Answers

1 (a) Awami Cars Limited
Accounting year ended 30 June 2009
Tax year 2009

Computation of taxable income	Rupees	Rupees	*Marks*
Income from business			
Accounting profit		9,961,000	
Add: Tax collected by the Collector of Customs (Note 1)	900,000		1·5
Accounting depreciation (Note 2)	4,269,800		0·5
Legal expenses (Note 3)	8,000		1
Donation (Note 4)	400,000		1
Advertising services (Note 5)	250,000		1·5
Loss on exchange (Note 6)	280,000		2
Provision for bad debts (Note 7)	265,000		1
Recovery of a bad debt (Note 8)	75,000		1
Accounting loss on destruction of building and disposal of motor car (Note 9)	1,287,000		1
		7,734,800	
		17,695,800	
Less: Trading debts written off (Note 10)	505,000		1
Net income on sale of imported cars (Note 11)	800,000		1
Tax loss on destruction of building (Note 12)	1,150,000		1·5
Tax loss on disposal of motor car (Note 13)	100,000		1
Initial allowance (Note 14)	600,000		1
Depreciation (Note 15)	7,090,750		5
		(10,245,750)	
		7,450,050	
Income from other sources			
Temporary advance received in cash (Note 16)		100,000	1
Taxable income		7,550,050	

The relevant notes for the explanations of the treatment of items included in the computation of taxable income and tax payable will be considered in allocating marks against each item.

In addition to the above, specific marks will be awarded for the explanations of the treatment of items not included in the computation of taxable income [1 mark for each item] as follows: 5

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Items not included in the computation of taxable income.

(1) Any salary paid or payable in excess of Rs. 15,000 per month, other than by crossed cheque or direct transfer of funds to the employee's bank account, is not deductible. As the salary paid in cash to the temporary employee is less than Rs. 15,000, the Rs. 14,500 is a deductible charge [s.21(m)]. Therefore, no adjustment is required in the computation of taxable income.

(2) Stamp and registration charges for entering into an agreement with Richbank for the overdraft facility is an expenditure incurred wholly and exclusively for the purposes of the business of Awami Cars Ltd (ACL). The expenditure of Rs. 37,000 is therefore a deductible charge.

(3) Rs. 300,000 paid to Mr A, for an out-of-court settlement against his claim for damages sustained to his motor car due to the negligence of ACL's employees, is an expenditure in the ordinary course of carrying on business and is therefore a deductible charge.

(4) Rs. 60,000 credited to the provision for bad debts is not a taxable receipt since the amount when written off in the tax year 2007 was not allowed as a deduction.

(5) The loan of Rs. 45,000 to a former employee written off against the provision for bad debts, is not deductible since ACL is not in the business of lending money.

		Marks
(b) Computation of tax payable	**Rupees**	
Tax on taxable income of Rs. 7,550,050 at 35%	2,642,518	0·5
Tax credit on donation of Rs. 400,000 (Note A)	(140,000)	2
	2,502,518	
Advance tax paid	(2,000,000)	0·5
Tax payable	502,518	3
		30

Note (A) Awami Cars Ltd (ACL) is entitled to a tax credit under s.61(1)(a) since the donation is to a university established by a provincial government. The tax credit is allowed at the average rate of tax (before allowance of tax credit) on the lower of the amount of the donation or 15% of the taxable income of the company [s.61(2)].

		Rupees
Tax on taxable income before tax credit	(A)	2,642,518
Taxable income for the year	(B)	7,550,050
The lesser of Rs. 400,000 (donation) or Rs. 1,132,507 (15% of Rs. 7,550,050)	(C)	400,000
A/B x C 2,642,518/7,550,050 x 400,000		140,000

Notes referred to in the computation of taxable income.

Note (1) The tax of Rs. 900,000 collected by the Collector of Customs on the import of motor cars in CBU condition is not deductible expenditure. The Rs. 900,000 is the final tax on the income from the sale of the imported motor cars [s.148(7)].

Note: if Awami Cars Ltd (ACL) had been a manufacturer of motor vehicles, the tax collected would not be final tax [s.148(7)(c)] but would be available as a tax credit.

