Fundamentals Level – Skills Module

Taxation (Pakistan)

Monday 6 June 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.

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 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

ALL FIVE questions are compulsory and MUST be attempted

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

Valuable Products Ltd (VPL), a manufacturer and seller of consumer goods, is a public limited company, quoted on the Karachi Stock Exchange (Guaranteed) Ltd. As per its accounts, VPL's turnover for the accounting year ended 30 June 2011 was Rs. 70,000,000 and its net profit Rs. 8,000,000. None of VPL's customers were registered under the Sales Tax Act, 1990.

Further information, gathered from the records of VPL relating to the year ended 30 June 2011, is as below:

(1) VPL had a brought forward assessed loss of Rs. 500,000 under the head 'Income from Business' relating to the tax year 2010. Minimum tax of Rs. 300,000 on the basis of turnover was paid in that tax year.

(2) VPL was allotted a plot in the Sundar Industrial Estate by the government in October 2005. In January 2011, VPL paid an instalment towards the purchase price, to the government, of Rs. 400,000. Considering that there was no indication of the early establishment of industry on the plot, VPL claimed this amount as a revenue expense.

(3) Different banks have deducted tax of Rs. 140,000 on account of cash withdrawals made by VPL during the year. No charge has been made for this amount in the profit and loss account.

(4) During the year, VPL spent Rs. 400,000 on conducting in-house scientific research to reduce wastage. However, the research did not bring any visible improvement. This expense was charged to the profit and loss account.

(5) VPL received from Imtiaz Ltd, one of its suppliers of raw materials, Rs. 100,000 as damages for delayed supplies. This amount was taken directly to the capital account.

(6) Perusal of the telephone and electricity bills indicated tax payments of Rs. 150,000. This amount has been charged to the profit and loss account.

(7) Due to the downsizing of one area of its operations, VPL terminated services of an employee and, on 15 October 2010, paid him the following benefits:

	Rs.
– Leave encashment	100,000
– Payment in lieu of notice	50,000
– Support money for finding a new job (outplacement support)	400,000
– Compensation for premature termination	600,000

The average tax rate of the employee for the previous three years was 25%. No tax was deducted by VPL from these termination payments. The amount paid was fully verifiable, having been paid through a crossed cheque.

(8) Depreciation is charged in the accounts according to the rates admissible under the law except in respect of Machine A. This machine had been taken on a finance lease from a leasing company, duly approved by the Federal Board of Revenue (FBR), in the tax year 2007 and remained in use of the taxpayer till 30 June 2011. Other facts about Machine A are given below:

	Rs.
Depreciation charged to the accounts	300,000
Lease rentals paid during the year	200,000
Purchased on 30 May 2011 from the leasing company and transferred to own assets at residual value	500,000
Market value on 30 May 2011	900,000

(9) A donation of Rs. 200,000 paid, on 15 October 2010, to a flood relief fund established by a social worker has been claimed as revenue expenditure. The efforts of the social worker were appreciated by the Prime Minister of Pakistan in a ceremony held to encourage social workers.

(10) The net profit for the year includes a Rs. 500,000 share from an association of persons (AOP). The total income of the AOP, including the share of VPL, was Rs. 1,000,000 on which the tax liability has already been discharged by the AOP.

(11) A vacant tract of land within VPL's business premises was used for growing crops. A separate account was maintained for this activity and the net profit for the year of Rs. 200,000 was credited to the company's profit and loss account.

(12) On 30 June 2011, Rs. 450,000 was accrued as rent payable to the landlord of one of VPL's showrooms. No tax has yet been deducted from this amount. The amount has been debited to the profit and loss account.

(13) Turnover includes Rs. 400,000 received from a customer in respect of a bad debt that had been written off during the tax year 2005. This expense had not been allowed as a deduction in that tax year.

(14) On 30 June 2011, the company possessed US$ 20,000 brought forward from the financial year ended 30 June 2010 in respect of which an exchange gain of Rs. 100,000 is included in the net profits of the company.

