
Answers

Notes:

- The suggested answers provide detailed guidance on the subject for use as a study aid to the question paper. Candidates were not expected to produce answers with this extensive detail, which would not be possible in a three hour exam.
- All references to legislation shown in square brackets are for information only and do not form part of the answer expected from candidates.

1 Sahiwal Engineering Limited **Marks**

- (a) Since Sahiwal Engineering Ltd (SEL) is a company incorporated in Pakistan under the Companies Ordinance, 1984, it shall be treated as a resident taxpayer in Pakistan. For a company incorporated under the Companies Ordinance, 1984, the other test that the place of control and management of the company should be wholly situated in Pakistan at any time in a tax year needs not to be satisfied to qualify as a resident company.

2-0

(b) Taxable income for the tax year 2013 (accounting year ended 30 June 2013)

	Note	Rs.	Rs.	
Income from business				
Net profit as per income statement			10,550,000	0-5
Add:				
Sales under recorded due to an accounting error	(1)	35,000		1-0
Cess paid to the local government	(2)	50,000		0-5
Accounting depreciation	(3)	1,000,000		0-5
Contribution to an unapproved superannuation fund	(4)	300,000		0-5
Acquisition of manufacturing rights	(5)	1,600,000		0-5
Charitable donation made in kind	(6)	1,000,000		1-0
Salaries paid in cash	(7)	800,000		1-0
Provision for bad debts	(8)	1,500,000		0-5
Other expenditure	(9)	8,000,000		1-5
Rent payable since the tax year 2009	(10)	400,000		1-0
Purchase of furniture	(11)	750,000		0-5
			15,435,000	
Less:				
Amortisation of acquisition of manufacturing rights	(5)	40,000		1-5
Trade debts written off	(12)	800,000		1-0
Recoveries against bad debts written off in prior years	(13)	750,000		1-0
Additional payment for delayed tax refunds	(14)	1,300,000		0-5
Tax loss on sale of machinery	(11)	200,000		1-0
Initial allowance	(11)	1,750,000		1-0
Tax depreciation	(11)	2,662,500		3-0
			(7,502,500)	
Income from business			18,482,500	
Income from other sources	(14)		1,300,000	1-0
Total/taxable income			<u>19,782,500</u>	

Items not included in the computation of taxable income

- (i) Write off of obsolete stock – Rs. 500,000
- Writing off of obsolete stock is incidental to the carrying out of the business and allowable as a deduction. [s.20 and general principles of taxation] 1-0
- (ii) Compulsory annual fee to the Engineering Development Board – Rs. 200,000
- Any expenditure, in aggregate, under a single accounting heading in excess of Rs. 50,000 other than by crossed bank cheque or crossed bank draft or any other banking instrument is not deductible with certain exceptions. One of the exceptions is any fee expenditure. Hence, the Rs. 200,000 paid, in cash, to the Engineering Development Board established by the Federal Government is deductible and no adjustment is required. [2nd proviso to s.21(I)] 1-0

(iii) Expenditure on the annual get-together function for the employees – Rs. 600,000	
In order to promote harmony and cohesiveness among the employees, businesses arrange such functions in which employees and their families gather together and get to know each other better. Any expenditure incurred on such functions is allowable expenditure on the ground of commercial expediency, being expenditure incurred wholly and exclusively for the purposes of business. [s.20(1)]	1·0
(iv) Profit on debt paid to a subsidiary company of SEL – Rs. 700,000	
The withholding tax provisions do not apply in respect of inter-company profit on debt within a group of companies which are entitled to group taxation. Therefore, SEL was not required to deduct tax. So, no adjustment is required. [Cl.(11C) of Pt IV of 2nd Sch]	1·0
(v) Loan to associate written off – Rs. 300,000	
A loan to an associate written off against the bad debt provision is not deductible since it is not the business of SEL to lend money and it does not fulfil the condition that the debt should have previously been included in the person's income from business chargeable to tax. Since it has not been claimed as a deduction, no adjustment is required. [s.29(1)(a)]	1·0
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Notes:**Note 1**

The amount of any tax from any payment received is treated as income derived by the person to whom such payment is made. Therefore, the amount of tax deducted at source from the sale proceeds was part of the sale proceeds and taxable. The amount of tax deducted at Rs. 35,000 (1,000,000 x 3·5%) is, therefore, added to the income and allowed as advance tax paid when computing the tax payable by SEL. [ss.21(b) & 168(1)(a)]

Note 2

Any cess which is levied on the profits or gains of the business is assessed as a percentage or otherwise on the basis that such profits or gains are inadmissible against 'Income from Business'. [s.21(a)]

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 & 23] of the Ordinance.

