Answers

Notes:
1. The suggested answers provide detailed guidance on the subject for use as a study aid to the question paper. Students were not expected to produce the answer with this extensive detail, which would not be possible in a three hour exam.
2. All references to legislation shown in square brackets are for information only and do not form part of the answer expected from candidates.

Marks

1 Revolution Ltd
Accounting year ended 30 June 2010
Tax year 2010

(a) Computation of taxable income

	Rs.	Rs.	
Income from business			
Net profit as per profit and loss account		4,500,000	0·5
Less:			
(i) Rent from property (to be treated separately)	600,000		0·5
(ii) Accounting gain on the disposal of fixed assets	60,000		0·5
		(660,000)	
		3,840,000	
Add backs			
(i) Excess claim on account of use of secret formula (Note 1)	887,808		2·0
(ii) Commission Rs. 50,000 [s.21(c) and s.233(2)]	50,000		1·0
(iii) Repairs and maintenance [s.21(n) and Note 5 re tax depreciation]	500,000		1·5
(iv) Accounting depreciation	4,000,000		0·5
(v) Bad debts (Note 2)	300,000		2·0
(vi) Taxable gain on the disposal of fixed assets (Note 3)	250,000		2·0
(vii) Property tax and repair allowance [s.20(1)]	245,000		1·0
		6,232,808	
Admissible Deductions			
(i) Initial allowance (Note 4)	(1,250,000)		1·5
(ii) Tax depreciation (Note 5)	(3,162,500)		4·5
		(4,412,500)	
Income from business		5,660,308	
Income from other sources			
Share deposit money received in cash [s.39(3)]		1,000,000	1·0
Total income		6,660,308	
Share of profit from the association of persons [s.88A]		440,000	0·5
Taxable income		7,100,308	
Income from property [s.15]		600,000	1·0

Notes

Note 1
The total amount paid to purchase the secret formula for use in the business is an intangible asset and is allowed as an expense over the useful life of the asset. As the useful life of the asset cannot be ascertained, it is treated as ten years. The allowable amount is, thus:

	Rs.
Total price	1,500,000
Amount claimed during the year	1,000,000
To be amortised during the year for 273 days it was used	
Total price/useful life x 273/365 = 1,500,000/10 x 273/365	112,192
Excess claim inadmissible during the year (1,000,000 – 112,192) [s.24]	887,808

Marks

Note 2
Bad debt claim Rs. 500,000

(i) Rs. 100,000 claimed for possible future bad debts is not an allowable deduction as the debts have not become bad in the tax year 2010.

(ii) Rs. 200,000 given as a loan and becoming bad is not an allowable deduction as the amount was not previously included in the income from business chargeable to tax and the taxpayer is not a financial institution.

(iii) The other amount of Rs. 200,000 written off as bad debts is admissible as there are reasonable grounds to believe that the debt has become bad. Non-filing of recovery suits in a court of law is not a precondition to a claim for deduction.

Therefore, out of the total claim, the amount of Rs. 300,000 is not allowable. [s.29]

Note 3
The taxable gain on the sale of fixed assets [assessable as 'Income from business'] is computed on the basis of the sale price received minus the tax written down value (TWDV) as on 1 July 2009 of the assets disposed of. However, in the case of the sale of the computer, the consideration received is taken as the fair market value of the computer on the date of its disposal. [ss.22(8) & 77]

Asset	TWDV of assets disposed of	Higher of sale proceeds or fair market value at the time of disposal	Gain or (loss)
	Rs.	Rs.	Rs.
Plant and machinery	100,000	250,000	150,000
Computer	50,000	100,000	50,000
Furniture and fittings	50,000	100,000	50,000
			Total gain Rs. 250,000

Note 4
Initial allowance [s.23]
Out of fixed assets added and used during the year, the furniture and fittings and vehicles not plying for hire are not eligible assets for initial allowance. Initial allowance for eligible assets added and used during the year is Rs. 1,250,000 as under:

Asset	Cost of asset	Initial allowance at 50% of cost
	Rs.	Rs.
Plant and machinery	2,000,000	1,000,000
Computer	500,000	250,000
		Total Rs. 1,250,000

