Fundamentals Level – Skills Module

Taxation (Pakistan)

Tuesday 6 December 2011

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.

Paper F6 (PKN)

The Association of Chartered Certified Accountants

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 except where the exact number of days is given in the question.
3. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates and allowances for the tax year 2011 are to be used in answering all questions on this paper.

A. Tax rates for salaried individuals – where salary income exceeds 50% of taxable income

Taxable income	Rate of tax on taxable income
Up to Rs. 300,000	0%
Rs. 300,001 – 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%
Over Rs. 4,550,000	20·00%

B. Tax rates for non-salaried individuals to whom the rates given in A are not applicable

Taxable income	Rate of tax on taxable income
Up to Rs. 300,000	0%
Rs. 300,001 – Rs. 500,000	7·50%
Rs. 500,001 – Rs. 750,000	10·00%
Rs. 750,001 – Rs. 1,000,000	15·00%
Rs. 1,000,001 – Rs. 1,500,000	20·00%
Over Rs. 1,500,000	25·00%

C. Tax rate for associations of persons

On taxable income	25% of taxable income

D. Tax rates for companies

Small company	25% of taxable income
Public company/private company	35% of taxable income

E. Tax rates on capital gains on the disposal of securities

Where holding period of a security is

– less than six months	10·0%
– more than six months but less than 12 months	7·5%
– more than one year	0%

F. Tax rates for income from property

(i) For individuals and associations of persons

Up to Rs. 150,000	0%
Rs. 150,001 to Rs. 400,000	5% of the amount exceeding Rs. 150,000
Rs. 400,001 to Rs. 1,000,000	Rs. 12,500 plus 7·5% of the amount exceeding Rs. 400,000
Above Rs. 1,000,000	Rs. 57,500 plus 10% of the amount exceeding Rs. 1,000,000

(ii) For companies

Up to Rs. 400,000	5%
Rs. 400,001 to Rs. 1,000,000	Rs. 20,000 plus 7·5% of the amount exceeding Rs. 400,000
Above Rs. 1,000,000	Rs. 65,000 plus 10% of the amount exceeding Rs. 1,000,000

G. Other tax rates

On dividends received from a company	10%

H. Rates of deduction/collection of tax at source

Sale of goods (general)	3·5%
Services (other than transport)	6%
Contracts	6%
Commission or brokerage	10%
Profit on debt	10%
Import of goods (general rate)	5%

I. Depreciation rates

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

J. Initial allowance

Eligible depreciable asset	50% of cost

K. Benchmark rate

Interest free loan to employees	13% per annum

M. Tax levied in the Income Tax (Amendment) Ordinance, 2011 may not be taken into consideration while answering this question paper.

ALL FIVE questions are compulsory and MUST be attempted

1 For the purpose of this question, you should assume that today's date is 15 July 2011.

Star Pakistan Limited (SPL) is a pharmaceutical company using mainly Swedish formulae in the preparation of medicines. SPL has been granted permission by the Commissioner Inland Revenue to use a 12-month period ending 31 December as its tax year since its incorporation on 1 January 2003. The following information is available for the accounting year ended 31 December 2010:

(1) SPL is a non-listed public company incorporated under the Companies Ordinance, 1984.

(2) All the shareholders of SPL are individuals.

(3) The control and management of the affairs of SPL during the year was outside Pakistan.

(4) SPL's total sales were at Rs. 80,000,000. No sales tax was payable on the products manufactured by SPL.