Note 4

Any contribution to a superannuation fund which is not approved is not admissible for deduction. [s.21(e)]

Note 5

Acquisition of the contractual right to manufacture 'water-kits' for cars in Pakistan is an intangible for income tax purposes. The total amount cannot be deducted in one year. It has to be amortised over its useful life (in years) and allowed on the basis of the number of days it is used in a year as below:

Total amount paid for the intangible	Rs. 1,600,000
Useful life of the intangible	8 years
Per year deduction (1,600,000/8)	Rs. 200,000
Proportionate allowable deduction for 73 days during the tax year 2013 (73/365 x 200,000)	Rs. 40,000
[ss.24(4), (6) and (11)]	

Note 6

A donation in kind to a relief fund run by the Government of Sindh is not for the purpose of business, hence not allowable as expenditure. However, it is eligible for tax credit under the law. [s.20(1)]

Note 7

If the salary of an employee exceeds Rs. 15,000 per month, it should be paid through a crossed cheque or by direct transfer of funds to the employee's bank account, otherwise such an expense becomes inadmissible. Since the salaries of the temporary workers were paid in cash, the whole amount of Rs. 800,000 is inadmissible despite the fact that tax was deducted from such salaries. [s.21(m)]

Note 8

Since the provision made for bad debts is a general provision and there are no reasonable grounds to believe that the debts have become irrecoverable, the provision of Rs. 1,500,000 is inadmissible. [s.29(1)(c)]

Note 9

Other expenditure

- (1) Accounting loss on sale of machinery Rs. 500,000

An accounting loss or profit resulting from the disposal of an asset is tax neutral. Therefore, to nullify its effect, the amount of the accounting loss is added back in the total income. A loss is only allowable where the consideration received on the disposal of a fixed asset is less than the tax written down of the asset. [s.22(8)(b)]

- (2) Provision for taxation Rs. 5,500,000

Provision for taxation is in the nature of an appropriation of profit and not expenditure to earn business income. Hence, it is not allowable under the law. [s.21(a)]

- (3) Provision for anticipated losses Rs. 2,000,000

Tax law allows only losses which are revenue in nature and which have occurred during the relevant tax year. Anticipated losses are not allowable. [s.34(1)]

Note 10

Where a taxpayer is allowed a deduction for any expenditure in deriving income under the head 'Income from Business' and the person has not paid the liability to which the deduction relates within three years of the end of the tax year in which the deduction was allowed, the unpaid amount of the liability is chargeable to tax in the first year following the end of the three years.

Since the liability on account of rent payable was allowed in the tax year 2009 and it has not been paid by the end of the tax year 2012, it is added back in the tax year 2013. [s.34(5)]

Note 11

Fixed assets

- (1) Initial allowance and tax depreciation:

Asset	TWDV on 1 July 2012	Addition/ (deletion) during the year	Initial allowance at 25% of addition of eligible buildings (4) = (3) x 25%	TWDV for depreciation (5) = (2 + 3) – (4)	Rate of depreciation (6)	Depreciation (7)
(1)	(2)	(3)	(4) = (3) x 25%	(5) = (2 + 3) – (4)	(6)	(7)
	Rs.	Rs.		Rs.		Rs.
Land	15,000,000	3,000,000 (see (a))	–	–	–	–
Office and factory buildings	9,000,000	–	–	9,000,000	10%	900,000
Residential quarters	–	7,000,000 (see (a))	1,750,000 (see (b))	5,250,000	10%	525,000
Plant and machinery	4,000,000	(500,000)	–	3,500,000	15%	525,000
Motor vehicles	1,500,000	2,500,000 (see (c))	–	4,000,000	15%	600,000
Furniture	–	750,000 (see (d))	–	750,000	15%	112,500
Total			<u>1,750,000</u>			<u>2,662,500</u>

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

Sub-notes to Note 11 (1)

- (a) Land is not eligible for depreciation. The cost of construction of the residential quarters is, therefore, reduced by Rs. 3,000,000, being the price of land. [s.22(15)]
- (b) Only the cost representing the construction of the residential quarters is eligible for initial allowance and depreciation. The rate of initial allowance in the tax year 2013 is 25% [previously it was 50%]. Depreciation is charged on the cost of construction of the residential quarters after the initial allowance has been deducted. Use of the eligible asset for even one day is sufficient for a valid claim of depreciation and initial allowance.