Note (2) Accounting depreciation is not deductible. Tax depreciation and initial allowance are deductible at the rates prescribed in the Third Schedule.

Note (3) ACL is not in the business of lending money. The legal expenses of Rs. 8,000 incurred in connection with a loan given to a former employee is not an expenditure incurred wholly and exclusively for the purposes of business. Therefore, the Rs. 8,000 is not deductible.

Note (4) The donation of Rs. 400,000 paid to XYZ University is not deductible. ACL is entitled to a tax credit on the amount of the donation, calculated under a prescribed formula [s.61(1)(a) and (2)].

Note (5) Every person making a payment for advertisement services to a non-resident media person relaying from outside Pakistan is required to deduct tax from the gross amount paid at the prescribed rate (s.153A). The payment of Rs. 250,000 to the non-resident Wireless Operators Dubai is not deductible as no tax was deducted from the payment made [s.21(c)].

Note (6) Where an asset has been acquired with a loan denominated in foreign currency, any difference in exchange arising on the repayment of the loan is to be adjusted against the cost of the asset. Therefore, the loss in exchange amounting to Rs. 280,000 is not deductible. The written down value of plant and machinery has been increased by Rs. 280,000.

Note (7) The provision of Rs. 265,000 for bad debts, calculated on the basis of 5% of the outstanding debtors at the end of the year, is not a provision against specific debts. Therefore, the Rs. 265,000 is not deductible.

Note (8) Rs. 75,000 credited to the provision for bad debts is in respect of a receipt against a bad debt which was allowed as a deduction in the tax year 2007. The Rs. 75,000 is now chargeable to tax since it represents a recoupment of a loss previously allowed as a deduction (s.70).

Note (9) The accounting profit or loss on the disposal of a depreciable asset is not considered in the determination of taxable income. It is the tax profit or loss that is chargeable to tax or allowed as a deduction. The accounting loss of Rs. 1,287,000 on the destruction of the building and on the disposal of the motor car is, therefore, not deductible.

Note (10) Trading debts written off against the provision for bad debts is taken as a deductible charge on the assumption that Rs. 505,000 was previously included in ACL's business income chargeable to tax and ACL has reasonable grounds for believing that the debts are now irrecoverable [s.29(1)].

Marks

Note (11) The net income (adjusted for tax purposes) of Rs. 800,000 on the sale of the three motor cars imported in CBU condition is not chargeable to tax under any head of income, since the tax collected by the Collector of Customs at the import stage (note (1)) is the final tax on the income of the sale of the imported motor cars.

Note (12) The destruction of the building due to fire is considered as a disposal of the building [s.75(1)(b)]. ACL did not receive any consideration (indemnity) as the building was not insured for fire risk. As there is no consideration, the tax written down value of Rs. 1,150,000 is allowable as a deductible loss.

Note (13) The tax loss of Rs. 100,000 on the disposal of the motor car is computed as under:

	Rupees
Tax written down value of the motor car at the time of its transfer to the director	500,000
Consideration received (Note A)	(400,000)
	100,000

Note (A) As the motor car was gifted by ACL to the director, the fair market value (FMV) of the motor car at the time of its transfer is treated as the consideration received [s.77(1)]. The FMV has been taken at Rs. 400,000 being the amount received on the sale of the motor car, two days after its acquisition by the director.

Note (14) Initial allowance

	Rupees
Cost of personal computers	1,200,000
Initial allowance at 50%	600,000

Note (15) Depreciation

	Plant and machinery	Buildings	Computer hardware	Motor cars	Furniture	Total depreciation
Rate of depreciation	15%	10%	30%	15%	15%	
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Written down value	9,200,000	10,400,000	8,700,000	5,700,000	2,450,000	
Disposal		(1,150,000)		(500,000)		
	9,200,000	9,250,000	8,700,000	5,200,000	2,450,000	
Depreciation	1,380,000	925,000	2,610,000	780,000	367,500	6,062,500
Additions			1,200,000	5,375,000		
Loss on exchange (Note 6)	280,000					
Initial allowance			(600,000)	*		
Written down value	280,000		600,000	5,375,000		
Depreciation	42,000		180,000	806,250		1,028,250
						7,090,750

* Any road transport vehicle not plying for hire is not eligible for initial allowance.

