Fundamentals Level – Skills Module

Taxation (Pakistan)

Tuesday 3 December 2013

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 2013 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
0 to Rs. 400,000	0%
Rs. 400,001 to Rs. 750,000	5% of the amount exceeding Rs. 400,000
Rs. 750,001 to Rs. 1,500,000	Rs. 17,500 plus 10% of the amount exceeding Rs. 750,000
Rs. 1,500,001 – Rs. 2,000,000	Rs. 95,000 plus 15% of the amount exceeding Rs. 1,500,000
Rs. 2,000,001 – Rs. 2,500,000	Rs. 175,000 plus 17·5% of the amount exceeding Rs. 2,000,000
Rs. 2,500,001 and above	Rs. 420,000 plus 20% of the amount exceeding Rs. 2,500,000

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

Taxable income	Rate of tax on taxable income
0 to Rs. 400,000	0%
Rs. 400,001 to Rs. 750,000	10% of the amount exceeding Rs. 400,000
Rs. 750,001 to Rs. 1,500,000	Rs. 35,000 plus 15% of the amount exceeding Rs. 750,000
Rs. 1,500,001 – Rs. 2,500,000	Rs. 147,500 plus 20% of the amount exceeding Rs. 1,500,000
Rs. 2,500,001 and above	Rs. 347,500 plus 25% of the amount exceeding Rs. 2,500,000

C. Tax rates for companies

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

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

Where the holding period of a security is

– less than six months	10%
– more than six months but less than 12 months	8%
– 12 months or more	0%

E. Tax rates on capital gains on the disposal of immovable properties

Where the holding period of immovable property is

– up to one year	10%
– more than one year but not more than two years	5%

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

(ii) For companies

Up to Rs. 400,000	5% of the gross amount
Rs. 400,001 to Rs. 1,000,000	Rs. 20,000 plus 7·5% of the gross amount exceeding Rs. 400,000
Above Rs. 1,000,000	Rs. 65,000 plus 10% of the gross 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 rate)	3·5%
Sale of immovable property	0·5%
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 assets other than buildings	50% of cost
Eligible buildings	25% of cost

K. Pre-commencement expenditure

Amortisation rate for pre-commencement expenditure	20%

L. Benchmark rate

Interest free loans to employees	10% per annum

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Question 1 begins on page 5.

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 2013.

Faisal Industries Limited ('FIL') is an unlisted company incorporated under the Companies Ordinance, 1984. The company has 1,000 employees. The goods manufactured by FIL are exempt from sales tax. The company prepares its financial statements to 30 June each year.

The following are the audited financial results for the year ended 30 June 2013:

	Note	Rs.
Sales	1	110,000,000
Cost of sales	2	(62,000,000)
Gross profit		48,000,000
Administrative expenses	3	(15,000,000)
Distribution and selling costs	4	(13,000,000)
Other operating expenses	5	(10,000,000)
Other operating income	6	5,000,000
		(33,000,000)
Profit/(loss) from operations		15,000,000
Finance cost	7	(4,000,000)
Net profit		11,000,000

Unless stated otherwise, FIL paid for all the expenditure through crossed cheques and tax was deducted and deposited by FIL as required under the law.

Notes

Note 1

Sales include goods, having a fair market value of Rs. 700,000, which were sold for Rs. 500,000 to an associate of FIL.

Note 2

Cost of sales

		Rs.
Stock consumed	(i)	52,000,000
Freight inwards	(ii)	1,000,000
Depreciation		2,000,000
Other	(iii)	7,000,000
		62,000,000

Sub-notes to note 2:

(i) Stock consumed has been computed as follows:

		Rs.
Opening stock		18,000,000
Purchases		66,000,000
Closing stock	(a)	(32,000,000)
		52,000,000

(a) The net realisable value of the closing stock is Rs. 40,000,000 against its cost of Rs. 35,000,000.

(ii) The freight inwards was all paid in cash.

(iii) This includes an amount of Rs. 1,500,000 paid to a French company as consideration for a non-exclusive, non-transferable right for the production of an item for a period of 15 years. Production of the item started on 1 July 2012.

