Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

11 December 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 For the purpose of this question, **assume that the date today is 30 September 2022.**

Akbar Industries Limited (AIL), a public unlisted company, is primarily engaged in the business of manufacturing, import, export and sale of home and electronic appliances.

AIL's Tax Manager is in the process of finalizing income tax return for the tax year 2022 and has presented following information along with supporting notes for the year ended 30 June 2022:

Income from business:	**Note**	**Rs. in million**
Profit before taxation	(i), (ii)	306.0
Add: Inadmissible expenses / admissible income:		
Cash dividend	(iii)	4.5
Bonus shares	(iv)	19.0
Payment to TV channel	(v)	9.9
Various payments in respect of foreign consultant's visit to Pakistan	(vi)	6.8
Payment of commission	(vii)	1.4
Less: Admissible expense:		
Lease rental	(viii)	(9.0)
Taxable income for the year under Normal Tax Regime (NTR)		**338.6**

Notes to the computation:

(i) Break down of AIL's sales during the year is as follows:

	Rs. in million
Local sales of manufactured goods *(including toll manufacturing services of Rs. 65 million)*	940
Local sales of imported goods	90
Exports	436

(ii) Other income includes net amount of royalty of Rs. 62 million received through normal banking channel from an enterprise in UAE as consideration for use of scientific knowledge outside Pakistan. The amount is net of 5% withholding tax deducted by UAE enterprise.

(iii) AIL received cash dividend of Rs. 4.5 million from Salam Textile Limited (STL), in which AIL has 25% investment. The amount was net of 10% withholding income tax. AIL's share of profit from STL of Rs. 8.2 million was recorded under equity method of accounting and is included in profit before taxation of Rs. 306 million.

(iv) AIL received 200,000 bonus shares issued by Haider Limited (HL), a listed company, on 30 September 2021. The market price of each share on the date of entitlement of bonus shares and the date on which bonus shares were credited in AIL's account was Rs. 80 and Rs. 95 respectively. On 1 January 2018, AIL had purchased 400,000 shares of HL at a cost of Rs. 45 per share. On 31 May 2022, AIL sold 450,000 shares of HL at a price of Rs. 110 per share and recorded a gain of Rs. 36 million which is included in profit before tax.

(v) Rs. 9.9 million was paid to a TV channel for advertising AIL's products. Withholding income tax was deducted at the rate of 1% of the amount payable.

(vi) Following payments were made in respect of foreign consultant's visit to Pakistan for 12 days with regard to AIL's ongoing projects:

(a) Consulting fee of USD 30,000 for providing technical services. Exchange rate parity was USD 1 = PKR 172.
(b) Air ticket of Rs. 675,000.
(c) Hotel accommodation of Rs. 840,000.
(d) Cash payments of Rs. 125,000 to restaurants.

No withholding income tax was deducted while making the above payments.

(vii) Commission of Rs. 1.4 million was paid to AIL's distributor, Nawab Malik, on sale of products of Rs. 70 million listed in the Third Schedule of the Sales Tax Act, 1990. Nawab Malik's registration was suspended on 1 July 2021 in terms of section 21 of the Sales Tax Act, 1990.

(viii) Rs. 9 million represents the payment of the last instalment of a lease rental in respect of a machine obtained by AIL on finance lease in tax year 2018. The lease term expired on 31 March 2022 and the machine was transferred to AIL at a residual value of Rs. 2 million which is included in the payment of last instalment. The market value of the machine at the time of its transfer to AIL amounted to Rs. 6 million. Interest expense and depreciation charged by AIL on the machine to profit and loss account during the year amounted to Rs. 1.1 million and Rs. 5 million respectively.

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 tax manager for tax year 2022. Give suggestion(s), wherever required. **(25)**

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

Q.2 Sitara (Pvt) Limited (SPL), a small and medium enterprise, is engaged in the business of manufacturing and supply of superior grade trousers for children. Following information has been extracted from SPL's records for the year ended 30 September 2021:

	Rs. in '000
Sales	184,125
Cost of sales	(128,880)
Gross profit	55,245
Administrative and selling expenses	(36,825)
Financial charges	(8,430)
Other income	10,300
Profit before taxation	**20,290**

Additional information:

(i) **Sales include:**

- Rs. 6,000,000 received as advance from a trader in Karachi against sale of trousers. SPL has agreed to supply the trousers in January 2022.
- Rs. 18,000,000 as profit from a business set up by SPL on 1 October 2020 in Gwadar Free Zone for the manufacture of readymade garments.

(ii) **Cost of sales include:**

- Rs. 6,600,000 in respect of work-in-progress for the construction of a store within factory premises.
- Rs. 2,750,000 paid in cash on account of freight charges to a freight forwarding company in Karachi. SPL did not deduct withholding tax from the payment.
- Rs. 800,000 for used label printing machine imported from Taiwan. The cost includes sales tax of Rs. 116,000 and income tax of Rs. 48,000 paid to custom authorities at import stage.