Note (16) An amount received by a person, *inter alia*, as a loan from another person (not being a banking company or a financial institution) which is not paid by a crossed cheque or through a banking channel from a person holding a national tax number card, is treated as the income of the recipient chargeable to tax in the year of receipt under the head 'income from other sources' [s.39(3)]. The Rs. 100,000 received in cash is the income of ACL (recipient) chargeable to tax under the head 'income from other sources'.

Marks

2 (a)

Mr Moshin
Accounting year ended 30 June 2009
Tax year 2009

Computation of taxable income	**Rupees**	**Rupees**	Marks
Salary			
From JMC Medical Centre (JMC)			
Basic salary for five months	1,500,000		0·5
Commission (Note 1)	780,000		1
Rent allowance – 45% of Rs. 1,500,000 (Note 2)	675,000		0·5
Medical allowance – 10% of Rs. 1,500,000 (Note 3)	150,000		1
Contribution of JMC to the employees provident fund (Note 4)	120,000		2
Bonus (Note 5)	150,000		1·5
		3,375,000	
Income from business (Note 6)		1,627,300	5
Income from other sources			
Foreign-source income exempt from tax (Note 7)	–		1·5
Consideration for vacating rented building (Note 8)	40,000		1·5
Consideration received for the use of a patent (Note 9)	2,000,000		1
		2,040,000	
Total income		7,042,300	
Allowance for zakat paid (Note 10)		(27,000)	0·5
Taxable income		7,015,300	

The relevant notes for the explanations of the treatment of items included in the computation of taxable income and tax payable will be considered in allocating marks against each item.

In addition to the above, specific marks will be awarded for the explanations of the treatment of items not included in the computation of taxable income [1 mark each for items (1), (3) and (4) and 2 marks for item (2)] as follows: 5

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Items not included in the computation of taxable income.

(1) The receipt of US$ 5,075 by Mr Moshin (M) is a gift, contributed by various individuals as a token of their personal esteem and appreciation for M's humane qualities. The US$ 5,075 is not for any services rendered but is a voluntary payment made by a group of individuals purely on personal grounds. Therefore, the US$ 5,075 is not income chargeable to tax.

(2) The Rs. 50,000 received from Mr X is against payment of an invoice for professional fees rendered by M in his accounting year ended 30 June 2004 when he was maintaining his accounts on the accrual basis. A person accounting for income chargeable to tax under the head 'income from business' on the accrual basis accounting is chargeable on income which is due to the person – when the person is entitled to receive it [s.34]. As M was following the accrual basis accounting, the Rs. 50,000 would have been charged to tax in the tax year 2004. Where an amount is chargeable to tax on the basis that it is receivable, the amount cannot be chargeable again when it is received [s.73(1)(a)]. Therefore, the Rs. 50,000 is not income chargeable to tax.

(3) A company is one of the prescribed persons who are required to deduct tax at the rate of 6% of the amount paid for the rendering of or providing of services. The fees of Rs. 5,640,000 is the amount received by M for medical services rendered to corporate clients. The tax deducted at source of Rs. 360,000 (6% of Rs. 6,000,000 – gross amount of the fees) is the final tax on the income arising from the services rendered to the corporate clients [s.153(1)(b) and (6)]. Such income is not chargeable to tax under any head of income [s.169(1) and (2)] and is, therefore, not included in the computation of taxable income.

(4) The Rs. 90,000 received by M as dividend from EFG Ltd is after deduction of tax of Rs. 10,000 at the rate of 10% of the gross amount of Rs. 100,000 (s.150). The tax imposed on dividend income is also at the rate of 10% (s.5). The Rs. 10,000 is the final tax and the dividend income of Rs. 100,000 received by M is not chargeable to tax under any head of income. Therefore, the Rs. 90,000 is not included in the computation of income.

