
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.

			Marks
1	Presson Industries Limited ('PIL')		
(a)	Taxable income for the tax year 2014 (accounting year ended 30 June 2014)		
		Note	Rs.
	Income from business		
	Net profit as per income statement		13,000,000
	<i>Add:</i>		0·5
	Penalty for violation of the Environmental Protection Act, 1997	(1)	700,000
	Accounting depreciation on plant and machinery charged to the cost of sales	(2)	1,500,000
	Income tax paid charged to the cost of sales	(3)	600,000
	Legal and other fees for acquisition of land	(4)	100,000
	Payment of bonus to a director without tax deduction	(5)	600,000
	Accounting depreciation charged to the distribution and selling costs	(2)	1,400,000
	Commission paid to distributors without tax deduction	(6)	900,000
	Provision for expenses to be incurred in July 2014	(7)	290,000
	Excess claim of pre-commencement expenditure	(8)	80,000
	Donation to school (in cash)	(9)	10,000
	Accounting loss from sale of motor vehicle	(10)	300,000
	Taxable gain on sale of motor vehicle	(10)	125,000
	Finance cost relating to work-in-progress	(12)	500,000
	Finance cost relating to photocopier taken on a finance lease	(13)	20,000
			<u>7,125,000</u>
	<i>Less:</i>		
	Fair value adjustment	(11)	5,000,000
	Lease rentals	(13)	75,000
	Initial allowance	(14)	45,000
	Tax depreciation	(14)	4,945,750
	Amortisation of computer software	(15)	6,000
			<u>(10,071,750)</u>
	Income from business/taxable income		<u>10,053,250</u>

Items not included in the computation of taxable income

- Compensation from Sui Southern Gas Company Ltd – Rs. 250,000
Compensation received on account of loss of income due to disruption of the production process is revenue in nature and is covered in the definition of income. No adjustment is required. 1·0
- Legal fees to collect business trade debts – Rs. 200,000
Legal fees to collect business trade debts are incidental to business and do not give rise to any capital asset. Hence allowable as a revenue deduction [s.20(1)]. 1·0
- Legal fees for defending the title to a piece of land – Rs. 300,000
Land is a capital asset. Any expenditure which enhances its value is capital expenditure and not allowable. However, any expenditure incurred to defend the title to an asset does not increase its value, hence is allowable as revenue expenditure [s.20(1) and general principles of taxation]. 1·0
- Free distribution of sample goods – Rs. 300,000
Free distribution of sample goods, being in line with practice in the industry, is an expenditure of commercial expediency and has been incurred wholly and exclusively for the purpose of business. Hence, it is allowable as revenue expenditure [s.20(1)]. 1·0

	<i>Marks</i>
(v) Non-deduction of tax from profit paid to banks – Rs.2,480,000 Payment of profit to a banking company by a company as defined in the Ordinance is not subject to the withholding tax provisions. Hence, non-deduction of tax does not lead to any adverse inference in this case. The amount of profit paid is fully admissible [s.151(1)(d)].	1·0
(vi) Capital loss brought forward from the tax year 2012 – Rs. 3,500,000 A capital loss can be brought forward and set off against capital gains subject to certain restrictions provided in the Ordinance. Since in the tax year 2014, PIL has no taxable capital gains, the loss shall be carried forward to the next year. A brought forward capital loss cannot be set off against 'Income from business' [s.59(2)].	1·0 27

Notes

Note 1

A penalty paid for violation of any law or rule, or regulation is not an admissible expenditure under the Income Tax Ordinance, 2001 [s.21(g)].

Note 2

Accounting depreciation, whether charged to cost of sales, administrative expenses or under any other head or classification, 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.

Note 3

Income tax collected by the electricity bill preparing authority along with electricity bills is not an expenditure of the company to earn business income, rather it is advance tax for which credit shall be allowed when calculating the tax payable or refundable from the taxpayer [s.21(a) and s.235] (see part (b) of the question).

Note 4

Land is a capital asset of the company. Any expenditure incurred to acquire or improve a capital asset is treated as capital expenditure and is not allowable as a deduction against 'Income from business' [s.21(n)]. Hence, legal and other fees spent to acquire land are not allowed as revenue expenditure, but are capitalised (see note 14).

