Answers

Note:
All references to legislation shown in square brackets are for information only and do not form part of the answer expected from candidates.

Section A *Marks*

1 **B**

2 **D** Rs. 37,500 [950,000 – 650,000) x 12·5% [s.37A(3A)(b)]

3 **A** [Rs. 1 million in the hands of Zaheer] [s.39(3)]

4 **C** [183 days] [s.82(a)]

5 **B** Rs. 10,800 [(730,000) x 18% x 30/365] [s.205]

6 **A** [s.129 (1)(a)]

7 **A** [Being the higher of 5% of the tax payable or Rs. 10,000, whichever is higher]

8 **B** [s.206A(1)]

9 **D** Rs. 1,000 [50,000 x 2%] [s.127(4)(a)]

10 **D** [s.37A(5)]

11 **C** Rs. 91,250 [(((900,000) x 75% + 450,000) – (750,000)) x 15% + 35,000]

12 **B** Rs. 17,000 [(42,500 x 40%)]

13 **A** Rs. 4,800 [(24,000 x 20%)]

14 **C** [In case of a small company, the number of employees cannot exceed 250 during the relevant tax year] [s.2(59A)(ia)]

15 **D** Rs. 22,500 [81,000 + 9,000) x 25%]

2 marks each **30**

Section B *Marks*

1 (a) Bilal Chemicals (Pvt) Ltd ('BCL') – Collection and payment of tax on bonus shares

(i) Tax is to be collected at 5% of the value of the bonus shares prevailing on the first day of the book closure as below:

	Rs.	
Number of bonus shares to be issued to Ilyas (150,000 x 20%)	30,000	
Value of shares for computation of tax (30,000 x 20)	600,000	
Tax to be collected (600,000 x 5%)	30,000	2

(ii) The tax due from Ilyas on account of the issuance of the bonus shares has to be deposited by BCL with the Commissioner Inland Revenue within 15 days of the book closure. 1

(iii) If Ilyas neither makes payment of the tax to BCL nor collects his bonus shares within three months of the date of issuance of the bonus shares, BCL may proceed to dispose of the bonus shares of Ilyas to the extent BCL has paid tax on his behalf. 2

(b) China Agrochemicals Ltd ('CAL') – Permanent establishment

(i) CAL will not be treated as having a permanent establishment in Pakistan as the office's only function is as a liaison office. [s.2(41)(a)] 1

(ii) A liaison office is not considered to be a permanent establishment unless the liaison office engages itself in the negotiation of contracts except for contracts of purchase. As the liaison office of CAL besides its routine liaison functions engages only in the negotiation of contracts of purchase, CAL will still not be considered to have a permanent establishment in Pakistan. [s.2(41(a)] 2

(iii) If a person has an agricultural, pastoral or forestry property in Pakistan, they will be treated as having a permanent establishment in Pakistan. Although the purpose of ownership of the land in Pakistan by CAL is just for demonstrating the use of chemicals and not for earning any taxable income, it will still be treated as having a permanent establishment in Pakistan. [s.2(41)(ba)] 2

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2 (a) Jami – Taxation of a gratuity from his employer

(i) An amount received from a gratuity fund approved by the Commissioner Inland Revenue ('CIR') in accordance with the rules in Part III of the Sixth Schedule to the Income Tax Ordinance, 2001 is exempt from tax. Therefore, no tax will be payable by Jami. [Cl. (13)(ii) of Part I of the 2nd Sch.] 1

(ii) A gratuity received from an employer is treated as salary income for taxation purposes. A gratuity amount not exceeding Rs. 200,000 received from a gratuity fund approved by the Federal Board of Revenue ('FBR') is exempt from tax. [Cl. (13)(iii) of Part I of the 2nd Sch.]

In this case, Jami's tax liability will be:

	Rs.
Total amount received on account of gratuity	2,000,000
Amount exempt from tax	(200,000)
Taxable salary	1,800,000
Tax on taxable salary [Sr. No. 6 of Para (1A) of Div. I Part I of the First Sch.]	140,000

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(iii) Where the gratuity is received from an unapproved gratuity fund, 50% of the amount of the gratuity received or Rs. 75,000, whichever is the lower, is exempt from tax. Hence, the gratuity received by Jami will be exempt from tax to the extent of Rs. 75,000. [Cl. (13)(iv) of Part I of the 2nd Sch.]