The conversion rates as per State Bank of Pakistan used to calculate this gain were as below:

1 July 2010	1 US$ = Rs. 80
30 June 2011	1 US$ = Rs. 85

Required:

(a) Compute the taxable income of Valuable Products Ltd (VPL), for the tax year 2011, giving brief explanations of your treatment of the items excluded from taxable income or for which no expense deduction is allowed. (15 marks)

(b) Compute the total tax payable by VPL, assuming that neither the workers' welfare fund nor quarterly advance income tax was payable by the company. (7 marks)

(c) Calculate the penalty that can be imposed on VPL for the non-deduction of tax from the amounts paid to the employee whose services were terminated (as referred to in Note (7)). (4 marks)

(d) State the methods which may be used to select VPL for audit of its tax affairs in the tax year 2011 and whether the company can be selected for audit again in the tax year 2012 if nothing adverse was found during the audit conducted in the tax year 2011. (4 marks)

(30 marks)

2 (a) Name ANY FOUR entities that are included in the definition of an association of persons (AOP). (2 marks)

(b) Three individuals, X, Y, and Z, are partners of a firm (XYZ), resident in Pakistan, carrying on the business of manufacturing and sale of agricultural implements for small individual farmers who are not required to deduct tax on payments made by them for any purchase. X, Y and Z share the profit and losses of the firm in the ratio of 3:2:1, respectively. For the tax year 2011, the net profit of the firm is Rs. 400,000 after debiting the following:

	Rs.
Commission paid to X	300,000
Performance bonus paid to Y	100,000
Salary paid to X	300,000
Interest paid to Z	200,000

Scrutiny of the accounts of the partnership, prepared on the accrual basis, reveal the following information:

(1) Food items costing Rs. 100,000 were distributed to farmers affected by floods in September 2010. All the farmers were regular customers of the firm.

(2) The son of partner Y worked as an engineer in the firm for three months during the year ended 30 June 2011. In total, he was paid Rs. 150,000 as salary through a crossed cheque. However, no tax was deducted.

(3) Expenditure debited to the profit and loss account includes a fine of Rs. 25,000 paid to the Engineering Development Board for an infraction of safety laws.

(4) An amount of Rs. 50,000 had been given as a loan to a farmer in 2003 which could not be recovered and has been written off as a bad debt on 20 May 2011.

(5) An amount of Rs. 100,000 due to the partnership by some of its customers had been treated as irrecoverable in 2009 but the partnership only chose to write off these amounts as bad on 15 April 2011.

(6) In September 2010 the firm obtained Rs. 300,000 as advances, in cash, from two customers against the supply of agricultural implements to be made by September 2011.

(7) Rs. 25,000, received from a farmer as an advance, was forfeited in October 2010 because the farmer failed to pay the balance amount of the price of the implement made on his orders according to the given specifications. This amount is not included in the income of the firm but was treated as a capital receipt.

(8) Expenditure charged includes Rs. 50,000 incurred in the tax year 2011 in respect of a vocational training institute run by the Sindh Government for the training of industrial workers. The amount was paid through a crossed cheque.

(9) Depreciation has been charged to the accounts according to the rates prescribed in the Income Tax Ordinance, 2001 except for one vehicle, used by a non-partner employee of the partnership, details of which are given below:

Cost of the vehicle	Rs. 2,300,000
Date of purchase	1 January 2011
Depreciation claimed	20% of cost using the straight line method

Besides their share of income from the AOP, partners X, Y and Z have taxable income, from their other businesses, of Rs. 500,000, Rs. 400,000, and Rs. 300,000 respectively in the tax year 2011.

