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# Answers

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		Meditech Pakistan Limited			Marks
		Accounting year ended 31 December 2009			
		Tax year 2010			
		Rupees	Rupees	Rupees	
<b>Computation of taxable income</b>					
Income from property					
	Rent from building SeaView (Note 1)			2,400,000	2
Income from business					
Accounting profit					
	<i>Add:</i> Accounting depreciation (Note 2)	1,325,000	41,870,000		0.5
	Installation expenses on new computers (Note 3)	900,000			1
	Tax collected on cash withdrawals (Note 4)	40,500			1
	Repairs and maintenance on building SeaView (Note 5)	714,400			2
	Deferred expenditure on intangible written off (Note 6)	2,400,000			1
			<u>5,379,900</u>		
			47,249,900		
<i>Less:</i> Rent received considered separately under Income from property (refer to Note 1)					
		2,400,000			0.5
	Tax loss on disposal of intangible (Note 7)	2,000,000			2
	Amortisation of intangible (Note 8)	302,466			2
	Provision for bad debts written back (Note 9)	3,445,000			1
	Initial allowance (Note 10)	27,950,000			2
	Depreciation (Note 11)	9,550,000			5
			<u>(45,647,466)</u>		
				<u>1,602,434</u>	
Taxable income				<u>4,002,434</u>	

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 (1 mark for each item) as follows.

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Items not included in the computation of taxable income.

- (1) The tax of Rs. 1,225,000 (3.5% of Rs. 35,000,000) deducted on the gross sales to companies of Rs. 35,000,000 is not the final tax since Meditech Pakistan Limited (MPL) is assessed to tax as a 'company' and the pharmaceuticals sold were MPL's own manufactured goods [s.153(6A)]. As the gross amount of Rs. 35,000,000 is included in the profits of MPL, no adjustment is required to be made in the computation of income. The Rs. 1,225,000 is allowed as a tax credit in the computation of tax payable.
- (2) The Rs. 2,340,000 spent on the replacement of old worn-out parts of an item of plant is an expenditure incurred wholly and exclusively for the business. Replacement of old and worn-out parts do not increase the capacity of the plant, nor add any value to the plant. As the Rs. 2,340,000 has been shown as an expense in the accounts, no adjustment is required to be made.
- (3) As the Rs. 12,000,000 expended on the in-house development of the computer software CS-2 and treated as deferred expenditure is to be written off in the accounts commencing with the accounting year ending on 31 December 2010 (tax year 2011), there is no charge in the accounts for the year ended 31 December 2009. Therefore no adjustment is required to be made in the computation of income.
- (4) An allowance for depreciation is allowable on a depreciable asset only if the asset is used in the tax year for the purposes of business [s.22(1)]. As the workers' residential quarters could not be occupied by the workers before 1 January 2010 (tax year 2011), the building has not been used by MPL in its business in the year ended 31 December 2009 (tax year 2010) and consequently no depreciation is allowable in the tax year 2010. Therefore, no adjustment is required to be made in the computation of income.
- (5) A tax credit is allowable to a person, except a company, on the purchases of shares from the Privatization Commission of Pakistan [s.62(1)]. MPL being a company is not entitled to the tax credit. Therefore, the investment of Rs. 500,000 has no impact on the computation of tax payable.

	Rupees	Marks
<b>(b) Computation of tax payable/refundable</b>		
Taxable income	4,002,434	
Less: Income from property to be taxed separately (refer to Note 1)	(2,400,000)	1
	<u>1,602,434</u>	
Tax on balance of Rs. 1,602,434 at 35%	560,852	0.5
Tax on Rs. 2,400,000 (Income from property) (65,000 + 140,000)	205,000	1
	<u>765,852</u>	
Tax deducted at source on sales	(1,225,000)	1
Advance tax collected on cash withdrawals (refer to Note 4)	(40,500)	1
Advance tax paid	(1,500,000)	0.5
Tax refundable	<u>(1,999,648)</u>	
		<u>5</u>
		<b><u>30</u></b>

Notes referred to in the computation of taxable income.

