THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

**Final Examinations Summer 2004**

**June 09, 2004**

# ADVANCED TAXATION

**(MARKS 100)**
**(3 hours)**

Q.1 Explain the taxability of the following under the head "salary":

(i) Loan given by an employer to an employee. **(03)**
(ii) Employee's tax borne by the employer. **(02)**
(iii) Employee share schemes with reference to the following. **(05)**

(a) Grant of an option
(b) Grant of shares
(c) Exercise of an option granted in prior year

Q.2 (a) Explain the term Fee for Technical Services. **(03)**
(b) Briefly comment on the taxability of Fee for Technical Services in the hands of a resident person, a non-resident person and a permanent establishment of a non-resident person. **(05)**
(c) Explain the tax withholding obligation on Fee for Technical Services paid to a non-resident person as well as a permanent establishment of a non-resident person. **(03)**

Q.3 In respect of the following given situations, you are required to briefly discuss the basis of chargeability of tax and also the applicable withholding tax provisions, if any, under the Income Tax Ordinance, 2001.

(a) MT vessel carrying light crude oil was grounded in the channel leading to Karachi Port. The ship owners and the cargo owners have engaged your client, being a company wholly engaged in salvage operations, who are resident of Netherlands to salvage the vessel. On successful completion of the salvage operation your client was paid US$ 40 million. **(06)**

(b) Following International Accounting Standard 40, your client revalued "investment property" in terms of "fair value model" and credited gain of Rupees 5 million to profit and loss account. **(04)**

(c) Your client, a charitable institution, which has not been registered as a "non-profit organization" under the Income Tax Ordinance, 2001 received a sum of Rs. 40 million from a company as voluntary financial contribution for the construction of a hospital. **(04)**

Q.4 Explain the concept of apportionment of common expenditure as envisaged under section 67 of the Income Tax Ordinance, 2001. **(05)**

Q.5 Under section 108 of the Income Tax Ordinance, 2001, the Commis Income Tax in respect of any transaction with associates is authorized to dis apportion or allocate income, deductions or tax credits etc. between the persons reflect the income that the persons would have realized in an arm's lengt transaction. In this context, briefly discuss:

(i) The arms length standard to be applied by the Commissioner; and

(ii) Methods to be applied for the purpose of determining the arm's length result. **(14)**

Q.6 M/s Khan, Hussain & Simon were equal partners in a firm KHS Textiles, engaged in the business of manufacturing and sale of garments. Their products were mainly supplied to large retail stores in Pakistan and certain European Union countries. They decided to convert their firm into a private limited company with effect from October 1, 2002.

All assets and liabilities of KHS Textiles were taken over by the new company named KHS & Co. (Pvt) Limited. Each partner received 400,000 shares of Rs. 10/= each in the new company. The profit & loss account and balance sheets of the two businesses are given below:

**BALANCE SHEET**

| | KHS Textiles as at Sep 30, 2002 **Rupees** | KHS & Co. (Pvt) Ltd. as at Jun 30, 2003 **Rupees** |
|---|---|---|
| **ASSETS** | | |
| NON CURRENT ASSET | | |
| Property, Plant & Equipment – Tangible | 8,000,000 | 17,000,000 |
| - Intangible | 984,375 | 937,500 |
| Investments | 1,000,000 | 2,000,000 |
| | 9,984,375 | 19,937,500 |
| CURRENT ASSETS | | |
| Stocks | 3,000,000 | 6,000,000 |
| Trade Debts | 2,500,000 | 4,200,000 |
| Other Assets | 500,000 | 2,600,000 |
| Cash & Bank | 215,625 | 362,500 |
| | 6,215,625 | 13,162,500 |
| Total Assets | 16,200,000 | 33,100,000 |
| **EQUITY & LIABILITIES** | | |
| Capital/Share Capital | 10,700,000 | 12,000,000 |
| Unappropriated Profit | - | 15,200,000 |
| | 10,700,000 | 27,200,000 |
| Long-term Loans | 4,000,000 | 4,000,000 |
| | 14,700,000 | 31,200,000 |
| Current Liabilities | 1,500,000 | 1,900,000 |
| | 16,200,000 | 33,100,000 |