Required:

(i) Compute the taxable income of the firm XYZ and the tax payable thereon for the tax year 2011. Give brief reasons for the treatment of the items excluded from taxable income or for which no expense deduction is allowed; (13 marks)

(ii) Compute their share of income from the firm, taxable income and tax payable by each partner of the firm XYZ. (7 marks)

(c) W, an individual taxpayer regularly filing his return of income, purchased a plot of land on 25 June 2009 for Rs. 5,000,000, the market value of which was Rs. 7,000,000 on 30 May 2011, the day the Commissioner discovered this investment. W has no evidence that can satisfactorily explain the source of funds used for the purchase of this plot. The Commissioner intends to issue W with a notice of amendment of already completed assessment to impose tax on account of concealment of this asset on 20 June 2011.

Required:

(i) **State the amount that can be treated as income chargeable to tax and under which head of income it will be included in W's total income;** (1 mark)

(ii) **State in which tax year the amount shall be chargeable to tax;** (1 mark)

(iii) **State the amount of the penalty which can be levied for the concealment of income with reference to the tax sought to be evaded in such cases.** (1 mark)

(25 marks)

3 (a) (i) Barring a few exceptions, any moveable property held for the personal use of a person or any member of such person's family dependent on him is not treated as a capital asset.

Required:

List ANY SIX categories of moveable property which are treated as a capital asset even if held for the personal use of the person himself or any dependent member of his family; (3 marks)

(ii) State what is meant by 'a security' for capital gains purposes. (2 marks)

(b) During the year ended 30 June 2011, Mr Sajid sold the following assets owned by him:

Asset	Date of acquisition	Date of disposal	Cost Rs.	Consideration received Rs.
5,000 shares of ABC Ltd listed on the KSE*	5 April 2010	1 March 2011	50,000	
10,000 shares of DEL Ltd listed on the ISE*	15 May 2011	20 May 2011	200,000	[See Note 1]
5,000 shares of DCH Ltd listed on the LSE*	10 June 2009	30 May 2011	400,000	
10,000 shares of KIM Ltd [not quoted on any stock exchange]	11 April 2005	30 May 2011	500,000	600,000
5,000 shares of JIL (Pvt) Ltd	11 May 2010	1 April 2011	600,000	700,000
A sculpture, held by his son dependent on him, sold at a loss after being damaged by fire	25 May 2005	20 May 2011	150,000	75,000
Golden coin of Mughal Era purchased from an antique store and sold to a museum	25 May 2005	15 July 2010	75,000	150,000
Commercial plot of land	14 May 2000	1 July 2010	500,000	1,500,000

*KSE = Karachi Stock Exchange (G) Ltd
ISE = Islamabad Stock Exchange (G) Ltd
LSE = Lahore Stock Exchange (G) Ltd

Notes:

1. The shares in each of the companies ABC Ltd, DEL Ltd and DCH Ltd were disposed of by transfer to his brother in the following manner:

   (i) 5,000 shares of ABC Ltd were exchanged for debt amounts due to his brother by third parties. The total debt amount was Rs. 200,000. However, Rs. 50,000 of the debt amount had already become bad.

   (ii) 10,000 shares of DEL would have fetched Rs. 300,000 in the open market, but were sold to his brother for Rs. 200,000.

   (iii) 5,000 shares of DCH Ltd were sold to his brother for their fair market value of Rs. 700,000. The cost of a normal sale in the form of commission, estimated to be Rs. 40,000, were saved.

2. Commission of Rs. 50,000 was paid, through a crossed cheque, to an agent for brokering the sale of shares in JIL (Pvt) Ltd. However, Mr Sajid forgot to deduct tax on this amount. The amount of commission paid has neither been included in the cost of the asset nor deducted as an expense from the sale proceeds.

Additional information:

(i) A cricket bat bearing the signature of a famous cricketer had been purchased by Mr Sajid for Rs. 100,000 on 10 June 2008. When his nephew was selected for Pakistan Cricket Team on 31 March 2011, Mr Sajid gifted him the bat. Had the bat been sold on 31 March 2011, in an open auction, it would have fetched Rs. 200,000.

(ii) On 15 January 2011, Mr Sajid received salary income of Rs. 345,000 from his ex-employer in respect of employment for the period July to October 2008. His average rate of tax in the years 2009 and 2010 was 15%.