- Note (1) Rent received or receivable by a person being the owner of land or buildings is chargeable to tax under the head 'Income from property' [s.15 (1)]. As 80% of the space in the residential building 'SeaView' is let out to individuals who are not prescribed persons required to deduct tax, the gross rent of Rs. 2,400,000 received from the tenants is chargeable to tax as Income from property. The Rs. 2,400,000 is taxed separately at the prescribed rate of tax [s.15 (6)].
- Note (2) Accounting depreciation is not deductible. Tax depreciation and initial allowance on depreciable assets used in the business in the tax year are deductible at the rates prescribed in the Third Schedule.
- Note (3) Installation costs of Rs. 900,000 on new computers purchased are capital expenditure and are therefore not deductible. The cost of the computers purchased is increased by Rs. 900,000 (Note 10).
- Note (4) The tax of Rs. 40,500 collected by XYZ Bank on cash withdrawals is treated as advance tax (s.231A). The Rs. 40,500 is allowed as a tax credit in the computation of tax payable.
- Note (5) As 20% of the space in the residential building 'SeaView' is occupied by the Chief Executive Officer of Meditech Pakistan Limited (MPL) as rent free accommodation under the terms of his employment, the 20% portion of the building is used by MPL for the purpose of business. Out of the total expenditure of Rs. 893,000 for repairs and maintenance of the building only Rs. 178,600 (20% of Rs. 893,000) is deductible. The balance amount of Rs. 714,400 is not deductible.
- Note (6) The computer software (CS-1) purchased on 1 January 2007 for Rs. 4,000,000, though an intangible for tax purposes, was treated as deferred expenditure in the accounts and was being written off equally over five years. The balance of Rs. 2,400,000 on 1 January 2009 in the deferred expenditure account charged to the cost of sales is not deductible. For tax purposes, amortisation deduction, in accordance with the provisions of s.24, would have been allowed in the tax years 2008 and 2009.
- Note (7) When the CS-1 ceased to be used in the business on 1 October 2009, MPL is treated as having made a disposal of the intangible [s.75(3A)]. The tax profit or loss on the disposal of an intangible is the difference between the consideration received and the tax written down value (WDV) of the intangible at the time of its disposal [s.24(8)]. As the CS-1 was not transferable and was destroyed, there is no consideration received. Therefore, the tax WDV of the intangible CS-1 at the time of its disposal is allowable as a deduction. The tax loss on the disposal of the CS-1 is Rs. 2,000,000 which is made up as follows:

	Rupees
Cost of the CS-1	4,000,000
Normal useful life of the CS-1 in whole years – 4 years	
Amortisation for one year (4,000,000/4) – Rs. 1,000,000	
Amortisation allowed in the tax years 2008 and 2009 (Note A)	(2,000,000)
Tax written down value of the CS-1 which is the loss on the disposal	<u>2,000,000</u>

Note A: No amortisation deduction is allowable in the tax year an intangible is disposed of [s.24(8)]. Therefore, no amortisation deduction is allowable for the period 1 January 2009 to 30 September 2009.

Note (8) The Rs. 12,000,000 expended on the in-house development of the computer software (CS-2) is treated as an intangible for tax purposes [s.24(11)]. The cost incurred in a tax year in acquiring or developing an intangible is allowed to be amortised over the normal useful life (NUL) of the intangible, proportionate to the number of days the intangible is used in that year in deriving income chargeable to tax. As the NUL of the CS-2 is estimated to be 12 years (i.e. more than 10 years), the CS-2 is treated as having a NUL of 10 years [s.24(4)(a)].

	<b>Rupees</b>
Cost of the CS-2	<u>12,000,000</u>
NUL in whole years – 10 years	
Amortisation for one whole year (12,000,000/10)	<u>1,200,000</u>
Amortisation for 92 days (1 October 2009 to 31 December 2009) in a year of 365 days (1,200,000 x 92/365)	<u>302,466</u>

Note (9) The excess provision for bad debts of Rs. 3,445,000 written back to the profit and loss account is not income chargeable to tax since the provision when made in the earlier years was not allowed as deductible.