Note 5

A director is included in the definition of an employee [s.2(20) and (22)]. A bonus is included in the definition of salary [s.12(2)(a)]; and any taxable salary paid without tax deduction is not an admissible expenditure [s.21(c)].

Note 6

PIL being a withholding agent [under s.233] was required to deduct tax from the commission paid to the distributor. Non-deduction of tax from the payment made on account of commission of Rs. 900,000 renders the expenditure inadmissible [s.21(c)].

Note 7

A provision for expenses to be incurred in July 2014 does not relate to the tax year 2014. Expenditure of one year cannot be claimed in another tax year [general principle of taxation]. Expenditure is also not allowed on the basis of a provision and is only admissible when it is incurred [i.e. when it is payable by the person] [s.34(1)].

Note 8

Pre-commencement expenditure is allowed by its amortisation on a straight-line basis at 20% per tax year. The income statement shows that pre-commencement expenditure of Rs. 200,000 has been charged to the accounts, whereas it should have been charged as computed below:

	<i>Rs.</i>
Total pre-commencement expenditure	600,000
Claim during the tax year 2014	200,000
Amount admissible for amortisation from the tax year 2012 onwards at 20% per year until the tax year 2016	120,000
Excess claim to be added back (200,000 – 120,000)	80,000

[s.25 read with Pt. III of the 3rd Sch.]

Note 9

The donation of Rs. 10,000 made to a school is not for the purposes of business and is disallowed. Further, a donation paid in cash to a school does not qualify for any tax credit [s.20(1) and s.61(4)].

Note 10

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 of Rs. 300,000 is added back to the total income.

Taxable profit is computed by deducting the tax written down value from the sale proceeds restricted in the same proportion in which the actual cost was restricted for the purposes of allowing depreciation as follows:

	Rs.	Rs.
Original cost of the motor vehicle	3,000,000	
Restricted value for tax depreciation	2,500,000	
Tax written down value (TWDV) on 1 July 2013	2,125,000	
Actual sale proceeds	2,700,000	
Sale proceeds restricted to $(2,700,000 \times 2,500,000/3,000,000)$	2,250,000	
Less: TWDV	<u>(2,125,000)</u>	
Gain on disposal to be taxed as 'Income from business'		125,000

[s.22(8)(a) and 22(10)]

Note 11

The value of land owned by PIL has been revalued upwards and the notional gain has been credited to the income statement. Under the Income Tax Ordinance only real income is charged to tax. The notional gain of Rs. 5,000,000 is therefore deducted from the accounting income for the purposes of taxation [s.2(29) and general principles of taxation].

Note 12

Finance costs relating to work-in-progress are not revenue expenditure for the purposes of carrying on business during the year. Further, at this stage PIL is not entitled to any capital allowance like depreciation, etc as work-in-progress does not constitute an eligible asset for any such allowances [s.20(1) and s.22(15)].

Note 13

A lease rental comprises both the principal amount and finance charges. Since the photocopier was taken on a finance lease from an approved leasing company, the lease rentals paid of Rs. 75,000 are fully admissible. However, the finance cost charged to profit and loss account at Rs. 20,000 is added back, otherwise it would result in a double deduction [s.28(1)(b)].

Note 14

Initial allowance and tax depreciation:

Asset	TWDV on 1 July 2013	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.
Freehold land	15,000,000	100,000		0	n/a	0
Building on freehold land	7,000,000			7,000,000	10%	700,000
Plant, machinery and equipment	15,000,000			15,000,000	15%	2,250,000
Computers	2,000,000	180,000 (see Note 15)	45,000	2,135,000	30%	640,500
Furniture and fittings	4,000,000	160,000	0	4,160,000	15%	624,000
Motor vehicles	7,000,000 (see note 10)	(2,125,000)		4,875,000	15%	731,250
Total			45,000			4,945,750

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

Note 15

The computer was purchased along with software for a total price of Rs. 300,000. While computer hardware costing Rs. 180,000 is to be added to the fixed assets for allowing initial allowance and depreciation (note 14 above), software costing Rs. 120,000 is eligible for amortisation being an intangible under the Ordinance [s.24]. Its cost is to be amortised over the useful life computed in number of years. Where an intangible is used only for a part of the tax year, the amount to be amortised is restricted proportionately on the basis of the number of days it is used in the tax year. The amount to be amortised is, therefore, computed as:

Cost of the intangible	Rs. 120,000
Useful life	4 years
Amortised cost chargeable in a full year	120,000/4 = Rs. 30,000
To be restricted proportionately on the basis of number of days it is used [s.24(3) and (11)]	30,000 x 73/365 = Rs. 6,000

(b) Tax liability for the tax year 2014

	Rs.	Rs.
Taxable income for the tax year 2014 (from (a))		10,053,250
Since the company does not fall within the definition of a 'small company', tax is charged at 34%	3,418,105	0·5
Less: Tax credit on account KSE listing at 15% of the tax payable	(512,716)	1·0
Less: Tax already paid		
Tax collected along with electricity bills [ss.168 and 235]	600,000	0·5
Advance tax paid in cash [s.147]	2,000,000	0·5
Advance tax on cash withdrawals from bank accounts [s.231A]	80,000	0·5
	(2,680,000)	
Tax payable by PIL [s.137]	225,389	
		3·0
		30

2 Mr Hassan

(a) Admissibility of repair allowance equal to one-fifth of the rent on the building rented out with plant and machinery

Where a building is rented out together with plant and machinery, the rent received or receivable is chargeable to tax under the head 'Income from other sources' [s.39(1)(f)]. Against this head of income, no repair allowance is admissible. However, the expenditure incurred on repairs, on an actual basis, is admissible subject to verification, payment through a prescribed mode, and deduction of tax, wherever applicable [s.40].

2·0

Marks

(b) Taxable income and tax payable for the tax year 2014 (accounting year ended 30 June 2014)

	Note	Rs.	Rs.	
Income from property				
Rent chargeable to tax – House at Multan				
Non-adjustable advance	(1)	130,000		2·0
Rent for 12 months (100,000 x 12)	(2)	<u>1,200,000</u>		1·0
			1,330,000	
Deductions:				
Repair allowance	(3)	266,000		1·0
Collection charges	(4)	70,000		1·0
Property tax paid to the Excise and Taxation Department	(5)	350,000		0·5
Legal fee for defending the title to the house	(6)	100,000		0·5
Profit paid on a loan for renovation of the house	(7)	50,000		0·5
Insurance premium paid	(8)	<u>30,000</u>		0·5
			(866,000)	464,000
Income from other sources				
A. Amount received from Waqar for provision of the services of a security guard (20,000 x 12)	(2)		240,000	0·5
Deductions:				
Amount paid to the security guard	(9)		<u>(200,000)</u>	40,000
B. Amount received from building rented out together with plant and machinery to Tasty Biscuits (Pvt) Limited				
Rent amount taxable during the tax year ended 30 June 2014 at Rs. 800,000 per month (800,000 x 9)	(10)		7,200,000	1·0
Deductions:				
(i) Distempering the building	(11)	90,000		0·5
(ii) Property tax paid to local government	(12)	300,000		0·5
(iii) Legal fee for preparing the rental agreement	(13)	35,000		0·5
(iv) Salary paid to a technician for machinery maintenance	(14)	400,000		0·5
(v) Initial allowance	(15)	<u>3,000,000</u>		1·0
(vi) Depreciation	(15)	<u>1,050,000</u>	(4,875,000)	2,325,000
Total taxable income				<u>2,829,000</u>

Explanation of items not included in the computation of taxable income

- (i) Expenditure for the preparation of the tenancy agreement with Waqar – Rs. 25,000
Expenditure for the preparation of a tenancy agreement is not included in the exhaustive list of admissible expenses given in the law against income under the head 'Income from property' [s.15A]. 1·0
- (ii) Non-adjustable security deposit received from Tasty Biscuits (Pvt) Limited – Rs. 1000,000
Income accrued as rent in respect of a building together with plant and machinery is chargeable to tax under the head 'Income from other sources'. A non-adjustable advance is taxable in the prescribed manner in the case of income falling under the head 'Income from property' only [s.16(1)]. 1·0
- (iii) Interest-free refundable security deposited with the electricity providing company – Rs.400,000
The amount paid is in the form of an interest-free refundable security and not in the nature of revenue expenditure. Therefore, it is not deductible. 1·0
- (iv) Pension received from ex-employer at Rs. 10,000 per month
The pension received from his ex-employer is exempt from tax [Cl. (8) & (9) of Pt. I of the 2nd Sch.]. 1·0
- (v) Expenditure incurred on medical treatment – Rs. 35,000
Expenditure incurred on his medical treatment is personal expenditure and has not been incurred to earn income under any head of income. Such expenditure is therefore not allowable under the Ordinance. 1·0

