THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2007

June 7, 2007

ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 (a) Mr. Green held 25% shares of ABC (Private) Limited at the time of its winding up on June 30, 2005. He has now received a notice from the Commissioner of Income Tax requiring him to pay Rs 500,000 on account of tax payable by the Company for the tax year 2005.

Discuss the legality of the notice issued to Mr. Green and the extent of his liability, if any. **(05)**

(b) Discuss the rules relating to "own estimate" with reference to quarterly payment of advance tax under the Income Tax Ordinance, 2001. **(04)**

Q.2 (a) Red, Blue & Co. has recently started business as Construction Contractors. During the year ended December 31, 2006, they have undertaken the following transactions:

(i) They entered into a contract for construction of a housing scheme with Mr. Ghalib, a Pakistani citizen. The project is likely to take three years to complete. Upto December 31, 2006 payments aggregating to Rs 10,000,000 were received from Mr. Ghalib. No tax has been deducted from these payments.

(ii) The firm was also awarded a contract by XYZ (Private) Limited for construction of residential quarters for its factory workers. The work shall commence from January 15, 2007 and will be completed within six months. However, a mobilization advance amounting to Rs 1,000,000 was paid by XYZ (Private) Limited in December 2006, after deducting tax of Rs 60,000.

The firm's partners are not very sure about the impact of the above transactions on the firm's taxation for tax year 2007. They are of the view that:

– Payments received from Mr. Ghalib should have been subjected to final tax. However, as he has not deducted the tax, they want to discharge the tax liability on their own.
– Work on contract with XYZ (Private) Limited has not commenced upto December 31, 2006 and therefore, the advance received is not taxable. The tax deducted should, therefore, be claimed as refundable.

Required:
Explain to the partners, the basis of taxation of the above payments received by the firm. **(06)**

(b) Under the Income Tax Ordinance, 2001, every importer is required to pay tax on the value of goods at the prescribed rates. State the conditions under which a manufacturer can obtain exemption certificate from the Commissioner of Income Tax, with regard to payment of tax at the import stage. **(04)**

Q.3 MNO Pakistan Limited is a public limited company whose shares are listed on all the registered stock exchanges in Pakistan and remained so listed during the year ended December 31, 2006. The Company is involved in the following activities:

- Supply of telecommunication equipment. The equipments are assembled in Pakistan after importing the major components from EU countries.
- Providing consultancy services in Pakistan to companies operating in the telecommunication sector.

The Tax Manager of the Company has computed the taxable income for the Tax Year 2007, as under:

	Note	Rupees in "000"
Profit before tax as per Profit & Loss Account		100,000
Add: Accounting depreciation		20,000
Accounting amortization	(i)	6,000
Excess cost of perquisites to employees		1,000
Provision for bad debts		2,000
Profit on debt to a foreign bank	(ii)	5,000
Tax gain on disposal of fixed assets	(iii)	5,000
		39,000
Less: Tax depreciation - initial	(iv)	5,000
- normal		10,000
Deferred expenditure	(v)	1,333
Accounting gain on disposal of fixed assets	(iii)	7,000
Bad debts actually written off	(vi)	1,000
		24,333
Less: Income attributable to services' revenue subject to Final Tax Regime	(vii)	15,000
Taxable income for the year		99,667

Notes to the Computation:

(i) On December 29, 2006, the Company has acquired rights for use of trade mark owned by a US company for a period of three years. The trade mark will be used for the equipments to be sold after March 31, 2007. For accounting purposes, the cost is being amortized equally over the three-year period.

(ii) The Company obtained a working capital loan from a foreign bank, the proceeds of which were utilized during the year. The Company did not deduct tax while paying interest on the loan. The Company is of the view that interest is not taxable in Pakistan as the bank does not have a Permanent Establishment in Pakistan.

(iii) Tax gains on disposal of fixed assets include a tax profit of Rs 60,000 on the sale of a car. It was acquired during the year ended December 31, 2004 at a cost of Rs 1,500,000. However, for the purpose of tax depreciation, the value was restricted at Rs 1,000,000. As a policy, the car was sold to the Managing Director of the Company for Rs 200,000. Tax gain represents the difference between fair market value i.e. Rs 700,000 and the tax written down value i.e. Rs 640,000.

(iv) During the year, the Company acquired second hand equipment at a cost of Rs 8,000,000. The Company is of the view that since the equipment was not used by the Company itself, it is entitled to claim initial depreciation allowance.

(v) The Company incurred an expenditure of Rs 2,000,000 on sales promotion. It has been estimated that the benefit of such expenditure will extend to three years and, therefore, the same is being amortized over a period of three years. However, for tax purposes, the whole of the expenditure has been claimed.

(vi) It includes a loan of Rs 500,000 to an associated undertaking. The amount has been written off because the borrower is in financial crisis and would not be able to discharge his debt.

(vii) The income attributable to services revenue has been excluded from the computation of taxable income. Tax deducted on such receipts was Rs 900,000.