- (c) For the tax year 2013 and onwards, a car having a cost of Rs. 2,500,000 is eligible for depreciation on its full cost [the previous maximum cost was Rs. 1,500,000]. Further, a car is not eligible for initial allowance. [ss.22(13)(a) and 23(5)]

The cost incurred to enhance the security and safety features of the car is capitalised and eligible for depreciation.

- (d) Furniture is eligible for tax depreciation but not for an initial allowance. [ss.22 & 23(5)(b)]
- (2) Debiting of the cost of the furniture purchased during the year to the income statement is not allowable, hence Rs. 750,000 must be added back in the total income, being capital expenditure. [s.21(n)]
- (3) The loss on the sale of machinery of Rs. 200,000 (representing excess TWDV of Rs. 500,000 over the sale proceeds of Rs. 300,000) is an admissible deduction. [s.22(8)]

Note 12

Trade debts written off – Rs. 800,000

Since trade debts are irrecoverable and have actually been written off (and not merely provided for) in the books of accounts, the amount is allowable as a deduction. [ss.29(1) & (2)]

Note 13

Recoveries against bad debts – Rs. 750,000

Since the amount recovered belongs to the bad debt of prior years, its recovery in the current tax year would only be taxable if it had previously been allowed as a deduction. Since the amount was not allowed as a deduction in previous years, taxable income is reduced by the same amount to avoid double taxation. [s.29(3) & s.73]

Note 14

Additional payment for delayed refund – Rs. 1,300,000

Under the law, if an excess amount of tax paid by a taxpayer is not refunded by the tax department within the prescribed time limit, the taxpayer is entitled to an additional amount from the tax department. Taxability of such additional amount was disputable. Through an amendment in the Finance Act, 2012, it has been made taxable under the head 'Income from Other Sources'. Therefore, it is deducted from the head 'Income from Business' and taxed under the head 'Income from Other Sources'.

(c) Tax liability for the tax year 2013

	Rs.	Rs.	
Taxable income for the tax year 2013 (from (b))		19,782,500	
Tax at 35%		6,923,875	0.5
Tax credit admissible on the donation in kind to the relief fund run by the Government of Sindh.			
The value of the donation in kind (Rs. 1,000,000) is 5.05% of the taxable income which is within the allowable upper limit of 20% of taxable income. Hence a tax credit is allowable on this amount as below:			
<u>Tax assessed</u>	x Value of donation in kind		
Taxable income			
6,923,875	x 1,000,000	[ss.61(1) & (2)]	
19,782,500		(350,000)	1.5
		6,573,875	
Less tax already paid			
Tax deducted from payment on account of sales to a public company	35,000		0.5
[ss.153(3) & 168]			
Tax paid at the time of registration of car [ss.168 & 231B]	50,000		0.5
Tax collected along with electricity bills [ss.168 & 235]	900,000		0.5
Advance tax paid in four instalments [s.147]	5,000,000		0.5
		(5,985,000)	
Tax payable with return [s.137]		588,875	
			4.0
			30

2 Mr Rizwan

Taxable income and tax payable for the tax year 2013 (accounting year ended 30 June 2013)

		Rs.	
Income from salary			
Basic salary	[s.12(2)(a)]	1,200,000	0.5
Technical allowance (Rs. 1,200,000 x 5%)	[s.12(2)(c)]	60,000	1.0
Payment in lieu of recreational leave	[s.12(2)(a)]	50,000	1.0
Utilities allowance (Rs. 1,200,000 x 6%)	[s.12(2)(c)]	72,000	1.0
Payment for honouring restrictive covenant	[s.12(2)(e)(v)]	100,000	2.0
Perquisite representing accommodation	(working 1)	720,000	2.0
Perquisite representing car	(working 2)	27,178	2.0
Benefit on purchase of car	(working 3)	100,000	1.0
Waiver of outstanding loan of Rs. 50,000	[s.13(9)]	50,000	0.5
Services of domestic servant to Rizwan	(working 4)	84,000	1.0
Income under the head 'salary'		2,463,178	
Income from business			
Share of profit from AOP 'Agrofriends'	(working 5)	0	2.5
Income from property [taxable under fixed tax regime]	(working 6)	796,500	2.0
Total taxable income		3,259,678	