Notes**Note 1**

A non-adjustable advance taken from a new tenant, as reduced by the non-adjustable advance of the previous tenant to the extent it has been charged to tax, is taxable in the year it is taken and for each of the next nine years, and is treated as rent received. Therefore, the amount chargeable to tax during the tax year 2014 is computed as below:

	Rs.
Amount of non-adjustable advance taken from Waqar	1,500,000
<i>Less:</i>	
Amount of non-adjustable advance earlier taken on 1 July 2011 from Kamal and taxed until 30 June 2013 ($1,000,000/10 \times 2$) [s.16(1) and (3)]	<u>(200,000)</u>
	<u>1,300,000</u>

Non-adjustable advance to be treated as rent during the tax year 2014
($1,300,000/10$) [s.16(3)] 130,000

Note 2

Where any amount is included in rent received by a person for the provision of amenities, utilities or any other service connected with the renting of the building, such amount shall be chargeable to tax under the head 'Income from other sources'. Hence, Rs. 20,000 per month included in the rent for the services of a security guard is to be treated as 'Income from other sources' at Rs. 240,000 [$20,000 \times 12$]. The amount chargeable under the head 'Income from property' shall, therefore, be Rs. 1,200,000 ((Rs. 120,000 – 20,000) $\times 12$) [s.15(3A)].

Note 3

When computing the income chargeable to tax under the head 'Income from property', one-fifth of the gross rent chargeable to tax is deductible as a repair allowance, irrespective of the amount spent or claimed. ($1/5 \times 1,330,000$) [s.15A(1)(a)].

Note 4

Any expenditure, not exceeding 6% of the gross amount of rent actually paid, or payable by the person in the year, for the purpose of collecting the rent due in respect of the property is admissible in computing the taxable income from the property. The incurred amount of Rs. 70,000 being within the prescribed limit [Rs. 79,800] is admissible, hence allowed as a deduction [s.15A(1)(h)].

Note 5

Property tax paid or payable during the tax year in respect of the rented out property to the Excise and Taxation Department is an admissible deduction [s.15A(1)(c)].

Note 6

Any expenditure incurred by the taxpayer in the tax year for legal services in a court of law to defend the person's title to the rented out property is an admissible expenditure [s.15A(1)(i)].

Note 7

The amount paid to the bank on a loan utilised for the renovation of the rented out property is an admissible deduction when computing taxable income under the head 'Income from property' [s.15A(1)(e)].

Note: Since this amount is not for the construction of a new house, it does not qualify for the tax credit which is admissible on profit on debt obtained for the construction of a new house or the acquisition of a house [s.64].

Note 8

An insurance premium paid to cover the risk of damage by fire is an admissible expenditure against rental income [s.21 (g)].

Note 9

The amount paid to the security guard employed for the house at Multan is deductible from the amount taxable under the head 'Income from other sources' due to the consideration received for this service from Waqar.

Note 10

Where a building is rented out together with plant and machinery, it is taxable as 'Income from other sources' [s.15(3) and s.39(1)(f)]. Deductions admissible against income under the head 'Income from other sources' are different from the deductions which are admissible against 'Income from property'.

Note 11

Distempering the property is incidental to earning the rental income assessable under the head 'Income from other sources' and admissible under the law [s.40(1)].

Note 12

Property tax paid to the local government in respect of the building is an admissible deduction [s.40(1)].

Note 13

The legal fee paid for preparing the rent agreement is allowable expenditure as it is revenue in nature and has been incurred to derive income chargeable to tax [s.40(1)].

Note: *Expenditure of the same kind is not admissible in the case of income derived under the head 'Income from property'.*

Note 14

The salary paid to a technician for machinery maintenance is not capital in nature and is also necessary for earning the income chargeable to tax. It is therefore fully admissible [s.40(1)].

Note 15

Initial allowance and depreciation

Asset	TWDV on 1 July 2013	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)
Building	0	8,000,000	2,000,000	6,000,000	10%	600,000
Plant and machinery	0	4,000,000	1,000,000	3,000,000	15%	450,000
Total			3,000,000			1,050,000

[ss.40(3), 22 and 23 read with 3rd Sch.]

