THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Winter 2007

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ADVANCED TAXATION

(MARKS 100)
(3 hours)

Q.1 A Pakistani company has engaged a foreign contractor to upgrade its production facility. The agreement with the foreign contractor specifies that:

- The foreign contractor would acquire the required plant and machinery and design it in accordance with the requirements of the Pakistani company.
- Plant and machinery will be assembled and installed at Pakistani company's location by a sub-contractor in Pakistan. The sub-contractor would be engaged by the foreign contractor and would work under the supervision of the foreign contractor's personnel who would also come to Pakistan for a certain period.
- Foreign contractor would also procure some parts of plant and machinery locally from the sub-contractor.
- On request of the foreign contractor, the Pakistani company will pay for local service and procurements cost of the sub-contractor directly to the sub-contractor. Payments to the sub-contractor totaling Rs.35 million will be deducted from the total contract price of Rs. 200 million. The net contract price of Rs. 165 million will be remitted outside Pakistan to the foreign contractor.

You are required to mention the critical points to determine the tax implications of the above contract with reference to the taxability of the foreign contractor as well as the sub-contractor. **(08)**

Q. 2 Mr. Kashif Ahmad, a Pakistani National, left the Pakistani subsidiary of a multinational company and was employed in the role of Commercial Director Middle East for the Group company with effect from January 1, 2007. Due to certain visa issues, he could not travel immediately and remained in Pakistan till February 28, 2007. While in Pakistan, he continued to work for the Middle East region and received payment from the Group company.

Mr. Kashif is required to return to Pakistan for sorting out certain issues on behalf of the group company and will be staying in Pakistan for about two months. On his return to Pakistan he will continue to be employed and paid by the Group company. The Group company deducts tax @ 20 % of the gross salary.

Required:
Briefly explain the Pakistan tax implications to Mr. Kashif for the tax years 2007 and 2008 in respect of the following:

(a) Salary earned while he was present in Pakistan from January 1, 2007 to February 28, 2007.
(b) If he returns to Pakistan before June 30, 2007.
(c) If he returns to Pakistan after June 30, 2007. **(10)**

Q. 3 RA (Pvt.) Limited, is a highly profitable company and is engaged in manufacturing activities. It has recently started a consultancy business through a newly formed company RA Consultancy (Pvt.) Limited, whose structure of shareholding is as follows:

RA (Pvt.) Ltd	60 %
Mr. Rashid	20 %
Mr. Arshad	20 %

RA Consultancy (Pvt.) Limited is suffering losses due to heavy expenditures on marketing and set-up of infrastructure. It is expected to continue incurring losses during the next few years.

Mr. Rashid and Mr. Arshad are also the Directors and majority shareholders of RA (Pvt.) Limited. They want to claim the tax losses of the subsidiary against the income of RA (Pvt.) Limited and have approached you, as their tax advisor for advice.

Required:
Advise your clients about the necessary steps which should be undertaken to avail the maximum benefit under the Income Tax Ordinance, 2001. **(09)**

Q. 4 Your company has filed return of income for tax year 2007 on September 30, 2007 according to which income tax amounting to Rs. 50 million was refundable. The Director Finance of the company is worried about the refund and has consulted you for advice.
Required:
Please advise the Director Finance in respect of the following:

(i) Procedure for claiming the refund.
(ii) Time frame within which cheque must be issued by the tax authorities.
(iii) Compensation allowed if refund cheque is not issued in time. **(07)**

Q. 5 A foreign Group is contemplating to start business in Pakistan. The Group Finance Director is analyzing options to establish either a branch or a locally incorporated company.

Required:
Briefly analyse the rules relating to computation of income and tax liability under each of the above options as regards the following:

(a) Business income.
(b) Head office expenses.
(c) Payment of royalty or fees for technical services to head office.
(d) Interest payments on loan given by the parent company.
(e) Remittance of profits. **(12)**

Q. 6 Mr. Aslam, a sole proprietor carrying on the business of trading died on January 1, 2007. He had the following assets at the time of his death:

Stock in trade	Rs. 5,000,000 at cost
Property	Rs. 1,200,000 at cost
Shares	200,000 shares of TMC Pakistan Ltd.

The stock in trade was sold by his legal representative on February 1, 2007 at a price of Rs. 7.0 million. Out of this amount Rs. 1 million has been utilized by him for personal expenditures. The property and the shares were however retained and were in possession of the legal representative on May 31, 2007.

On May 31, 2007 the legal representative received a notice for recovery of arrears of Mr. Aslam's income tax of Rs. 15 million.