Tax payable on taxable income

		Rs.	Rs.	
Tax on income from property	(working 6)	42,238		0.5
Tax on taxable income other than income from property	(working 7)	428,053		2.5
Total tax payable			470,291	
Less tax deducted at source by the employer	[s.149]		(125,000)	0.5
Tax payable with return	[s.137]		345,291	

Explanation of items not included in the computation of taxable income

- (i) Car provided for business use
A car was provided to Rizwan for business use. No personal benefit is derived by him, hence, no amount is taxable as a perquisite. [ss.12 & 13] 1.0
- (ii) Concessional loan – Rs. 400,000
Any loan advanced at a profit rate which is less than the benchmark rate constitutes a perquisite. However, by virtue of an amendment in the Finance Act, 2012, no amount on account of the concessional rate of profit is taxable if the loan amount does not exceed Rs. 500,000. [2nd proviso to s.13(7)] 1.0
- (iii) Benefit of shares allotted to Rizwan under an employee share scheme
Although the shares of the company were allotted to him at a price lower than the breakup value (which is assumed to be the fair market value in the absence of any other information about their valuation), there was a restriction on the sale or transfer of the shares. Where the issuance of shares is subject to a restriction on the transfer of the allotted shares, no amount is chargeable to tax to the employee until the earlier of:
(a) the time the restriction is removed; or
(b) the time the employee actually disposes of the shares.
Neither of these events occurred before 30 June 2013. Hence, no amount is taxable as salary of Rizwan for the tax year 2013. [s.14(3)] 1.0
- (iv) Expenditure on self-education
No deduction is allowable for any expenditure incurred by an employee in deriving his salary income. [s.12(4)] 1.0
- (v) Share from association of persons (AOP), Agrofriends
As an AOP is taxed separately from its members, where the AOP has paid the tax, the share of profit received by a member of the AOP out of the income of the AOP is exempt from tax. However, it shall be added for the determination of the tax rate applicable to his other income (working 7). [s.92(1)] 1.0

Workings:**Working 1**

Accommodation provided to Rizwan's family is a perquisite of Rizwan provided by his employer and is taxable. The value of this perquisite is equal to the amount that would have been paid by the employer if such accommodation were not provided, subject to a minimum value being equal to 45% of the basic salary. Since Rizwan was entitled to a 60% house rent allowance, had he not been provided with the accommodation, the same amount is taken as the value of the perquisite as computed below:

	Rs.
Basic salary	1,200,000
Value of the perquisite (1,200,000 x 60%)	720,000

The fair rent of the accommodation at Rs. 50,000 per month is not relevant for the purposes of computing the value of the perquisite representing accommodation. [s.13(12) read with rule 4 of the income tax rules, 2002]

Working 2

The car was provided for Rizwan's exclusive personal use on 1 January 2013 by leasing it on the same day. According to the tax law, 10% of the fair market value (FMV) of the car on 1 January 2013 shall be treated as a perquisite received by him. The lease rentals to be paid by the company are not taken into consideration when computing the value of the perquisite. Since the car was provided for half of the year, the value of the perquisite is worked out proportionately. Further, the amount paid by the employee is also to be deducted. Therefore, the perquisite shall be computed as below:

	Rs.
FMV of the car	2,000,000
10% of the FMV (2,000,000 x 10%)	200,000
Restricted to the number of days (181) it was used during the tax year 2013 (200,000 x 181/365)	99,178
Less amount paid by Rizwan	(72,000)
Amount to be treated as salary	<u>27,178</u>

[ss.13(3) & (6) read with rule 5 of the income tax rules, 2002]

Working 3

	Rs.
Fair market value of the car on 25 June 2013	500,000
Less:	
Amount paid by Rizwan	(400,000)
Perquisite on account of acquisition of car	<u>100,000</u>

[s.13(11)]

Working 4

Since the services of a domestic servant were provided to Rizwan by the employer, the amount Rizwan will be chargeable to tax will include the total amount paid to the domestic servant as computed below:

	Rs.
Monthly salary of domestic servant	7,000
Annual salary (7,000 x 12)	84,000

[s.13(5)]

Working 5

Share from 'Agrofriends'

Agrofriends is an AOP of which Rizwan has a 40% share in the profits.