Note (10) Initial allowance

	<b>Buildings</b>	<b>Computer hardware</b>	<b>Initial allowance deductible</b>
	<b>Rupees</b>	<b>Rupees</b>	<b>Rupees</b>
Cost of residential building 'SeaView'	<u>40,000,000</u>		
Initial allowance at 50% (Note A)			20,000,000
Cost of computers		15,000,000	
Add: Installation expenditure (refer to Note 3)		<u>900,000</u>	
		<u>15,900,000</u>	
Initial allowance at 50%			<u>7,950,000</u>
			<u>27,950,000</u>

Notes:

(A) As the new building 'SeaView' was used by MPL for the purposes of business for the first time in the tax year 2010 initial allowance is deductible [s.23(1)]. Under s.23 there is no concept of restriction of initial allowance in the case of assets which are not exclusively used for the purposes of business.

(B) Any road transport vehicle not plying for hire is not entitled for initial allowance [s.23(1) and (5)]. Therefore, no initial allowance has been claimed on the new motor car purchased for Rs. 1,500,000.

Note (11) Depreciation

	<b>Buildings</b>	<b>Plant and machinery</b>	<b>Computer hardware</b>	<b>Motor cars</b>	<b>Furniture</b>	<b>Total depreciation</b>
<b>Rate of depreciation</b>	<b>10%</b>	<b>15%</b>	<b>30%</b>	<b>15%</b>	<b>15%</b>	
	<b>Rs.</b>	<b>Rs.</b>	<b>Rs.</b>	<b>Rs.</b>	<b>Rs.</b>	<b>Rs.</b>
Written down value	<u>8,400,000</u>	<u>12,800,000</u>	<u>8,600,000</u>	<u>6,200,000</u>	<u>1,800,000</u>	
Depreciation	<u>840,000</u>	<u>1,920,000</u>	<u>2,580,000</u>	<u>930,000</u>	<u>270,000</u>	6,540,000
Additions	40,000,000		15,900,000	1,500,000		
Initial allowance	<u>(20,000,000)</u>		<u>(7,950,000)</u>			
	<u>20,000,000</u>		<u>7,950,000</u>	<u>1,500,000</u>		
Depreciation	<u>2,000,000</u>		<u>2,385,000</u>	<u>225,000</u>		
20% deductible (Note A)	400,000		2,385,000	225,000		<u>3,010,000</u>
						<u>9,550,000</u>

(A) As the building SeaView is not exclusively used for the purposes of business, the deduction for depreciation is restricted to 20% of the total depreciation, since 20% of the space in the building is used for the purposes of business. Out of the depreciation of Rs. 2,000,000, Rs. 400,000 (20% of Rs. 2,000,000) is deductible.

**Mr Zaki**  
**Accounting year ended 30 June 2010**  
**Tax year 2010**

(a) Computation of taxable income	Rupees	Rupees	
Salary			
From Aromatic Oils Pakistan Limited			
Basic salary for five months (Note 1)	2,500,000		1
Utility allowance for five months (Note 1A)	250,000		0.5
Medical allowance for five months (Note 1B)	125,000		1
Bonus (Note 2)	1,000,000		1
Benefit of company maintained car (Note 3)	10,000		1.5
Benefit on purchase of motor car (Note 4)	300,000		1.5
Pension for eight months (Note 5)	400,000		1.5
Golden handshake payment (Note 6)	7,000,000		1
Gratuity (Note 7)	6,000,000		2
AOPL's Employees Provident Fund – exempt (Note 8)	–		1
From Fragrant Oils plc			
Foreign-source salary – exempt (Note 9)	–		2
	<hr/>	17,585,000	
Income from business (Note 10)		52,000	2
Taxable income		<hr/> <u>17,637,000</u>	

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 income [1 mark for each item] as follows:

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Items not included in the computation of taxable income and tax payable.

- (1) The net profit of Rs. 78,125 on the sale of locally purchased aromatic oils is not chargeable to tax under any head of income since the tax deducted of Rs. 60,375 (3.5% of gross sales of Rs. 1,725,000) on the payments received from AOPL (a company), is the final tax on the income arising from the sale of aromatic oils [s.153(6)].
- (2) The tax of Rs. 5,000 collected by the Karachi Electric Supply Corporation against the monthly electricity bills of Zee Aromatic Sales (ZAS), the sole proprietorship firm of Zaki, is the minimum tax, since the monthly bills of ZAS have not exceeded Rs. 30,000 per month [s.235(4)(a)]. The Rs. 5,000 is therefore not allowable as a tax credit in the computation of tax payable.
- (3) Where a person has been allowed a tax credit under s.62 in a tax year in respect of the purchase of a share and the person disposes of the share within 12 months of the date of acquisition, the amount of the tax credit allowed is recouped by increasing the tax payable by that person for the tax year in which the share was disposed of, by the amount of the tax credit allowed [s.62(3)].