(c) Reduction in tax liability due to age and tax payable for the tax year 2014

The tax liability of a taxpayer for a tax year shall be reduced by 50% where all of the following conditions are fulfilled:

- (i) the taxpayer is an individual;
- (ii) the taxpayer is aged 60 or more on the first day of the tax year; and
- (iii) their taxable income for the tax year does not exceed rupees one million.

[Cl.(1A) of Pt. III of the 2nd Sch.]

1·5

Hassan fulfils the first two conditions but the third condition is not met as his 2014 taxable income (from part (b)) is Rs. 2,829,000. Hence, he is not entitled to this reduction of tax.

1·0

Tax on taxable income of Rs. 2,829,000

	Rs.	Rs.	Rs.
On first Rs. 2,500,000	347,500		
On remainder of Rs. 329,000 at 25%	82,250	429,750	0·5
Less tax paid or deducted/collected by withholding agents			
Tax collected with pre-paid mobile phone cards [s.236]	3,000		0·5
Advance tax on the purchase of air tickets by Hassan [s.236B]	20,000		0·5
Tax paid in four equal instalments [s.147]	350,000		0·5
Tax withheld by club [s.236D]	10,000		0·5
		(383,000)	
Tax payable with return [s.137]		46,750	
			5·0
			25

3 Ms Ruby

Marks

Tax payable for the tax year 2014 (accounting year ended 30 June 2014)

	Note	Capital gain/(loss) Rs.	Tax Rs.	Marks
Capital gains and tax on the disposal of immovable properties taxable as a separate block				
On the sale of the house in Lahore	(1)	5,000,000	500,000	1·5
On the sale of agricultural land	(2)	<u>2,450,000</u>	<u>122,500</u>	<u>2·0</u>
			<u>622,500</u>	
Income under the head 'Capital gains' assessable to tax along with other heads of income				
On the sale of paintings	(3)	75,000		1·5
On the sale of golden bangles	(4)	69,000		2·0
On sale of shares of Pinewood (Pvt) Ltd	(5)	95,625		2·0
On sale of agricultural tractor	(6)	150,000		1·5
On sale of shares of Sun Electric (Pvt) Ltd	(7)	<u>168,750</u>		<u>1·5</u>
Total taxable capital gains		558,375		
Less:				
Zakat paid	(8)	<u>(10,000)</u>		<u>1·0</u>
Taxable income		<u>548,375</u>		
Computation of tax				
Tax at 10% of the gain exceeding Rs. 400,000 (548,375 – 400,000) x 10%			14,838	0·5
[Para (1) of Div. I, Pt. I of the 1st Sch.]				
Tax credit given in the tax year 2012 reversed	(9)		25,000	1·0
On immovable assets (as computed above)			<u>622,500</u>	
Total tax			<u>662,338</u>	
Less: Tax already paid				
– on the sale proceeds of the house in Lahore at 0·5% of total proceeds Rs. 55,000,000 (55,000,000 x 0·5%) [s.236C]		275,000		0·5
– with educational fees of her daughter [s.236(I)]		50,000		0·5
– advance tax paid [s.147]		<u>240,000</u>		<u>0·5</u>
			<u>(565,000)</u>	
Tax payable with return			<u>97,338</u>	

Items not included in the computation of capital gain

1. Land compulsorily acquired for the construction of a dam

No gain or loss is recognised on the disposal of an asset by reason of the compulsory acquisition of the asset under any law where the consideration received for the disposal is reinvested by the recipient in an asset of a similar kind within one year of the disposal [s.79(1)(d)]. All these conditions are fulfilled in the disposal of her land. Hence, no gain or loss is recognised.

1·0

2. Sale of shares of Reliable Energy Limited

Shares in Reliable Energy Limited ('REL'), being listed on the Islamabad Stock Exchange, are to be treated as 'securities' for the purposes of computing any capital gain/loss. Since the securities of REL were disposed of after holding them for more than one year, no tax is payable on the disposal of these shares [s.37A read with Div. VII of part I of the 1st Sch.].

1·0

3. Brought forward loss from speculation business for the tax year 2013 – Rs. 700,000

A speculation loss from one business can be brought forward from the previous tax year but can be set off only against speculation income, if any. Since there is no income from speculation business during the tax year 2014, this loss cannot be set off against any other income. However, it will be carried forward to the next tax year [s.58(2)].