Note 3

Administrative expenses include the following:

- Salaries of four employees for six months at Rs. 20,000 per employee per month paid in cash;
- Rs. 600,000 paid as wages to a personal servant of a director of the company;
- Rs. 500,000 paid for the valuation of the assets of another company which FIL intended to acquire;
- Rs. 100,000 depreciation allowance on fixed assets acquired under a finance lease;
- Rs. 1,000,000 paid as rent for an office for two years from 1 July 2012;
- Rs. 45,000 paid as a penalty imposed by the Commissioner for late filing of the annual return of income for the tax year 2012; and
- Rs. 50,000 donated to a political party which is a staunch supporter of lower taxation for the corporate sector.

Note 4

Distribution and selling costs include the following:

- Rs. 500,000 paid to an employee as a reward for achieving his high sales target. As this was a one-off payment, no tax was withheld by FIL from the reward.
- Rs. 700,000 spent on a visitors' room for the customers of the company as detailed below:

	Rs.
Extension of the visitors' room	325,000
Installation of new air conditioners	275,000
Decoration items with a useful life of one year	100,000
	700,000

Note 5

Other operating expenses include the following:

- Rs. 110,000 written off as irrecoverable during the year ended 30 June 2013. The amount had been given to one of FIL's clients as a loan a year earlier.
- Rs. 50,000 paid as motor vehicle tax on the company's vehicles.
- Rs. 150,000 given as a scholarship to Mr Shafique, a citizen of Pakistan, for his technical training in connection with a scheme approved by the Federal Board of Revenue under the relevant provision of the law. Shafique is not an employee of FIL.

Note 6

Other operating income includes a gain of Rs. 200,000 accrued on the sale of some antique furniture.

Note 7

The finance cost includes:

- Rs. 50,000 as a provision for bad debts computed at 1% of the trade debtors outstanding on 30 June 2013.
- Rs. 700,000 [Rs. 600,000 as the principal cost and Rs. 100,000 as finance charges] paid to an approved modaraba in respect of plant and machinery taken on a finance lease on 1 January 2013.

Note 8

Other information

(i) Schedule of own fixed assets as per tax record

Assets	Tax written down value as on 1 July 2012 Rs.	Addition at cost during the year Rs.
Freehold land	10,000,000	–
Building on freehold land	5,000,000	1,000,000
Plant, machinery and equipment	12,000,000	200,000 [see note (a)]
Computers	1,825,000	1,000,000 [see note (b)]
Furniture and fittings	6,000,000 [see note (c)]	
Motor vehicles	7,000,000	2,400,000 [see note (d)]

Sub-notes to note 8(i):

(a) A machine having a residual value of Rs. 50,000 was transferred from the category of assets taken on finance lease to own fixed assets on the maturity of the finance lease term. The transfer was made at the book value of Rs. 200,000.

(b) Includes a new computer purchased for Rs. 300,000 on 20 June 2013 for which installation could not be made until 15 July 2013.

(c) Within furniture and fittings, antique furniture having a tax written down value (TWDV) of Rs. 300,000 on 1 July 2012 was sold for Rs. 800,000 on 30 June 2013 [refer to note 6].

(d) Represents the cost of an office car.

(e) Plant and machinery of Rs. 2,500,000 taken on a finance lease on 1 January 2013 is not included in the above schedule of fixed assets [refer to note 7].

(ii) Tax paid by or collected from FIL during the year ended 30 June 2013 was:

	Rs.
Income tax deducted from payments received for the supply of goods	45,000
Income tax paid along with electricity bills	800,000
Advance tax paid in cash in four equal instalments on the due dates	4,000,000

(iii) Goodluck Ltd, a public listed company, failed to deduct tax of Rs. 50,000 from payments it made to FIL on account of a supply of goods made by FIL.

Required:

(a) Compute the taxable income of Faisal Industries Ltd (FIL) for the tax year 2013, giving clear explanations for the inclusion or exclusion of each of the items listed in the notes.

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. (26 marks)

(b) Calculate the tax payable by/refundable to FIL for the tax year 2013 on the basis of taxable income computed in part (a).