Note 5
Tax depreciation

Asset	TWDV on 1 July 2009	TWDV of assets added during the year	Assets disposed of at TWDV	TWDV eligible for depreciation	Rate	Tax depreciation
(1)	(2)	(3)	(4)	(5) = 2 + 3 – 4	(6)	(6) x (5)
	Rs.	Rs.	Rs.	Rs.		Rs.
Buildings	5,000,000	0	0	5,000,000	10%	500,000
Plant and machinery	4,000,000	1,000,000 (see (a))	100,000	4,900,000	15%	735,000
Computers	2,000,000	250,000 (see (a))	50,000	2,200,000	30%	660,000
Vehicles	4,000,000	1,500,000 (see (b))	0	5,500,000	15%	825,000
Furniture and fittings	2,000,000	500,000	50,000	2,450,000	15%	367,500
						3,087,500
Tax depreciation on capitalised expenditure of Rs. 500,000 on plant and machinery at 15%						75,000
Total tax depreciation						3,162,500

Notes:
(a) The tax written down value TWDV of the addition in plant and machinery and computers for tax depreciation is worked out after deducting the allowable initial allowance as per Note 4 above. [s.22(5)(a)]

		Marks
(b)	Since the vehicle is not plying for hire, its cost for tax depreciation purposes is reduced to Rs. 1,500,000. [s.22 (13)(a)]	

Note 6
Property income
The rent received on account of property is taxed separately under the final tax regime (FTR). No expenses/deductions are available. [s.15 read with s.115]

Explanation of items not included in the computation of taxable income above

(i)	Write off of outdated Benzene Rs. 200,000 Since the raw material could not be used in time, it is a loss relating to normal business, therefore rightly claimed as an expense. No add back shall be made. [s.20]	1·0
(ii)	Surcharge Rs. 100,000 on utility bills Late payment of bills is not in the nature of a fine, and rightly claimed. Only penalties and fines for violation of any law, rule or regulation are inadmissible. [s.21(g)]	1·0
(iii)	Non-deduction of tax from supplier of goods Payment of an amount to the supplier of goods without tax deduction does not make such expenditure inadmissible. [s.21(c)]	1·0
(iv)	Outstanding trading liability allowed in the tax year 2003 It is not to be added back this year as the amount could have been added back in the tax year 2007 (being the next year after three years in which it was allowed) only. [s.34(5)]	1·0
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(b) Computation of tax liability

	Rs.	Rs.	
Taxable income	7,100,308		
Tax at 35%		2,485,108	0·5
Less tax credit on account of tax paid as member of association of person (AOP) [s.88A]			
A Amount of share of profit from AOP	440,000		
B Taxable income of the AOP	1,000,000		
C Tax assessed on the AOP at 17·5%	175,000		
Tax credit = (A/B) x C	77,000		
		(77,000)	1·5
Tax payable on taxable income		2,408,108	
Tax on the basis of turnover			
Total turnover	50,000,000		
Minimum tax at 0·5%	250,000		
Minimum tax is not applicable as tax on the basis of taxable income is more than the minimum tax.			1·0
Tax under the final tax regime (FTR)			
Amount of rent received	600,000		
Tax at Rs. 7·5% of the amount exceeding Rs. 400,000 plus Rs. 20,000 [7·5% x (600,000 – 400,000) + 20,000]		35,000	1·0
Total tax liability		2,443,108	
			4

(c)	The rate of tax deduction on supplies other than pharmaceuticals is 3·5%. It makes no difference whether the supply is under a contract or otherwise. Tax rate applicable to contracts is not applicable to contracts for supplies. Therefore, the company should have deducted tax at 3·5% of the gross amount paid for purchase of these chemicals. [s.153(1)(a) & (c)]	2
		30