1·0

	<i>Marks</i>
4. Credit for tax paid on mobile telephone bills during the tax year 2013 – Rs. 5,000	
Tax credit for tax paid in the period relevant to the tax year 2013 cannot be claimed in the tax year 2014 [s.168]. However, she may revise her return for the tax year 2013 to claim this amount of tax paid in that tax year.	1·0
	20

Notes

Note 1

Sale of house in Lahore

From the tax year 2013 onwards, a gain on the disposal of an immovable property 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 the house in Lahore is computed as:

	Rs.	Rs.
Consideration received		55,000,000
<i>Less:</i>		
Cost of acquisition		
Market value at the time of inheritance [s.37(4A)(a) and 79(3)(b)]	40,000,000	
Extension of the covered area [s.76(2)(c)]	10,000,000	
	<hr/>	<hr/>
Capital gain		(50,000,000)
		<hr/>
Tax at 10% as the holding period of the house was less than one year (5,000,000 x 10%) [Div. VIII of Pt. I of 1st Sch.]	5,000,000	
		<hr/>
	500,000	
		<hr/>

The cost of acquisition incurred by her brother is not relevant in computing Ruby's taxable gain.

Note 2

Sale of agricultural land in Sahiwal

From the tax year 2013 onwards, a gain on the disposal of an immovable property 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 the land is computed as:

	Rs.	Rs.
Consideration received		5,000,000
<i>Less:</i>		
Cost of acquisition		
Market value when gifted by her father [s.37(4A)(a) and 79(3)(b)]	2,000,000	
District Council fee for the transfer of the land into her name [s.76(2)(b)]	200,000	
Construction of water channels for the irrigation of the land [s.76(2)(c)]	300,000	
Commission paid to a commission agent [s.76(2)(b)]	50,000	
	<hr/>	<hr/>
Capital gain		(2,550,000)
		<hr/>
Tax at 5% as the holding period of the land was more than one year but less than two years (2,450,000 x 5%) [Div. VIII of Pt. I of 1st Sch.]	2,450,000	
		<hr/>
	122,500	
		<hr/>

The fine paid for violation of the terms of use of the land neither improved the land nor was incidental to the acquisition or disposal of the property, hence is not considered as part of the cost of the asset.

Note 3

Sale of paintings used in her house

(i) Disposal of Gulgee's painting

	Rs.	Rs.
Consideration received on sale		300,000
<i>Less:</i>		
Cost of the painting	400,000	
Valuation fee paid	25,000	
	<hr/>	<hr/>
Loss on disposal	425,000	
		<hr/>
	(125,000)	

No loss is to be recognised [hence cannot be set off against any other capital gain] on a painting [s.38(5)].

		<i>Marks</i>
(ii) Disposal of Shakir Ali's painting		
Consideration received on sale of the painting on 30 August 2013	Rs.	Rs.
Less:		800,000
Purchase price on 15 January 2013.	700,000	
Fee paid for valuation of the painting	<u>25,000</u>	
		(725,000)
Taxable gain on disposal of the painting		<u>75,000</u>

The painting is a capital asset on which a capital gain is taxable but a capital loss is not recognised [s.37(5) read with s.38(5)(a)]. Since the disposal was made before one year of holding, the full amount of capital gain is taxable.

Note 4

Sale of golden bangles

Jewellery held as a personal asset is also a capital asset on which, though a loss is not deductible, a capital gain is taxable [s.37(5) read with s.38(5)(b)] as computed below:

	Rs.	Rs.
Consideration received on the sale of golden bangles on 15 September 2013	350,000	
Less:		
Cost of the golden bangles sold		
Purchase of gold [10,000 x 22] [s.76(2)(a) and s.71]	220,000	
Import duties and other indirect taxes [s.76(2)(b)]	8,000	
Payment to goldsmith for preparing of bangles [s.76(2)(c)]	<u>30,000</u>	
		(258,000)
Capital gain		<u>92,000</u>

Since the jewellery was sold after holding it for more than 12 months, only 75% gain (Rs. 69,000) is taxable [s.37(3)].