(5) An extract of SPL's accounts shows:

		Rs.
–	Profit before tax	4,940,000
–	Tax paid	(1,100,000)
–	Profit after tax	3,840,000

(6) Deductions charged in the accounts to arrive at profit before tax include:

		Rs.
(i)	Accounting depreciation.	5,400,000
(ii)	Expenditure relating to share registrar services. Maintenance of SPL's shares records has been outsourced. The total expenditure incurred was Rs. 400,000, including the fee paid of Rs. 245,000 to increase the company's authorised capital.	
(iii)	Payments to the Federal Government on account of:	
	– charges for late delivery of vaccines	350,000
	– infraction of the Federal law regarding the quality of drugs	575,000
(iv)	Annual subscription fee paid to the Pharmaceutical Association of Pakistan, in cash.	150,000
(v)	Provision for bad debts calculated as 0·5% of the total amount receivable from trade debtors.	187,000
(vi)	Payments to the workers welfare fund and workers' participation fund established under the relevant laws of Rs. 80,000 and Rs. 205,000, respectively.	
(vii)	Scientific research expenditure incurred in Sweden. The research has helped in improving the quality of SPL's products.	900,000
(viii)	A civil suit has been filed against SPL by a client for the alleged wrong supply of medicine. Pending a decision by the competent court of law, SPL, acting cautiously, has deducted the amount which it might have to pay in future for the wrong done in year ended 31 December 2010.	1,000,000

(7) Profit before tax shown in the accounts includes:

		Rs.
(i)	Accounting profit on the sale of a motor car.	255,000
(ii)	Unclaimed bonus relating to the tax year 2004. SPL considers that this amount will no longer be claimed. The Commissioner had not allowed it in the tax year 2004, considering it as unverifiable expenditure.	645,000

(8) Fixed assets

(i) The tax written down values of the assets of the company on 1 January 2010 were:

	Rs.
Plant and machinery	6,500,000
Building	5,270,000
Motor cars	2,030,000
Furniture and fixtures	1,980,000
Computers	2,800,000

(ii) The following assets were purchased on 1 July 2010 and used for business during the year:

- One new motor car for Rs. 5,000,000.
- Ten old personal computers, previously used in Pakistan, for Rs. 375,000.
- Two old packing machines, not previously used in Pakistan, for Rs. 4,370,000.

(iii) On 15 November 2010 a motor car was sold for Rs. 1,000,000. The car had been purchased for Rs. 2,500,000 but for the purpose of claiming tax depreciation its cost was restricted to Rs. 1,500,000. The tax written down value of the car on 1 January 2010 was Rs. 710,000.

(9) Other information

(i) During the year, Rs. 800,000 was spent on improving the structure of SPL's building to make it safer for the workers and claimed this amount as a revenue expense in the accounts.

(ii) No payment was made to any employee during the year from the approved gratuity fund of the company, but SPL still contributed Rs. 500,000 to the fund during the year. This amount was charged as an expense under the head 'salaries and wages'.

(iii) In the tax year 2010, the Commissioner Inland Revenue assessed a loss of Rs. 3,500,000 under the head 'Income from business'. SPL had, however, paid income tax of Rs. 245,000 on the basis of the turnover of the company.

(iv) Paid Rs. 1,072,370 on account of technical services, to an individual resident in the USA who remained in Pakistan for one week during the year ended 31 December 2010. This amount was paid through a banking channel but no tax was deducted. According to the tax treaty between Pakistan and the USA, the amount paid was not taxable in Pakistan. The amount was deducted by SPL in its accounts when arriving at the profit before tax.

(v) Paid Rs. 700,000 towards the Prime Minister's Flood Relief Fund 2010. This amount has not been charged in the profit and loss account when arriving at the profit before tax.

Required:

(a) Briefly state with reasons whether for tax purposes Star Pakistan Limited (SPL):

(i) is or is not a public company for tax purposes; and (2 marks)

(ii) is a resident company or a non-resident company. (1 mark)

(b) State the calendar year which will denote SPL's tax year for the accounting year ended 31 December 2010; and the last due date for filing SPL's income tax return for the relevant tax year. (2 marks)

(c) Compute the taxable income of SPL for the relevant tax year under the appropriate heads of income, giving clear reasons/explanations for the inclusion in or exclusion from the computation of each of the items listed in the question.

