Fundamentals Level – Skills Module

# Taxation (Pakistan)

Tuesday 3 June 2014

**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.**

Paper F6 (PKN)

**The Association of Chartered Certified Accountants**

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 2014 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. 1,400,000 | Rs. 17,500 plus 10% of the amount exceeding Rs. 750,000 |
| Rs. 1,400,001 to Rs. 1,500,000 | Rs. 82,500 plus 12·5% of the amount exceeding Rs. 1,400,000 |
| Rs. 1,500,001 to Rs. 1,800,000 | Rs. 95,000 plus 15% of the amount exceeding Rs. 1,500,000 |
| Rs. 1,800,001 to Rs. 2,500,000 | Rs. 140,000 plus 17·5% of the amount exceeding Rs. 1,800,000 |
| Rs. 2,500,001 to Rs. 3,000,000 | Rs. 262,500 plus 20% of the amount exceeding Rs. 2,500,000 |
| Rs. 3,000,001 to Rs. 3,500,000 | Rs. 362,500 plus 22·5% of the amount exceeding Rs. 3,000,000 |
| Rs. 3,500,001 to Rs. 4,000,000 | Rs. 475,000 plus 25% of the amount exceeding Rs. 3,500,000 |
| Rs. 4,000,001 to Rs. 7,000,000 | Rs. 600,000 plus 27·5% of the amount exceeding Rs. 4,000,000 |
| Rs. 7,000,001 and above | Rs. 1,425,000 plus 30% of the amount exceeding Rs. 7,000,000 |

### 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 – Rs. 4,000,000 | Rs. 347,500 plus 25% of the amount exceeding Rs. 2,500,000 |
| Rs. 4,000,001 – Rs. 6,000,000 | Rs. 722,500 plus 30% of the amount exceeding Rs. 4,000,000 |
| Rs. 6,000,001 and above | Rs. 1,322,500 plus 35% of the amount exceeding Rs. 6,000,000 |

### C. Tax rates for companies

| | |
|---|---|
| Small company | 25% of taxable income |
| Public company/private company | 34% 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. Other tax rates**

| | |
|---|---|
| On dividends received from a company | 10% |

**G. Rates of deduction/collection of tax at source**

| | |
|---|---|
| Sale of goods (general rate) | |
| – where the payment is being made to a company | 3·5% |
| – where the payment is being made to a taxpayer other than a company | 4% |
| Sale of immovable property | 0·5% |
| Services (other than transport) | |
| – where the payment is being made to a company | 6% |
| – where the payment is being made to a taxpayer other than a company | 7% |
| Contracts | |
| – where the payment is being made to a company | 6% |
| – where the payment is being made to a taxpayer other than a company | 6·5% |
| Commission or brokerage | 10% |
| Profit on debt | 10% |
| Import of goods (general rate) | |
| – in the case of industrial undertakings | 5% |
| – in all other cases of companies | 5% |
| – in the case of other taxpayers | 5·5% |

**H. 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% | |

**I.** Initial allowance 25% of cost

**J. Pre-commencement expenditure**

| | |
|---|---|
| Amortisation rate for pre-commencement expenditure | 20% |

**K. 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 2014.**

Presson Industries Limited ('PIL'), incorporated on 1 July 2010 as an unlisted public company under the Companies Ordinance, 1984, started its business operations on 1 July 2011. The company became listed on the Karachi Stock Exchange with effect from 1 July 2013. PIL does not fall within the definition of a small company. The products of PIL are exempt from sales tax. The company prepares its financial statements to 30 June each year.

The following are the audited financial results of PIL for the year ended 30 June 2014:

| | Note | Rs. |
|---|---|---|
| Sales | 1 | 130,000,000 |
| Cost of sales | 2 | (80,000,000) |
| Gross profit | | 50,000,000 |
| Administrative expenses | 3 | (15,000,000) |
| Distribution and selling costs | 4 | (13,000,000) |
| Other operating expenses | 5 | (11,000,000) |
| Other operating income | 6 | 5,000,000 |
| | | (34,000,000) |
| Profit/(loss) from operations | | 16,000,000 |
| Finance cost | 7 | (3,000,000) |
| Net profit | | 13,000,000 |

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

**Notes:**

Note 1

Sales include Rs. 250,000 received as compensation from Sui Southern Gas Company Ltd for partial loss of profits on account of disrupted gas supply, as per the terms of the agreement.