Note: Ignore workers' welfare fund and the minimum tax provisions. (2 marks)

(c) (i) State, giving reasons, whether the Commissioner of Inland Revenue (CIR) can recover the tax of Rs. 50,000 from Goodluck Ltd which it failed to deduct from FIL, after FIL has filed its return of income and paid the tax due on the declared income. (1 mark)

(ii) State from which company the CIR will recover the default surcharge on account of the non-deduction of tax referred to in (i) above, together with the period of default.

Note: No calculations are required in this part of the question. (1 mark)

(30 marks)

2 For the purpose of this question, you should assume that today's date is 15 July 2013.

Dr Ali, aged 48, a citizen of Pakistan, returned to Pakistan on 1 May 2012 after spending ten years in Dubai. He started his medical practice in Karachi on 1 July 2012. He has adopted accrual based accounting for computing his taxable income on a regular basis and has calculated his net income for the year ended 30 June 2013 as follows:

	Note	Rs.	Rs.
Receipts			
Fees for treatment of patients at the clinic			2,500,000
Fees for treatment of patients at their homes			900,000
			3,400,000
Expenses			
Rent of clinic	1	120,000	
Salaries paid to staff	2	650,000	
Purchase of car		1,200,000	
Car running expenses	3	180,000	
Utility bills paid in cash		75,000	
Advance income tax		25,000	
Communication expenses	4	80,000	
Medicines used	5	850,000	
Fees paid to the Pakistan Medical Association (PMA)	6	90,000	
Fine paid for violation of Electricity Rules, 1937		50,000	
			(3,320,000)
Net profit			80,000

All the payments were made through crossed cheques drawn on a scheduled bank unless stated otherwise, but no tax has been deducted from any of the payments made.

Notes:

Note 1

Of the rent of Rs. 120,000, an amount of Rs. 60,000 was paid in cash in accordance with the terms of the rental agreement. The expense was otherwise fully verifiable.

Note 2

Salaries paid comprised:

– Rs. 575,000 to a nurse; and
– Rs. 75,000 to an office boy as advance salary for six months starting from 1 January 2013.

Note 3

It is estimated that one-third of the usage of the car was for personal reasons without any business connection.

Note 4

Communication expenses comprised:

– Rs. 40,000 incurred for the purchase of a second-hand mobile phone set, this payment was made in cash; and
– Rs. 40,000 paid as mobile phone call bills, inclusive of advance income tax at Rs. 4,000.

It is fairly estimated that half of the calls were made for non-business reasons.

Note 5

Medicines used include the cost of expired medicines of Rs. 50,000, which were destroyed on 30 June 2013.

Note 6

The fees were paid on 1 July 2012 and were for a period of five years.

Note 7

Other information:

(i) Dr Ali has received Rs. 250,000 as his 50% share of profit from an association of persons (AOP) in Pakistan. The AOP is engaged in the business of the import and sale of surgical goods without any value addition. Tax of Rs. 50,000 deducted at the import stage constituted the AOP's final tax liability.

(ii) During the tax year 2013, Dr Ali also received Rs. 450,000 as salary pertaining to the previous tax year 2012 from his ex-employer in Dubai.

(iii) Dr Ali's bank statement shows that a gross amount of Rs. 100,000 was credited to his account on 30 June 2013. The bank deducted Rs. 5,000 as Zakat along with income tax at the specified rate.

(iv) Dr Ali is the owner of two acres of agricultural land situated in the province of Sindh. During the tax year 2013, he received Rs. 40,000 as rent for this land from his tenant whereas a fair market rent of such land would have been Rs. 60,000.

(v) Rs. 5,000 was collected as income tax along with the electricity bills paid by Dr Ali.