Note: the reasons/explanations for the items not listed in the computation of taxable income should be shown separately. Specific marks are allocated for this part of the requirement. (22 marks)

(d) Calculate the tax payable by/refundable to SPL for the relevant tax year. (3 marks)

(30 marks)

2 For the purpose of this question, you should assume that today's date is 15 July 2011.

Mr Rameez, a medical doctor, retired on 15 July 2010, at the age of 58 from the health department of the Government of Punjab after rendering meritorious services for 25 years. The following information relates to Mr Rameez's income from all sources during the year ended 30 June 2011:

From the Government of Punjab

(1) Received Rs. 165,000 as basic salary.

(2) Received on encashment of leave preparatory to retirement, Rs. 456,000.

(3) Received Rs. 4,250,000 by way of commutation of pension at retirement.

(4) Received Rs. 150,000 on account of travelling allowance and daily allowance for participation in a four day workshop in Karachi on hepatitis. His actual expenditure was only Rs. 114,500.

(5) He fell ill on 15 August 2010, and was admitted into the hospital he had been working with during his employment. Estimated expenditure incurred by the hospital on his treatment was Rs. 175,000 but no amount was charged to him.

(6) Received arrears of salary of Rs. 250,000 relating to a previous year, in which the tax rate applicable to his taxable income was 25%.

(7) Received a certificate of deduction of tax from his salary of Rs. 6,000.

From the Medicare Institute

Effective from 1 October 2010, Mr Rameez became an employee of a private medical institute on the following terms and conditions:

– Basic salary for the first year of his employment of Rs. 100,000 per month.
– A utilities allowance of 15% of basic salary.
– A medical allowance of 20% of basic salary, without the facility of reimbursement of medical expenses.

His salary, including allowances, for each month was paid on the fifth day of the month following the month to which it related.

Further, as per his terms of the employment, Mr Rameez was obliged to attend patients at odd hours at the call of the Medicare Institute. For this inconvenience, he was entitled to a 20% share in the fees the Medicare Institute received from such patients attended by him. For the period up to 30 June 2011, he received Rs. 230,000 as his share of these fees, on which tax was deducted at Rs. 23,000, by treating it commission paid.

No other tax was deducted on any amount paid to Mr Rameez by the Medicare Institute.

From bank accounts

(1) Received profit of Rs. 510,000 from his Pensioner's Benefit Account maintained with a scheduled bank. No tax or zakat was deducted from this profit. No expenditure was incurred to earn this profit.

(2) Rs. 45,000 (net of tax of Rs. 5,000) was received as profit from a profit and loss account maintained with a scheduled bank.

From agriculture

Mr Rameez owns 25 acres of agricultural land in District Okara. He does not cultivate the land himself and during the year ended 30 June 2011, received annual rent of Rs. 1,000,000 from the tenant cultivating the land.

From a commercial building on rent

A commercial building owned by him was rented to a new tenant on 1 July 2010, at a monthly rent of Rs. 90,000. He received the following advances from the new tenant:

– Rs. 1,080,000 adjustable against monthly rent; and
– Rs. 100,000 non-adjustable and returnable at the end of the tenancy.

The non-adjustable advance was used to repay the non-adjustable security deposit of Rs. 50,000 received from the out-going tenant in July 2009.

Property tax on the building was paid on 15 June 2011, of Rs. 135,000.

Other information

(1) Rs. 500,000 was received for lectures delivered to medical students of a private medical college run by an individual. No tax was deducted on this amount.

(2) Rs. 9,000 was received from a newspaper for writing a short article on health issues in Pakistan.

(3) From 1 March 2011 he incurred Rs. 300,000 on the renovation of his residential house. The full amount was obtained as a loan from a scheduled bank. The bank charged Rs. 10,000 profit on this debt for the period falling in the tax year 2011.

(4) He donated the following amounts during the year:

- Rs. 118,000 to the Prime Minister's Special Fund for victims of terrorism.
- Rs. 200,000 to the Chief Minister's (Punjab) Relief Fund for internally displaced persons of NWFP (Pakhtunkhwa).