		Marks
(b) Computation of tax payable	**Rupees**	
Tax at 25% on taxable income of Rs. 7,015,300	1,753,825	0·5
Tax credit on purchase of shares from the Privatisation Commission (Note A)	(75,000)	3
	1,678,825	
Tax deducted at source by JMC from M's salary income	(250,000)	0·5
Tax payable	1,428,825	4
		25

Note (A) A person (other than a company) is allowed a tax credit, *inter alia*, on the cost of acquiring shares from the Privatisation Commission of Pakistan. The credit is to be calculated on the lower of (a) the cost of acquiring the shares (b) 10% of the person's taxable income for the year or (c) Rs. 300,000 [s.62(1) and (2)].

The amount of the investment on which the tax credit is to be calculated is Rs. 300,000 since both the cost of acquiring the shares (Rs. 500,000) and 10% of Moshin's taxable income (Rs. 701,530) are more than Rs. 300,000. The tax credit is calculated as under:

		Rupees
Tax assessed before allowance of tax credit	(A)	1,753,825
Taxable income for the tax year	(B)	7,015,300
Amount of investment on which the tax credit is calculated	(C)	300,000
Tax credit allowable		
A/B x C		
1,753,825/7,015,300 x 300,000		75,000

The disposal of the shares in Newgas Ltd on 1 July 2009 (tax year 2010) would not disentitle M of the benefit of the tax credit in the tax year 2009. The consequence of the disposal of the shares on 1 July 2009 (i.e. within 12 months of the date of its acquisition) is that the tax payable by M for the tax year 2010 would be increased by Rs. 75,000 being the amount of tax credit allowed in the tax year 2009 [s.62(3)].

Notes referred to in the computation of taxable income.

Note (1) The Rs. 780,000 (20% of Rs. 3,900,000) commission received by Mr Moshin (M) from JMC Medical Centre Karachi (JMC) is taxable as his salary income as the receipt is directly connected to his employment with JMC.

Note (2) The rent allowance is fully taxable [12(2)(c)].

Note (3) A medical allowance up to 10% of the basic salary of an employee is exempt from tax, if free medical treatment or hospitalisation or reimbursement of medical or hospitalisation charges is not provided for in the terms of employment by the employer [Clause 139(b) of Part I of the Second Schedule]. M's terms of employment provide for free medical treatment. Therefore, the medical allowance is fully taxable.

Note (4) The Rs. 240,000 received by M on 31 December 2008 at the end of his service contract from the JMC Employees Provident Fund (Fund) represents Rs. 120,000 contributed by JMC and Rs. 120,000 contributed by M. As the Fund is not recognised by the commissioner and no tax has been deducted by the Fund from the payment of Rs. 240,000, the employers contribution to the Fund of Rs. 120,000 is chargeable to tax under head 'salary' [s.12(2)(e)(iv)].

Note (5) An amount is treated as received by an employee from any employment regardless of whether the amount is paid or provided by a past employer or a prospective employer [(s.12(5)(b)]. Furthermore, a person is treated as having received an amount, *inter alia*, if the amount is applied on behalf of the person, at the instructions of the person [s.69(b)]. The Rs. 150,000, bonus from JMC (past employer), is considered to be M's income from employment. M is treated as having received the Rs. 150,000 since, as instructed by him, the Rs. 150,000 was paid, on his behalf, to the Poor Patients Unit of JMC.

Note (6) Income from business

(i) Receipts not taken into account for the purpose of computing income under the head 'Income from business'.

- Rs. 50,000 received from Mr X.
  The amount was charged to tax in the tax year 2004 and is therefore not chargeable to tax in the tax year 2009 (referred to in item (2) in the list of items not included in the computation of taxable income).

– Rs. 6,000,000 received from corporate clients.
The tax of Rs. 360,000 deducted by the corporate clients is the final tax on the income arising from the gross fees of Rs. 6,000,000 (referred to in item (3) in the list of items not included in the computation of taxable income).