(viii) The fixed assets of the Company include vehicles having fair market value of Rs 20,000,000 taken on finance lease from a scheduled bank. The tax depreciation has been computed at 15% of the FMV. Lease rentals paid during the year were Rs 2,000,000 including financial charges of Rs 500,000.

(ix) The Company disputes certain amounts invoiced by its suppliers. As a matter of prudence, it has provided such liabilities although the same are still under dispute. Year-wise breakup of such liabilities is as follows:

Year of Supply	**Rupees in "000"**
Tax Year 2003	790
Tax Year 2004	1,251
Tax Year 2005	1,244
Tax Year 2006	1,596
	4,881

Required:
Give your comments as regards the:
- tax treatment in the computation of taxable income with which you concur or disagree.
- implication for tax purposes of the information disclosed in the notes to the computation. **(24)**

Note: Restrict your answer to comments only. Revised computation is not required.

Q.4 (a) With reference to the concept of geographical source of income as enumerated in the Income Tax Ordinance, 2001, briefly comment on the taxability of income in each of the following situations separately:

(i) Profit on debt paid by STU (Private) Limited, a company incorporated in Pakistan, to a US bank against a short term loan, obtained to meet working capital requirements of the company's UK branch.

(ii) Mr. Black, a foreign national working as a General Manager for a Japanese company, is deputed in Pakistan to carry out market research for a product sold in Pakistan. His remuneration for the services rendered in Pakistan is transferred directly to his bank account in Japan.

(iii) Mr. White, a non resident, sold his shareholding in KLM Inc. and derived capital gains. A significant part (97%) of assets of KLM Inc. consists of the right to explore natural resources in Pakistan. **(06)**

(b) Mr. Blue had filed his return of income for tax year 2003 on September 30, 2003. Discuss the following in terms of the Income Tax Ordinance, 2001:

(i) by what date the Commissioner of Income Tax could make the first amendment of the assessment, if required?

(ii) by what date any further amendment can be made if the first amendment was made on September 29, 2006? **(04)**

Q.5 (a) To receive and retain recognition, a provident fund has to satisfy various conditions mentioned in the Sixth Schedule to the Income Tax Ordinance, 2001. Based on these conditions, comment on the legality of each of the following:

(i) The recognition can also be granted by the Commissioner of Income Tax to an employer whose principal place of business is not in Pakistan.

(ii) Employer does not have the power to recover any sum whatsoever from the employees' provident fund balance, under any circumstances. **(04)**

(b) During the tax year 2006 and 2007, a local bank provided various types of consumer loan facilities to its customers. Details of interest earned on consumer loans and bad debts provided against consumer loans are as follows:

	2006	**2007**
	Rupees in million	
Interest earned on consumer loans	300	370
Bad debt provision for the year	12	10

Required:
Compute the allowable bad debt provision on consumer loans in accordance with the Income Tax Ordinance, 2001 for tax years 2006 and 2007. **(06)**

Q.6 (a) DEF Limited supplied goods valuing Rs 1,000,000 to one of its distributor, Mr. Pink who is also registered for sales tax purposes. Sales tax invoice was issued for the said amount plus sales tax of Rs 150,000. The transaction was recorded in the monthly sales tax return for the month of January 2007.

In February 2007 the internal auditor of the Company observed that the accountant had applied incorrect selling prices. As a result, the Company will have to refund the excess amount to Mr. Pink.

Required:
Advise the procedure to be adopted by the Company and the distributor to adjust the excess amount of sales tax. **(05)**

(b) Mr. Lal, an unregistered person, is engaged in the supply of imported and locally purchased good. He has received a notice from a local registration office of the sales tax for compulsory registration.

Before submitting the application for registration, he wants to know whether he will be able to claim the input tax paid on the unsold stocks purchased before registration.

Required:
Explain the legal provisions of the Sales Tax Act, 1990 regarding tax paid on stocks before registration. **(06)**

Q.7 GHI Limited has been engaged in the import and supply of taxable goods which are listed in the Third Schedule to the Sales Tax Act, 1990. You have been provided the following quarterly information relating to the company's operations:

Rupees in million

	July–Sept 2006	**Oct–Dec 2006**	**Jan–Mar 2007**
Sales	35.00	28.00	26.00
Value of goods imported determined under section 25 of the Customs Act, 1969	20.00	22.00	19.00
Closing Stock	4.00	5.00	3.20

Following additional information is available:

(i) There was no opening stock as at July 1, 2006;
(ii) Custom duty is payable at the rate of 20%;
(iii) Minimum value addition on the goods is prescribed at 15% of import value;
(iv) Retail price of goods sold in first, second and third quarter amounted to Rs 45 million, Rs 37 million and Rs 32 million respectively.

Required:
(a) Compute the sales tax payable, if any, in respect of each of the three quarters;
(b) Work out the amount of input tax, foregone by the commercial importer, if any, in each of the three quarters. **(17)**

Q.8 (a) Explain the basis of determination of Federal Excise Duty in each of the following cases:
(i) Services provided free of charge; and
(ii) Goods liable to duty at a rate dependent on their value. **(06)**

(b) Explain the term "Franchise" and "Franchiser". **(03)**

(THE END)