(5) The following amounts of income tax were collected by the Provincial Excise and Taxation Department in connection with a vehicle purchased by Mr Rameez:

- Rs. 16,875 at the time of registration on 1 July 2010; and
- Rs. 8,000 at the time of paying his annual motor vehicle tax.

(6) His bank has provided a certificate of tax deduction of Rs. 5,350 on cash withdrawals by him during the year ended 30 June 2011.

Required:

Compute Mr Rameez's taxable income and total tax payable for the tax year 2011. Give brief reasons for the treatment of any items excluded from taxable income or for which no expense deduction or tax credit is allowed.

(25 marks)

3 For the purpose of this question, you should assume that today's date is 15 July 2011.

Mrs Robina, who is resident in Pakistan, disposed of the following assets during the year ended 30 June 2011:

(1) 1 July 2010: Sold 1,000 shares of PPL, a listed public company, for Rs. 150,000. The shares had been purchased for Rs. 75 per share (face value of Rs. 10 plus premium of Rs. 65) on 23 December 2009 from PPL on its initial offer. She had availed of a tax credit of Rs. 5,000 in the tax year 2010 on account of this investment.

(2) 7 July 2010: Sold a platinum necklace for Rs. 1,000,000. The necklace had been gifted to her on marriage on 20 March 2006, by her mother. The original cost of the necklace was Rs. 300,000; whereas, at the time of the gift, its fair market value was estimated at Rs. 500,000.

(3) 8 August 2010: Gifted her golden bangles to her sister who has been residing in Canada since 15 June 2006. The bangles were purchased by her for Rs. 600,000 on 4 April 2010 and their fair market value on the date of the gift was Rs. 800,000.

(4) 15 August 2010: Sold 90 grams of gold at Rs. 40,000 per ten grams out of a total 100 grams which she had purchased at Rs. 35,000 per 10 grams on 30 June 2010.

(5) 3 September 2010: Gifted a painting by Sadequain to her cousin in Lahore. Her cousin, an American citizen, has been resident in Pakistan since 2008 doing her PhD in Oriental Languages. She had purchased this painting for Rs. 750,000 and incurred a further Rs. 50,000 on a new frame following purchase. On the date of gift, its fair market value was Rs. 1,200,000.

(6) 20 September 2010: Received compensation of Rs. 500,000 from her broker on account of theft of 4,000 shares of Taste (Pvt) Ltd on 17 July 2010, while in the custody of the broker. The shares had been purchased by her on 1 September 2005, at Rs. 315,000 excluding brokerage charges of Rs. 10,000. She also paid a fee of Rs. 25,000, through crossed bank draft, to the counsel who represented her in the settlement proceedings. The fair market value of these shares was as below:

– On 17 July 2010	Rs. 500,000
– On 20 September 2010	Rs. 575,000

(7) 17 October 2010: Sold old furniture from her residence for Rs. 200,000. The furniture had been purchased for Rs. 735,000 on 23 March 2007.

(8) 1 January 2011: Sold her licence to import and distribute LPG for Rs. 5,000,000. The licence had been issued to her by the Government on 1 November 2010, on payment of Rs. 2,500,000 in cash as a non-refundable security and Rs. 100,000 as a processing fee. She never entered into the business of import and distribution of LPG. On the sale of the licence the non-refundable security was transferred into the name of the buyer.

(9) 20 March 2011: Received Rs. 300,000 through a crossed cheque on entering into an agreement to sell an antique for a total consideration of Rs. 950,000. It was agreed that the antique would be handed over to the purchaser on 30 July 2011, subject to payment of the balancing amount on 25 July 2011, and confirmation of its stated origin in the agreement to sell, by the archaeology department. She had purchased this antique for Rs. 700,000 on 27 June 2002.

(10) 30 June 2011: Out of a total of 12,000 shares of Goldmine (Pvt) Ltd, a private company under the Companies Ordinance, 1984, received on 10 July 2010 as a dividend *in specie*, she sold 10,000 shares for Rs. 395,000. On the date of issue, the fair market value had been estimated at Rs. 20 per share.