	Rs.
Taxable income before adjustment on account of capital allowances on computers	1,600,000
Initial allowance on computers (Rs. 200,000 x 50%) [s.23]	(100,000)
Tax depreciation on computers (Rs. 200,000 – 100,000) x 30% [s.22]	(30,000)
Taxable income of the AOP	<u>1,470,000</u>
Rizwan's share (1,470,000 x 40%)	588,000

Working 6

Income from property

The property is jointly owned with his brother and each has a specific share; therefore, the share in property income is to be assessed in the hands of individual partners and not as an association of persons. [s.66]

Since the rent is received in foreign currency, it must be converted into Pakistan rupees at the State Bank of Pakistan rate prevailing on the day the amount was received, i.e. on 1 July 2012 as below:

Total annual rent of the property in US\$ (1,500 x 12) US\$ 18,000

	Rs.
Total rent in Pakistan Rupees (18,000 x 88.5) [s.71]	1,593,000
Rizwan's 50% share	796,500
Tax payable on Rs. 796,500	
[Rs. 12,500 plus 7.5% of the gross amount exceeding Rs. 400,000]	
(12,500 + 7.5% x (796,500 – 400,000))	42,238
[s.15 read with Div VI of Pt I of the 1st Sch]	

Working 7

	Rs.
Taxable income including 'Income from property'	3,259,678
Less 'Income from property' to be taxed separately [working 6]	(796,500)
	2,463,178
Add share from the Agrofriends for rate purposes [working 5]	588,000
Taxable income plus share from Agrofriends	3,051,178

Rs. 588,000 being the share of profit [working 5] received by Rizwan from the AOP 'Agrofriends' is exempt from tax. [s.92(1)] However, for the purpose of determining the rate of tax applicable to the other taxable income (Rs. 2,463,178), Rs. 588,000 is included in Rizwan's income as if it were chargeable to tax. [s.88] The computation is as below:

	Rs.	Rs.
Tax payable on taxable income including share from AOP		
[Rs. 420,000 plus 20% of the amount exceeding Rs. 2,500,000]		
(420,000 + 20% x (3,051,178 – 2,500,000))	(A) 530,236	
Taxable income if the share of profits from the AOP were chargeable to tax	(B) 3,051,178	
Actual taxable income	(C) 2,463,178	
Tax on taxable income		
A/B x C		
(530,236/3,051,178 x 2,463,178)		428,053

3 (a) Immunity from enquiries into the nature and sources of amounts invested in shares

No enquiries as to the nature and sources of an amount invested in the shares of a public company traded at a registered stock exchange in Pakistan shall be made provided that the following conditions are fulfilled:

- (1) the investment is made any time between 24 April 2012 and 30 June 2014;
- (2) the amount remains invested for a minimum period of 120 days in the prescribed manner;
- (3) tax on the capital gains, if any, is discharged in accordance with the rules provided in the Eighth Schedule to the Income Tax Ordinance, 2001; and
- (4) a statement of investments is filed with the Commissioner Inland Revenue along with the return of income and wealth statement for the relevant tax year within the due date as provided in the law. [s.118]

[Rule 2(2) of the 8th Schedule]

4.0

(b) Mr Bilal

Tax payable for the tax year 2013 (accounting year ended 30 June 2013)