Marks

In this case, Jami's tax liability will be:

	Rs.	
Total amount received on account of gratuity	2,000,000	
Amount exempt from tax	(75,000)	
Taxable salary	1,925,000	
Tax on taxable salary [140,000 + (1,925,000 – 1,800,000) x 17·5%]	161,875	
[Sr. No. 6 of Para (1A) of Div. I Part I of the First Sch.]		2

(b) Asif – Taxable income and tax liability for the tax year 2015

	Rs.	Rs.	
Taxable income other than perquisite on account of concessional loan		10,000,000	
Value of perquisite on account of concessional loan (working 1)		90,000	2·0
Taxable salary		10,090,000	
Tax on taxable salary (1,425,000 + (10,090,000 – 7,000,000) x 30%)		2,352,000	0·5
Less:			
Tax credit on account of profit on loan used for purchase of a house (working 2)	167,833		2·0
Tax credit of tax collected at the time of payment of college fee	50,000		0·5
		(217,833)	
Tax payable		2,134,167	
			5
			10

Workings:

1. Concessional loan

	Rs.	Rs.
Loan given by the employer	9,000,000	
Profit computable at the bench mark rate of 10% (10% x 9,000,000)		900,000
Profit charged by the employer at 9% (9% x 9,000,000)		(810,000)
Amount to be treated as perquisite [s.13(7)]		90,000

2. Tax credit on the profit paid on the debt

   The profit paid on a loan from a public listed company to the extent that it is used for the purchase of a house qualifies for tax credit. [s.64]

	Rs.
Loan obtained	9,000,000
Profit paid of 9% per annum on eligible amount of Rs. 8,000,000 used for the purchase of the house (8,000,000 x 9%)	720,000
Since the profit paid is less than both Rs. 750,000 and 50% of taxable income, a tax credit can be computed on this amount.	
Tax assessed before any tax credit (A)	2,352,000
Taxable income for the year (B)	10,090,000
Profit eligible for tax credit (C)	720,000
Tax credit (A/B) x C	167,833

Marks

3 (a) Capital assets on the disposal of which a gain is taxable but a loss is not recognised

The six categories of movable assets on the disposal of which any gain will be taxed but any loss will not be recognised as a capital loss are:

(i) a painting, sculpture, drawing or other work of art;
(ii) jewellery;
(iii) a rare manuscript, folio or book;
(iv) a postage stamp or first day cover;
(v) a coin or medallion; and
(vi) an antique

[s.37(5)(d) read with s.38(5)]

½ mark per item 3

(b) Ismat – Tax payable for the tax year 2015 (accounting year ended 30 June 2015)

	Note	Capital gain/(loss) Rs.	Tax Rs.	Marks
Income under the head 'Capital gains' assessable to tax under the normal law				
On sale of the gold bracelet	(1)	517,500		2·5
Less:				
Zakat paid [s.60]		(42,500)		1·0
Total taxable income under the head capital gains		475,000		
Tax on taxable income (475,000 – 400,000) x 10%			7,500	0·5
Capital gains and tax on the disposal of immovable properties taxable as a separate block				
On the sale of land in Lahore	(2)	8,000,000	400,000	1·0
Total tax payable			407,500	

Items not included in the computation of capital gain

1 Sale of treadmill

The treadmill, being a movable asset held by Ismat for her personal use, is not included in the definition of a capital asset. Hence the gain of Rs. 90,000 (290,000 – 200,000) is not taxable. [s.37(5)(d)] 1·0

2 Sale of participation term certificates

Participation term certificates are included in the definition of 'debt securities' which in turn is included in the definition of a 'security'. There is a loss of Rs. 100,000 (500,000 – 400,000) on the sale of these securities. Since there is no capital gain accruing on account of the disposal of a security, this loss cannot be set off against any other taxable income. 1·0

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Notes

Note 1

Sale of the gold bracelet

Jewellery held as a personal asset is also a capital asset for the purpose of taxation of capital gains arising from its disposal. The capital gain is computed as:

	Rs.	Rs.
Consideration received on the sale of the gold bracelet on 7 July 2014		1,700,000
Less:		
Cost of acquisition [market value at the time of the gift] [s.37(4A)(a)] 20 March 2006	900,000	
Capital expenditure incurred on modification of the design [s.76(2)(c)]	100,000	
Valuation fee paid in connection with the disposal of the asset [s.76(2)(b)]	10,000	
Charges paid for safe custody of the bracelet [Not allowed under s.76(2)]	0	
		(1,010,000)
Capital gain		690,000

Since the bracelet was sold after holding it for more than 12 months, only 75% of the gain is taxable at Rs. 517,500. [s.37(3)]

Marks

Note 2

Sale of land in Lahore

A gain on the disposal of an immovable property is chargeable to tax as a separate block of income, according to the rates prescribed for such capital gains in the First Schedule to the Income Tax Ordinance, 2001. The capital gain on the disposal of the land is computed as:

	Rs.
Consideration received	28,000,000
Less:	
Cost of acquisition being the market value when received on the dissolution of the firm [s.37(4A)(c)]	(20,000,000)
Capital gain	8,000,000
Tax at 5% as the holding period of the land was more than one year but less than two years (8,000,000 x 5%) [Div. VIII of Pt. I of 1st Sch.]	400,000

4 (a) Imran – Sales tax registration

(i) Imran can be de-registered if he is no longer required to remain registered under the Sales Tax Act, 1990, because he ceased to carry on a taxable activity. [s.21(1)]

The Federal Board of Revenue (FBR) or any officer, authorised by the FBR in this behalf, may de-register Imran. [s.21] 2

(ii) Imran's registration can be suspended when the Commissioner Inland Revenue has reason to believe that Imran has:

– issued fake invoices; or
– committed a tax fraud. [s.21(2)] 2

(iii) No sales tax refund or input tax credit will be given to any person on the basis of any invoice issued by Imran during the period of the suspension of his registration. [s.21(3)] 1

(b) Sales tax – Value of a supply

(i) Where the consideration for a supply is received partly in kind and partly in cash, the value of the supply for sales tax purposes would be taken as the open market price of the supply excluding the amount of sales tax. [Proviso (i) to s.2(46)(a)] 2

(ii) Where goods are supplied at a discounted price, the value of the supply would be the discounted price excluding the amount of sales tax, provided that:

– the discounted price and the related tax is shown on the tax invoice; and
– the trade discount allowed is in conformity with the normal business practices of the industry.

Where the above conditions are not fulfilled, the discount allowed cannot be reduced from the price of the supply. [s.2(46)(b)] 3

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5 Punjab Poultry Mills (Pvt) Ltd *Marks*

(a) Taxable income for the tax year 2015 (accounting year ended 30 June 2015)

	Note	Rs.	Rs.	
Income from business				
Profit before tax			3,000,000	0·5
Less:				
Profit from debt, not being income under the head 'Income from business'	(1)	900,000		0·5
Additional payment for delayed refund, not being income under the head 'Income from business'	(1)	700,000		0·5
Bad debts recovered during the year	(2)	600,000		1·0
			(2,200,000)	
Add:				
Accounting depreciation	(3)	5,500,000		0·5
Expenditure on treatment of peacocks	(4)	1,000,000		1·0
Trade creditors	(5)	500,000		1·0
			7,000,000	
Less admissible deductions:				
Initial allowance	(6)	750,000		1·0
Tax depreciation	(6)	5,999,500		3·0
			(6,749,500)	
Income from business			1,050,500	
Income from other sources				
Profit on debt	(1)	1,000,000		0·5
Additional payment for delayed refunds	(1)	700,000		0·5
			1,700,000	
Taxable income			2,750,500	

Items not included in the computation of taxable income

1 Cost of food grains – Rs. 250,000

The cost of food grains destroyed by pests is an allowable deduction as it is incidental to the business operations of the taxpayer. [s.20] 1·0

2 Legal fee to defend domain name – Rs. 50,000

The cost of defending the internet website domain name, an asset of the taxpayer, is an allowable expenditure. [s.20] 1·0

