Fundamentals Level – Skills Module

Taxation (Pakistan)

Monday 7 June 2010

Time allowed

Reading and planning:	15 minutes
Writing:	3 hours

ALL FIVE questions are compulsory and MUST be attempted.
Tax rates and allowances are on pages 2–3.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper F6 (PKN)

ACCA

SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need only be made to the nearest rupee.
2. All apportionments should be made to the nearest month.
3. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates and information are to be used in answering the questions:

A. **Tax rates for individuals**
where salary income exceeds 50% of taxable income for the tax year 2010

Taxable income	Rate of tax
Up to Rs. 200,000*	0%
Rs. 200,001 – Rs. 250,000	0·50%
Rs. 250,001 – Rs. 350,000	0·75%
Rs. 350,001 – Rs. 400,000	1·50%
Rs. 400,001 – Rs. 450,000	2·50%
Rs. 450,001 – Rs. 550,000	3·50%
Rs. 550,001 – Rs. 650,000	4·50%
Rs. 650,001 – Rs. 750,000	6·00%
Rs. 750,001 – Rs. 900,000	7·50%
Rs. 900,001 – Rs. 1,050,000	9·00%
Rs. 1,050,001 – Rs. 1,200,000	10·00%
Rs. 1,200,001 – Rs. 1,450,000	11·00%
Rs. 1,450,001 – Rs. 1,700,000	12·50%
Rs. 1,700,001 – Rs. 1,950,000	14·00%
Rs. 1,950,001 – Rs. 2,250,000	15·00%
Rs. 2,250,001 – Rs. 2,850,000	16·00%
Rs. 2,850,001 – Rs. 3,550,000	17·50%
Rs. 3,550,001 – Rs. 4,550,000	18·50%
Rs. 4,550,001 – Rs. 8,650,000	19·00%
Rs. 8,650,001 and over	20·00%

* For a woman taxpayer, no tax is chargeable if taxable income does not exceed Rs. 260,000

B. **Tax rates for individuals**
to whom the rates given in A are not applicable for the tax year 2010

Taxable income	Rate of tax
Up to Rs. 100,000*	0%
Rs. 100,001 – Rs. 110,000	0·50%
Rs. 110,001 – Rs. 125,000	1·00%
Rs. 125,001 – Rs. 150,000	2·00%
Rs. 150,001 – Rs. 175,000	3·00%
Rs. 175,001 – Rs. 200,000	4·00%
Rs. 200,001 – Rs. 300,000	5·00%
Rs. 300,001 – Rs. 400,000	7·50%
Rs. 400,001 – Rs. 500,000	10·00%
Rs. 500,001 – Rs. 600,000	12·50%
Rs. 600,001 – Rs. 800,000	15·00%
Rs. 800,001 – Rs. 1,000,000	17·50%
Rs. 1,000,001 – Rs. 1,300,000	21·00%
Rs. 1,300,001 and over	25·00%

* For a woman taxpayer, no tax is chargeable if taxable income does not exceed Rs. 125,000

C. **Internally Displaced Persons Tax (IDPT)**
For certain salaried individuals for the tax year 2010

IDPT on bonus	30%

D. **Tax rates for companies**
Tax year 2010

Public/private company	
On taxable income	35%
On Income from property	
Gross rent	
Up to	
Rs. 400,000	5%
Rs. 400,001 – Rs. 1,000,000	Rs. 20,000 plus 7·5% of amount exceeding Rs. 400,000
Rs. 1,000,001 and over	Rs. 65,000 plus 10% of amount exceeding Rs. 1,000,000

E. **Rates of deduction of tax at source**

Sale of goods	3·5% of gross payment
Execution of contract on payment to non-resident	6% of gross payment

F. **Other tax rates**

On dividends received from a company	10%

G. **Capital allowances**

Depreciation		
Buildings (all types)	10%	of the tax written down value
Furniture and fittings	15%	of the tax written down value
Plant and machinery (not otherwise specified)	15%	of the tax written down value
Motor vehicles (all types)	15%	of the tax written down value
Computer hardware	30%	of the tax written down value
Initial allowance	50% of cost	

ALL FIVE questions are compulsory and MUST be attempted

1 Meditech Pakistan Limited (MPL) is a public company under the Companies Ordinance, 1984. The following information is provided to you by MPL for its accounting year ended 31 December 2009.

