Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

10 June 2023
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 Cloud (Private) Limited (CPL) was incorporated on 1 January 2022. 55% shares of CPL are owned by UAE based company namely Temperature LLC (TL).

Under a technical license agreement with a European Company, namely Rainbow Ltd (RL), CPL made an investment of Rs. 100 million to setup a plant for manufacturing agricultural drones that aid in crop monitoring and optimisation. On 1 May 2022, CPL was awarded the status of greenfield industrial undertaking when it began its commercial production.

The following information has been extracted from CPL's records for the year ended 31 December 2022:

Particulars	Rs. in million
Balance sheet	
Share capital	60
Non-current liabilities	190
Current liabilities	50
Equity and liabilities	**300**
Non-current assets	180
Current assets	120
Total assets	**300**
Profit or loss statement	
Sales	220
Other income	20
Expenses (including finance costs of Rs. 22 million)	(197)
Net profit before tax	**43**

Additional information:

(i) Sales include exports of Rs. 55 million, which includes an advance receipt of USD 20,000 equivalent to Rs. 5 million against an export order delivered in February 2023.

(ii) Other income is comprised of:

- a government grant of Rs. 10 million, received to promote awareness among farmers about the usage of agricultural drones. The grant was intended to cover the actual expenses incurred in this regard. During the year, Rs. 3 million was spent for this purpose.
- rent and non-adjustable security deposit amounting to Rs. 4 million and Rs. 6 million, respectively, received for providing office space. No material expense was incurred against this income.

(iii) Expenses include:

- amortization of Rs. 5 million regarding the payment of Rs. 15 million made to a foreign consultant for conducting a feasibility study of the business. This expense is being amortized over a period of three years.

- royalty of Rs. 20 million payable under the technical license agreement. Due to the government's restrictions on the outflow of US dollars, only Rs. 8 million could be remitted to RL by the end of the year.
- advertisement expense of Rs. 8 million.
- traveling expense of Rs. 1.3 million, paid to an authorised travel agent for purchasing air ticket for CEO to attend an international conference in the United Kingdom. No withholding tax was deducted at the time of payment.
- depreciation of Rs. 36 million. Tax depreciation other than plant is Rs. 14 million.

(iv) Finance costs include the interest expense of Rs. 15 million paid to TL. On 1 July 2022, CPL borrowed Rs. 150 million from TL to meet its working capital requirement. The principal is repayable in 2025.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute the total income, taxable income, and tax liability of CPL for the tax year 2023, considering all available options for computing its tax liability. **(20)**

Note:
- ***Ignore WPPF and WWF.***
- ***Show all relevant exclusions, deductions and exemptions.***

Q.2 (a) The following information pertains to four different not-for-profit companies registered with the Securities and Exchange Commission of Pakistan under the Companies Act, 2017, for the year ended 31 December 2022:

	A	**B**	**C**	**D**
Year of commencement of business	2018	2021	2018	2017

Income:	**Rs. in million**			
Donations and subscriptions	48.2	97.9	197.6	297.3
Dividend	2.0	4.0	6.0	8.0
Profit on debt from a scheduled bank	12.0	14.0	16.0	18.0
Total	62.2	115.9	219.6	323.3
Expenses in respect of:				
Administration and management	12.0	20.0	40.0	42.0
On-going projects as per their charter	32.2	71.9	131.6	215.3
Total	44.2	91.9	171.6	257.3

None of the above companies have receivables or payables at year-end.

All four companies have consistently filed their income tax returns, deducted or collected the necessary taxes, and ensured their timely payment. They have also been diligent in filing withholding tax statements and obtaining approval from the Commissioner. Additionally, these companies have fulfilled their obligations by submitting the statement of voluntary contributions and donations received.

Required:
Under the provisions of the Income Tax Ordinance, 2001, calculate the tax liability of each of the above four companies for the tax year 2023. **(13)**
(Ignore minimum tax and alternative corporate tax)

(b) Lighting Resource (Private) Limited (LRPL), owned by Falak Holding Limited (FHL), a Pakistan based group, is engaged in the business of commercial imports of generator sets from Germany. These imported generators are then sold to power generation companies, including their installation and commissioning services.

Considering the income tax exemption available in United Arab Emirates (UAE), FHL is evaluating the option to incorporate a separate company in UAE. The new company would import generators from Germany and export them from the UAE directly to the power generation companies in Pakistan. However, LRPL will remain responsible for the installation and commissioning of those generators.