On 8 June 2009 (tax year 2009) Z had acquired 5,000 shares in CeeDee Pakistan Limited from the Privatization Commission of Pakistan and had been allowed a tax credit of Rs. 50,000 against the tax payable for the tax year 2009. The 5,000 shares were sold by Z on 11 June 2010. As the shares were held for more than 12 months of the date of acquisition, the tax credit of Rs. 50,000 allowed in the tax year 2009 cannot be recouped. Therefore no adjustment is required to be made in the computation of tax payable.

	Rupees	Rupees	Marks
<b>(b) Computation of tax payable</b>			
Taxable income		17,637,000	
Less: Income to be taxed separately			
– bonus (Note 2)	1,000,000		0-5
– golden handshake payment (Note 6)	<u>7,000,000</u>		0-5
		(8,000,000)	
		<u>9,637,000</u>	
Tax on balance of Rs. 9,637,000 at 20%		1,927,400	1
Tax on Rs. 1,000,000 (bonus) at 30% (refer to Note 2)		300,000	1
Tax on Rs. 7,000,000 (golden handshake) at 12% (refer to Note 6)		<u>840,000</u>	1
		3,067,400	
Advance tax collected by bank on cash withdrawals (Note 11)		(16,700)	1
Tax deducted at source by AOPL from salary income		<u>(1,800,000)</u>	1
Tax payable		<u><u>1,250,700</u></u>	
			<u>6</u>
			<b><u>25</u></b>

Notes referred to in the computation of taxable income and tax payable.

Note (1) As the salary and allowances of each month are transferred to each employee's bank account on the first working day of the following month, the monthly remuneration for June 2009 had been received by Zaki (Z) in July 2009 and is therefore chargeable to tax in the tax year 2010. Therefore, the basic salary and allowances have been calculated for five months (June 2009 to October 2009). [s.12(1) read with s.69]

Note (1A) The allowance for utilities is fully taxable. The amount chargeable to tax is Rs. 250,000 being 10% of basic salary for five months.

Note (1B) As Z's terms of employment with Aromatic Oils Pakistan Ltd (AOPL) do not provide for free medical treatment or hospitalisation or reimbursement of such expenses, any medical allowance not exceeding 10% of his basic salary is exempt from tax [clause 139(b) of Part I of the Second Schedule].

	Rupees
Medical allowance received for five months (Rs. 75,000 x 5)	375,000
Exempt from tax – 10% of basic salary for five months	<u>(250,000)</u>
Chargeable to tax	<u><u>125,000</u></u>

Note (2) A bonus paid by an employer is chargeable to tax as the salary income of the employee. However, any bonus paid or payable to corporate employees receiving salary of Rs. 1,000,000 or more in the tax year 2010 is chargeable to tax as a separate block of income at the rate of 30% [proviso to s.12(2)(a)].

Note (3) As the motor car purchased by AOPL on 1 January 2005 for Rs. 3,000,000 is used by Z partly for private and partly for office use, the taxable benefit is 5% of Rs. 3,000,000 proportionate to the use of the car by Z for four months (July 2009 to October 2009) as reduced by Rs. 10,000 per month paid by Z to AOPL.

	Rupees
Annual benefit – 5% of Rs. 3,000,000	150,000
For four months	50,000
Less: Payment by Z to AOPL – Rs. 10,000 per month for four months	<u>(40,000)</u>
Chargeable to tax	<u><u>10,000</u></u>

Note (4) Z purchased the car from AOPL for Rs. 600,000. As AOPL had received an offer of Rs. 900,000 for the sale of the car from another employee, it is reasonable to assume that the fair market value (FMV) of the car on the date of its transfer to Z was Rs. 900,000. The difference of Rs. 300,000, between the FMV of the car (Rs. 900,000) and the payment made by Z (Rs. 600,000), is a benefit chargeable to tax as the salary income of Z [s.13(11)].

