Fundamentals Level – Skills Module

Taxation (Pakistan)

Tuesday 4 June 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.

Sahiwal Engineering Limited (SEL) is a public company incorporated under the Companies Ordinance, 1984 whose shares were traded on the Lahore stock exchange from 1 July 2012 until 30 April 2013, on which date SEL was delisted from the exchange. The control and management of the affairs of SEL was situated partly outside Pakistan during the year ended 30 June 2013. More than 500 persons remained on the payroll of SEL during the year ended 30 June 2013.

SEL is engaged in the manufacture of engineering goods and its summarised income statement for the accounting year ended 30 June 2013 is as follows:

	Note	Rs.	Rs.
Turnover	1		90,000,000
Cost of sales	2		(58,000,000)
Gross profit			32,000,000
Less Expenditure			
Administration expenses	3	7,000,000	
Selling and distribution expenses	4	5,000,000	
Financial charges	5	2,000,000	
Provision for bad debts	6	1,500,000	
Other expenditure	7	8,000,000	
			(23,500,000)
			8,500,000
Other income	8		2,050,000
Net profit			10,550,000

Unless stated otherwise, SEL paid for all the expenditure through crossed cheques and tax was deducted and deposited as required under the law. The goods manufactured by SEL are exempt from sales tax and SEL has not opted to be assessed on the final tax basis on income arising from the sales of goods it manufactures.

Notes:

Note 1

Goods of Rs. 1,000,000 were sold to a public limited company which deducted tax from the payment made to SEL. Due to an accounting error, only the net amount was recorded in the turnover.

Note 2

Cost of sales includes the following:

	Rs.
Write off of obsolete stock	500,000
Cess paid to the local government on the profits of the company	50,000

Note 3

Administration expenses include:

	Rs.
Accounting depreciation	1,000,000
Contribution to an unapproved superannuation fund	300,000
Amount paid to a non-resident company for securing the exclusive rights to manufacture 'water-kits' for cars in Pakistan for a period of eight years commencing from 19 April 2013	1,600,000
Donation in kind to a relief fund run by the Government of Sindh	1,000,000
Compulsory annual fee, paid in cash, to the Engineering Development Board established by the Federal Government	200,000

Note 4

Selling and distribution expenses include:

	Rs.
Payment to Monsoon Hotel for holding the annual get-together function for the employees of the company and their families	600,000
Salaries paid, in cash, to temporary employees in rural areas. Tax was deducted as required under the law. The monthly salary of each employee was Rs. 16,000	800,000

Note 5

Financial charges include:

	Rs.
Profit on debt paid to a subsidiary company of SEL on which no tax was deducted. SEL and its subsidiary are entitled to group taxation under the provisions of the Income Tax Ordinance, 2001	700,000

Note 6

The bad debts account comprises:

	Rs.
Balance on 1 July 2012	2,000,000
Provision made during the year (2% of debtors)	1,500,000
	3,500,000
Trade debts written off being irrecoverable	(800,000)
Loan to an associate written off being irrecoverable	(300,000)
Balance on 30 June 2013	2,400,000

Note 7

Other expenditure comprises:

	Rs.
Accounting loss on sale of machinery	500,000
Provision for taxation	5,500,000
Provision for anticipated losses	2,000,000
	8,000,000

Note 8

Other income comprises:

	Rs.
Recoveries against bad debts written off but not allowed as a deduction in the prior years	750,000
Additional payment received on the delayed payment of a tax refund by the Federal Board of Revenue	1,300,000
	2,050,000

Note 9

Creditors include:

	Rs.
Rent payable which was allowed as a deduction, on the accrual basis, against the income for the year ended 30 June 2009	400,000

Note 10

The tax written down values (TWDV) of SEL's fixed assets on 1 July 2012 were:

	Rs.
Land	15,000,000
Office and factory buildings	9,000,000
Plant and machinery	4,000,000
Motor vehicles	1,500,000

Further information about SEL's fixed asset transactions during the year to 30 June 2013:

(i) The construction of residential quarters for the factory workers was completed on 31 January 2013 at a cost of Rs. 10,000,000 and the workers were allowed occupation on 15 March 2013. The cost includes the price of the land paid at Rs. 3,000,000.