Required:
Under the provisions of the Income Tax Ordinance, 2001, advise whether introduction of changes in the existing corporate structure would be beneficial for FHL. **(05)**
(Ignore tax treaty)

Q.3 Feels-Like (Private) Limited (FLPL) is engaged in the business of manufacturing and supplying foam mattresses.

FLPL's finance department is currently in the process of finalizing the income tax return for the tax year 2023 and has prepared the following computation, along with the supporting notes for the year ended 31 December 2022:

	Note	Rs. in million
Income from business:		
Sales		1,252
Other income		150
Expenses		(840)
Profit before tax		562
Adjustments:		
Deemed income on loan provided to CEO	**(i)**	5
Inadmissible expenses	**(ii)**	40
Accounting gain on sale of showroom	**(iii)**	(110)
Interest income on government debt securities (being FTR income)		(30)
Loss on sale of government debt securities	**(iv)**	(18)
Gain on sale of unlisted shares	**(v)**	28
Accounting depreciation		51
Tax depreciation		(77)
Income from business before adjustment of b/f losses		451
Less: Brought forward business loss – Tax Year 2016		(29)
– Tax Year 2020		(224)
50% of unabsorbed tax depreciation (186 × 50%)		(93)
		105
Capital Gain:		
Gain on sale of showroom (158 – 120)	**(iii)**	38
Loss on sale of government debt securities	**(iv)**	(18)
Gain on sale of unlisted shares (28 × 75%)	**(v)**	21
		41
Total income		**146**
Less: Capital gain – Separate block of income		(41)
Taxable income		**105**

Notes to the income tax computation:

(i) In January 2022, an interest-free loan of Rs. 50 million was provided to FLPL's CEO. Interest income at benchmark rate of 10% is offered for tax purposes as FLPL's deemed income. The CEO owns 5% of FLPL shares.

(ii) These expenses are attributable to sales made to Breeze Enterprise (BE), an unregistered dealer. During the year, sales of mattresses totalling Rs. 106 million (exclusive of sales tax) were made to BE, which sells mattresses to end users at a margin of 20%.

(iii) On 31 December 2022, FLPL sold one of its showrooms for Rs. 158 million. This showroom was purchased on 1 April 2016 at a cost of Rs. 120 million.

(iv) On 15 August 2022, FLPL sold government securities at a loss of Rs. 18 million. These securities were purchased on 31 October 2018.

(v) Only 75% of the gain amount is offered for tax purposes, taking into account the holding period of unlisted securities being more than a year.

Required:
Under the provisions of the Income Tax Ordinance, 2001, and Rules made thereunder, comment on each element of the above computation of total and taxable income, including adjustments, along with the accompanying notes, prepared by the finance department for the tax year 2023. Give suggestion(s), wherever necessary. **(22)**

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

Q.4 Pleasant Healthcare Limited (PHL) is engaged in the business of manufacturing and supplying pharmaceutical and nutritional products. It is registered as an importer, manufacturer, and distributer with the Sales Tax Authorities.

The following information has been extracted from PHL's records for the month of May 2023:

(i) Import of Active Pharmaceutical Ingredients (APIs) worth Rs. 150 million for the manufacture of medicines. 80% of the related medicines produced are sold locally, and the remaining 20% are exported to Bangladesh.

(ii) Import of multi-vitamins (not registered under the Drugs Act, 1976) worth Rs. 30 million used as food supplements from an international brand. PHL sells these multi-vitamins in the same condition as imported.

(iii) Purchase of artificial flavours worth Rs. 20 million from the local market for use in various medicines of PHL.

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

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, discuss the chargeability of sales tax on the above transactions. ***(Calculations are not required)*** **(07)**

Q.5 Storm Limited (SL) is engaged in the business of manufacturing and supplying cigarettes and e-liquid for electronic cigarette kits. SL is registered under the Federal Excise Act, 2005. The following information is available from SL's records for the month of May 2023:

(i) Purchase of 5,000 kg of un-manufactured tobacco worth Rs. 8,000,000. SL paid 80% of this amount, while the remaining is payable on 20 June 2023.
(ii) Payment of inland carriage charges of Rs. 30,000 to an air cargo company for shipping the consignment of un-manufactured tobacco from the purchase location to SL's manufacturing facility.
(iii) Sale of 9,500 packs of cigarettes to dealers at a wholesale price of Rs. 8,000 per pack.
(iv) Export of 2,500 packs of cigarettes to Indonesia via sea at a price of Rs. 9,000 per pack.
(v) Payment of Rs. 10,000 for marine insurance in respect of cigarettes exported to Indonesia.
(vi) Sale of 1,000 kg of un-manufactured tobacco to another cigarette manufacturer located in Export Processing Zone, Karachi, at Rs. 2,000 per kg.
(vii) Import of bulk shipment of 200kg of e-liquid. The value assessed by the customs authorities at the import stage amounted to Rs. 3,000,000.
(viii) Sale of the entire imported 200 kg of e-liquid after processing and packaging in small bottles at Rs. 7,000,000.

For the purpose of (iii) and (iv), each pack contains 400 cigarettes, and its retail price is Rs. 9,800.

Required:
Under the provisions of the Federal Excise Act, 2005, compute the amount of duty payable by or refundable to SL for the month of May 2023. **(08)**
Note: Show all relevant exemptions, exclusions and disallowances.

Q.6 Heatwave Pakistan Limited (HPL) is engaged in the business of manufacturing and supplying automotive vehicles and their parts. It is registered as an importer, manufacturer and distributer with the Sales Tax Authorities. The following information has been extracted from HPL's records for the month of May 2023:

	Rs. in million
Purchases	
From registered suppliers	218.0
From unregistered suppliers	40.0
Imports	1,365.5
Supplies	
To registered persons	1,150.0
To unregistered persons	125.0
Exports	45.0

Additional information:

(i) Purchases from registered suppliers include 2,500 car batteries in retail packaging for Rs. 8,000 each. The retail price of these batteries is Rs. 10,000 each.

(ii) Purchases from unregistered suppliers comprise various auto parts.

(iii) Imports are comprised of:

- plant and machinery worth Rs. 500 million for setting up a new assembly facility of electric vehicles duly certified and determined by the Engineering Development Board.
- 40 electric cars with 50 KWH battery in CBU condition for Rs. 6.20 million each.
- 25 heavy motorbikes in CBU condition for Rs. 0.70 million each.
- various auto parts for the manufacturing of motor vehicles for Rs. 600 million.

(iv) Supplies to registered persons are comprised of:

- 32 imported electric cars at a price of Rs. 7.50 million each.
- 200 locally manufactured cars for Rs. 4.50 million each.
- motorcycle parts for Rs. 10 million to distributors whose names are not appearing in the active taxpayers list.

(v) Supplies to unregistered persons (individuals) are comprised of:

- 1,000 motorcycles sold for Rs. 0.11 million each.
- 20 heavy motorbikes sold for Rs. 0.75 million each.

(vi) Exports comprise of 300 motorcycles to Sri Lanka, priced at Rs. 0.15 million each.

Further information (not included above):

(i) Electricity charges of Rs. 16 million were paid. The bill showed the subsidies of Rs. 4 million and a late payment surcharge of Rs. 1 million.

(ii) A payment of Rs. 12 million was made for software maintenance to a software house, registered under the Islamabad Capital Territory (Tax on Services) Ordinance, 2001.

(iii) The input tax carried forward from previous tax period is Rs. 14 million, which includes Rs. 5 million in respect of auto parts that were taxable but became exempted through a notification issued by the Federal Board of Revenue in the current tax period.

(iv) 10 ambulance vehicles manufactured by HPL were sold to a charitable hospital with 100 beds, for Rs. 9 million each.

All the payments were made through cross cheque/pay order. All the above figures are **exclusive of sales tax**, unless specified otherwise.

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 HPL and the amount of input tax to be carried forward, if any, for the tax period May 2023. Also compute withholding tax, wherever applicable. ***Note: Show all relevant exemptions, exclusions and disallowances.*** **(20)**

Q.7 Hina Abbasi (HA) is a tax partner in a firm of Chartered Accountants. Blazing (Private) Limited has approached her and disclosed their involvement in the tax evasion in the past. However, they express their willingness to rectify their situation and become compliant. They seek HA's assistance in filing accurate tax returns going forward, while keeping their previous illegal activities hidden from the tax authorities.

Required:
In the light of ICAP's Code of Ethics, identify and evaluate the fundamental principles of code of ethics that may be breached in the above situation. **(05)**

(THE END)