(1) MPL is in the business of the manufacture of pharmaceuticals.

(2) The shares of MPL are not listed on any registered stock exchange in Pakistan.

(3) MPL's net profit as per the profit and loss account for the year ended 31 December 2009 is Rs. 41,870,000.

(4) Sales of MPL's own manufactured pharmaceuticals as per the profit and loss account are Rs. 43,825,000 made up as follows:

	Rupees
To companies	35,000,000
To persons who are not 'prescribed persons' required to deduct tax	8,825,000
	43,825,000

Tax at the applicable rate was deducted from the Rs. 35,000,000 and has been included as advance tax in the balance sheet as at 31 December 2009. The finance director of MPL is of the view that the tax deducted is the final tax on these sales of Rs. 35,000,000.

(5) Deductions charged in the profit and loss account include:

		Rupees
(i)	Accounting depreciation	1,325,000
(ii)	Replacement of old and worn-out parts of an item of plant	2,340,000
(iii)	Installation expenditure on new computers purchased	900,000
(iv)	Tax collected by XYZ Bank on cash withdrawals	40,500
(v)	Repairs and maintenance on the residential building SeaView [refer to item (8)]	893,000

(6) Income in the profit and loss account includes:

		Rupees
(i)	Rent received from the tenants of the residential building SeaView [refer to item (8)]	2,400,000
(ii)	Excess provision made in the previous years for bad debts written back. The provision made in the earlier years has not been allowed as a deduction	3,445,000

(7) Computer software

(i) On 1 January 2007, MPL had purchased for Rs. 4,000,000 computer software (CS-1) for providing information to the management. The CS-1, under the terms of purchase, was not transferable. The normal useful life (NUL) of the CS-1 was estimated to be four years. The CS-1 was used in the business for the whole of the tax years 2008 and 2009 and amortisation deductions in accordance with the tax statute had been allowed in the tax years 2008 and 2009.

For accounting purposes, the Rs. 4,000,000 was treated as deferred expenditure to be written off equally over the five years commencing with the accounting year ended 31 December 2007. The balance in the deferred expenditure account on 1 January 2009 was Rs. 2,400,000.

(ii) Due to a substantial increase in the business there was a need for more sophisticated software for the purpose of timely management decisions. Accordingly, Rs. 12,000,000 was expended on the in-house development of new computer software (CS-2). MPL continued to use the CS-1 until 30 September 2009. On 1 October 2009, the CS-1 ceased to be used in the business and on the same day the CS-2 was commissioned into use. The NUL of the CS-2 was estimated to be 12 years.

(iii) As the CS-1, under the terms of purchase, was not transferable and had become unusable, the software was destroyed on 31 December 2009. The balance in the deferred expenditure account as on 1 January 2009 was charged to the cost of sales in the accounts for the year ended 31 December 2009.

(iv) For accounting purposes, the Rs. 12,000,000 expended on the development of the CS-2 was treated as deferred expenditure in the accounts for the year ended 31 December 2009 to be written off over six years commencing with the accounting year ending on 31 December 2010.

(8) Fixed assets

(i) The tax written down values of MPL's fixed assets on 1 January 2009 were:

	Rupees
Buildings	8,400,000
Plant and machinery	12,800,000
Computer hardware	8,600,000
Motor cars	6,200,000
Furniture	1,800,000

(ii) During the year ended 31 December 2009:

- one new motor car was purchased for Rs. 1,500,000
- a new residential building 'SeaView' was purchased for Rs. 40,000,000. 20% of the space in SeaView was used for the residential accommodation of the Chief Executive Officer (CEO) of MPL and the balance of the space was rented out to unrelated individuals. The CEO's terms of appointment provided for rent-free accommodation.
- Rs. 16,000,000 was expended on the construction of workers' residential quarters. The quarters were ready for occupancy on 1 December 2009, but due to a delay in getting a completion certificate from the local building authority, the workers could not occupy the building before 1 January 2010.
- new computers were purchased for Rs. 15,000,000.