(ii) A new car for the business use of the chief executive was purchased on 15 February 2013 for Rs. 2,300,000. The company incurred a further Rs. 200,000 to enhance the security and safety features of the car before handing it over to the chief executive on 1 March 2013.

(iii) It is a consistent accounting policy of SEL that any item of furniture costing less than Rs. 75,000 is written off immediately in the accounts as expense. Purchases of such items in the accounting year ended 30 June 2013 amounted to Rs. 750,000.

(iv) Machinery having TWDV of Rs. 500,000 on 1 July 2012 was sold for Rs. 300,000 on 31 December 2012.

Note 11

In addition to the advance tax referred to in Note 1, tax paid by or collected from SEL during the year ended 30 June 2013 was:

	Rs.
Income tax paid on the registration of the new car (as in Note 10(ii))	50,000
Income tax paid along with electricity bills	900,000
Advance tax paid in cash in four equal instalments on the due dates	5,000,000

Required:

(a) State, with reasons, whether you consider Sahiwal Engineering Ltd (SEL) to be a resident or a non-resident company. (2 marks)

(b) Compute the taxable income of SEL 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. (24 marks)

(c) Calculate the tax payable by/refundable to SEL for the tax year 2013.

Note: Ignore the minimum tax provisions. (4 marks)

(30 marks)

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

Mr Rizwan, resident in Pakistan, has provided the following information in respect of his tax affairs for the year ended 30 June 2013.

From employment with Highgrowth Ltd as technical officer

Mr Rizwan worked with Highgrowth Ltd ('Highgrowth') throughout the year ended 30 June 2013. On reaching the age of 55 years, he opted for early retirement with effect from 20 July 2013. He has provided the following information relating to his employment with Highgrowth:

(i) Emoluments received in cash:

- annual basic salary of Rs. 1,200,000;
- technical allowance at 5% of his basic salary;
- Rs. 50,000 in lieu of availing of his annual recreational leave;
- utility allowance at 6% of his basic salary; and
- Rs. 100,000 as consideration for consenting to a restrictive covenant refraining him from entering into employment with any other competitive company for a period of one year.

(ii) Highgrowth provided Rizwan with fully furnished accommodation for his family in Lahore. The fair rent of the accommodation was estimated to be Rs. 50,000 per month. Had the company not provided him with this accommodation, he would have been entitled to a house rent allowance at 60% of his basic salary.

(iii) A new car was taken on a finance lease on 1 January 2013 by Highgrowth exclusively for Rizwan's private use. The fair market value of the leased car at the commencement of the lease was Rs. 2,000,000. The total payments to be made over the lease term of three years were Rs. 2,500,000. The company deducted Rs. 72,000 from Rizwan's salary for his personal use of the car for the six months to 30 June 2013.

(iv) Another car was provided for the business use of Rizwan. On 25 June 2013, in accordance with the terms of his employment, Rizwan purchased this car from Highgrowth for Rs. 400,000. The fair market value of the car on 25 June 2013 was Rs. 500,000.

(v) Highgrowth gave Rizwan a loan of Rs. 400,000 at a 2% mark-up on 1 October 2012 for the education of his children. On 30 June 2013, Rizwan returned the principal amount of Rs. 350,000 along with the mark-up payable on the total loan. The balance amount of Rs. 50,000 was, however, waived by Highgrowth on that day.

(vi) Rizwan was provided with the services of a domestic servant for the full year. The monthly cost to Highgrowth for the provision of this service was Rs. 7,000.

(vii) Rizwan was issued 1,000 shares in Highgrowth on 25 June 2013 under the company's employee share scheme. There is a restriction on Rizwan not to sell or transfer the shares before 25 June 2014. On 25 June 2013, the breakup value of each share of Highgrowth was Rs. 15 per share against a face value of Rs. 10 per share. Rizwan did not sell any of the shares during the year ended 30 June 2013.

(viii) Highgrowth deducted Rs. 125,000 as tax from Rizwan's salary and this was deposited with the Commissioner Inland Revenue as required under the law.

(ix) Rizwan incurred expenses of Rs. 150,000 relating to self-education which was directly connected with his employment at Highgrowth. The expenses included fees, books and travel, etc.