Note 2

Cost of sales includes:

- Penalty for violation of the Environmental Protection Act 1997 of Rs. 700,000.
- Depreciation on plant and machinery of Rs. 1,500,000.
- Income tax paid along with electricity bills for the factory of Rs. 600,000.

Note 3

Administrative expenses include:

(i) Legal and other fees of Rs. 600,000 paid comprising:

| | Rs. |
|---|---|
| – Legal fees paid to collect business trade debts | 200,000 |
| – Legal fees incurred for defending the title to a piece of land owned by the company | 300,000 |
| – Legal and other fees paid in connection with the acquisition of a piece of land | 100,000 |
| | 600,000 |

(ii) Payment of a bonus to a director of the company without deduction of tax 600,000

Note 4

Distribution and selling costs include:

– Depreciation of Rs. 1,400,000 on fixed assets.
– Free distribution of sample goods manufactured by the company in line with practice in the industry. The market value of the samples distributed was Rs. 300,000.
– Commission of Rs. 900,000 paid to distributors without tax deduction.

Note 5

Other operating expenses include:

– Provision for expenses of Rs. 290,000 to be incurred in July 2014.
– Amortisation of pre-commencement expenditure of Rs. 200,000. The total eligible pre-commencement expenditure incurred by PIL before 1 July 2011 was Rs. 600,000.
– Direct donation to a school (in cash) of Rs. 10,000.
– Accounting loss of Rs. 300,000 on the sale of a motor vehicle on 15 September 2013 [refer to note 8].

Note 6

Other operating income of Rs. 5,000,000 is due to a fair value adjustment (upwards) of a piece of land owned by PIL.

Note 7

The finance cost of Rs. 3,000,000 consists of:

| | | Rs. |
|---|---|---|
| – | Profit paid on funds borrowed to finance work-in-progress | 500,000 |
| – | Finance cost paid to the leasing company relating to the photocopier taken on a finance lease [refer to note 8] | 20,000 |
| – | Profit paid to a scheduled bank on funds borrowed for the purchasing of stock in trade and the incurring of other day-to-day expenditure. No tax was deducted from this payment by PIL | 2,480,000 |
| | | 3,000,000 |

Note 8

Other information

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

| **Asset** | **Tax written down value (TWDV) as on 1 July 2013 Rs.** |
|---|---|
| Freehold land | 15,000,000 |
| Building on freehold land | 7,000,000 |
| Plant, machinery and equipment | 15,000,000 |
| Computers | 2,000,000 |
| Furniture and fittings | 4,000,000 |
| Motor vehicles | 7,000,000 |

(ii) During the year ended 30 June 2014, PIL had the following movements in fixed assets:

| Date | Description |
|---|---|
| 1 August 2013 | Acquired a photocopier having a fair market value of Rs. 250,000 under a finance lease from an approved leasing company. Lease rentals of Rs. 75,000 were paid during the tax year ended 30 June 2014. |
| 15 September 2013 | Sold a motor car for a total consideration of Rs. 2,700,000. The motor car had been purchased for Rs. 3,000,000 on 1 July 2012 for the use of the chief executive of the company. Its value had been restricted for tax depreciation purposes to Rs. 2,500,000. The tax written down value of the vehicle on 1 July 2013 was Rs. 2,125,000. |
| 19 April 2014 | Bought a new computer for Rs. 300,000 including software with a price of Rs. 120,000. The computer software is expected to have a useful life of four years. The computer was put to use on the same day. |
| 29 June 2014 | Purchased a table for the conference room for Rs. 160,000 and put into use on 30 June 2014. |

(iii) The company has a brought forward capital loss of Rs. 3,500,000 from the tax year 2012.

(iv) Tax paid by or collected from PIL during the year ended 30 June 2014 was:

| | Rs. |
|---|---|
| Advance tax paid in cash in four equal instalments on the due dates | 2,000,000 |
| Advance tax on cash withdrawals from bank accounts | 80,000 |

**Required:**

**(a) Compute the taxable income of Presson Industries Ltd (PIL) for the tax year 2014, 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, as specific marks are allocated for these explanations. (27 marks)

**(b) Calculate the tax payable by/refundable to PIL for the tax year 2014 on the basis of the taxable income computed in part (a).**

Note: Ignore workers' welfare fund and the minimum tax provisions. (3 marks)

**(30 marks)**

**2 For the purpose of this question, you should assume that today's date is 15 July 2014.**

Mr Hassan, aged 65, has been resident in Pakistan for many years and offers his income for tax on the accrual basis. He has provided the following information about his immovable properties rented out to different persons during the year ended on 30 June 2014:

**House in Multan**

(i) Hassan rented out his house in Multan to Kamal on 1 July 2011, at a monthly rent of Rs. 100,000. He had also received a non-adjustable deposit of Rs. 1,000,000 from Kamal at the commencement of the rental. On 1 July 2013, Kamal vacated the house and the non-adjustable deposit was returned to him in full.