(iii) The following unabsorbed losses of Mr Sajid from previous tax years are available in the tax year 2011:

Tax year 2007	
Loss under the head 'Income from Other Sources'	Rs. 400,000
Tax Year 2010	
Loss from speculation business	Rs. 100,000
Capital loss on sale of shares of a private limited company	Rs. 180,000

Required:

Compute the taxable income of Mr Sajid for the tax year 2011 and compute the tax payable on this income. Give reasons for your treatment of each item. (15 marks)

(20 marks)

4 (a) Mr Suleman, a resident taxpayer, is 62 years of age. During the tax year 2011, he derived taxable income of Rs. 600,000 from his business of trading in dry fruits. He also received a taxable dividend of Rs. 300,000 from which the distributing company withheld tax at Rs. 30,000 at the prescribed rate.

Required:

State, giving reasons, whether Mr Suleman is entitled to any tax reduction, and if so, give the amount of the tax reduction. (4 marks)

(b) Mr Daud and his friend Mr Akmal jointly own a commercial property, in the ratio of 80:20. During the tax year 2011, the total rent earned by them was Rs. 1,000,000. Property tax and collection charges of Rs. 200,000 and Rs. 10,000, respectively, were also paid by them jointly. Neither Mr Daud nor Mr Akmal has any other source of income.

Required:

Explain whether the income from the property will be assessed in the hands of Mr Daud and Mr Akmal, jointly or separately, and calculate their tax liability for the tax year 2011. (4 marks)

(c) Mr Wasif did not file a return of income for the tax year 2010. The Commissioner of Inland Revenue (CIR), being of the opinion that Mr Wasif was required to file a return of income for the said tax year, served on him a notice requiring him to file a return within 30 days of the date of service of the notice. No return was filed in the given time so the CIR made a provisional assessment which was served on Mr Wasif on 30 May 2011.

Required:

Explain the steps that should be taken by Mr Wasif in order to prevent the provisional assessment from becoming a final assessment. (3 marks)

(d) Based on the Income Tax Ordinance, 2001, state when a return of income is taken to be complete and explain when and how a return of income filed by a taxpayer can be treated as invalid. (4 marks)

(15 marks)

5 (a) For the purpose of this part question, you should assume today's date is 1 October 2010.

Uzair Enterprises Ltd (UEL), a registered person under the Sales Tax Act, 1990, is engaged in the production of a variety of goods. UEL's business transactions for the month of September 2010 were as below:

	Rs.
Sale of taxable goods to registered persons	10,000,000
Sale of taxable goods to unregistered persons	6,000,000
Exports of goods to a buyer in Kuwait	22,000,000
Sale of exempt supplies	4,000,000
Payments to registered persons for the purchase of raw materials	15,000,000
Payments to unregistered persons for the purchase of raw materials	4,000,000

Additional information:

(1) The figures for the sales of all goods are stated exclusive of any applicable sales tax.

(2) The sale of taxable goods to registered persons includes goods sold to an associated company of UEL at Rs. 200,000, the open market price of which at the time of sale was Rs. 400,000.

(3) The figures for the purchases of raw materials are stated inclusive of any applicable sales tax.

(4) All payments were made through crossed cheques.

(5) Free replacement of defective parts is made in the case of taxable goods, which have been sold under warranty. During the month of September 2010 the market value of such replacement parts was Rs. 500,000 exclusive of sales tax.

(6) The raw materials purchased from registered persons are utilised for the making of both taxable and non-taxable supplies. The raw material purchased from unregistered persons are utilised exclusively for the making of taxable supplies.

Required:

Calculate the sales tax payable or refundable to Uzair Enterprises Ltd, for the month of September 2010, giving explanations for the treatment of:

- **the goods sold to an associated company, and**
- **the free replacement of the defective parts.** (6 marks)

(b) List the situations in which a person once registered for sales tax is liable to be de-registered. (4 marks)

(10 marks)

End of Question Paper