3 A company is required to account for income chargeable to tax under the head 'Income from business' on an accrual basis [s.32(2)] according to which expenditure is to be recognised when it becomes payable. [s.34(1)] Although the reward of Rs. 1,000,000 has not yet been paid to the salesman, it has become payable during the year ended 30 June 2015, and hence is allowable. There is no default of non-deduction of tax as the amount has not yet been paid. The expenditure is thus fully admissible. 1·0

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Notes

Note 1

Profit from debt is taxable under the head 'Income from other sources'. Since the declared amount is net of tax, the gross amount to be taxed is Rs. 1,000,000. [(900,000 + 100,000)] [ss.39 and 151]

Similarly, the additional payment for the delayed issuance of a refund by the Inland Revenue is also treated as income under the head 'Income from other sources'. [s.39(1)(cc)]

Note 2

Since the amount of the bad debt was not allowed as a deduction in the relevant tax year 2011, its recovery in the tax year 2015 is not taxable, otherwise it would result in double taxation which is not permissible under the law. [s.73]

Note 3

Accounting depreciation is not a deductible charge. Tax depreciation and initial allowance are deductible at the rates prescribed in the Third Schedule and subject to the conditions mentioned in the relevant provisions [ss.22 and 23] of the Ordinance.

Marks

Note 4

Expenditure on the treatment of peacocks was not incurred to earn income from business, hence it is not an admissible deduction. Further, the amount spent is not admissible for any tax credit as it was not a donation or payment to any approved institution.

Note 5

As the amount was allowed as a deduction in the tax year 2011 and it has not been paid until the tax year 2014, it must be added back in the income in the tax year 2015 (being the next year after three years in which it was allowed). [s.34(5)] However, if it is paid in future, it will be deductible in the year of payment.

Note 6

Tax depreciation and initial allowance

Asset	TWDV on 1 July 2014	Addition/ (deletion) during the year	Initial allowance at 25%	TWDV for depreciation	Rate of depreciation	Depreciation
(1)	(2)	(3)	(4)	5 = (2 + 3) – (4)	(6)	(7)
	Rs.	Rs.		Rs.		Rs.
Building on freehold land	25,000,000			25,000,000	10%	2,500,000
Plant and machinery	10,000,000	5,000,000	750,000 (see (a))	14,250,000	15%	2,137,500
Motor cars	5,000,000	2,500,000 (see (b))	–	7,500,000	15%	1,125,000
Furniture and fittings	1,580,000		–	1,580,000	15%	237,000
Total			750,000			5,999,500

[ss.22 and 23 read with 3rd Sch.]

Sub-notes to note 6

(a) Only plant and machinery of Rs 3,000,000 which has not previously been used in Pakistan [although used abroad] is eligible for initial allowance. [s.23]

(b) Rs. 300,000, being advance income tax does not form part of the cost of the asset. It is adjustable against the tax liability of the year. [refer to part (b) of the question]

(b) Tax payable/refundable for the tax year 2015

	Rs.	Rs.	Marks
Taxable income for the tax year 2015 (from (a))		2,750,500	
Tax at 33%		907,665	0·5
Less: Tax already paid			
On profit on debt [s.151]	100,000		0·5
With registration of motor car [s.231B]	300,000		0·5
With electricity bills [s.235]	500,000		0·5
		(900,000)	
Tax payable with return		7,665	
			2
			15

Marks

6 Muneer, Kabeer and Zaheer

(a) **MKZ – Taxable income and tax payable for the tax year 2015 (accounting year ended 30 June 2015)**

	Note	Rs.	Rs.	Marks
Net profit of the firm			495,000	0·5
Add:				
Commission paid to Muneer	(1)	100,000		0·5
Reward to Kabeer	(1)	100,000		0·5
Salary to Muneer	(1)	400,000		0·5
Profit paid to Zaheer	(1)	200,000		0·5
Excess depreciation claimed	(2)	7,500		1·5
Scholarship amount paid to Muneer's daughter	(1)	110,000		0·5
Expenditure incurred on feasibility report	(3)	25,000		1·0
			942,500	
Less:				
Initial allowance	(2)	25,000		1·0
			(25,000)	
Taxable income			1,412,500	
Tax liability of the firm (35,000 + 15% x (1,412,500 – 750,000)]			134,375	1·0
Less:				
Advance tax [u/s.147]			(100,000)	0·5
Tax payable with the return			34,375	