Marks

2 Mr Sannan
Accounting year ended 30 June 2010
Tax year 2010

(a) Computation of taxable income

	Rs.	Rs.	
Income from salary			
Basic salary			
Received	10,000,000		0·5
Paid to hospital as a donation on his behalf [s.12(5)]	500,000		0·5
		10,500,000	
Medical allowance (Note 1)		500,000	1·0
Leave fare assistance		400,000	0·5
Amount for employment relationship			
Taxable as part of salary and not exempt on the basis of any contingent condition [s.12(2)(e)(i)]		2,500,000	1·0
Valuation of perquisites in the form of:			
(i) Assets given for use at home (Note 2)		200,000	1·0
(ii) Concessional loan (Note 3)		60,000	2·0
(iii) Reimbursement of medical expenses (Note 1)		0	0·5
Income under the head 'salary'		14,160,000	
Income from other sources			
Gift received in cash Rs. 3,000,000 [s.39(3)]		3,000,000	1·0
Total income		17,160,000	
Less deductible allowances:			
Zakat paid (Note 4)		(500,000)	1·0
Taxable income		16,660,000	
Tax at 20%		3,332,000	0·5
Tax credits:			
	Rs.		
(i) Rs. 500,000 paid in cash to the government hospital in Sindh is not eligible for credit. [s.61(4)]	0		0·5
(ii) Profit paid on debt obtained for purchase of house (Note 5)	26,000		2·0
(iii) Investment in shares (Note 6)	60,000		1·5
(iv) Contribution to an approved pension fund (Note 7)	100,000		1·5
Total tax credits		(186,000)	
Tax payable on taxable income		3,146,000	

Income covered by the final tax regime (FTR)

	Amount Rs.	Tax Rs.		
(i) Tax on profit on bank account at 10% [s.151]	100,000	10,000		0·5
(ii) Dividend received at 10% [s.150]	350,000	35,000		0·5
Total tax on FTR		45,000		
Tax already deducted		(10,000)		0·5
Balance payable			35,000	
Total tax payable			3,181,000	

Notes

Note 1
Medical allowance is exempt, in the case of a salaried person up to 10% of the basic salary, if free medical treatment or hospitalisation or reimbursement of medical or hospitalisation charges is not provided for in the terms of his employment. Since Mr Sannan was also given reimbursement of medical and hospitalisation charges as per terms of his employment, the medical allowance is not exempt. However, no addition is made on account of the reimbursed amount as it qualifies for exemption [under clause (139)(a) of the First Part to the 2nd Schedule to the Income Tax Ordinance, 2001].

Marks

Note 2
The ownership of the assets remains with the employer. However, for the use of the assets, the expense charged in the accounts is treated as income of the employee, fairly estimated at 20% of the book value of these assets. [ss.13 and 68]

Note 3
Concessional loan

	Rs.	Rs.
Loan given by the employer	3,000,000	
Profit computable at the bench mark rate of 12% for six months of use during the year (12% x 6/12 x 3,000,000)		180,000
Profit charged by the employer at 8% for six months of use during the year (8% x 6/12 x 3,000,000)		(120,000)
Amount to be treated as perquisite [s.13(7)]		60,000

Note 4
It is not necessary to pay Zakat by a crossed cheque in order to claim it as an allowance. The essential condition, that it should be paid under the Zakat and Ushr Ordinance, 1980, is fulfilled.

Note 5
Tax credit on the profit paid on the debt obtained for the purchase of a house. [s.64]

(i) As HPL is not a public company, the profit paid on the loan from such a company does not qualify for tax credit.

(ii) Profit paid to a scheduled bank on a loan obtained for the purchase of a house qualifies for tax credit as under:

		Rs.
Loan obtained		2,000,000
Profit paid for six months at 13% per annum (2,000,000 x 13% x 6/12)		130,000
Since profit paid is less than both Rs. 750,000 and 50% of taxable income, tax credit can be computed on this amount.		
Tax assessed before any tax credit	(A)	3,332,000
Taxable income for the year	(B)	16,660,000
Profit eligible for tax credit	(C)	130,000
Tax Credit	(A/B) x C	26,000

Note 6
Only the investment in shares offered to the public by Good Luck Ltd qualify for tax credit. [s.62]