Note (5) Under clause (8) of Part I of the Second Schedule, a citizen of Pakistan receiving a pension from a former employer is exempt from tax unless the individual continues to work for the same employer or an associate of the employer. As Z, after retiring from AOPL, took up employment with Fragrant Oils plc, an associate of AOPL, the pension of Rs. 50,000 per month for the months of November 2009 to June 2010 is chargeable to tax as the salary income of Z.

- Note (6) The Rs. 7,000,000 received as a golden handshake payment under the AOPL voluntary retirement scheme is treated as a profit in lieu of or in addition to salary and is chargeable to tax as salary income [s.12(2)(e)(iii)]. Z elected to have the Rs. 7,000,000 taxed at the average rate of tax for the preceding three tax years. As the notice of election was furnished by Z to the Commissioner before 30 September 2010 (the due date for furnishing his return of income for the tax year 2010), the tax on the Rs. 7,000,000 is calculated separately at 12%, being the average rate of tax of Z for the preceding three years [s.12(6) and (8)].
- Note (7) The Rs. 6,000,000 due to Z for the gratuity from AOPL, even though paid to him by Fragrant Oils plc, an associate of AOPL, is Z's income from employment [s.12(5)(a)]. As AOPL's gratuity scheme was not approved by the Federal Board of Revenue, the amount of the gratuity exempt from tax should have been 50% of the amount received or Rs. 75,000 whichever is the least. However, since the payment of the gratuity was received by Z outside Pakistan, the above exemption is not available [proviso (a) to sub-clause (iv) of clause (13) of Part I of the Second Schedule]. The entire amount of Rs. 6,000,000 is therefore chargeable to tax.
- Note (8) As the AOPL Employees Provident Fund is recognised by the Commissioner, the accumulated amount of Rs. 9,000,000 received by Z is exempt from tax [clause (23) of Part I of the Second Schedule].
- Note (9) Under the provisions of s.51(2), if a citizen of Pakistan leaves Pakistan during a tax year and remains abroad during that tax year, any salary income earned by the individual outside Pakistan is exempt from tax. As Z is a resident in the tax year 2010, the salary of Rs. 4,800,000 (Rs. 1,600,000 per month for three months) earned by him in Saudi Arabia as an employee of Fragrant Oils plc would normally be chargeable to tax in the tax year 2010. However, since Z left Pakistan for Saudi Arabia on 1 April 2010 (tax year 2010) and remained abroad till the end of the tax year 2010, the Rs. 4,800,000 is exempt from tax.
- Note (10) If any income has been derived by a person in a tax year, *inter alia*, from a business that has ceased before the commencement of that year and if that income would have been taxable had there been no cessation, then the provisions of the tax statute would apply to that income as if the business had not ceased at the time the income was derived (s.72).  
As Z was maintaining the accounts of Zaki Sons on the cash-basis, the sale on credit of Rs. 52,000 to Honest Hoshi (HH) would not have been charged to tax. Under the provisions of s.72, the business of Zaki Sons is deemed to have been carried on by Z in the tax year 2010 in which year he received the Rs. 52,000 from HH. The Rs. 52,000 is therefore treated as Z's income chargeable to tax in the tax year 2010 under the head 'Income from business'.
- Note (11) Every banking company, subject to certain exceptions, is required to collect tax at the rate of 0.3% of the sum total of the payments for cash withdrawal exceeding Rs. 25,000 in a day. The tax collected is allowable as a tax credit (s.231A). The Rs. 16,700 tax collected by RichBank Limited is therefore allowed as a tax credit in the computation of tax payable.