Note 5

Sale of shares in Pinewood (Pvt) Ltd

	Rs.	Rs.
Consideration received on the sale of 11,000 shares on 15 December 2013 [s.77(1)]	330,000	
Less:		
Purchase price of 5,000 shares at Rs. 20 per share on 5 February 2002 (5,000 x 20)	100,000	
Purchase price of 5,000 rights issue shares at Rs. 20 per share (5,000 x 20) [Breakup value is not relevant.]	100,000	
Allotment of 1,000 bonus shares on 1 October 2011 (Fair market value is not relevant.)	0	
Capital value tax paid on acquisition of right shares [s.76(b)]	<u>2,500</u>	
		(202,500)
		<u>127,500</u>

Since the disposal of the shares was made after holding them for more than a year, only 75% of the capital gain is taxable at Rs. 95,625 [s.37(3)].

Note 6

Disposal of agricultural tractor

An agricultural tractor is a movable asset on which depreciation is not allowable, hence it is treated as a capital asset. The subsidised purchase price of the tractor paid by Ruby was Rs. 1,000,000 against the market price of Rs 1,500,00 on 1 February 2013. Since the subsidy has not been taxed, the subsidised price will be taken as its cost [s.76(10)]. The taxable gain shall be computed as:

	Rs.
Consideration received 15 February 2014	1,200,000
Less:	
Subsidised cost of the tractor on 1 February 2013	<u>(1,000,000)</u>
Capital gain	<u>200,000</u>

Since normal repairs do not improve the asset, Rs 90,000 does not form part of the cost as per the definition given in the Ordinance [s.76(2)].

Since the disposal was made after one year of acquiring the asset, 75% of the capital gain is taxable at Rs. 150,000 [s.37(3)].

Note 7

Disposal of shares in Sun Electric (Pvt) Ltd

	Rs.
The fair market value [Rs. 45 per share] of 15,000 shares sold on 1 April 2014 being higher than the actual amount received [Rs. 40 per share (Rs. 600,000/15,000)] is to be taken as the consideration received [15,000 x 45] [s.77(1)]	675,000
Purchase price on 1 July 2012 at Rs. 30 per share [15,000 x 30] [sub-note (a)]	<u>(450,000)</u>
Capital gain	225,000

Since the disposal was made after one year of acquiring the asset, 75% of the capital gain is taxable at Rs.168,750 [s.37(3)].

Note (a): The fair market value of the shares on the date an employee can dispose of the shares would have been treated as the consideration received on that date for the purpose of computation of salary income on account of benefit under the employee share scheme. Subsequently this amount is treated as the cost paid for the purpose of computing taxable capital gains [s.14(3)(b) and s.14 4)(c)].

Note 8

Zakat paid is to be deducted from the total taxable capital gains [and not from the disposal of any single asset] to reach taxable income [s.60(1)].

Note 9

The tax credit of Rs. 25,000 allowed in respect of the investment in the shares in Reliable Energy Limited in the tax year 2012 is to be reversed and added back in calculating the tax liability for the tax year 2014 as Ruby has made a disposal of these shares within 24 months of the date of their acquisition [s.62(2)].

4 (a) Mr Muzammil

(i) Circumstances under which an assessment order can be amended

An assessment order can be amended in either of the following two circumstances:

- (1) the Commissioner has definite information, acquired from audit or otherwise, to his satisfaction that:
 - (i) any income chargeable to tax has escaped assessment;
 - (ii) total income has been under-assessed, or assessed at too low a rate, or has been the subject of excessive relief or refund; or
 - (iii) any amount under a head of income has been misclassified [s.122(5)].
- (2) the Commissioner considers the assessment order to be erroneous in so far as it is prejudicial to the interest of revenue [s.122(5A)].

4·0

(ii) Further amendment of an amended order

Where an assessment order has been amended by the Commissioner, it can be further amended by him as many times as may be necessary subject to the availability of the time limit prescribed in law [s.122(4)].

1·0

(b) Precious Goods Limited (PGL)

(i) Basis for permission to change to a special tax year

Change from normal tax year (to 30 June) to a special tax year (e.g. to 31 December) and vice versa is not a routine matter. The Commissioner shall only grant permission if PGL is able to show a compelling need for the requested change in the tax year from normal to special [s.74(5)].