(ii) Fees received from individuals – Rs. 3,000,000.
An individual is not required to deduct tax from payments made for the rendering of or providing of services. The Rs. 3,000,000 is chargeable to tax under the head 'Income from business'. The income chargeable to tax on the gross receipts of Rs. 3,000,000 is Rs. 1,627,300 which is computed as under:

	Rupees
Fees received from individuals	3,000,000
Allowable deductions (Note 6A)	(1,372,700)
	1,627,300

Note (6A) The Rs. 1,372,700 is computed as under:

	Rupees
Gross fees received from consultations at the Cardiac Clinic (Rs. 6,000,000 + Rs. 3,000,000)	9,000,000
Total expenditure of M's consulting practice at the Cardiac Clinic	5,731,500
Less: 50% of rent of Rs. 3,600,000 paid for the bungalow Cardiac Clinic since one-half of the bungalow was used by M for his residence	(1,800,000)
Deductible expenditure	3,931,500

Allowable deduction against the gross fees of Rs. 9,000,000 is Rs. 4,118,100 which is made up as follows:

Deductible expenditure	3,931,500
Depreciation	186,600
	4,118,100

The Rs. 4,118,100 is allocable to the fees received from individuals in the proportion that the said fees bear to the total gross fees received.

		Rupees
Deductible expenditure and depreciation	(A)	4,118,100
Fees received from individuals	(B)	3,000,000
Total gross fees received	(C)	9,000,000
A x B/C		
4,118,100 x 3,000,000/9,000,000		1,372,700

Note (7) The foreign-source income of M is exempt from tax for the tax year 2009 since M was not resident in any of the four tax years (2005, 2006, 2007 and 2008) preceding the tax year 2009 in which year M became a resident individual for Pakistan tax [s·51(1)].

Note (8) Any amount received by a person as consideration for vacating the possession of a building or part thereof, reduced by the amount paid to acquire possession of such building or part thereof, is chargeable to tax under the head 'Income from other sources' in ten years in equal proportion including the year in which the consideration is received. Therefore, Rs. 40,000 – 1/10 of Rs. 400,000 (Rs. 1,000,000 consideration received less Rs. 600,000 paid to acquire possession of the building) is chargeable to tax [s.39(1)(k) and (2)].

Note (9) The Rs. 2,000,000 received as consideration for the use of the patent owned by M is income from royalty [s.2(54)(a)] and is chargeable to tax under the head 'Income from other sources' [s.39(1)(b)].

Note (10) Zakat paid is an allowable deduction from the total income to arrive at the taxable income [s.9 read with s. 60].

Marks

3 **Mr Zaffer**
Accounting year ended 30 June 2009
Tax year 2009

Computation of taxable income	Rupees	Rupees	Marks
Salary			
Employee share scheme			
Gain on disposal of rights (Note 1)		100,000	1
Income from business			
Tax profit on disposal of depreciable assets of Zaffer Sons	278,900		0·5
Set off of brought forward loss (Note 2)	(148,000)		1·5
		130,900	
Capital gains			
Gain on the sale of one share in Karachi Stock Exchange Guarantee Ltd (Note 3)	18,000,000		1
Gain on the disposal of shares held by Zaffer Sons (Note 4)	163,630		4
Gain on the sale of shares acquired under an employee share scheme (Note 5)	142,500		3
Gain on sale of antique vase (Note 6)	300,000		2
	18,606,130		
Set off of brought forward loss (Note 7)	(740,900)		1
		17,865,230	
Taxable income		18,096,130	

The relevant notes for the explanations of the treatment of items included in the computation of taxable income will be considered in allocating marks against each item.

In addition to the above, specific marks will be awarded for the explanations of the treatment of items not included in the computation of taxable income [2 marks for item (3) and 1 mark each for the other four items] as follows: 6

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Items not included in the computation of taxable income.

(1) In computing income from business chargeable to tax, a deduction is allowable for any expenditure incurred in the tax year wholly and exclusively for the carrying on of the business [s.20(1)]. Mr Zaffer (Z) was not carrying on any business as and from 1 July 2008. Therefore, the expenditure of Rs. 70,000 is not deductible.

(2) Where, in any year, a person disposes of a depreciable asset, no depreciation deduction is allowed on the asset for that year [s.22(8)]. The depreciable assets of Zaffer Sons were disposed of in the tax year 2009. Therefore, the accounting depreciation of Rs. 8,550, though calculated at the rates given in the Third Schedule, is not deductible.