(9) On 28 December 2009, MPL purchased 50,000 shares in Pharma Industries Ltd from the Privatization Commission of Pakistan for Rs. 500,000.

(10) The advance tax paid by MPL for the tax year 2010 is Rs. 1,500,000.

Required:

(a) Compute the taxable income of Meditech Pakistan Limited for the tax year 2010 under the appropriate heads of income, giving clear reasons/explanations for the inclusion or exclusion in the computation of taxable income of each of the items listed.

Note: the reasons/explanations for the items not listed in the computation should be shown separately from the other reasons/explanations. (25 marks)

(b) Calculate the tax payable by or refundable to Meditech Pakistan Limited for the tax year 2010. (5 marks)

(30 marks)

2 For the purpose of this question, you should assume that today's date is 31 July 2010.

Mr Zaki (Z), a citizen of Pakistan, has approached you to compute his taxable income and tax payable for his accounting year ended 30 June 2010 and the following information is provided to you.

(1) Until 31 October 2009, Z was an employee of Aromatic Oils Pakistan Limited (AOPL), an associated company of Fragrant Oils plc (FOP). On 31 October 2009, Z opted for early retirement under the voluntary retirement scheme of AOPL. Z had been in the employment of AOPL since 1 January 1985. On retirement, Z, in addition to his monthly remuneration, received:

- Rs. 7,000,000 from AOPL as a golden handshake payment under the AOPL voluntary retirement scheme.
- Rs. 9,000,000 from the AOPL Employees Provident Fund. Rs. 9,000,000 represents the accumulated amount in Z's account of the fund. The fund has been recognised by the Commissioner.
- A bonus equal to two months basic salary.

(2) Z's terms of employment with AOPL provided for the following:

(i) A basic salary of Rs. 500,000 per month

(ii) Monthly allowances of:

- 10% of basic salary for utilities
- Rs. 75,000 for medical

(iii) No entitlement for free medical treatment or hospitalisation or reimbursement of such expenses.

(iv) A company maintained car for office and private use. Z to pay AOPL Rs. 10,000 per month for the private use of the car. [refer to item (7)]

(v) A pension of Rs. 50,000 a month payable on the first working day of each month.

(3) The monthly salary and allowances of all employees of AOPL are deposited into each employee's bank account on the first working day of the following month.

(4) On 1 November 2009, Z commenced his sole-proprietorship firm of Zee Aromatic Sales (ZAS) to carry on the business of sales of locally purchased aromatic oils. Due to a recession in the trade of aromatic oils, Z ceased doing business on 31 March 2010. Z's profit for the period from 1 November 2009 to 31 March 2010 of Rs. 78,125 which is made up as follows:

	Rupees	Rupees
Sales to AOPL (net of tax deducted)		1,664,625
Less: Purchases	1,500,000	
Electricity (Note)	68,500	
Other utilities	10,000	
Miscellaneous	8,000	(1,586,500)
Profit		78,125

Note: The Rs. 68,500 for electricity includes Rs. 5,000 tax collected by the Karachi Electricity Supply Corporation on the monthly bills for electricity consumption. The electricity bills on which tax has been collected have not exceeded Rs. 20,000 per month.

(5) On 1 April 2010, Z left for Saudi Arabia and commenced employment on the same day with the branch office of FOP (Fragrant Oils plc). Z agreed to work as the branch manager for a period of two years at a consolidated salary of US$ 20,000 (Rs. 1,600,000) per month. No tax has been paid or deducted at source in Saudi Arabia on the salary income of Z. For the tax year 2010, Z is resident for Pakistan tax since his stay in Pakistan before leaving for Saudi Arabia was more than 182 days. Following his departure, Z returned to Pakistan for the first time on 5 July 2010 for a short stay of one week.

(6) On retirement from AOPL on 31 October 2009, Z was due Rs. 6,000,000 as a gratuity under the gratuity scheme of AOPL. The scheme was not approved by the Federal Board of Revenue. Due to cash constraints, the gratuity though due to Z on 31 October 2009 was not paid to Z. On 30 April 2010, at the request of AOPL, FOP transferred the equivalent of Rs. 6,000,000 in US dollars into Z's US dollar account in Saudi Arabia in lieu of the gratuity due from AOPL.