1·0

(ii) Personal hearing to the applicant

The Commissioner shall pass a written order on the application of PGL for a change in the tax year after providing them an opportunity of being heard. After providing the opportunity of a hearing, the Commissioner may accept or reject the application [s.74(6)].

1·0

	<i>Marks</i>
(iii) Imposition of conditions when granting permission for a change in the tax year	1·0
The Commissioner may impose conditions subject to which the permission would be granted and effective [s.74(5)].	
(iv) Effective date of change in the tax year	1·0
An order granting permission shall take effect from such date, being the first day of the special tax year as may be specified in the order [s.74(8)].	
(v) Withdrawal of permission	1·0
The Commissioner may, after providing to the person concerned an opportunity of being heard, by an order, withdraw the permission granted earlier for a change in the tax year. Reasons will be given for such withdrawal of permission [s.74(7)].	
(c) Methods of selection of cases for audit by the Federal Board of Revenue	
The Federal Board of Revenue ('FBR') is empowered to select either persons or class of persons for audit of their income tax affairs by one of the following two methods:	
(i) selection through computer ballot on a random basis; and	
(ii) selection through computer ballot on a parametric basis [s.214C(1)].	
The FBR may keep the parameters confidential, if it so deems fit [s.214C(1A)].	2·0
(d) Mr Imran – additional amount due for late payment of the refund	
Where a refund due to a taxpayer is not paid within three months of the date on which it becomes due, the Commissioner Inland Revenue is duty bound to pay compensation at 15% of the amount of the refund for the period, reduced by the three months, during which the refund is not paid [s.171(1)].	1·0
Where the refund is created as a result of an appellate order, the refund is said to be due on the date on which the appellate order is received by the Commissioner [s.171(2)(a)].	0·5
Hence, the compensation will be:	
Amount of refund	Rs. 500,000
Due date of refund	31 December 2013
Date of payment of refund	30 May 2014
Delay in number of days	(150 – 90) = 60
Amount of compensation	500,000 x 15% x 60/365 = Rs. 12,329
	1·5
	3·0
	15
5 (a) (i) Main function of an e-intermediary	
On authorisation by a registered person, an e-intermediary's function is to file returns, declarations and other documents, etc electronically on behalf of the registered person [s.52A(2)].	1·0
(ii) Joint and several liability	
Where an e-intermediary, authorised by a registered person, knowingly and willfully submits false or incorrect information or documents or declaration with the intention to avoid payment of the due amount of tax or to claim a refund or a tax credit which is not due to the taxpayer, such an e-intermediary shall be jointly and severally responsible for recovery of the amount of tax underpaid or the excess amount refunded as a result of such incorrect or false information or documents or declaration. This responsibility is in addition to any other action which may be taken against him/her under the relevant provisions of the law [s.52A(5)].	2·0

(b) Taqi Engineering Ltd	Marks
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(i) Sales tax payable for May 2014

	Rs.
Output tax	
On exempt supplies of Rs. 4,000,000	0 0·5
On taxable supplies	
– in local market to registered persons (Rs. 2,000,000 x 17%)	340,000 0·5
– in local market to unregistered persons (Rs. 3,000,000 x (17 + 1%))	540,000 1·0
– being exports to Singapore (Rs. 1,000,000 x 0%)	0 0·5
As credit purchases of Rs. 580,000 remain unpaid on 31 May 2014 the input tax previously claimed on this amount needs to be reversed (Rs. 580,000 x 100/116 x 16%)	<u>80,000</u> 1·5
	<u>960,000</u>
Input tax	
Purchases of raw materials (inclusive of sales tax)	Rs. 5,850,000
Input tax (Rs. 5,850,000 x 100/117 = 5,000,000 x 17%)	Rs. 850,000
Apportionment of above input tax on purchases relatable to taxable supplies:	
Taxable supplies/(Taxable supplies + exempt supplies) x input tax 6,000,000/(6,000,000 + 4,000,000) x 850,000	<u>(510,000)</u> 2·0
Sales tax payable	<u>450,000</u>
	<u>6·0</u>

(ii) Treatment of creditor payable

A buyer is not entitled to claim an input tax credit, adjustment or deduction, or refund, repayment or draw-back or zero rating of tax under the Sales Tax Act, 1990 if in the case of a transaction on credit payment is not transferred to the seller within 180 days of the issuance of the sales tax invoice [s.73(2)].

1·0

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