			Rs.	Rs.
Tax credit is allowed according to the formula (A/B) x C				
Where	A	is tax assessed before any tax credit		3,332,000
	B	is taxable income for the year		16,660,000
	C	is lesser of:		
	(i)	Actual investment	300,000	
	(ii)	10% of taxable income	1,666,000	
	(iii)	Maximum amount of	300,000	
Tax credit admissible (3,332,000/16,660,000) x 300,000				60,000

Note 7
Contribution to an approved pension fund are eligible for tax credit [s.63] as per formula (A/B) x C where

			Rs.	
A	is tax assessed before any tax credit		3,332,000	
B	is taxable income for the year		16,660,000	
C	is lesser of:			
	(i)	actual contribution	700,000	
	(ii)	20% of taxable income	3,332,000	or
	(iii)	Maximum amount of	500,000	
Tax credit is therefore (3,332,000/16,660,000) x 500,000			100,000	

Explanation about items not included in the computation of taxable income:

1. The value of a right or option to acquire shares under an employee scheme granted to an employee is not chargeable to tax unless such a right or option is exercised. [s.14(1)] 1·0

		Marks
2.	The salary in arrears from his ex-employer in Canada of Rs. 500,000 falls under the definition of salary [s.12(5)(b)]. However, since Mr Sannan is a national of Pakistan who has acquired the status of resident (from non-resident) in the tax year 2010 after his return from abroad, his foreign source income is exempt in the tax years 2010 and 2011. [s.51]	1·0
3.	No expenses incurred to secure employment or to earn income under the head 'Salary' are admissible. Therefore, the Rs. 2,000,000 paid to the head-hunter and Rs. 300,000 on books and subscriptions cannot be deducted to arrive at taxable salary income.	1·0
4.	The rent of Rs. 1,000,000 received in respect of his apartment in the USA is exempt from tax in Pakistan as Mr Sannon is a national of Pakistan and acquired the status of resident (from non-resident) in the tax year 2010. His foreign source income from Canada or any other country is exempt in the tax year 2010 and 2011. [s.51]	0·5
		20

(b) Explanations sought by the Commissioner of Income Tax in respect of non-deduction of tax. [ss.21 & 161]

(i)	Where an employer fails to deduct tax as required from the salary paid to its employees or to pay over the deducted tax then the tax department can recover such tax from the employer along with additional tax. However, in this case Mr Sannan has already paid the tax prior to the issuance of the show cause notice and the tax department cannot recover the tax again from the employer (HPL).	1·5
(ii)	The actual default period is from the date of payment of the salary until 30 September 2010 (the date Mr Sannan filed his return and paid the tax), not as stated in the show notice from 1 January 2010 to 15 October 2010.	1·0
(iii)	Since the tax has already been paid, therefore, the expense of salary, otherwise admissible, will not be inadmissible on this ground.	0·5
		3

(c) Disposal of shares in Good Luck Ltd

The shares in Good Luck Ltd were purchased on 25 March 2010. If they are disposed of on 25 September 2010, i.e. within 12 months of their purchase, the tax credit allowed will be taken back by way of enhancing the tax liability of the tax year in which this disposal takes place. In the given situation, tax liability of the tax year 2011 would be enhanced by Rs. 60,000. 2

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3 Mr Shahid
Accounting year ended 30 June 2010
Tax year 2010

(a) Computation of taxable income

		Rs.	
Taxable capital gain on:			
Sale of statue of Buddha	(Note 1)	75,000	1·5
Sale of 4,000 shares of ABC Ltd.	(Note 2)	255,000	3·0
Sale of oil painting in personal use	(Note 3)	350,000	1·5
Sale of antique vase	(Note 4)	412,500	2·0
Sale of shares of KLM (Pvt) Ltd	(Note 5)	40,000	2·0
Total taxable gains for the year		1,132,500	
Set off of brought forward losses	(Note 6)	(90,000)	2·0
Taxable income		1,042,500	
Computation of tax			
Tax on taxable income at 21%		218,925	0·5

Marks

Notes

Note 1
The cost of acquisition of the statue paid by his wife is irrelevant. The fair market value [Rs. 150,000] at the time of the gift is treated as the cost of the asset [s.37(4A)].