Required:

(a) Compute Dr Ali's taxable income, the income assessable under the final tax regime and his total tax payable for the tax year 2013. Give reasons for the treatment of any items excluded from the taxable income or for which no expense/deduction is allowed. (20 marks)

(b) State the type of mistakes found in an assessment order which can be rectified by the Commissioner under the Income Tax Ordinance, 2001 and the situation(s) in which a taxpayer must be given an opportunity of being heard by the Commissioner before he can make a rectification order. (2 marks)

(c) State the time limit in which an appeal can be filed before the Commissioner (Appeals) against a rectification order and the maximum period for which the Commissioner (Appeals) can stay the recovery of a tax demand contested in the appeal. (3 marks)

(25 marks)

3 For the purpose of this question, you should assume that today's date is 15 July 2013.

Mr Ilyas, aged 50 and resident in Pakistan, disposed of the following assets during the year ended 30 June 2013:

Immovable assets

(1) 5 July 2012: Sold his house in Lahore for Rs. 30,000,000. He had bought the house on 5 December 2011 for Rs. 20,000,000, incurring the following expenses:

- stamp duty at 2% of the purchase price;
- capital value tax at 2% of the purchase price;
- broker's fee at 2% of the purchase price; and
- corporation tax at 1% of the purchase price.

During his ownership of the house, Ilyas incurred the following expenses:

- Rs. 300,000 on the modification of the drawing room to give it a modern look; and
- Rs. 25,000 as property tax.

Further payments made at the time of the sale of the house were:

- broker's fee at 2% of the sale price;
- income tax at 0·5% of the sale price at the time of the transfer of the house to the buyer.

(2) 30 September 2012: The government of Punjab compulsorily acquired his land under the Land Acquisition Act, 1894 and paid him Rs. 30,000,000. He had purchased the land for Rs. 25,000,000 on 1 January 2011. On 7 October 2012, he invested the whole amount of the consideration received in a ten-year fixed term deposit account with the National Bank of Pakistan. The profit on the deposit will become due to Ilyas at the time of maturity of the term.

(3) 1 January 2013: Ilyas entered into a contract for the sale of his house in Islamabad with Mr Sohail for a consideration of Rs. 50,000,000. Sohail paid Rs. 5,000,000 at the time of the contract for sale. However, he failed to pay the balance of the amount by 30 April 2013 and Ilyas forfeited the Rs. 5,000,000 in accordance with the terms of the contract. Subsequently, the house was sold for Rs. 49,000,000 to Mr Mumtaz on 30 June 2013. Ilyas had inherited the house on 25 June 2010, on which date the fair market value of the house was estimated at Rs. 39,000,000.

Movable assets

(1) 15 July 2012: Sold 2,500 shares in Pakistan Petroleum Ltd, a company listed on the Karachi Stock Exchange, for Rs. 500,000. He had purchased these shares on 15 September 2011 for Rs. 350,000. No tax was withheld at source on this transaction.

(2) 30 August 2012: Gifted a painting, having a market value of Rs. 1,000,000, to his brother, a citizen of Germany, and who had lived in Germany for the last ten years. In 2012 the brother visited Pakistan for a period of 180 days, flying back to Germany again on 30 August 2012. Ilyas had bought the painting for Rs. 500,000 on 1 January 1990.

(3) 15 September 2012: Gifted jewellery, having a fair market value of Rs. 1,500,000, to his sister who is an employee of the Federal Government and has been posted in Saudi Arabia since 1 June 2010. Ilyas had bought this jewellery on 1 September 2011 for Rs. 500,000.

(4) 14 December 2012: Sold 10,000 shares in Interwood (Pvt) Ltd for Rs. 300,000. He had acquired these shares as follows:

- 5,000 shares were purchased at Rs. 18 per share on 5 February 2010.
- 5,000 bonus shares were allotted to him on 1 July 2010 when the fair market value was Rs. 22 per share.

Incidental charges relating to the purchase and sale of these shares of Rs. 10,000 were paid in cash.

(5) 15 February 2013: Discarded a machine which he had imported from China for Rs. 1,000,000 on 1 January 2013 to start the business. However, the machine was badly damaged during the shipment, rendering it unfit for use. The shipping company paid him Rs. 850,000 as damages. The scrap value of the machine on the date it was discarded was estimated to be Rs. 200,000. The documentation charges incurred in connection with the claim for damages were Rs. 25,000.

(6) 15 April 2013: Sold 50,000 shares in Delta (Pvt) Ltd for Rs. 450,000. The shares were originally purchased for Rs. 550,000 on 15 May 2009. On 30 June 2012, Ilyas had made a provision for diminution in the value of the shares of Rs. 125,000.

