21,695,645**
Less: Tax deduction at source:			
Advance tax paid u/s 147			(14,400,000)
Advance tax paid u/s 153			(196,000)
			(14,596,000)
Net tax payable			**7,099,645**

Notes to the computation:

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

- Rs. 14,040,000 received against sale of electric toasters from Mujahid Associates (MA), a sales tax registered person. This amount was inclusive of sales tax but net of 4% withholding tax deducted by MA.
- Rs. 800,000 received as a monetary award from the President of Pakistan for best corporate practices and Rs. 400,000 received from the provincial health minister in recognition of BVL's services for Covid patients during the current pandemic.
- Rs. 425,000 on account of service charges deducted and kept by BVL from the tax withheld from suppliers.

(ii) Rs. 900,000 paid to Trial Limited (TL) for the purchase of raw materials. BVL paid the amount without withholding tax of Rs. 36,000.

(iii) Rs. 235,000 incurred on account of industrial training of Saulat Baig, a Pakistani citizen working at Pakistan Council of Scientific and Industrial Research in connection with a scheme approved by the Federal Board of Revenue.

(iv) Rs. 160,000 received in respect of inter-corporate dividend from a subsidiary within the group. BVL owns 51% interest in the subsidiary. No withholding tax was deducted by the subsidiary.

(v) A voluntary grant of Rs. 25,000,000 was provided by the Federal Government to BVL towards the cost of a new machinery purchased for the manufacture of ventilators for Covid-19 patients. BVL had acquired the machinery in July 2021 at the cost of Rs. 65,000,000. Tax depreciation charged during the year on the machinery at the rate of 15% amounted to Rs. 9,750,000.

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. **(25)**

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

Q.3 For the purpose of this question, **assume that the date today is 30 September 2021.**

Compost (Pvt.) Limited (CPL), incorporated under the Companies Act, 2017 is engaged in the business of providing wastewater treatment solutions to hospitals, industries and agricultural sites across Pakistan.

CPL is 70% owned by a Belgium based company Belgian Aqua Plc. (BAP) and 15% each by a Dutch company Dutch Waste LLC. (DWL) and a Pakistani company Tezabi Pani Limited (TPL).

BAP is 50% owned by DWL whereas TPL is 100% owned by a German company Berlin Wasser Gmbh (BWG).

On 18 December 2020 CPL received a loan of US$ 4 million from BAP for the installation of a wastewater treatment plant in rural Sindh. The project was approved by the Federal Government. The loan carries interest at the rate of 9% per annum. Interest is to be paid quarterly in arrears by the 8th day of the next quarter.

On 11 February 2021 CPL received another loan of US$ 1.5 million from BWG for the same nature of project in Balochistan with an interest of 8% per annum. Interest is to be paid monthly in arrears by the 5th day of each following month.

On 1 April 2021 another loan of US$ 2.9 million was received by CPL from DWL. The loan was received for the purchase of specialized machinery for wastewater management and carries interest at the rate of 6% per annum. Interest is to be paid quarterly in arrears by the 10th day of the next quarter. DWL has no permanent establishment in Pakistan.

The above loans are duly registered with the State Bank of Pakistan and the principal repayment in each case would commence from the year 2022.

Following information is available from CPL's records:

	Rupees
Paid-up capital as at 30-06-2020	145,000,000
Paid-up capital as at 30-06-2021	175,000,000
Retained earnings as at 30-06-2020	95,000,000
Retained earnings as at 30-06-2021	128,000,000
Taxable income as per return of income for tax year 2021	178,000,000
Tax depreciation and amortization included in taxable income	21,000,000

The above taxable income as per return is exclusive of foreign profit on debt claimed as deduction in respect of above loans.

Required:
Under the provisions of the Income Tax Ordinance, 2001 calculate the amount of foreign profit on debt which can be claimed as deduction for tax year 2021. ***(Assume that the dollar rupee parity during the year ended 30 June 2021 remained constant at USD 1 = PKR 150)*** **(16)**

Q.4 Ikhtiar Traders (IT), a sole trader, was engaged in the business of distribution of various goods for many years. IT was not registered with Inland Revenue Department due to low turnover. However, in order to diversify and grow its business, IT acquired a factory in Gwadar Free Zone for the production and supply of vegetable ghee. IT also converted its business into a limited liability company in the name and style of Ikhtiar (Pvt.) Limited (IPL) and got registered with the Federal Sales Tax Authority as a manufacturer, importer, and distributor. The application for registration was made on 24 April 2021 and the certificate of registration was issued to IPL on 1 May 2021. The production of vegetable ghee is expected to be commenced from next year.

Following information is available from IPL's records for the month of May 2021:

	Rupees
Unsold stock	
Transferred to IPL from IT at the time of conversion	4,525,000
Purchases	
From registered suppliers	5,460,000
From un-registered suppliers	750,000
Imports	2,725,000
Supplies	
To registered persons	2,040,000
To un-registered persons	3,615,000

Additional Information:

(i) Verifiable unsold stock transferred by IT to IPL at the time of conversion include the following:

- Goods purchased from registered persons on different dates:
  - On 15 March 2021 purchased industrial sewing machines for Rs. 300,000.
  - On 5 April 2021 purchased sewing machines of the household type for Rs. 250,000.
- Goods purchased from un-registered persons on different dates:
  - On 1 April 2021 purchased 45,000 packs of candies at Rs. 35 per pack.
  - On 10 April 2021 purchased 800 bags of fertilizers at a discounted price of Rs. 3,000 per bag.