	Rs.
Consideration received	250,000
Cost of acquisition	(150,000)
Capital gain	100,000

The taxable gain will be reduced to 75% [Rs. 75,000] as the statue was sold after one year. [s.37(3)]

Note 2
The shares of ABC Ltd are not listed on any stock exchange, therefore, the capital gain accruing on the disposal of these shares is taxable.

	Rs.
Consideration received	500,000
Cost of acquisition (see working)	(160,000)
Capital gain	340,000

The taxable gain will be reduced to 75% [Rs. 255,000] as the shares were sold after one year.

Working: Cost of 4,000 shares of the company

	Rs.
1,000 shares purchased on 4 April 2006	50,000
2,000 shares purchased on 7 August 2008	110,000
1,000 right shares at Rs. 40 per share	40,000
1,000 bonus shares	0
Total cost of 5,000 shares	200,000
Cost of 4,000 shares sold (200,000/5,000 x 4,000)	160,000

Note 3
An oil painting in the personal use of the taxpayer is treated as a capital asset [ss.37(5) and 38(5)]. Any gain on the disposal of the oil painting is taxable. The cost of the oil painting has been paid in kind [old car] and the fair market value of the car given in exchange is treated as the cost of acquisition of the painting [s.76(2)(a)].

Since the period of holding was less than a year, the full capital gain is taxable.

	Rs.
Consideration received	550,000
Cost of acquisition	(200,000)
Taxable capital gain	350,000

Note 4
Computation of capital gain on the vase is as under:

		Rs.	Rs.
Consideration received			800,000
Less cost			
(i)	Purchase price of vase [in 2001]	250,000	
(ii)	The commission paid Rs. 75,000 is not allowable as it was paid in cash [s.37(4)(b)]	0	
	Total cost		(250,000)
	Capital gain		550,000

The taxable gain will be reduced to 75% [Rs. 412,500] as the vase was sold after one year.

Note 5
Although the shares were purchased for Rs. 80,000 (Rs. 10 per share) the taxation officer treated the transaction as a non-arm's length transaction and determined the sale price in the hands of Mr Shahid's brother as Rs. 15 per share, thus Rs. 120,000 will be taken as the purchase price to Mr Shahid [s.78]. Since the period of holding was less than a year the full gain is taxable.

Marks

	Rs.
Consideration received 8,000 shares at Rs. 20 per share	160,000
Cost of the shares	(120,000)
Taxable capital gain	40,000

Note 6

(i) Business loss Rs. 100,000
The brought forward business loss can be set off only against the business income of the succeeding six tax years. Hence it is inadmissible as there is no business income. [ss.56 & 58]

(ii) The loss under the head 'Income from other sources' cannot be brought forward for tax purposes. [s.57]

(iii) Capital losses
(a) Since the capital gains on listed shares are not taxable, any capital loss on their disposal is also not allowable. [s.38(2)]
(b) The capital loss (Rs. 90,000) on account of the sale of shares in a private limited company can be carried forward for up to six succeeding tax years after the year in which it is determined and set off against future capital gains. The loss for the tax year 2007 can therefore be claimed against the capital gains of the tax year 2010. [s.59]

Capital gains or losses not included in the computation of capital gains

1. Disposal of car
Although on the basis of the given cost of the car and the fair market value at the date of disposal of the car, there is a loss of Rs. 200,000, the loss is not recognised as the car is for personal use and does not fall within the definition of a capital asset. [s.37(5)] 1·0

2. Sale of shares in Innovation Ltd
A gain on account of the sale of shares in a public company [as defined in s.2(47)] is exempt from tax [Clause (110) of part I of the Second Schedule to the Income Tax Ordinance, 2001]. A company whose shares are listed on any registered stock exchange in Pakistan is a public company. [Listing on all stock exchanges is not the requirement.] Therefore the capital gain of Rs. 300,000 computed as below is exempt from tax. 1·0