(ii) On 1 July 2013, Hassan let the house to Waqar at a monthly rent of Rs. 120,000 which included Rs. 20,000 for the services of a security guard. Hassan also received a new non-adjustable deposit of Rs. 1,500,000 from Waqar.

(iii) In the accounting year ended 30 June 2014, Hassan incurred the following expenditure on the house:

| | **Rs.** |
|---|---|
| Repair of the house | 120,000 |
| Collection charges | 70,000 |
| Property tax paid to the Excise and Taxation Department | 350,000 |
| Expenditure for the preparation of the tenancy agreement with Waqar | 25,000 |
| Legal fee paid for defending the title to the house in a court of law | 100,000 |
| Annual salary paid to the security guard | 200,000 |
| Profit paid to a bank on a loan utilised for renovating the house | 50,000 |
| Insurance premium paid to cover the risk of damage by fire | 30,000 |

**Building with plant and machinery**

(i) On 1 August 2013, Hassan purchased a new building in which new biscuit manufacturing plant and machinery had been installed. The consideration paid as specified in the purchase deed was Rs. 8,000,000 for the building and Rs. 4,000,000 for the plant and machinery installed in the building. On 1 October 2013, the building together with the plant and machinery was rented out to Tasty Biscuits (Pvt) Limited for a composite rent of Rs. 800,000 per month. Hassan also received a non-adjustable advance of Rs. 1,000,000 from the company.

(ii) In the accounting year ended 30 June 2014, Hassan incurred the following expenditure on the building:

| | **Rs.** |
|---|---|
| Distempering the building | 90,000 |
| Interest-free refundable security deposited with the electricity providing company | 400,000 |
| Property tax on the building paid to the local government for nine months | 300,000 |
| Legal fee for preparing the rental agreement | 35,000 |
| Salary paid to a technician for maintaining the machinery | 400,000 |

Hassan has also provided the following additional information relevant to the accounting year ended 30 June 2014:

(i) Unless stated otherwise, all expenditure has been paid via a mode admissible under the law and tax deducted wherever applicable.

(ii) During the year, Hassan received a pension of Rs. 10,000 per month from his ex-employer, the Government of Pakistan.

(iii) Hassan had incurred Rs. 35,000 on his medical treatment. He has kept complete evidence of the expenditure, as required under the law.

(iv) Tax withheld from/paid by Hassan was:

- Rs. 3,000 on his prepaid mobile phone cards.
- Rs. 20,000 on the purchase of domestic air tickets by Hassan.
- Rs. 350,000 paid as advance tax in four equal quarterly instalments.
- Rs. 10,000 withheld by a club where he had arranged a birthday party for his wife.

**Required:**

**(a) Explain whether or not Mr Hassan is entitled to claim a deduction for a repair allowance equal to one-fifth of the rent chargeable to tax on account of the building rented out to Tasty Biscuits (Pvt) Limited.** (2 marks)

**(b) Compute Mr Hassan's taxable income for the tax year 2014, giving clear explanations for the treatment of any items excluded from taxable income or for which no expense/deduction is allowed.** (18 marks)

**(c) State, giving reasons, whether or not Mr Hassan will be entitled to a reduction in his tax liability for the tax year 2014 due to his age and calculate the total tax payable by him on the basis of the taxable income computed in part (b).** (5 marks)

**(25 marks)**

**3 For the purpose of this question, you should assume that today's date is 15 July 2014.**

Ms Ruby, aged 55, is a taxpayer resident in Pakistan. During the year ended 30 June 2014, she disposed of the following assets:

**Immovable assets**

(1) 15 July 2013: Sold her house in Lahore for Rs. 55,000,000. She had inherited the house from her brother in his will on 15 December 2012. The house had cost her brother Rs. 20,000,000 in the year 2006. At the time of the transfer into her name, the market value was estimated to be Rs. 40,000,000. Before the sale of the house, Ruby incurred Rs. 10,000,000 on the extension of its covered area.

Income tax at 0·5% of the sale price at the time of its transfer to the buyer was collected at source by the transferring authority.