(ii) Purchases from registered suppliers comprise of the following:

- Cane molasses worth Rs. 310,000 purchased from a supplier whose name was not appearing in the active taxpayer's list.
- Storage batteries purchased at a price of Rs. 650,000. These batteries are sold in the market at a retail price of Rs. 700,000. IPL paid the amount via online transfer of money into supplier's business bank account. However, this account has not yet been declared by the supplier to the Commissioner Inland Revenue.
- Machinery worth Rs. 2,500,000 imported for use at IPL's new production facility at Gwadar. All the procedures, limitations and restrictions applicable under the Customs Act, 1969 relating to import of machinery were duly complied with.
- Hoarding board advertisement worth Rs. 2,000,000 for the promotion of IPL's products in Karachi and Lahore. The hoarding board services were provided by a Karachi based advertising agency which spend 60% of the cost for advertisement in Karachi and the remaining 40% for advertisement in Lahore.

(iii) Purchases from un-registered suppliers comprise of 50 metric tons of locally produced coal at Rs. 15,000 per metric ton.

(iv) Imports comprise of the following:

- 4,500 packs of vegetable ghee from Malaysia in retail packing at a price of Rs. 250 per pack. All duties and taxes were paid at the time of import.
- Raw cotton worth Rs. 1,600,000 from China.

(v) Supplies to registered persons comprise of the following:

- 3,800 packs of imported vegetable ghee in retail packing at a retail price of Rs. 300 per pack.
- Industrial sewing machines for Rs. 900,000 to Gwadar Special Economic Zone.

(vi) Supplies to un-registered persons comprise of the following:

- 40,000 packs of candies to number of retailers. The candies were supplied in retail packing at a price of Rs. 40 per pack. Each pack consisted of 25 candies with a retail price of Rs. 2 per candy.
- 650 bags of fertilizers to various distributors across Pakistan at a price of Rs. 3,100 per bag. The retail price of each bag in the market is Rs. 3,300.

All the above figures are **exclusive of federal excise duty (FED) and sales tax**, wherever applicable.

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 IPL and the amount of input tax to be carried forward, if any, for the tax period May 2021. Also compute withholding tax, wherever applicable. **(20)**
Note: Show all relevant exemptions, exclusions and disallowances.

Q.5 (a) Mukhtar has been running a small meat shop measuring 750 square feet in a small commercial area for the last three years. The average electricity bill of his shop is Rs. 40,000 per month. Mukhtar currently purchases a variety of meat cuts from a local supplier and sells it to end-users.

In order to expand his business, he has decided to acquire another meat shop, measuring 600 square feet, in a nearby commercial area. His plan is to procure livestock instead of meat cuts and after processing it into frozen fine cuts, sell it to the end-users in retail packing under the brand name of 'MeatIt' from both of his shops.

Mukhtar is not registered with the sales tax authorities. However, he is paying sales tax at the rate of 7.5% on his monthly electricity bills. He is of the opinion that since he is not falling within the ambit of Tier-1 retailers, he is not required to be registered with the sales tax authorities and can continue to operate and pay sales tax as un-registered person.

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, discuss whether Mukhtar is justified in his contention. **(06)**

(b) Baqir Sulman established a small toy manufacturing facility at Mirpurkhas and obtained sales tax registration in January 2021. However, due to lockdown imposed by the government and strict Covid restrictions, he could not commence his business activities as stipulated. As a result, no sales tax returns were filed as he did not carry on any taxable activity. In May 2021 he received a notice from Inland Revenue Department requiring him to furnish the return by 15 June 2021.

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, advise whether Baqir Sulman is required to file the sales tax return and what consequences, if any, he may face in case of non-filing of such return. **(03)**

Q.6 Ahad is the tax partner in Hammad and Company, Chartered Accountants. Ahad is presently in the process of preparing the annual tax return of Deewar Limited (DL), a listed audit client. The tax manager, Kamran Wasi, responsible for DL's return is on emergency medical leave and the return has to be submitted within three days from now. DL has been denied any further extension in date of filing of return by the tax authorities.

Due to excessive workload and shortage of staff, Ahad has requested one of their audit partners to temporarily assign a team member for the timely preparation and filing of DL's income tax return.

The audit partner has assigned Feroze, who has been associated with DL's audit for the past two years. However, Feroze has no previous experience in filing of tax returns.

While working on the assignment, Feroze discovered some errors in the preparation of DL's previous year's tax return. These errors were the fault of Kamran Wasi. Ahad has requested Feroze not to disclose the errors to DL.

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 Cool Pakistan Limited (CPL) is engaged in the business of manufacture and supply of food and beverages. CPL is a subsidiary of Cool Blue Inc. (CBI), headquartered in USA. In order to ensure high standards of quality, CPL's products are manufactured with the technical assistance of CBI for which CBI charges a service fee of 3% of products' gross revenue.

Recently CPL has introduced a new chocolate chip cookie in Pakistan under the brand name of 'Choco chip' following its successful launch in USA by CBI.

CPL and CBI have a formal agreement for the provision of services for the manufacture of biscuits and cookies according to which CPL is required to pay service charges to CBI on 31 December each year. However, there is no formal agreement for the manufacture of beverages and Choco chip between the two companies.

Following information has been extracted from CPL's records for the month of May 2021:

	Rupees
Concentrates supplied by CBI for beverages	14,000,000
Sales revenue	
Beverages	20,000,000
Biscuits and cookies*	42,000,000

It includes sales revenue of Rs. 9,000,000 (net of 10% trade discount) pertaining to 'Choco chip'.

Required:
Under the provisions of the Federal Excise Act, 2005 and Rules made thereunder:

(a) Explain whether CPL is required to pay federal excise duty on services rendered by CBI relating to above products. If the answer is in affirmative, then compute the amount of duty payable by CPL on these services. **(05)**

(b) Identify the time of payment of duty in case of each of the above products. **(03)**

(THE END)