The market value of Mr. Aslam's assets is given below:

	On January 1	**On May 31**
	---------Rs. in million---------	
Stocks	5.50	N/A
Property	1.50	2.5
Shares	1.40	3.0

The legal representative has also received rent of Rs. 10,000 and dividends amounting to Rs. 40,000 from the above assets, after Mr. Aslam's death.

Required:
Compute the amount which the taxation authorities can recover from the legal representative alongwith necessary explanations. **(05)**

Q. 7 Jabbar and Company Limited carries on business in Pakistan as well as abroad. Sales revenue from business activity in Pakistan and abroad are separately identified. Some of the business expenditures relate exclusively to business activity outside Pakistan. The business expenditure incurred inside Pakistan relates to both and is allocated on the basis of revenue earned from each type of activities.

The following information is available in respect of the tax year 2007:

	Operations inside Pakistan	**Operations outside Pakistan**
	------------Rs. in thousand------------	
Sales revenue	105,000	35,000
Allowable business expenses	136,000	12,000
Brought forward business losses	Nil	5,000
Taxes paid in foreign countries	Nil	1,000

The company has also paid advance tax in Pakistan amounting to Rs. 0.5 million.

Required:
Compute the taxable income of the company for the tax year 2007 and the tax payable with the return. **(07)**

Q. 8 Sulpher Pakistan Limited (SPL) manufactures two products locally and is also engaged in the import of a product which is supplied to the distributors without any further processing. Some of the details are as under:

	Alpha	**Bravo**	**Charlie**
Source of product	manufactured	manufactured	imported
Listed under 3rd schedule of Sales Tax Act	Yes	No	Yes
Federal Excise Duty – rate	10%	10%	Exempt
– basis	retail price	wholesale cash price	-
Retail price-per unit *(including all taxes & duties)*	100	150	200
Retail price-per unit *(excluding all taxes & duties)*	-	-	140
Price to distributors *(excluding all taxes & duties)*	65	125	122

Following information is also available:

- Price to distributors may be assumed to be the Wholesale Cash Price.
- The import value of Charlie under the Customs Act, 1969 is Rs. 100 and the rate of custom duty is 10%.
- All the products are exempt from levy of Special Excise Duty.

Required:
In respect of each unit of the three products, calculate the following:

(a) Sales Tax and Federal Excise Duty payable by SPL.
(b) Withholding tax to be deducted by the distributors. **(15)**

Q. 9 (a) Sales Tax Act, 1990 places certain restrictions on adjustment of input tax. Please explain its provisions in respect of the following:

(i) Extent of restriction on admissibility of input tax;
(ii) The conditions under which the amount of input tax which had been so restricted, may subsequently be allowed;
(iii) Treatment of sales tax paid on acquisition of fixed assets. **(06)**

(b) XYZ Limited is a public listed company engaged in a wide range of business activities. You are required to advise them on the following issues:

(i) The procedure for claiming input tax if the claim is not made in the relevant month.
(ii) The proportion of sales tax that may be claimed as a drawback on re-export of imported goods and the conditions (if any) which must be complied with in this regard.
(iii) The admissibility of sales tax paid on courier services as input tax. **(07)**

Q. 10 Uzair is the senior incharge at the audit of Faysal Technologies Limited for the year ended June 30, 2007. He has developed serious differences with the management as regards the computation of the company's income tax liability. The following transactions are the subject of the dispute:

(a) Investment in a Pakistani subsidiary at a cost of Rs. 30 million was disposed off to an associated undertaking at an arm's length price of Rs. 20 million.
(b) FTL sold self-manufactured goods at a sale price of Rs.20 million to its customer, Alpha Pakistan Limited (APL). Due to certain financial constraints, APL could not discharge its liability in cash and instead, under an agreement with FTL, transferred its land and building on January 1, 2007 as final settlement of its liability. At the date of transfer, the assets had a tax written down value of Rs. 16 million, however, the fair market value of the assets was Rs 22 million. For claiming depreciation, FTL has valued the building at Rs. 15.0 million.
(c) Research & Development expenditure amount to Rs 2 Million. As a result of the expenditure, FTL has been able to develop a new design for its products, which will be used for business purposes from the next accounting year. However, the useful life of the design cannot be ascertained.
(d) FTL is in the process of establishing a subsidiary company in a foreign country, with the objective of setting up a plant. In order to ascertain the technical feasibility of establishing the plant, FTL sought consultancy services of a firm resident of that country and paid Rs. 1.0 million from Pakistan without deduction of withholding tax.

Required:
As tax manager in the firm you are required to give your views with regard to the tax treatment of each of the above transaction. **(14)**

(THE END)