Additional information:

(1) Income tax collected from Mrs Robina along with her mobile phone bills was Rs. 15,000. The phone was used for personal calls only.

(2) On the basis of her tax liability for the tax year 2010, Mrs Robina paid advance tax of Rs. 400,000 for the tax year 2011.

(3) Rs. 50,000 was paid as zakat fulfilling all the conditions under the law relating to zakat.

(4) She had brought forward losses relating to the tax year 2010 as given below:

(a) Rs. 122,000 capital loss from the sale of shares of private limited companies.
(b) Rs. 242,000 capital loss from the sale of shares listed on Lahore Stock Exchange.
(c) Rs. 452,000 from a speculation business.

Required:

Compute the taxable income of Mrs Robina for the tax year 2011 and compute the tax payable on this income. Give brief reasons for your treatment of each item.

(20 marks)

4 **(a)** A company, engaged in the manufacture and sale of solar gadgets, extended a loan of Rs. 500,000 to one of its shareholders on 31 December 2010, when its accumulated profits were Rs. 400,000. The amount of the loan was advanced through a crossed cheque.

Required:

Explain the tax implications of this loan, for both the shareholder and the company, if the company is:

(i) a private limited company as defined in the Companies Ordinance, 1984; and
(ii) an unlisted public limited company. (4 marks)

(b) Define a 'small company' for the purposes of the Income Tax Ordinance, 2001 and state whether or not a small company is a prescribed person for the purposes of withholding tax from a payment made on 1 March 2011, to a supplier of goods of Rs. 50,000. (5 marks)

(c) State the time limit within which:

(i) an application for a refund should be made to the Commissioner Inland Revenue; (2 marks)

(ii) an order should be passed by the Commissioner Inland Revenue on the application filed for a refund; and (1 mark)

(iii) an appeal can be filed against the order of the Commissioner (Appeals). (1 mark)

(d) An assessment order was made by the Commissioner Inland Revenue on 30 September 2006. On 15 November 2011, the Commissioner issued a notice to the tax payer showing his intention to rectify a mistake of computation in the order which would result in an increase in the tax liability of Rs. 100,000.

Required:

Explain why the proposed rectification is or is not permissible, stating the tax payer's best legal defence against the proposed rectification. (2 marks)

(15 marks)

5 **(a) State what is meant by a 'cottage industry' together with the sales tax treatment of local supplies made by a cottage industry.** (3 marks)

(b) For the purpose of this part question, you should assume today's date is 5 March 2011.

Mr Waseem, a registered person under the Sales Tax Act, 1990, is engaged in the manufacture of electric goods. The business transactions of Mr Waseem for the month of February 2011, are given below:

	Rs.
Sale of taxable goods to registered persons	6,900,000
Sale of taxable goods to unregistered persons	8,600,000
Export of taxable goods to the UAE	5,700,000
Sale of exempt goods	4,100,000
Payment for purchases of raw materials for manufacturing taxable supplies	10,500,000
Payment for advertisements on electronic media for both exports and local taxable supplies	1,200,000
Payment for purchases of raw materials for manufacturing both exempt and taxable supplies	3,950,000

Additional information:

(1) All payments are stated inclusive of sales tax.
(2) All sales are stated exclusive of sales tax.
(3) Sales tax of Rs. 100,000 was paid along with the electricity bill paid in cash during February 2011. The bill pertained to the manufacture of the goods exported to the UAE.
(4) Out of the payment for the purchase of raw materials for manufacturing taxable supplies, Rs. 500,000 were paid in cash.

Required:

Calculate the sales tax payable by or refundable to Mr Waseem for the month of February 2011, giving clear explanations for the treatment accorded to the input tax relating to the payment made in cash; and the sales tax paid along with the electricity bill. (7 marks)

(10 marks)

End of Question Paper