Share of income from Agrofriends

On 1 January 2013, Rizwan commenced a partnership with Mr Aqeel running a small consultancy firm, 'Agrofriends'. Profits are shared 40% to Rizwan and 60% to Aqeel.

The accounting year of Agrofriends ends on 30 June. The taxable income of the firm for the year ended 30 June 2013 was computed at Rs. 1,600,000 before adjustment on account of capital allowances (initial allowance and depreciation) on computers purchased on 25 June 2013. The computers were put into use for the first time in Pakistan on 30 June 2013. The total cost incurred on these computers was Rs. 200,000. Agrofriends has already paid income tax on its income as required under the law.

Share of income from property

Rizwan and his brother, Saeed, jointly own a freehold house in Islamabad which is let out. Each brother has a 50% share in the house. The house was let throughout the tax year 2013 to Mr Waseem, at a monthly rent of US$ 1,500. The total rent amount was paid in advance on 1 July 2012, on which date the exchange rates were:

State Bank of Pakistan rate	1 US$ = Rs. 88·5
Open market rate	1 US$ = Rs. 90·0

Required:

Compute Mr Rizwan's taxable income and income assessable under the final/fixed 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.

(25 marks)

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

(a) List the conditions which need to be fulfilled in order that no enquiries as to the nature and sources of an amount invested in the shares of a public company traded on a registered stock exchange in Pakistan can be made by the Commissioner Inland Revenue. (4 marks)

(b) Mr Bilal, aged 45 and resident in Pakistan, disposed of the following assets during the year ended 30 June 2013:

Immovable assets

(1) 5 July 2012: Sold agricultural land for Rs. 9,000,000 which he had bought on 15 September 2011 for Rs. 6,500,000, along with paying transfer fees of Rs. 160,000.

The following expenses were also made by Bilal in relation to the property:

– Rs. 40,000 for a valuation of the property;
– Rs. 80,000 on account of brokerage to a real estate agent; and
– Rs. 200,000 on improving the fertility of the land by better drainage.

Although the above amounts were all paid through a crossed bank draft, no tax was deducted by Bilal.

The registration authority collected tax on the sale proceeds of land from Bilal as required under the law.

(2) 15 July 2012: Exchanged his plot of land in Lahore which had a fair market value of Rs. 7,500,000 for a plot in Okara, owned by Mr Asad, which had an estimated value of Rs. 6,500,000. Bilal had bought his plot in Lahore on 15 February 2011 for Rs. 6,000,000. It is expected that due to future development in the area, the price of the plot in Okara will rise to Rs. 8,000,000 in 2014.

No tax was collected by the transferring authority at the time of this transaction.

(3) 10 August 2012: Sold a flat in Karachi for Rs. 5,000,000 which he had bought on 1 January 1995 for Rs. 4, 000,000.

Securities and other shares

(1) 25 June 2013: Sold 100,000 call options (right to purchase shares) in a public company listed on the Islamabad Stock Exchange at Rs. 2·5 per call option. He had purchased these call options on 20 June 2013 at Rs. 1·90 per call option. Other admissible expenses incurred on these transactions were Rs. 10,000.

(2) 30 June 2013: Sold 5,000 shares in Turbo Motors Limited, an unlisted company in which 50% of the shares are held by the Government of Balochistan, at Rs. 170 per share. He had purchased these shares on 1 November 2012 at Rs. 120 per share. The following expenses were incurred in connection with these shares:

– capital value tax paid at 0·01% of the purchase price of the shares; and
– commission of Rs. 0·10 per share on each side of the trade.

(3) 1 January 2013: Sold 150,000 shares in Farid Sugar Mills (Pvt) Ltd (FSM) for Rs. 3,000,000. He had received these shares on 1 January 2011 as a dividend *in specie* from United Sugar Mills Ltd. On 1 January 2011, the fair market value of the shares in FSM was estimated to be Rs. 10 per share.

Additional information:

(1) Bilal had suffered a loss of Rs. 440,500 under the head 'capital gains' in the tax year 2010 from a sale of shares in a private limited company. The loss has remained unadjusted as he had no capital gains in the tax years 2011 and 2012.