(2) 30 September 2013: The government of Punjab compulsorily acquired her land under the Land Acquisition Act, 1894 for the construction of a water dam and paid her compensation of Rs. 30,000,000. She had purchased the land for Rs. 25,000,000 on 1 January 2012. On 7 October 2013, she invested the whole amount of the compensation received in the acquisition of another piece of land in an area designated by the government for the people affected by the dam.

(3) 1 January 2014: Ruby sold her ten acres of agricultural land in Sahiwal for Rs. 5,000,000. She had received the land as gift from her father on 30 June 2012, on which date the fair market value of the land was estimated at Rs. 2,000,000. Originally the land had been given to her father for free to make it fit for cultivation. Ruby incurred the following expenditure on the land:

| | **Rs.** |
|---|---|
| District Council fee for the transfer of the land into her name | 200,000 |
| Fine paid for a violation of the terms of use of the land | 150,000 |
| Cost of construction of water courses for the irrigation of the land | 300,000 |
| Commission paid to a commission agent for the sale of the land | 50,000 |

**Movable assets**

(1) 30 August 2013: She sold two paintings by renowned artists as below:

(i) Gulgee's painting for Rs. 300,000 which she had originally acquired for Rs. 400,000 on 15 August 2010 to display in her drawing room.

(ii) Shakir Ali's painting for Rs. 800,000 which she had acquired for Rs. 700,000 on 15 January 2013 for her study room.

Rs. 25,000 was paid for an expert valuation in respect of each painting on the date of sale.

(2) 15 September 2013: She sold her golden bangles for Rs. 350,000. She had incurred the following expenditure in respect of the bangles:

- Acquired gold from Saudi Arabia on 1 January 2012 for 10,000 Saudi Riyals.
- Paid import duties and other indirect taxes of Rs. 8,000.
- Paid Rs. 30,000 to a goldsmith on 10 January 2012 for preparation of the bangles' exquisite design.
- Paid Rs. 10,000 as Zakat under the existing Zakat and Ushr law in Pakistan on 1 August 2013.

Currency rates on 1 January 2012 were:

| | |
|---|---|
| Notified by the State Bank of Pakistan | 1 Saudi Riyal = 22 Pak Rupees |
| Open market rate | 1 Saudi Riyal = 24 Pak Rupees |

(3) 30 September 2013: Sold 10,000 shares in Reliable Energy Limited, a company listed on the Islamabad Stock Exchange, for Rs. 350,000. She had acquired these shares on 15 October 2011 at Rs. 15 per share by subscribing to the initial public offer of the shares by the company. She was allowed a tax credit of Rs. 25,000 in the tax year 2012 against this investment. No tax was withheld at source on this transaction.

(4) 15 December 2013: Sold 11,000 shares in Pinewood (Pvt) Ltd for Rs. 330,000. She had acquired these shares as follows:

- 5,000 shares purchased at Rs. 20 per share on 5 February 2002.
- 5,000 rights issue shares acquired by her on 1 July 2005 at Rs. 20 per share when the breakup value was Rs. 25 per share.
- 1,000 bonus shares allotted to her on 1 October 2011 when the fair market value was Rs. 35 per share.

A capital value tax of Rs. 2,500 was paid at the time of the acquisition of the rights issue shares.

(5) 15 February 2014: Sold her tractor (used for agricultural purposes on her land in Sahiwal) for Rs. 1,200,000. The market value of the tractor at the time of acquisition on 1 February 2013 was Rs. 1,500,000, but Ruby had purchased the tractor from the Government of Punjab at the subsidised price of only Rs. 1,000,000. She had incurred Rs. 90,000 on normal repairs for the tractor.

(6) 1 April 2014: Sold 15,000 shares in Sun Electric (Pvt) Ltd for Rs. 600,000 which she had acquired on 1 July 2010 from her ex-employer under an employee share scheme for Rs. 150,000. She had the option to dispose of the shares on or after 1 July 2012.

The fair values of the shares were as below:

- Rs. 20 per share on 1 July 2010
- Rs. 30 per share on 1 July 2012
- Rs. 45 per share on 1 April 2014

**Other information:**

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

(ii) Ruby has a brought forward loss of Rs. 700,000 from the tax year 2013 on account of speculation business.

(iii) Tax of Rs. 50,000 was collected by a medical college from the fees paid for her daughter, who is studying there, during the tax year 2014.

(iv) Advance tax of Rs. 240,000 has been paid by Ruby on the basis of her tax liability for the tax year 2013.