- 3 (a)** Mr Property (P) is a non-resident in the tax year 2010. As a non-resident he is chargeable to tax only on Pakistan-source income. 1
- Ordinarily, a gain made by a non-resident person on the disposal of shares in a non-resident company would not be Pakistan-source income. However, under the provisions of s.101(10), any gain from the alienation of any share in a company, the assets of which consist wholly or principally, directly or indirectly, of immovable property in Pakistan, shall be Pakistan-source income. 1.5
- The gain of US\$ 3,600,800 has arisen to P on the disposal of his shares in Building Rental Inc (BRI), a non-resident company. Since the assets of BRI consist principally of immovable property in Pakistan, the gain of US\$ 3,600,800 on the disposal of the shares in BRI is Pakistan-source income of P chargeable to tax in Pakistan under the head 'Capital gains'. Therefore, P's view of the transaction is not correct. 1.5
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- (b)** A 'public company' for Pakistan tax purposes, *inter alia*, means a company in which not less than 50% of the shares are held by a foreign government [s.2(47)(ab)]. Since 50% of the shares in XYZ Ltd are held by the Government of Austria, XYZ Ltd is a public company for tax purposes. 1
- No loss is deductible in computing income under the head 'Capital gains' on the disposal of a capital asset where the gain on the disposal of such asset is not chargeable to tax [s.38(2)]. As XYZ Ltd is a 'public company' for tax purposes, any gain on the disposal of its shares is exempt from tax [clause (110) of Part I of the Second Schedule]. Therefore, the loss of Rs. 75,000 on the disposal of the shares in XYZ Ltd is not deductible as a loss under the head 'Capital gains'. Therefore, X's view of the transaction is not correct. 2
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**Mr Ardesheer Petigara**  
**Accounting year ended 30 June 2010**  
**Tax year 2010**

	Rupees	Rupees	
<b>(i) Computation of taxable income</b>			
Salary			
Employee share scheme			
Sale of rights to purchase shares (Note 1)		300,000	1·5
Capital gains			
Gain on the disposal of shares in Petigara (Private) Ltd (Note 2)	125,000		2
Loss on the disposal of shares in ABC (Private) Ltd (Note 3)	(70,000)		1
Gain on the disposal of painting B (Note 4)	225,000		1
	280,000		
Set off of brought forward loss (Note 5)	(10,000)		1
		270,000	
Taxable income		570,000	

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) and (2) and 1·5 marks for item (3)] as follows:

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Items not included in the computation of taxable income.

- (1) In an employee share scheme (ESS) where there is a restriction on the transfer of shares, the benefit, if any, accruing to an employee is chargeable to tax, not at the time the shares are issued to the employee, but at the time the employee has the free right to transfer the shares or when the employee disposes of the shares (if allowed by the custodian of the ESS), whichever is the earlier [s.14(3)(a)].

The 1,000 shares of SuperPower Inc (SPI) issued to Ardesheer Petigara (AP) at the exercise price of US\$ 15 per share when the fair market value of one share in SPI was US\$ 20, though a benefit of employment, is not chargeable to tax in the tax year 2010. The benefit, if any, would have to be calculated at the time AP has the free right to transfer the shares i.e. at the end of the three years holding period. Therefore, no adjustment is required to be made in the computation of taxable income.

- (2) The transfer of Rs. 3,000,000 by AP to his wife's bank account is a disposal since AP has parted with the ownership of an asset [s.75(1)]. However since no gain or loss can arise on the transfer of cash from one person to another, the transfer of Rs. 3,000,000 has no impact on the computation of income.
- (3) Income under the head 'Capital gains' can only arise on the disposal of a capital asset. Movable assets held for personal use are excluded from the definition of capital asset with certain exceptions. The exceptions include jewellery and a painting which are treated as capital assets. The gain on the disposal of jewellery and a painting is chargeable to tax as 'Capital gains' but no loss is recognised on the disposal of such assets. [s.38(5)]

	Rupees
Loss on disposal of:	
Jewellery (cost as declared in AP's wealth statement as on 30 June 2009 Rs. 6,500,000 less sale proceeds Rs. 5,750,000)	750,000
Painting 'A' (cost as valued by the reputed art dealer Rs. 600,000 less sale proceeds Rs. 400,000)	200,000
	950,000

The loss of Rs. 950,000 is not recognised as a loss and is not deductible. Therefore, the Rs. 950,000 has no impact on the computation of taxable income.



## (ii) Computation of tax payable

	Rupees	
Tax on taxable income of Rs. 570,000 at 4.50%	25,650	1
Tax credit on donation of Rs. 200,000 (Note 6)	7,695	2
Tax payable	<u>17,955</u>	<u>3</u>
		<u>20</u>

Notes referred to in the computation of taxable income and tax payable

Note (1) It could be argued that a right to purchase shares in an employee share scheme is a capital asset and any gain on the disposal of the right should be taxable as capital gains. However s.14, relating to employee share schemes, specifically states that any gain made on the disposal of a right or option to acquire shares in an employee share scheme is chargeable to tax under the head 'Salary'.