(7) Other information:

(i) In order to provide the benefit of a company maintained car to Z, a new Honda Accord had been purchased on 1 January 2005 for Rs. 3,000,000. In accordance with AOPL's policy for the sale of a company maintained car used by an employee, Z purchased the Honda Accord on 31 October 2009 at its book value of Rs. 600,000. Another employee of AOPL had then offered to purchase the car at that date for Rs. 900,000.

(ii) On 8 June 2009, Z had acquired 5,000 shares in CeeDee Pakistan Limited from the Privatization Commission of Pakistan for Rs. 500,000 and had been allowed a tax credit thereon of Rs. 50,000 against the tax payable for the tax year 2009. On 11 June 2010, Z sold these 5,000 shares in CeeDee Pakistan Limited for Rs. 500,000.

(iii) Tax collected by RichBank Limited on payments for cash withdrawal by Z amounted to Rs. 16,700 for the accounting year ended 30 June 2010.

(iv) On 15 June 2010, Z received Rs. 52,000 from Mr Honest Hoshi (HH) which HH owed Zaki Sons, a sole-proprietorship firm of Z, in respect of aromatic oils purchased on credit. Zaki Sons had ceased to exist on 3 December 2001. Zaki Sons had maintained proper accounts adopting the system of cash-basis accounting. No tax was deducted by HH from the payment of Rs. 52,000 since HH being an individual is not a 'prescribed person' required to deduct tax.

(v) On 1 July 2010 (after the end of the tax year 2010), by a notice in writing to the Commissioner, Z elected to be taxed on the amount of the golden handshake payment received from AOPL at the average rate of tax on his taxable income for the preceding three years. This average tax rate worked out at 12%.

(vi) The tax deducted at source from Z's salary by AOPL for the tax year 2010 is Rs. 1,800,000.

Required:

(a) Compute the taxable income of Mr Zaki for the tax year 2010 under the appropriate heads of income, giving clear reasons/explanations for the inclusion or exclusion in the computation of taxable income and tax payable of each of the items listed.

Note: the reasons/explanations for the items not listed in the computation of taxable income should be shown separately from the other reasons/explanations. (19 marks)

(b) Calculate the taxable payable by or refundable to Mr Zaki for the tax year 2010. (6 marks)

(25 marks)

3 For the purpose of this question you should assume that today's date is 31 July 2010:

(a) The following information is provided to you:

(1) Mr Property (P) holds 75% of the shares in Building Rentals Inc (BRI), a non-resident company incorporated in a country which has no tax treaty with Pakistan for the avoidance of double taxation.

(2) BRI has been operating in Pakistan since the year 1947 as a branch. BRI closes its accounts on 30 June each year.

(3) BRI's income in Pakistan is from rentals derived from the lease of immovable properties consisting of shopping malls, residential estates, marriage halls and gardens. The immovable properties are all owned by BRI and the assets of BRI consist principally of the said properties.

(4) On 28 June 2010, P sold his entire share holding in BRI to an enterprise of the United Kingdom and made a gain US$ 3,600,800.

(5) P's stay in Pakistan in the tax year 2010 (accounting year ended 30 June 2010) is less than 183 days.

P is of the view that the US$ 3,600,800 is not chargeable to tax in Pakistan.

Required:

State, giving reasons, whether or not the view of Mr Property is correct. (4 marks)

(b) On 1 June 2010, Mr X, whose accounting year ends on 30 June of each year, sold 3000 shares in XYZ Ltd and suffered a loss of Rs. 75,000. XYZ Ltd is a company incorporated under the Companies Ordinance, 1984 and is not listed on any stock exchange in Pakistan. 50% of the shares in XYZ Ltd are held by the Government of Austria.

Mr X is of the view that the loss of Rs. 75,000 is a loss under the head 'Capital gains'.

Required:

State, giving reasons, whether or not the view of Mr X is correct. (3 marks)

(c) Mr Ardesheer Petigara (AP) is preparing his return of income for his accounting year ended 30 June 2010 and the following information is provided by him.