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

- Rs. 950,000 paid as commission to various distributors. Each payment ranged between Rs. 15,000 to 25,000 and was settled in cash. Applicable withholding tax was deducted from each payment.
- Rs. 125,000 incurred in respect of free provision of trousers, as a promotional item, to garment shops in large shopping malls. However, no evidence of the transaction is available to SPL.
- Rs. 4,000,000 incurred for the acquisition of a right to use a formula for the development of a new fabric softener for SPL's manufacturing process. The right was obtained on 1 July 2021 from a company in Germany.

(iv) **Financial charges include:**

- Rs. 520,000 in relation to a finance facility obtained from a scheduled bank for the construction of a store as mentioned in point (ii) above. SPL did not deduct any tax from the payment.

(v) **Other income includes:**

- Rs. 8,800,000 in respect of gain on sale of immovable property consisting of an office building. SPL purchased the building in 2019 at a cost of Rs. 20,000,000. The tax written down value of the building at the time of sale was Rs. 16,200,000. The building was sold to a customer for Rs. 25,000,000.
- Dividend of Rs. 1,500,000 received from a corporate agricultural enterprise. No withholding tax was deducted by the agricultural enterprise on payment of dividend.

Other information:

(i) Tax paid by SPL u/s 147 amounted to Rs. 650,000.
(ii) Accounting depreciation charged during the year on assets brought forward from previous year is the same as tax depreciation.

Required:

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

(a) compute under the correct head of income, the total income, taxable income and net tax payable by or refundable to SPL for the tax year 2022. **(15)**

Note:
- ***Your computation should commence with the profit before tax figure of Rs. 20,290K.***
- ***Ignore WWF, WPPF, Minimum tax u/s 113, Alternative Corporate Tax and default surcharge, if any.***
- ***Show all relevant exemptions, exclusions and disallowances.***

(b) what would be your answer in (a) above if SPL opts to be taxed under FTR. **(03)**

Q.3 (a) On 30 September 2021 Jawwad, a resident tax payer, in order to reduce the incidence of tax on sale of his immovable property, transferred the property to his adopted son Khalid, a permanent resident of China, by way of a gift. Khalid was on vacation to Pakistan for a period of one month.

Jawwad bought this property in 2019 at a price of Rs. 16.5 million. The value of the property fixed by the District Officer (Revenue) (DOR) at the time of its transfer to Khalid was Rs. 20 million whereas the value determined by the Federal Board of Revenue (FBR) amounted to Rs. 25 million. The open market value of the property on the date of transfer was Rs. 29 million.

On 15 October 2021 Khalid sold the immovable property to his friend for Rs. 30 million. There was no change in values assessed by DOR and FBR.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, discuss the tax implication/treatment for Jawwad and Khalid in the above scenario. **(10)**

(b) Ikram is an investor. On 6 November 2021 he entered into an energy derivative contract for the purchase of 500 barrels of crude oil. The contract was to be expired on 11 December 2021. Ikram sold the contract before the settlement date and incurred a net loss of Rs. 1,250,000 on the contract.

Required:
Under the provisions of the Income Tax Ordinance, 2001 briefly discuss the tax implication/treatment of the above transaction. **(04)**

Q.4 Tabish Limited (TL), a listed company, is engaged in the business of manufacturing, import and sale of various fast moving consumer goods. TL is registered as a manufacturer, importer and distributor with sales tax authorities in Lahore. Following information has been extracted from TL's records for the month of November 2021:

	Rs. in million
Purchases	
Taxable goods from registered suppliers	306
Taxable goods from unregistered suppliers	44
Imports	238
Supplies	
Taxable supplies to registered persons	478
Taxable supplies to unregistered persons	84

(i) Purchases from registered suppliers include:

- 200,000 litres of milk, purchased in 40-litre container at Rs. 4,400 per container. The retail price of milk was Rs. 150 per litre.
- 60,000 kg of sugar, purchased at a price of Rs. 140 per kg from a distributor as an industrial raw material. The retail price of sugar was Rs. 160 per kg whereas the value of sugar fixed by the Federal Board of Revenue (FBR) through notification was Rs. 120 for November 2021.

(ii) Imports comprise of:

- new machinery of Rs. 34 million from Japan for the production of ice cream. The machinery is covered under Eighth Schedule.
- raw material of Rs. 178 million for manufacturing of infant nutrition items.
- chocolates of Rs. 26 million in retail packing.

The value of imports are inclusive of custom and federal excise duties but exclusive of sales tax.

(iii) Transportation charges of Rs. 3 million paid to Dawood Transport Company (DTC) for delivering goods to the customers in Karachi. DTC's main office is located in Lahore.

