**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN**

**Intermediate Examinations    Autumn 2007**

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# TAXATION

**(MARKS 100)**

**Module C**

**(3 hours)**

Q.1 Mr. Ayub, after retirement from a multinational company as a senior executive, was rehired on contract for a period of three years. However, due to certain reasons, the contract was prematurely terminated six months earlier i.e. on December 31, 2006.

The detail of emoluments received by him during the tax year 2007 are given below:

| | **Rupees** |
|---|---|
| Basic salary (per month) | 70,500 |
| Rent of furnished accommodation (per month) | 30,000 |
| Utilities allowance (per month) | 12,000 |
| Medical benefits reimbursed during the year | 25,000 |

House rent was paid by the company directly to the landlord. Medical benefits were reimbursed against bills submitted by Mr. Ayub.

On his retirement as a permanent employee, he had been paid gratuity from the approved fund. According to the rules of the fund, he was also entitled to a special gratuity in lieu of his services rendered under the contract. Accordingly, an amount of Rs. 120,000 was also paid out of the fund, on termination of the contract.

In lieu of premature termination, the following additional benefits were allowed to Mr. Ayub:

(i) A compensation for early termination of Rs. 150,000 was paid.

(ii) Mr. Ayub had obtained an interest free loan of Rs. 200,000 on July 1, 2006 which was payable in lumpsum on March 31, 2007. 25% of the outstanding balance was waived and remaining amount of loan was deducted from his final settlement. The benchmark rate according to the Income Tax Ordinance, 2001 is 10%.

(iii) He was allowed to retain a 1600cc car which was in his use, at accounting book value of Rs. 650,000. The fair market value of the car at the time of settlement was Rs. 700,000.

**Required:**
Compute the taxable income and tax liability for the tax year 2007. The rates of tax as given in the First Schedule to the Income Tax Ordinance, 2001 are as under:

| **Taxable Income (Rs.)** | **Rate of Tax (%)** |
|---|---|
| 700,000 – 850,000 | 7.50 |
| 850,000 – 950,000 | 9.00 |
| 950,000 – 1,050,000 | 10.00 |
| 1,050,000 – 1,200,000 | 11.00 |

**(14)**

Q.2 (a) What do you understand by the concept “apportionment of expenditures” as explained in the Income Tax Ordinance, 2001? **(06)**

(b) One of your client which is a subsidiary of a foreign company wants to change its accounting year from June 30 to December 31 as the income year of its parent company ends on December 31. Advise the client about the requirements of the Income Tax Ordinance, 2001 regarding change in tax year from normal to special. **(03)**

(c) Mr. Rafiq, a salaried individual, whose taxable income for previous year was more than Rs. 500,000, has not filed the wealth statement. He is of the view that since he has no other source of income besides salary and his employer has already filed the annual statement, he is not required to file a wealth statement.

Evaluate Mr. Rafiq's point of view in the light of Income Tax Ordinance, 2001. **(03)**

Q.3 (a) Mr. Zia inherited certain assets from his father in the year 2004. The fair market values of the assets on the date of inheritance were as follows:

| | **Fair Market Value (Rs.)** |
|---|---|
| 25,000 shares of a private limited company | 2,500,000 |
| 21,000 shares of a public listed company | 462,000 |
| Membership card of Karachi Stock Exchange | 20,000,000 |
| Jewellery | 1,500,000 |

During the tax year 2007, Mr. Zia undertook the following transactions:

(1) He gifted some of the assets to his 20-year old son Mr. Ishaq. The detail and fair market values of the assets are as follows:

| | **Fair Market Value (Rs.)** |
|---|---|
| 10,000 shares of the private limited company | 2,000,000 |
| 10,000 shares of the public listed company | 1,700,000 |
| Membership card of Karachi Stock Exchange | 40,000,000 |

(2) The remaining shares were sold as follows:
- shares of private limited company for Rs. 3,000,000,
- shares of public limited company for Rs. 1,500,000.

Mr. Ishaq sold all the assets transferred through gift in the same year. The assets fetched the following amounts:

| | **Sales Proceeds (Rs.)** |
|---|---|
| 10,000 shares of a private limited company | 2,500,000 |
| 10,000 shares of a public listed company | 1,500,000 |
| Membership card of Karachi Stock Exchange | 55,000,000 |

**Required:**

(i) Based on the above information, compute the taxable income of Mr. Zia and Mr. Ishaq for the tax year 2007.

(ii) Give brief explanation for the items not included in the taxable income. **(10)**

(b) Every prescribed person is required to deduct tax while making payments on account of sale of goods, rendering of services and execution of contracts. Specify any seven exceptions to this rule. **(07)**

Q.4 (a) In certain circumstances, the Income Tax Ordinance, 2001 empowers the Commissioner of Income Tax to make assessment based on any available information or material, to the best of his judgment.

List down the conditions under which the Commissioner can exercise such powers. Also state the time limit within which such power can be exercised. **(04)**

(b) During the tax year 2007, Mr. Yahya, a resident person, derived an income of Rs. 1,500,000 from his business in Pakistan. He has also earned an amount of US$ 30,000 from his business in a foreign country on which he paid income tax to tax authorities of that country, amounting to US$ 10,500.

Compute the tax liability of Mr. Yahya for the tax year 2007.

**Note:** Applicable Tax Rate in Pakistan = 25%; US$ 1 = Pak Rupees 60. **(04)**

Q.5 (a) Identify the situations in which two companies shall be considered to be associates within the meaning of the Income Tax Ordinance, 2001. **(06)**

(b) Briefly discuss the allowability of the following against business income chargeable to tax:

(i) Payment of utility bills in cash amounting to Rs. 15,000.
(ii) Penalty of Rs. 5,000 paid for late submission of quarterly statement under the Income Tax Ordinance, 2001.
(iii) Depreciation on leased assets amounting to Rs. 150,000. **(05)**

(c) Explain the term "Permanent Establishment" with reference to the Income Tax Ordinance, 2001. **(06)**

Q.6 (a) A resident person is about to leave the country. Briefly explain the following in the light of Income Tax Ordinance, 2001:
– responsibility of such person in relation to filing of tax return;
– powers of the Commissioner of Income Tax in such situation;
– rules relating to assessment of income. **(06)**

(b) A person who places an eligible depreciable asset into service in Pakistan for the first time in a tax year shall be allowed initial depreciation allowance. List down the assets which do not come under the purview of "eligible depreciable assets" for the purpose of initial allowance. **(04)**

Q.7 (a) How would the input tax on raw material be determined and claimed where a registered person is engaged in making taxable as well as exempt supplies? **(06)**

(b) A contract has been signed on May 20, 2006 by Mr. Pervez and Mr. Farooq. Both of them are registered persons. Under the contract, Mr. Pervez will supply branded computers to Mr. Farooq within two months. At the time of entering into contract, the goods were exempt from sales tax. Through the Finance Act, 2006, the Government withdrew this exemption with effect from July 1, 2006.

25% advance was paid on signing of contract and balance on the delivery of goods on July 15, 2006. Advise Mr. Pervez on the chargeability of sales tax. **(03)**

Q.8 (a) Every registered person making a taxable supply is required to issue a tax invoice at the time of supply of goods. List down the particulars which are required to be contained in a sales tax invoice. **(04)**

(b) Describe the provisions of the Sales Tax Act, 1990 relating to filing of retail tax return and revision of retail tax return by a registered retailer. **(06)**

(c) What are the circumstances in which a person registered under the Sales Tax Act, 1990 may apply for cancellation of his registration? **(03)**

**(THE END)**