(1) Details of the assets disposed of by AP in June 2010 are:

(i) Shares in Petigara (Private) Ltd (PPL)

AP had purchased 1,000 shares in PPL in the tax year 2007 for Rs. 450,000. On 1 January 2010 he received 500 bonus shares in PPL. All 1,500 shares were sold for Rs. 600,000 on 1 June 2010.

(ii) The right to purchase shares in an employee share scheme

– AP as a past employee of SuperPower Inc (SPI) was entitled to participate in the SPI Employee Share Scheme (Scheme). On 1 July 2009, AP received the right to purchase 2,000 shares in SPI at the exercise price of US$ 15 per share. Under the terms of the Scheme, any shares issued to an employee can only be transferred after a holding period of three years. No consideration was payable for the right to acquire the 2,000 shares.

– On 1 June 2010, the price of one share quoted on the SF stock exchange was US$ 20. On the same day, AP exercised his right to purchase 1,000 shares at the exercise price of US$ 15 per share and remitted US$ 15,000 to the custodian of the Scheme. The remaining 1,000 rights were sold by AP for Rs. 300,000. (The rate of exchange is to be taken at US$ 1 = Rs. 80).

(iii) Shares in ABC (Private) Ltd.

AP suffered a loss of Rs. 70,000 on the sale of shares in ABC (Private) Ltd.

(iv) Cash transferred to his wife, Nilufar

On 10 June 2010 AP transferred Rs. 3,000,000 into Nilufar's bank account under an arrangement to live apart. Nilufar had left Pakistan on 31 July 2009 and has been living in London since then.

(v) Movable property held for personal use

(a) Jewellery
AP, in his wealth statement as on 30 June 2009, had shown jewellery at Rs. 6,500,000 which was held by his wife for her personal use. AP sold the jewellery to a reputed dealer for Rs. 5,750,000 on 1 June 2010.

(b) Paintings
AP had received two paintings on 1 April 2008 on the distribution of assets on the liquidation of Ardesheer Aspi (Pakistan) Ltd (AAPL). For the purpose of the distribution of assets, the liquidator of AAPL, on the basis of a valuation made by a reputable art dealer, had valued the two paintings 'A' and 'B' at Rs. 600,000 and Rs. 700,000 respectively. AP sold painting 'A' for Rs. 400,000 and painting 'B' for Rs. 1,000,000 respectively, on 15 June 2010. The paintings had been retained by AP for his own personal use in the intervening period.

(2) On 30 June 2010, AP made a donation of Rs. 200,000 to the Civil Hospital Karachi which was established by the Federal Government.

(3) Unadjusted loss brought forward Rs. 10,000.

The loss of Rs. 10,000 was sustained under the head 'Capital gains' in the tax year 2004.

Required:

(i) Compute the taxable income of Mr Ardesheer Petigara for the tax year 2010 under the appropriate heads of income, giving clear reasons/explanations for the inclusion or exclusion in the computation of taxable income and tax payable of each of the items listed.

Note: the reasons/explanations for the items not listed in the computation of taxable income should be shown separately from the other reasons/explanations. (10 marks)

(ii) Calculate the taxable payable by or refundable to Mr Ardesheer Petigara for the tax year 2010. (3 marks)

(20 marks)

4 **(a)** Aabee, a resident association of persons (AOP), is engaged in the business of providing consultancy services to corporate clients. Aabee closes its accounts on 31 December each year. The taxable income (adjusted for tax) of Aabee for the year ended 31 December 2009 is Rs. 1,000,000 and the tax deducted by the clients of Aabee from the payments made to Aabee for the rendering of services is Rs. 400,000.