(iv) Supplies to registered persons include:

- advance of Rs. 17.9 million received from Moon Associates against goods to be delivered in December 2021.
- 140,000 bottles of aerated water at a price of Rs. 160 per bottle. The price of each bottle in the market (inclusive of federal excise duty and sales tax) is Rs. 260.
- goods worth Rs. 127 million to duty free shops.
- goods worth Rs. 51 million on three months' credit to Tier-1 retailer. The price is inclusive of mark-up at the rate of 8% per annum.
- imported chocolates as mentioned in point no. (ii) above to departmental stores in Lahore for Rs. 30 million. The chocolates were sold in the same condition as imported.

(v) Supplies to unregistered persons include 50,000 packs of flavoured milk under the brand name of 'Tabish flavoured milk'. The packs were supplied in retail packing of 200 ml to distributors at a discounted price of Rs. 60 each. The retail price per pack is Rs. 90.

(vi) During the current month, it was discovered that output tax on purchase of packing material for juices of Rs. 2.25 million in October 2021 was paid by the supplier in November 2021.

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 TL and the amount of input tax to be carried forward, if any, for the tax period November 2021. 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.5 (a) Zaman Associates (ZA) is registered as a wholesaler-cum retailer and is engaged in the business of bulk import and supply of shoes and leather products. On 15 July 2021 ZA received a notice from the Deputy Commissioner Inland Revenue requiring it to integrate its retail outlets with Board's Computerized System for real-time reporting of sales by 31 October 2021. However, ZA failed to comply with the notice till the date for filing of November 2021 return.

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, briefly advise ZA with regard to the consequences of non-compliance with the notice. **(05)**

(b) Mosa, a registered person, is engaged in the business of trading branded office and home furniture through a showroom in Islamabad. His showroom, measuring 3,200 square feet, is located in a hyper mall and is integrated with Board's Computerized System for real time reporting of sales. On 15 November 2021 Mosa sold office furniture worth Rs. 1,500,000 to an Italian diplomat.

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, advise Mosa with regard to the chargeability of sales tax on the above transaction. **(05)**

Q.6 Specify with reasons, whether the following independent acts may be considered as a tax evasion or tax avoidance: **(05)**

(i) In order to reduce his tax liability, Mr. Jaffer, a resident individual, paid a premium of Rs. 100,000 to the life insurance company on his policy.

(ii) Sakhi Limited (SL) paid 50% of Ahmad's salary i.e. Rs. 30,000 in cash whereas the remaining 50% of his salary was credited to his bank account. SL claimed Rs. 60,000 as admissible deduction in its return of income.

(iii) Bahadur Limited is planning to set up a new factory under Export Processing Zone, Gwadar to get tax incentives.

(iv) Aagaz Limited sold fixed asset to an associated company at its tax written down value and consequently reported nil gain or loss on disposal of asset in its return of income.

(v) In order to reduce her tax liability, Mrs. Shamim who runs her own business, paid higher salary to her spouse, keeping in view that lower slab rates are applicable on salary income as compared to income from business.

Q.7 Roshni Limited (RL) is engaged in the business of manufacturing and supply of tobacco products in the district of Dir and is registered under the Federal Excise Act, 2005. Following information is available from RL's records for the month of November 2021:

(i) Purchase of 2,000 kg of un-manufactured black leaf tobacco worth Rs. 228,000 from Dera Ghazi Khan. RL manufactured 46,000 packs of chewed smokeless tobacco commonly known as 'Naswar' and sold them to various stores in Khyber Pakhtunkhwa at a retail price of Rs. 10 per pack.

(ii) Import of 1,000 kg of un-manufactured tobacco from Brazil. The value assessed by the customs authorities at import stage amounted to Rs. 880,000.

RL used 768 kg of un-manufactured tobacco for the production of 8,000 packs of tapered shape biris with the help of manually operated machine. Each pack consisted of 480 biris. RL sold 6,500 packs to dealers at a wholesale price of Rs. 600 per pack whereas 1,500 packs were supplied as provisions for consumption on board a ship that was proceeding to Bangladesh at a price of Rs. 650 per pack. These packs are usually sold in the market at a retail price of Rs. 696 per pack.

The remaining quantity of 232 kg of un-manufactured tobacco was sold to a manufacturer in District Mardan at Rs. 1,050 per kg.

(iii) Inland carriage charges of Rs. 25,000 were paid to an air cargo company for shipping the consignment of biris to Karachi Port.

(iv) Advertisement charges for the promotion of biris on a local cable T.V network amounted to Rs. 30,000. RL agreed to pay the amount to the cable network in the first week of December 2021.

Required:
Under the provisions of the Federal Excise Act, 2005 compute the amount of duty payable by or refundable to RL for the tax period November 2021. **(08)**

Note: Show all relevant exemptions, exclusions and disallowances.

(THE END)