(3) Any stock-in-trade is excluded from the definition of a 'capital asset' as normally any gain or loss on the sale of stock-in-trade is chargeable as 'Income from business'. However, there is one exception. Where stocks and shares are held as stock-in-trade, such stocks and shares are considered to be capital assets [s.37(5)(a)]. The gain or loss on the disposal of such stocks and shares is chargeable as a capital gain or allowed as a capital loss respectively.

Bright Lights Ltd (BLL) is a public company for tax purposes since 50% of the shares are held by the Federal Government [s.2(47)(a)]. Any gain on the disposal of shares in BLL, being a public company, is exempt from tax up to the tax year 2010 [clause 110 of Part I of the Second Schedule]. However, no loss is deductible in computing capital gains, on the disposal of a capital asset where a gain on the disposal of such asset is not chargeable to tax [s.38(2)]. Therefore, the loss of Rs. 70,400 is not deductible.

(4) A capital gain or loss can only arise on the disposal of a capital asset. Any immoveable property is excluded from the definition of a capital asset [s.37(5)(c)]. Therefore, the gain of Rs. 4,950,000 is not considered as a capital gain.

(5) Moveable assets held for personal use (with certain exceptions) are excluded from the definition of a capital asset. A motor car does not fall in the list of exceptions. As a capital gain or loss can only arise on the disposal of a capital asset, the loss of Rs. 5,000 suffered by Z on the disposal of his motor car is not deductible as a capital loss.

Notes referred to in the computation of taxable income.

Note (1) Gain on the disposal of rights under an employee share scheme
Any gain on the disposal of rights to acquire shares under an employee share scheme is chargeable to tax under the head 'salary'. As no payment was made to acquire the rights, the consideration of Rs. 100,000 received on the disposal of the rights to acquire 300 shares in Safe Securities Inc is chargeable to tax as Z's salary income [s.14(5)].

Note (2) Set off of brought forward loss

Out of the unadjusted business loss of Rs. 948,000, Rs. 800,000 is a loss from speculation business (s.19) which can be set off only against income from speculation business (s.58). As there is no income from speculation business in the tax year 2009, the Rs. 800,000 cannot be set off.

The balance loss of Rs. 148,000 (Rs. 948,000 less Rs. 800,000) is set off against the business income of Zaffer Sons.

Note (3) Gain on the sale of one share in Karachi Stock Exchange (Guarantee) Ltd

The gain on the transfer of shares of a stock exchange in Pakistan by an individual to a company was exempt from tax, if the transfer was effected between 1 July 2005 and 30 June 2008. The Finance Act, 2008 did not extend the exemption and therefore the gain of Rs. 18,000,000 is chargeable to tax under the head 'capital gains'.

	Rupees
Consideration received	34,000,000
Cost	(10,000,000)
	24,000,000
75% of Rs. 24,000,000 is chargeable to tax since the share was held for more than one year	18,000,000

Note (4) Disposal of shares by Zaffer Sons

Stocks and shares held as stock-in-trade are considered as capital assets [referred to in item (3) of the items not included in the computation of income].

	Rupees
Loss on the sale of shares in XYZ (Private) Ltd	(5,120)
Gain on the disposal of 15,000 shares in Saeed (Private) Ltd (Note 4A)	168,750
	163,630

Note (4A) The gift of 15,000 shares in Saeed (Private) Ltd (SPL) to Parveen is a disposal of the shares by Z (s.75). Under the non-recognition rules, no gain or loss is taken to have arisen on the disposal of an asset, *inter alia*, by reason of a gift of the asset, provided the person acquiring the asset is not a non-resident at the time of the acquisition [s.79(1)(c) and (2)]. The non-recognition rule is not applicable to the gift of 15,000 shares in SPL made to Parveen, since Parveen was non-resident for Pakistan tax purposes at the time she acquired the shares. Parveen was non-resident in Pakistan in the tax year 2009, since her stay in Pakistan was less than 183 days in the tax year [s.82(a)].

When an asset is disposed of, *inter alia*, by reason of a gift, the fair market value (FMV) of the asset on the date of its disposal is treated as the consideration received on the disposal of the asset (s.77). The break up value of Rs. 25 per share in SPL is treated as the FMV of one share in SPL on the date of the gift to Parveen.