The Chief Financial Officer of the AOP is of the view that Aabee, in its tax return of income for the tax year 2010, should claim a refund of Rs. 225,000 which is made up as follows:

	Rupees
Taxable income	1,000,000
Tax thereon at 17·5%	175,000
Less: Tax deducted from payments for the rendering of services	(400,000)
Refund due	(225,000)

Required:

(i) Explain why the Chief Financial Officer's contention of claiming a refund of tax of Rs. 225,000 is not correct; (3 marks)

(ii) State what would be the treatment of the tax deducted of Rs. 400,000, if the entity rendering the consultancy services were a company (Aabee Pakistan Limited) incorporated under the Companies Ordinance, 1984. Your answer should be supported by a calculation of the tax payable by or refundable to Aabee Pakistan Limited for the tax year 2010. (3 marks)

(b) Prime Builders Corporation (PBC) is a company incorporated in Australia. Pakistan does not have a tax treaty with Australia for the avoidance of double taxation.

PBC has entered into an agreement, hereinafter referred to as the 'Solar Contract', with SolarEnergy Pakistan Ltd (SEPL) for the construction of SEPL's plant in Hyderabad Sindh for the manufacture of solar panels. SEPL has informed PBC that tax at the applicable rate would be deducted from the gross amount of the payments made to PBC under the Solar Contract.

PBC is aware that the Pakistan tax statute has the concept of final tax whereby the tax deducted from payments made can be treated as the final tax. PBC wants you to explain the procedure to be followed to ensure that the tax deducted from the payments made by SEPL under the Solar Contract would be the final tax on the income arising under the Solar Contract.

Required:

Provide the information required by Prime Builders Corporation. (4 marks)

(c) Mungali Petroleum Inc (MPI), a company incorporated in the US, is operating in Pakistan as a branch. MPI has entered into an agreement with the Government of Pakistan under which MPI has been given the right to explore and produce crude oil and natural gas in specified areas of the province of Sindh.

The Finance Director of MPI wants you to explain the tax law on remittances of after tax profit made by a branch of a foreign company operating in Pakistan and the tax implications on MPI's branch in Pakistan of the remittance of the after tax profits of the branch to its head office in the USA.

Required:

Provide the information required by the Finance Director of Mungali Petroleum Inc. (5 marks)

(15 marks)

5 Hamza Usman & Sons (HUS), a partnership firm registered under the Sales Tax Act, 1990, commenced business on1 July 2009 as manufacturers of low priced polythene bags (PB), mostly used as carry-bags for merchandise sold by small retail shops and street vendors. The raw materials for the manufacture of PBs were purchased from the local market.

Following the on-going agitation in the press against the use of PBs for edibles and its adverse effect on the environment, a group of concerned citizens approached the Federal Board of Revenue (FBR) to consider increasing the rate of sales tax on PBs to make their use uneconomical for the retail shops and the street vendors. At this stage, HUS decided to diversify its business and also manufacture shampoos and perfumes. The Central Registration Office of the FBR, established for the purpose of centralised registration, was informed, through the taxpayer's registration form, of the new business activity of HUS, which is to be in addition to the original activity of the manufacture of PBs.

The business transactions of HUS for the month of December 2009 included the following:

	Rupees
Sale of scrap material on 1 December 2009	75,000
Payments to courier on 2 December 2009	12,000
Payments for purchase of raw materials on 7 December 2009	1,395,000
Sale of taxable supplies from 1 December 2009 to 22 December 2009	1,570,000
Payment for purchase of raw materials on 26 December 2009	583,000
Sale of taxable supplies on 30 December 2009	363,000
Sale of scrap material on 30 December 2009	19,000

Additional information:
(1) All figures relating to sales are stated exclusive of sales tax.
(2) All payments are stated inclusive of sales tax at the rate applicable at the relevant dates.
(3) All purchases made during the period from 1 December 2009 to 22 December 2009 were consumed/utilised in manufacturing the polythene bags sold during the said period.

Required:

(a) State when Hamza Usman & Sons had to apply for registration under the Sales Tax Act, 1990. (1 mark)

(b) State, giving reasons, whether or not Hamza Usman & Sons has to apply for a separate registration number for the business of the manufacture of shampoos and perfumes. (2 marks)

(c) Assuming that the rate of sales tax on the low-priced polythene bags is increased from 16% to 20% effective from 23 December 2009:

(i) State the manner in which the sales tax return for the month of December 2009 would need to be furnished; (2 marks)

(ii) Calculate the sales tax payable by Hamza Usman & Sons for the month of December 2009. (5 marks)

(10 marks)

End of Question Paper