(2) Tax on cash withdrawals from his bank during the year ended 30 June 2013 is Rs. 12,000.

(3) With the prior approval of the Commissioner, Bilal has opted that his capital gains may NOT be determined and taxed under the Eighth Schedule to the Income Tax Ordinance, 2001.

Required:

Compute the tax payable by Mr Bilal for the tax year 2013 on the taxable income arising from the above transactions. Give brief reasons for your treatment of each item. (16 marks)

(20 marks)

4 (a) Briefly explain the basic features of direct and indirect taxes. Give two examples of each. (4 marks)

(b) Mr Naveed, a businessman, filed his return for the tax year 2012 on 30 September 2012. The Federal Board of Revenue (FBR) selected him for an audit of his income tax affairs. During the audit proceedings, it was found that he had failed to maintain records as required under the Income Tax Ordinance, 2001. As a result of the audit proceedings, his taxable income and tax thereon were determined at Rs. 1,500,000 and Rs. 300,000, respectively. The Commissioner has issued him a show cause notice to levy a penalty for non-maintenance of the records.

Required:

(i) Calculate the amount of penalty which can be levied on Mr Naveed for non-maintenance of the records as required under the Income Tax Ordinance, 2001;

(ii) State the time periods for which records are required to be maintained for a tax year in different situations.

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

(c) Briefly explain the procedure to be followed when the Federal Board of Revenue (FBR) exercises its powers to exempt a taxpayer from penalty and default surcharges. (3 marks)

(d) For the purpose of this part, you should assume that today's date is 15 July 2013.

Ms Kausar filed her return of income for the tax year 2011 on 30 September 2011 at Rs. 700,000. Today, she has discovered that, due to an omission, a taxable amount of Rs. 100,000 had not been declared in the original return. Although no notice for audit or amendment has yet been received from the Commissioner Inland Revenue, she intends to revise the return immediately.

Required:

State:

(i) the documents Ms Kausar will be required to file with the revised return;

(ii) whether it will be necessary to submit reasons for the revision of the return along with revised return;

(iii) whether Ms Kausar will be liable to pay any default surcharge or penalty on account of revision of her return; and

(iv) whether Ms Kausar can revise the return without seeking the permission of the Commissioner Inland Revenue.

Notes:

1. No computation is required in this part of the question.
2. The total marks will be split equally between each part. (4 marks)

(15 marks)

5 **For the purpose of this question, you should assume that today's date is 5 April 2013.**

Mr Usman, a registered person under the Sales Tax Act, 1990, is engaged in the manufacture and supply of consumer goods. His business transactions for March 2013 were as below:

	Rs.
Payments for the purchase of raw materials from registered persons	70,000,000
Payments for the purchase of raw materials from unregistered persons	30,000,000
Payment for the purchase of machinery from a registered person	10,000,000
Sale of taxable goods to registered persons	80,000,000
Sale of taxable goods to unregistered persons	16,000,000
Sale of goods against an international tender to the Punjab Government	10,000,000
Sale of exempt goods to a local charity	10,000,000
Exports of goods to Turkey	5,000,000
Purchases made in February 2013 returned to the vendor for being substandard	1,000,000

Additional information:

(1) All the payments to registered persons were made inclusive of sales tax and through a mode admissible in the Sales Tax Act, 1990.

(2) The raw materials purchased were used for the manufacture of both taxable and exempt supplies.

(3) The machinery purchased during the last week of March 2013 was used for the manufacture of taxable goods only.

(4) The figures for the sales of goods (including exports) are all stated exclusive of sales tax.

(5) In the case of the purchase returns, the debit/credit notes have been issued in conformity with the provisions of the Sales Tax Act, 1990.

Required:

(a) Calculate the sales tax payable by, or refundable to, Mr Usman, for the month of March 2013, giving an explanation for the treatment of input tax on the purchase of the machinery during the month. (7 marks)

(b) Define the 'time of supply' in relation to the following:

(i) a supply of goods under a hire purchase agreement;
(ii) a supply of goods other than under a hire purchase agreement; and
(iii) the rendering of services.

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

(10 marks)

End of Question Paper