	Rs.
Consideration received from sale of 5,000 shares	800,000
Cost [deemed under s.37(4A)] at Rs. 100 per share	(500,000)
Exempt capital gain	300,000

3. Capital loss on sale of necklace
Although there was a loss of Rs. 150,000 [Rs. 100,000 – Rs. 250,000], a capital loss is not allowable on jewellery. [s.38(5)(b)] 1·0

4. Sale of farm house
The definition of a capital asset does not include an immovable property. Therefore, no capital gain arises on the sale of the farm house. [s.37(5)(c)] 1·0

5. Taxable gain on sale of plant
No gain or loss shall be recognised where the disposal of an asset is by reason of the compulsory acquisition of the asset under any law where the consideration received for disposal is reinvested by the recipient in an asset of a like kind within one year of the disposal. All the conditions in this case are fulfilled. Therefore, no gain or loss is recognised. [s.79(1)(d)] 1·5

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(b) A capital gain or loss can only be recognised for tax purposes on the disposal [as defined in s.75] of an asset. Since in this case the asset has not been disposed of, no loss can be recognised. Mark to market value adjustments of capital assets are tax neutral. 2

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Marks

4 (a) Tax credit at 2·5% of the tax payable by Mr Yousha

The opinion of the accountant is incorrect. 0·5

A taxpayer who is registered as a manufacturer under the Sales Tax Act, 1990 is entitled to a tax credit at 2·5% of the tax payable for a tax year under the Income Tax Ordinance, 2001 [s.65A] if all of the following conditions are met:

(i) 90% of his sales are to persons who are registered under the Sales Tax Act, 1990 during the said tax year.
(ii) The taxpayer provides complete details of the persons to whom the sales were made.
(iii) The income of the taxpayer is not covered by the final tax or minimum tax regimes. 2·5

Since in this case the income of Mr Yousha is covered by the final tax regime no tax credit is allowable to him [s.65A read with s.153(6)] 1·0

Tutorial note: this tax credit was introduced in the Finance Act, 2009 thus applicable with effect from the tax year 2010.

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(b) Difference between 'total income' and 'taxable income'

The total income of a person for a tax year is the sum of that person's income under each of the heads of income for that year. 1·0

Taxable income is arrived at by deducting the following amounts paid, if any, from the total income:

(i) Zakat under the Zakat and Ushr Ordinance, 1980.
(ii) Workers' welfare fund under the Workers' Welfare Fund Ordinance, 1971.
(iii) Workers' participation fund under the Companies Profits (Workers' Participation) Act, 1968. 1·5

Tax rates and tax credits are computed with reference to taxable income of a taxpayer. [ss.9 and 10] 0·5

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(c) Mr Waail's income for the tax year 2010

(i) Income from land situated in Canada Rs. 1,000,000
Income from growing crops on lands situated in Pakistan is treated as agricultural income. However, where income is from agricultural operations on lands situated outside Pakistan, it is not treated as 'agriculture income' [s.41]. Since Mr Waail is resident in Pakistan, his income from abroad is taxable in Pakistan. 1·0

(ii) Gross receipts from poultry farm Rs. 1,500,000
Poultry farming does not fall within the definition of agriculture [s.41]. Therefore the income from the poultry farm is taxable. Expenses relating to deriving this income will, however, be allowable as per the provisions of the Income Tax Ordinance, 2001. 1·0

(iii) Forfeited deposit Rs. 1,000,000
A forfeited deposit paid under a contract for the sale of the land or a building is included in the definition of rent and as such is taxable. [s.15(2)] 1·0

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(d) Dividend paid by a company engaged in agriculture

Income from agriculture is exempt from tax. However, this exemption is limited to the original recipient of agricultural income. Dividends paid out of this exempt income is not exempt from tax. [s.55] 1·0

The company should have deducted tax at 10% of the amount of the dividend paid unless the payee had specific exemption. Therefore, Modern Agricultural Farms Ltd can be treated as defaulter for non-deduction of tax from the amount of dividend paid by it. [ss.150 and 161] 1·0