Transaction	Note	Capital gain/(loss) Rs.	Tax Rs.	
Capital gains/(losses) and tax on the disposal of immovable properties taxable as a separate block				
On the sale of agricultural land	(1)	2,020,000	202,000	3.0
On the exchange of the plot in Lahore	(2)	1,500,000	75,000	1.5
On the sale of the flat in Karachi	(3)	0	0	1.0
Capital gains on securities taxable as a separate block				
On the sale of call options	(4)	50,000	5,000	2.0
On the sale of shares in Turbo Motors Ltd	(5)	248,940	19,915	3.0
Income under the head 'Capital gains' assessable to tax along with other heads of income				
On the sale of shares in Farid Sugar Mills	(6)	1,125,000		1.5
Less:				
Capital loss brought forward	(7)	(440,500)		1.0
Total taxable income		684,500		
Tax at 10% of the amount exceeding Rs. 400,000 (684,500 – 400,000) x 10% [Para (1) of Div I, Pt I of the 1st Sch]				
			28,450	0.5
Tax payable under the final tax regime (FTR)				
		Rs.	Rs.	
Dividend income	(6)	1,500,000		1.0
Tax on dividend income at 10% (1,500,000 x 10%)	(6)		150,000	0.5
Total tax			480,365	
Less: tax already paid				
– on the sale proceeds of agricultural land at 0.5% of total proceeds Rs. 9,000,000 (9,000,000 x 0.5%) [s.236C]		45,000		0.5
– on cash withdrawals from bank [s.231A]		12,000		0.5
			(57,000)	
Tax payable with return			423,365	
				16
				20

Notes:

Note 1

Sale of agricultural land

Through an amendment in the Finance Act, 2012, a gain on the disposal of immovable properties held not beyond two years has been made chargeable to tax 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 agricultural land is computed as below:

	Rs.	Rs.
Consideration received		9,000,000
Less:		
Purchase price [s.76(2)(a)]	6,500,000	
Transfer fees [s.76(2)(b)]	160,000	
Expenditure on the valuation of the property [s.76(2)(b)]	40,000	
Brokerage to real estate agent [s.76(2)(b)]	80,000	
Expenditure to improve the fertility of the land [s.76(2)(c)]	200,000	
		(6,980,000)
Capital gain		2,020,000
Tax at 10% as the holding period of the land was less than one year (2,020,000 x 10%) [Div VIII of Pt I of 1st Sch]		
		202,000

Note 2

Exchange of a plot of land in Lahore with a plot in Okara

The exchange of an asset is also treated as a disposal of the asset for tax purposes. [s.75(1)(a)]

The fair market value of the plot that was obtained in exchange with Mr Asad is less than the fair market value of the plot Bilal gave to him. Tax law in such situations prescribes that the fair market value of the asset disposed of shall be taken as the consideration received. [s.77(1)] Consequently, the capital gain/(loss) is worked out by taking the consideration received at Rs. 7,500,000. Other factors given in the question, such as the expected future increase in the value of the plot received in exchange, are not relevant for the computation of the capital gain.

	Rs.
Deemed consideration on the disposal on 15 July 2012	7,500,000
Less:	
Cost of the plot on 15 February 2011	(6,000,000)
Capital gain	<u>1,500,000</u>
Tax at 5% as the holding period of the land was more than one year and less than two years (1,500,000 x 5%) [Div VIII of Pt I of 1st Sch]	<u>75,000</u>

Note 3

Sale of flat in Karachi

	Rs.
Consideration received for the sale on 10 August 2012	5,000,000
Less cost incurred at the time of purchase on 1 January 1995	(4,000,000)
	<u>1,000,000</u>

Since the disposal was made after holding the flat for more than two years, no gain is taxable under the law. [s.37(1A)]

Note 4

Sale of call options

Gain on the sale of securities is taxed as a separate block of income. The definition of a 'security' includes derivative products, e.g. call options. [s.37A(3)] The capital gain on the sale of the call options is, therefore, treated as a gain on securities and tax thereon is computed as below:

	Rs.	Rs.
Consideration received on the sale of 100,000 call options at Rs. 2.5 per call option on 25 June 2013 (100,000 x 2.5)		250,000
Less:		
Cost incurred on 20 June 2013 at Rs. 1.9 per call option (100,000 x 1.9)	190,000	
Other admissible expenditure	<u>10,000</u>	
		(200,000)
Capital gain		<u>50,000</u>
Tax on the capital gain of Rs. 50,000 at 10% as the holding period is less than six months (50,000 x 10%) [Div VII of Pt I of 1st Sch]		<u>5,000</u>