As no consideration was paid by Ardesheer Petigara (AP) at the time of the acquisition of the rights, the sale consideration of Rs. 300,000 is the gain on disposal of the 1,000 rights which is chargeable to tax under the head 'Salary'.

Note (2) The gain of Rs. 125,000 on the disposal of 1,500 shares in Petigara (Private) Ltd is made up as under:

	Rupees
Cost of 1,500 shares	
– 1,000 shares purchased	450,000
– 500 bonus shares received	–
	<u>450,000</u>
Sale proceeds of 1,500 shares	600,000
Gain on disposal of the 1,500 shares	<u>150,000</u>
Gain per share (Rs. 150,000/1,500)	<u>100</u>
As the 1,000 shares were held by AP for more than one year, only 75% of the gain on the 1,000 shares is chargeable to tax [(gain on 1,000 shares is Rs. 100,000 (75% of Rs. 100,000)]	75,000
As the 500 bonus shares were held for less than a year the entire gain on the 500 shares is chargeable to tax	<u>50,000</u>
	<u>125,000</u>

Note (3) In computing the amount chargeable to tax of a person under the head 'Capital gains' for a tax year, a deduction is allowable for any loss on the disposal of a capital asset by the person in the year [s.38(1)]. The loss of Rs. 70,000 on the sale of shares in ABC (Private) Ltd is a capital loss and is deductible against capital gains in the tax year 2010.

Note (4) As stated in item (3) of the 'Items not included in the computation of taxable income', a painting is one of the movable assets which is treated as a capital asset. Though the painting 'B' was held by AP for his own use, the painting is a capital asset and the gain on its disposal is chargeable to tax as capital gains.

Where a capital asset becomes the property of a person, *inter alia*, on the distribution of assets on liquidation of a company, the fair market value of the asset on the date of its acquisition by the person is treated as the cost of the asset [s.37(4A)(d)]. Since the painting 'B' was valued at Rs. 700,000 by an art expert at the time of its acquisition by AP, the Rs. 700,000 is treated as the cost of the painting. The gain of Rs. 225,000 on the sale of the painting 'B' is made up as under:

	Rupees
Sale proceeds	1,000,000
Cost	<u>700,000</u>
	<u>300,000</u>
75% of Rs. 300,000 is chargeable to tax as capital gains since the painting was held for more than one year	<u>225,000</u>

- Note (5) 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 sustained. As the loss of Rs. 10,000 was sustained in the tax year 2004, the loss can be set off in the tax year 2010.
- Note (6) The donation of Rs. 200,000 is entitled to a tax credit [s.61(1)]. As an individual, AP is allowed a tax credit at the average rate of tax (before allowance of the tax credit) on the lower of the amount of donation or 30% of the taxable income [s.61(2)(b)].

	<b>Rupees</b>
Tax on taxable income before the tax credit	A 25,650
Taxable income for the year	B 570,000
The lesser of Rs. 200,000 (donation) or Rs. 171,000 (30% of taxable income)	C 171,000
A/B x C (25,650/570,000 x 171,000)	7,695

- 4 (a) (i) Under the provisions of s.153(6), if the tax payable by a resident association of persons (AOP) on its taxable income is less than the tax deducted from the payments received by the AOP for the rendering of or providing of services, the tax deducted is treated as the minimum tax. 1
- The Chief Financial Officer's contention of claiming a refund of Rs. 225,000 is not correct, since the tax payable by Aabee on its taxable income for the tax year 2010 is Rs. 175,000 whereas the tax deducted from the payments received by Aabee for the rendering of services is Rs. 400,000. As the tax deducted (Rs. 400,000) is more than the tax payable (Rs. 175,000), the Rs. 400,000 is the minimum tax. 2
- 3
- (ii) In the case of a company, the tax deducted from payments for the rendering of or providing of services is neither the final tax nor the minimum tax. The tax deducted is, therefore, available to the company as a tax credit. 1.5