	Rupees
Consideration received for 15,000 shares in SPL (Rs. 25 x 15,000)	375,000
Cost of the 15,000 shares (Rs. 10 x 15,000)	(150,000)
Gain on disposal	225,000
75% of the capital gain of Rs. 225,000 is chargeable to tax since the shares in SPL were held by Z for more than one year [s.37(3)]	168,750

Note (5) Gain on the sale of 900 shares in Safe Securities Ltd (SSI) acquired under an employee share scheme

	Rupees
Consideration received on disposal of the 900 shares	1,000,000
Cost of the 900 shares (Note 5A)	(810,000)
Gain on disposal	190,000
75% of the capital gain of Rs. 190,000 is chargeable to tax, since the shares in SSI were held for more than one year	142,500

Note (5A) The cost of the shares acquired under an employee share scheme is the sum of (i) the consideration if any, paid for the shares; (ii) the consideration, if any, paid for the right or option to acquire the shares and (iii) the amount chargeable to tax as the salary income of the employee on acquiring the shares [s.14(4)].

Marks

		Rupees
(i)	Consideration paid to acquire the shares. US$ 10 paid on the acquisition of 900 shares on 1 November 2006 (tax year 2007) – US$ 10 x 900 = US$ 9,000 (US$ 1 = Rs. 60]	540,000
(ii)	Amount charged to tax as salary income in the tax year 2007. 900 shares were acquired at US$ 10 per share when the price on the New York stock exchange was US$ 15 per share which is the fair market value on the date of its acquisition. The difference of US$ 5 per share equal to Rs. 270,000 [US$ 5 x 900 = US$ 4,500 i.e. Rs. 270,000 (US$ 1 = Rs. 60)] is the taxable benefit which would have been taxed under the head 'salary' in the tax year 2007.	270,000
		810,000

Note (6) Gain on the sale of antique vase

Moveable assets held for personal use (with certain exceptions) are excluded from the definition of a capital asset. Antiques are included in the list of the exceptions. Though the antique vase was held by Z for his own use, the vase is considered to be a capital asset. Any gain on the disposal of an antique is chargeable to tax as capital gains but no loss is deductible on the disposal of an antique [s.37(5)(d) and s.38(5)(f)].

The antique vase was received by Z on the distribution of assets on the dissolution of a firm in which he was a partner and therefore no cost was paid by him. Where a capital asset becomes the property of a person, *inter alia*, on the distribution of assets on the dissolution of a firm, the fair market value of the asset on the date of its acquisition is treated as the cost of the asset (s.37(4A)]. Since the vase was valued at Rs. 750,000 for the purpose of insurance at the time of its acquisition, the Rs. 750,000 is considered to be its cost for determining the capital gain or loss on its disposal.

	Rupees
Sale proceeds	1,150,000
Cost	(750,000)
Capital gain	400,000
75% of Rs. 400,000 is chargeable to tax since the antique vase was held for more than a year.	300,000

Note (7) A loss under the head 'capital gains' can be carried forward for a period of six years immediately succeeding the tax year in which the loss was incurred [s.59(2)]. The brought forward capital loss of Rs. 740,900 incurred in the tax year 2008 is accordingly set off against the income from capital gains.

4 (1) Deduction of tax on payments for the sale of goods.

The view of the Chief Financial Officer (CFO) is erroneous. For the period from 1 January 2008 to 30 June 2008, no tax was required to be deducted by a small company from payments for the sale of goods. However, after the enactment of the Finance Act, 2008 (applicable from 1 July 2008) a small company is required to withhold tax not only from payments for the sale of goods but also on payments for the rendering of or providing of services and on the execution of a contract. 2

(2) Repairs to an item of plant.

Deductions can be allowed in respect of only those expenses incurred in the relevant accounting year and expenses incurred before the commencement of that year are not deductible under the accrual basis accounting. 1

Rafiq Industries Ltd being a company has to account for income chargeable to tax under the head 'Income from business' on an accrual basis [s.32(2)]. The expenditure of Rs. 1,780,000 was incurred in the accounting year ended 31 December 2007 (tax year 2008) and should have been claimed as a deduction in that tax year and not in any subsequent year [s.20]. Therefore, the expenditure of Rs. 1,780,000 is not deductible in the tax year 2009. 2

(3) Minimum tax.