(v) Ruby had been unable to claim Rs. 5,000 deducted on her mobile telephone bills during the tax year 2013 in her tax return for that year.

**Required:**

**Compute the tax payable by Ms Ruby for the tax year 2014 on the taxable income arising from the above transactions. Give brief reasons for your treatment of each item.**

**Note: The reasons/explanations for the items not listed in the computation should be shown separately, as specific marks are allocated for these explanations.**

**(20 marks)**

**4** **(a)** Mr Muzammil filed his return of income for the tax year 2013 on 30 September 2013. The return of income was complete in all respects and as such was treated as an assessment order passed by the Commissioner Inland Revenue.

**Required:**

**(i) State the circumstances under which the Commissioner Inland Revenue may amend the assessment order of Mr Muzammil for the tax year 2013.** (4 marks)

**(ii) State whether an assessment order which has been amended once can be further amended.** (1 mark)

**(b)** Precious Goods Limited ('PGL') currently uses a normal tax year of 12 months ending on 30 June each year. However, it has applied in writing to the Commissioner Inland Revenue for a change of its normal tax year to a special tax year ending on 31 December each year.

**Required:**

**(i) State on what basis Precious Goods Limited can be allowed a change to a special tax year by the Commissioner Inland Revenue.**
**(ii) State whether it is mandatory for the Commissioner to give a personal hearing to the applicant before passing an order either accepting or rejecting the request.**
**(iii) State whether the Commissioner can impose any conditions when allowing a change in the tax year.**
**(iv) State from what date the order of change in the tax year will take effect.**
**(v) State whether permission, once granted, can be withdrawn by the Commissioner.**

Note: The total marks will be split equally between each part. (5 marks)

**(c) State the TWO methods available to the Federal Board of Revenue to select taxpayers' cases for audit under [s.214 C of] the Income Tax Ordinance, 2001.** (2 marks)

**(d)** The assessment order of Mr Imran for the tax year 2013 taken to have been passed by the Commissioner Inland Revenue on 30 September 2013 was amended by the Commissioner on 10 October 2013, as a result of which a tax demand for Rs. 500,000 was created. The demand was paid by Imran on 15 October 2013.

On appeal before the Commissioner (Appeal), the entire tax demand of Rs. 500,000 was deleted. The appellate order was received by the Commissioner on 31 December 2013 and a refund of Rs. 500,000 was paid to Imran on 30 May 2014.

**Required:**

**Explain how the additional amount to which Mr Imran is entitled for the delayed issuance of the refund by the Commissioner Inland Revenue will be determined and compute the amount of compensation due.**

(3 marks)

**(15 marks)**

**5 (a) (i) State the main function of an e-intermediary.** (1 mark)

**(ii) State under what circumstances an e-intermediary may be held jointly and severally responsible for the acts done on behalf of a taxpayer for whom he or she works.** (2 marks)

**(b) For the purpose of this question, you should assume that today's date is 10 June 2014.**

Taqi Engineering Limited ('TEL'), a manufacturer and supplier of engineering goods, is registered under the Sales Tax Act, 1990. The summarised business transactions of TEL for the month of May 2014 are as follows:

- Purchases of raw materials of Rs. 5,850,000.
- Exempt sales in the local market of Rs. 4,000,000.
- Taxable sales in the local market of Rs. 2,000,000 made to registered persons.
- Taxable sales in the local market of Rs. 3,000,000 made to unregistered persons.
- Export of taxable goods of Rs. 1,000,000 to Singapore.

Additional information:

(i) The purchases are stated inclusive of sales tax and were used for the manufacturing of both taxable and exempt goods sold during May 2014.

(ii) Sales (including exports) are all stated exclusive of sales tax.

(iii) The normal rate of tax on sales made to registered persons is 17%.

(iv) Creditors payable as at 31 May 2014 include Rs. 580,000 (inclusive of sales tax at 16%) on account of purchases of raw materials from a registered supplier made on 15 November 2013. The input tax on these purchases was claimed in the monthly sales tax return of November 2013 and related to taxable sales only. No further action has been taken so far in respect of this amount.

**Required:**

**(i) Compute the sales tax liability of Taqi Engineering Limited ('TEL') in respect of its sales tax return for the month of May 2014.** (6 marks)

**(ii) Explain the treatment of the creditor payable of Rs. 580,000 outstanding since 15 November 2013.** (1 mark)

**(10 marks)**

**End of Question Paper**