**Aabee Pakistan Limited**  
**Accounting year ended 31 December 2009**  
**Tax year 2010**

	<b>Rupees</b>	
Taxable income	1,000,000	
Tax at 35%	350,000	
Less: Tax deducted from payments for the rendering of services	(400,000)	
Refund due	(50,000)	1.5
		3

- (b) As Prime Builders Corporation (PBC) is a non-resident for Pakistan tax purposes SolarEnergy Pakistan Ltd is required to deduct tax at 6% of the gross amount from all payments made under the Solar Contract [s.152(1A)]. 0.5
- For the tax deducted under the Solar Contract to be treated as the final tax, PBC has to specifically opt for assessment under the final tax regime. The declaration of the option must be furnished, in writing, to the Commissioner or the relevant tax authority, within three months of the commencement of the tax year. 2
- The declaration of the option is irrevocable and shall remain in force for three tax years i.e. the tax year in which the option was filed and the two succeeding tax years [s.152(1B) read with clause (41) of Part IV of the Second Schedule]. 1.5
- 4
- (c) The definition of 'dividend' has been enlarged to include the remittance of the after tax profit of a branch of a foreign company operating in Pakistan [s.2(19)(f)]. In other words, the remittance of after tax profit by a branch in Pakistan to its head-office outside Pakistan is treated as dividend income and taxed at the rate of 10%. 2
- However, the remittance of after tax profits by a branch of a 'Petroleum Exploration and Production (E&P)' foreign company operating in Pakistan has been excluded from the definition of 'dividend' [s.2(19)(f)(iv)]. 1.5

The Pakistan branch of Mungali Petroleum Inc (MPI) is a branch of an E&P foreign company operating in Pakistan. Therefore the remittance of the after tax profits of MPI's branch in Pakistan would not be considered to be dividend income and would not suffer tax withholding of 10%.

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**5 Hamza Usman & Sons.**

(a) Hamza Usman & Sons (HUS) being a manufacturer making taxable supplies is required to be registered under the Sales Tax Act, 1990. HUS had to apply for registration before making any taxable supplies. 1

(b) A separate registration number is not required for the business of the manufacture of shampoos and perfumes since no person already registered under the Sales Tax Act, 1990 can be issued with more than one registration number. 2

(c) (i) If there is a change in the rate of tax during a tax period, a separate return in respect of each portion of the tax period has to be furnished showing the application of the different rates of tax. 1

Therefore, Hamza Usman & Sons will furnish two returns:

- a return for the period from 1 December 2009 to 22 December 2009; and
  - a separate return for the period from 23 December 2009 to 31 December 2009 1
- 2

(ii) Sales tax payable for December 2009.

Return for the period from 1 December 2009 to 22 December 2009 – sales tax at the rate of 16%.

	Rupees	Rupees	
Output tax			
On sale of taxable supplies (Rs. 1,570,000 x 16%)	251,200		0.5
On sale of scrap material (Rs. 75,000 x 16%)	<u>12,000</u>		0.5
		<u>263,200</u>	
Input tax			
On payment to courier (Rs. 12,000 x 16/116)	1,655		0.5
On payment for purchase of raw materials (Rs. 1,395,000 x 16/116)	<u>192,414</u>		0.5
		<u>194,069</u>	
Sales tax payable			
Output tax		263,200	
Input tax		(194,069)	
		<u>(A) 69,131</u>	

Return for the period from 23 December 2009 to 31 December 2009 – sales tax at the rate of 20%			<i>Marks</i>
	Rupees	Rupees	
Output tax			
On sale of taxable supplies (Rs. 363,000 x 20%)	72,600		0.5
On sale of scrap material (RS. 19,000 x 20%)	<u>3,800</u>		0.5
		<u>76,400</u>	
Input tax			
On payment for purchase of raw materials (Rs. 583,000 x 20/120)		<u>97,167</u>	0.5
Sales tax payable			
Output tax		76,400	
Input tax Rs. 97,167 restricted to 90% of output tax (90% of Rs. 76,400)		<u>(68,760)</u>	1
		(B) <u>7,640</u>	
Sales tax payable for the month of December 2009			
A + B = (69,131 + 7,640)		<u><u>76,771</u></u>	<u>0.5</u>
			<u>5</u>
			<u>10</u>