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Marks

(e) Income tax liability of Mr Ukasha

		Rs.	
Taxable income other than share of profit from the AOP	[C]	1,000,000	0·5
Share of profit from the AOP		600,000	0·5
Total taxable income, including share of AOP income	[B]	1,600,000	
Amount of tax on [B] above at 25% [as per first schedule to the Income Tax Ordinance, 2001]	[A]	400,000	0·5

Tax liability of Mr Ukasha $= \frac{A \times C}{B}$

$= \frac{400{,}000 \times 1{,}000{,}000}{1{,}600{,}000}$

= Rs. 250,000 — 1·5

Tutorial note: if the amount was not added for tax rate purposes, tax liability at 17·5% on Rs. 1,000,000 would have been Rs. 175,000 instead of Rs. 250,000 (s.88).

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5 Zubair Enterprises Ltd

(a) Sales tax payable/(refundable) for June 2010

Output tax	Rs.	
On sale of taxable goods in Pakistan (Note 1)		
Rs. 45,000,000 x 16%	7,200,000	0·5
On sale of goods exported to Saudi Arabia		
Rs. 18,000,000 x 0%	0	0·5
On goods given to the Chief Executive free of cost (Note 2)		
Rs. 100,000 x 16%	16,000	0·5
Total output tax	7,216,000	
Input tax		
Purchases of raw material for manufacturing goods (see working)	6,494,400	1·5
On purchase of new machinery (Note 3)		
(10,000,000 x 16/116 x 1/12)	114,943	0·5
Total input tax	6,609,343	
Tax payable/(refundable)		
Output tax	7,216,000	
Input tax	(6,609,343)	
Input tax pertaining to November, 2009 (Note 4)	0	
Tax payable	606,657	0·5

Working:
A registered person is not allowed to adjust input tax for a tax period in excess of 90% of the output tax for that tax period. [s.8B]

	Rs.
On payment for purchases of raw material for manufacturing goods (exports as well as local supplies) [Rs. 58,000,000 x 16/116]	8,000,000
Restricted to 90% of output tax for June 2010 (90% of Rs. 7,216,000)	6,494,400

Tutorial note: the balance of Rs. 1,505,600 (8,000,000 – 6,494,400) would be allowed as input tax adjustment/refund in August 2010, the second month following the end of the financial year ending on 30 June 2010, subject to the fulfilment of certain conditions.

Marks

Explanations:

Note 1
Total supplies other than exports are Rs. 45,000,000. The value of a supply can be reduced by a trade discount only if:

(i) the trade discount is in conformity with the normal business practices; and
(ii) is shown on the sales tax invoices.

In the instant case the second condition is not fulfilled; therefore, the value of the supply is not reduced for the purposes of charging sales tax. [s.2(46)(b)] 1·0

Note 2
The goods given to the chief executive are not exempt but fall within the definition of a supply and are liable to payment of sales tax. 0·5

Note 3
The input tax on the Rs. 10,000,000 paid for the acquisition of the machinery is adjustable in 12 equal monthly instalments starting from the month in which the machine is acquired. [First proviso to s.8B] 0·5

Note 4
The input tax of Rs. 100,000 pertaining to the raw material purchased in November 2009 cannot be claimed in June 2010 as it is older than six months and so ineligible for adjustment. It could only have been claimed up to May 2010. [First proviso to s.7(1)] 1·0

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(b) Tax liability on behalf of a supplier of goods

A registered person receiving a supply from another registered person can be held liable to pay tax on the supplies received where the person receiving the supplies has knowledge or reasonable grounds to suspect that the person making the supplies has not paid tax in respect of:

– current supplies;
– previous supplies; or
– subsequent supplies.

The above liability shall be joint and several with the person making supplies. [s.8A] 1·5

Zubair Enterprises Ltd (ZEL) should avoid dealing with this supplier as it is exposing ZEL to the risk of a tax liability to the extent of any non-payment of tax on the supplies made to ZEL. 0·5

However, the Federal Bureau of Revenue (FBR) can notify in the Official Gazette certain transactions on which this liability will not arise. If the transactions made by ZEL with the supplier are included in such notification, there would be no liability on ZEL on this basis. 1·0

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