Note 5

Sale of shares in Turbo Motors Ltd

Since 50% of the shares in Turbo Motors Limited are held by the Government of Balochistan, the company is treated as a public company for the purposes of the computation of any capital gain/(loss) despite the fact that it is not a listed company. Shares of a public company are included in the definition of a 'security'. The capital gain/(loss) is computed as below:

	Rs.	Rs.
Consideration received on the sale of 5,000 shares at Rs. 170 per share (5,000 x 170)		850,000
Less:		
Purchase price at Rs. 120 per share (5,000 x 120)	600,000	
Capital value tax paid (5,000 x 120 x 0.01%)	60	
Commission on purchase of the shares (5,000 x 0.1)	500	
Commission on sale of the shares (5,000 x 0.1)	500	
		<u>(601,060)</u>
		<u>248,940</u>
Tax at 8% of the capital gain as the holding period is more than six months but less than 12 months (248,940 x 8%) [Div VII of Pt I of 1st Sch]		<u>19,915</u>

Note 6

Sale of FSM shares

A dividend *in specie* derived in the form of shares of a company registered under the Companies Ordinance, 1984, is taxed at the time of disposal of such shares and not at the time of their receipt. In this instance, although 150,000 shares were received as a dividend *in specie* in the tax year 2011, the dividend was not taxable in that year, but in the tax year 2013, when the shares were disposed of. Therefore, the fair market value of these shares on the date of acquisition, i.e. Rs. 10 per share, will be taxed as dividend income in the tax year 2013.

The amount of dividend taxed is treated as the cost of these shares and taken into account for the purpose of the calculation of the capital gain:

Dividend income

	Rs.
Dividend in the form of 150,000 shares in Farid Sugar Mills (Pvt) Ltd at Rs. 10 per share taxed in the tax year 2013	<u>1,500,000</u>

Capital gain

	Rs.
Consideration received on 1 January 2013	3,000,000
Cost of the dividend <i>in specie</i>	<u>(1,500,000)</u>
Capital gain	1,500,000
Since the shares were held by Bilal for more than one year, only 75% of the capital gain is taxable (1,500,000 x 75%) [s.37(3)]	<u>1,125,000</u>

Note 7

Capital loss

Bilal had a brought forward loss of Rs. 440,500 relating to the tax year 2010 arising from a disposal of shares in a private company. Bilal is entitled to carry forward this loss for a period of six years following the year in which it arose and set it off against capital gains (which are not taxable as a separate block). Since there were no capital gains in the tax years 2011 and 2012, it has rightly been brought forward for offset against the capital gains accruing to Bilal on the disposal of capital assets (other than immovable properties and securities). [s.59]

4 (a) Direct and indirect taxes

Taxes are broadly categorised into direct and indirect taxes. Indirect taxes are also called 'consumption taxes'. A direct tax is one which is demanded from the very person who it is intended or desired should pay it, whereas an indirect tax is one which is demanded from one person in the expectation and with the intention that they shall pass on the burden of the tax to another person, ultimately to the end consumer of the goods or services. In other words, in the case of indirect taxes, the immediate payer of the tax only acts as an intermediary or a tax collecting agent.

Examples of direct taxes include: income tax, wealth tax and property tax.

Examples of indirect taxes include: sales tax, federal excise, customs duty and provincial sales tax.

4.0

(b) Mr Naveed**(i) Penalty payable for non-maintenance of records**

Where a person does not maintain records as required under the Income Tax Ordinance, 2001 or the rules made thereunder, a penalty of Rs. 10,000 or 5% of the amount of tax payable on taxable income, whichever is higher, can be levied by the Commissioner.

On the basis of income tax liability determined by the Commissioner, Mr Naveed is liable to pay the penalty below:

	Rs.
Tax due	300,000
5% of tax	15,000

Since the amount calculated at 5% of the tax is higher than Rs. 10,000, Mr Naveed shall be liable to pay a penalty of Rs. 15,000 for the non-maintenance of records as required under the Income Tax Ordinance, 2001. [Sr. No. 7 of table under s.182]

2.0

(ii) Period of maintenance of records

Records are required to be maintained for six years after the end of the tax year to which they relate.