Other information:

(i) Unless stated otherwise, Ilyas paid all the amounts through crossed cheques and tax was deducted and deposited as required under the law.

(ii) Ilyas has a brought forward capital loss of Rs. 700,000 from the tax year 2011 which had arisen on account of a sale of shares in Pakistan Petroleum Ltd.

(iii) Advance tax of Rs. 25,000 has been deducted on his cash withdrawals from the bank during the tax year 2013.

(iv) Advance tax of Rs. 50,000 has been paid by Ilyas on the basis of his tax liability for the tax year 2012.

Required:

Compute the tax payable by Mr Ilyas for the tax year 2013 on the taxable income arising from the above transactions. Give brief reasons for your treatment of each item.

(20 marks)

4 **(a)** Mr Muddasir has had an appeal pending before the Appellate Tribunal for a long time. He is thinking about seeking relief through the alternative dispute resolution (ADR) mechanism provided in the law and seeks your opinion on some aspects relating to the ADR mechanism.

Required:

Advise Mr Muddasir on the following:

(i) In which two situations a taxpayer CANNOT apply to the Federal Board of Revenue (the 'Board') for the appointment of a committee for the resolution of a dispute under the alternative dispute resolution (ADR) mechanism. (2 marks)

(ii) The persons eligible to be appointed by the Board as members of the resolution committee. (2 marks)

(iii) Whether, if he is not satisfied with the final orders of the Board, he can continue to pursue his remedy before the Appellate Tribunal. (1 mark)

(b) In the case of each of the following, state the last date of filing of the return of income as provided under s.118 of the Income Tax Ordinance, 2001:

(i) Bryonia Laboratories (Pvt) Ltd, a manufacturer of medicines, for the tax year ended on 31 March 2012.
(ii) Silk Bank Ltd, a banking company, for the tax year ended on 31 December 2012.
(iii) Ms Mehwish, a salaried person, filing her return through the e-portal for the tax year ended on 30 June 2013.
(iv) Mr Osmani, a property dealer, for the tax year ended on 28 February 2013.

Note: Ignore any extensions given by the Board or the government in any of the above categories of cases.

Note: The total marks will be split equally between each part. (4 marks)

(c) State the grounds on which an individual taxpayer can apply for an extension of time for furnishing his/her return of income; by when such an application must be made and how many days extension the Commissioner can grant in normal circumstances. (3 marks)

(d) Mr Adeel purchased a luxury car having a market value of Rs. 3,000,000 on 1 January 2013. The Commissioner of Inland Revenue (the 'CIR') served a notice on Adeel requiring him to file his return for the tax year 2013 but Adeel failed to comply with the terms of the notice.

Required:

Given the circumstances:

(i) State the type of assessment order which the Commissioner of Inland Revenue (CIR) will issue and the basis on which that assessment order will be framed.
(ii) State after how many days from serving the assessment order in (i) on Adeel, the CIR can take coercive measures to recover tax from him.
(iii) State the steps Adeel will need to take for the assessment order served on him to be abated without filing an appeal.

Note: The total marks will be split equally between each part. (3 marks)

(15 marks)

5 (a) List the persons who are required to be registered for sales tax under the Sales Tax Act, 1990. (7 marks)

(b) Ms Mehr filed her sales tax return for April 2013 on 15 May 2013. She has now discovered that, due to an error, taxable supplies of Rs. 500,000 had not been declared in the original return. Although no notice of audit has yet been received from the Commissioner Inland Revenue, Ms Mehr wishes to revise the return immediately and pay the due amount of tax.

Required:

(i) State whether Ms Mehr can revise the return without seeking the permission of the Commissioner of Inland Revenue (CIR).

(ii) State whether Ms Mehr will be liable to pay the full amount of default surcharge or if there is any concession in this regard.

(iii) State whether the CIR can recover any penalty from Ms Mehr for this default, and if so, of how much.

Note: No computations are required.

Note: The total marks will be split equally between each part. (3 marks)

(10 marks)

End of Question Paper