The provision relating to minimum tax has been deleted by the Finance Act, 2008 [s.113 prior to its omission by the Finance Act, 2008]. Therefore, the view of the CFO is erroneous. No minimum tax is payable along with the return of income for the tax year 2009. 2

Marks

(4) Gain on the sale of shares held as an investment.
The computation of the gain on the sale of 6,000 shares in Amber Pakistan Ltd (Amber) is erroneous. The 2,000 bonus shares in Amber were issued in respect of the existing 4,000 shares in Amber held by RIL. The real cost of the bonus shares is not the face value of the shares. The cost of the existing 4,000 shares (Rs. 80,000) has to be spread over 6,000 shares (the existing 4,000 shares and the 2,000 bonus shares). In other words, the cost of the 6,000 shares is now Rs. 80,000. 3

The gain on the sale of 6,000 shares in Amber is Rs. 270,000 which is chargeable to tax under the head 'capital gains'. The Rs. 270,000 is computed as under:

	Rupees	Marks
Consideration paid on 21 March 2008 for the acquisition of 4,000 shares in Amber	80,000	
2,000 bonus shares in Amber issued on 31 March 2008	–	
Cost of 6,000 shares in Amber	80,000	
Consideration received on the sale of the 6,000 shares in Amber	350,000	
	270,000	2

(5) Capital reserve Rs. 20,000
The Rs. 20,000 credited to capital reserve is not RIL's income chargeable to tax. The definition of 'income' [s.2(29)] specifically excludes from its ambit, in the case of a shareholder of a company, the amount representing the face value of any bonus shares issued by a company to the shareholders. RIL is a shareholder of Amber and therefore, the Rs. 20,000 representing the face value of the 2,000 bonus shares issued by Amber, is not RIL's taxable income. 3

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Input tax	**Rupees**	
On purchase of raw materials for manufacturing taxable supplies (Rs. 10,127,800 x 16/116)	1,396,938	0·5
On purchase of raw material for manufacturing both taxable and exempt supplies (Note 1)	483,816	3
On advertisement for taxable supplies (Rs. 1,000,000 x 16/116)	137,931	0·5
Excise duty paid on raw material under the sales tax mode	100,000	1
Input tax not deducted in the return for the month of September 2008 (Note 2)	185,700	1
	2,304,385	

No input tax is allowable on the purchase of gifts given to customers [s.8 read with SRO 490(1)/2004 dated 12 June 2004]. 1

Output tax	**Rupees**	
On sale of taxable goods to registered persons (Rs. 6,296,000 x 16%)	1,007,360	0·5
On sale of taxable goods to unregistered persons (Rs. 6,874,650 x 16%)	1,099,944	0·5
On export of goods to Nigeria Rs. 5,790,000 – zero rated	0	1
	2,107,304	

Sales tax payable for the month of October 2008	**Rupees**	
Output tax	2,107,304	
Input tax – Rs. 2,304,385 (restricted to 90% of output tax Rs. 2,107,304 x 90%)	(1,896,574)	1
	210,730	

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Marks

Note (1) Input tax on the purchase of raw materials for manufacturing both taxable supplies and exempt supplies (Rs. 3,945,000 x 16/116). Rs. 544,138

	Rupees		Rupees
Apportionment of Rs. 544,138 to taxable supplies:			
– Value of taxable supplies			
– sale to registered persons	6,296,000		
– sale to unregistered persons	6,874,650		
– export to Nigeria	5,790,000		
		(A)	18,960,650
– Value of taxable supplies + exempt supplies (Rs. 18,960,650 + Rs. 2,364,000)		(B)	21,324,650
– Input tax to be apportioned		(C)	544,138
A/B x C			
18,960,650/21,324,650 x 544,138			483,816

Note (2) Any input tax not deducted by a registered person can be claimed in the return for any of the six succeeding months [s.7(1)].