However, where any proceedings are pending before any authority or court, the taxpayer is required to keep the records until the final decision of the proceedings. [s.174(3)]

2.0

4.0

(c) Exemption from penalty and default surcharge by the Federal Board of Revenue (FBR)

The FBR is empowered to exempt any person or class of persons from payment of the whole or part of any penalty or default surcharge payable under the Income Tax Ordinance, 2001 in the following manner:

- (1) The exemption may be published as a notification or as an order in the official Gazette of Pakistan.
- (2) The reasons for the exemption shall be given in the notification or the order so published.
- (3) The conditions or limitations, if any, applicable to such exemption from payment of the penalty or default surcharge shall also be given in the notification or the order. [s.183]

3.0

(d) Ms Kausar

Ms Kausar can revise her return, on her own, without waiting for any notice from the Commissioner for this omission. The points raised in the question are answered as follows:

- (i) The revised return shall be accompanied by the revised accounts or the revised audited accounts, as the case may be. [s.114(6)(a)]
- (ii) Ms Kausar will have to give the reasons for the revision of the return, in writing, duly signed by her. [s.114(6)(b)]
- (iii) Ms Kausar will be liable to pay a default surcharge on the amount of tax evaded by the omission of the amount for the period starting from the date it was due (30 September 2011) to the date it is actually paid.

However, she will not be liable to pay any penalty as she is revising the return without receiving any notice of audit or amendment of the assessment from the Commissioner Inland Revenue. [s.114(6A)]

- (iv) Ms Kausar can revise her return to declare the correct amount of income without seeking any permission from the Commissioner Inland Revenue. [s.114(6)]

4.0

15

5 (a) Mr Usman

Sales tax payable/(refundable) for March 2013

	Rs.	
Output tax		
Sale of taxable goods to the registered and unregistered persons (Rs. 80,000,000 + Rs. 16,000,000) x 16%	15,360,000	0·5
Sale of goods against international tender Rs. 10,000,000 [exempt]	0	0·5
Sale of exempt goods to a local charity Rs. 10,000,000	0	0·5
Export of goods to Turkey (Rs. 5,000,000 x 0%)	0	0·5
	<u>15,360,000</u>	
Input tax		
Purchase of raw materials for the manufacture of both taxable and exempt supplies (working)	7,944,143	3·0
Input tax relating to the machinery (10,000,000 x 16/116) (also see explanation)	1,379,310	0·5
	<u>9,323,453</u>	
Sales tax payable/(refundable)		
Output tax	15,360,000	
Input tax	(9,323,453)	
Payable	<u>6,036,547</u>	0·5

Working:

	Rs.
Input tax on the purchase of raw materials from registered persons for manufacturing both taxable supplies and exempt supplies (Rs. 70,000,000 x 16/116)	9,655,172
Input tax on the purchase of raw materials from unregistered persons	0
	<u>9,655,172</u>
Less input tax on purchases returned (Rs. 1,000,000 x 16/116)	(137,931)
	<u>9,517,241</u>

Apportionment of Rs. 9,517,241 to taxable supplies

	Rs.	Rs.
Value of taxable supplies		
– sales to registered persons	80,000,000	
– sales to unregistered persons	16,000,000	
– exports to Turkey	<u>5,000,000</u>	
	(A)	101,000,000
– Value of taxable supplies + exempt supplies (Rs. 101,000,000 + Rs. 20,000,000)	(B)	121,000,000
– Input tax to be apportioned	(C)	9,517,241
A/B x C		
101,000,000/121,000,000 x 9,517,241		<u>7,944,143</u>

Explanation:

With effect from 1 July 2011, input tax paid on fixed assets is allowable fully in the tax period the input tax is paid. Further, the restriction on the adjustment of input tax in excess of 90% of the output tax does not apply in the case of fixed assets or capital assets. [Proviso to s.8B]

1·0

7·0**(b) Time of supply**

The Sales Tax Act, 1990 defines 'time of supply' as below:

(i) For goods supplied under a hire purchase agreement

The time at which the agreement for the supply of goods under hire purchase is entered into is treated as the time of supply for such goods.

1·0

	<i>Marks</i>
(ii) For goods supplied otherwise than under a hire purchase agreement	
The time of supply is the time at which the goods are delivered or made available to the buyer.	1·0
(iii) For the rendering of services	
The time of supply in relation to services is the time at which the services are rendered or provided to the person obtaining such services. [s.2(44)]	1·0
	3·0
	10