Items not included in the computation of taxable income

1 Reimbursement of expenses incurred for the business by Kabeer Rs. 60,000

Since the expenses were incurred by Kabeer on a car wholly and exclusively used for business, the expenses are admissible as a deduction. [s.20(1)] Further, the amount is not of the category which are inadmissible when paid to the partners of the firm. [s.21(j)] 1·0

2 Rent paid without tax deduction Rs. 400,000

An association of persons is required to deduct tax only when the amount of rent to be paid is Rs. 1,500,000 or above in a tax year. Hence MKZ was not required to deduct tax on the amount of rent paid by it and so the amount is fully admissible. [s.155(3)(vib)] 1·0

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Notes

Note 1

Amounts paid to partners of the firm Rs. 910,000

The amounts paid to partners in the form of profit on debt, commission, salary [including bonus, rewards] and other remuneration with any description and in any form are inadmissible. [s.21(j)] Payment of these amounts in accordance with the agreement of partnership deed or in line with a policy equally applicable to all employees (whether partner or not) is not a determining factor. Detail of the amounts being inadmissible on account of having been paid to the partners is as below:

Amounts paid to partners

	Muneer Rs.	Kabeer Rs.	Zaheer Rs.	Total Rs.
Commission	100,000			100,000
Performance-based reward		100,000		100,000
Salary	400,000			400,000
Profit on debt			200,000	200,000
Scholarship to Muneer's daughter	110,000			110,000
Total	610,000	100,000	200,000	910,000

Marks

Note 2

Tax depreciation and initial allowance on a new computer costing Rs. 100,000

(i) A new computer was used for the purposes of business which is eligible for initial allowance at 25% of the cost of the computer. Hence, initial allowance is admissible at Rs. 25,000 (100,000 x 25%). [s.23]

(ii) Allowable depreciation, against claimed Rs. 30,000, on the computer is computed as:

	Rs.
Cost of new computer	100,000
Initial allowance	(25,000)
Tax written down value for depreciation	75,000
Allowable depreciation at 30% (75,000 x 30%)	22,500
Excess depreciation claimed on the computer (30,000 – 22,500)	7,500

Note 3

Any expenditure incurred on the restructuring of a business is not for the purpose of earning business income and is not admissible. Hence, the amount of Rs. 25,000 incurred on the feasibility report to convert MKZ into a company is not admissible.

(b) Taxable income and tax payable of each partner

Allocation of profit among the partners

	Rs.	Marks
Total income of the firm	1,412,500	
Less:		
Salary, commission, performance bonus, profit, etc paid to the partners (from (a))	(910,000)	0·5
Divisible income	502,500	

Share income of partners

	Muneer Rs.	Kabeer Rs.	Zaheer Rs.	Total Rs.	Marks
Income from AOP [note 1 of part (a)]	610,000	100,000	200,000	910,000	1·0
Divisible income in the ratio of 2:2:1	201,000	201,000	100,500	502,500	1·0
	811,000	301,000	300,500	1,412,500	

Assessment of partners

	Muneer Rs.	Kabeer Rs.	Zaheer Rs.	Marks
Share from AOP as above	811,000	301,000	300,500	
Other business income (A)	600,000	700,000	0	0·5
Total income for rate purposes (B)	1,411,000	1,001,000	300,500	
Tax on B above as per para (1) of Div.I of Part I of the First schedule (C) [Working]	134,150	72,650	0	1·0
Tax payable by each member on income (other than share from AOP) A above (C/B x A)	57,045	50,804	0	1·0
				5
				15

Working:

Tax on Muneer's income	[35,000 + (1,411,000 – 750,000) x 15%]	134,150
Tax on Kabeer's income	[35,000 + (1,001,000 – 750,000) x 15%]	72,650

No tax is payable on Zaheer's income being below the taxable limit.