## PROFIT & LOSS ACCOUNT

| | KHS Textiles<br>Jul 02– Sep 02<br>**Rupees** | KHS & Co.<br>(Pvt) Ltd.<br>Oct 02 – Jun 03<br>**Rupees** |
|---|---|---|
| Sales | 10,000,000 | 45,000,000 |
| Cost of Sales | 5,500,000 | 23,000,000 |
| Gross Profit | 4,500,000 | 22,000,000 |
| Selling & Administrative Expenses | 1,500,000 | 6,000,000 |
| Operating Profit | 3,000,000 | 16,000,000 |
| Other Income | 500,000 | 1,200,000 |
| | 3,500,000 | 17,200,000 |
| Financial & Other Charges | 500,000 | 2,000,000 |
| Profit before tax | 3,000,000 | 15,200,000 |

The following further information is available

1) At the time of transfer, Property Plant & Equipment consisted of the following

| | **OWNED** | **LEASED** |
|---|---|---|
| Plant & Machinery | 1,000,000 | 4,000,000 |
| Furniture & Equipment | 1,000,000 | 0 |
| Vehicles | 2,000,000 | 0 |
| Rupees | 4,000,000 | 4,000,000 |

The accounting depreciation charged in the books during the three months ended September 2002 was Rs. 256,545. Tax WDV of owned assets as on June 30, 2002, was as under:

| | |
|---|---|
| Plant & Machinery | 500,000 |
| Furniture & Equipment | 1,000,000 |
| Vehicles | 2,000,000 |

Monthly rentals of the leased assets are Rs. 120,000 per month. The fair market value of the owned assets on September 30, 2002 was Rs. 5,200,000 and the assets were recorded accordingly in the books of the new company. No new assets were acquired during the year except for plant and machinery which was imported in January, 2003 at a total cost of Rs. 8,500,000.

2) Intangibles were acquired in 1999 and had a further useful life of 16 years as on 1.7.2002.

3) The cost of stock-in-trade valued in accordance with section 35 of the Income Tax Ordinance 2001, as on September 30, 2002 was Rs. 3,200,000 whereas net realizable value was Rs. 3,000,000. It was taken over in the books of the new company at NRV.

4) Trade debts of Rs. 2,500,000 were net of provision for bad debts of Rs. 200,000 provided in prior years. However, since bad debts were actually estimated at Rs. 100,000, these were taken over by the new company at Rs. 2,600,000. No further provisions were made.

5) Financial charges include those booked on finance leases amounting to Rs. 100,000 in the books of KHS Textilities and Rs. 275,000 booked by KHS & Co. (Pvt) Ltd.

6) 50% of the sale of both entities was export sales. All exports were made against confirmed LC's

**Required:**
After considering the information given above, work out taxable income and income tax liability of the firm as well as the company for the tax year 2003.

Q.7 M/S ABC Limited is contemplating ways to increase its sales. They have approached you for advice on the sales tax implications of the various schemes as under:

(i) For a certain range of products, it is being proposed to provide sample packs 'Free of Cost' to the customers. **(02)**

(ii) A mix of products X, Y & Z is proposed to be sold at a concessional rate as a 'Package Deal'. **(03)**

(iii) Sales of a certain product is intended to be introduced under the hire purchase / installment mode. An additional issue in this regard has been raised in the context of a subsequent change in the rate of sales tax. **(06)**

Q.8 K Limited is a manufacturer of vehicles and has its production facility in Karachi. In view of the warranty given on vehicles sold, K Limited is under obligation to remove any defects/faults in the vehicle including replacement of parts free of cost and without any consideration during the warranty period.

Discuss the sales tax implication on the replacement of parts during the warranty period. **(05)**

Q.9 (a) Explain the terms and procedures laid down for registration and/or enrolment of persons engaged in taxable activities. **(04)**

(b) Explain the procedure to be complied with in respect of "Deregistration" if a person decides to discontinue the business. **(06)**

(c) Is there any possibility of having a multiple registration for a enterprise having more than one branch or division? **(02)**

**(THE END)**