Fundamentals Level – Skills Module

Taxation (Pakistan)

Tuesday 2 December 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.

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 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.

Anwar Chemicals Limited ('ACL'), incorporated on 1 July 2009, is a public listed company incorporated under the Companies Ordinance, 1984. ACL does not fall within the definition of a small company. The goods manufactured by ACL are exempt from sales tax. The company prepares its financial statements to 30 June each year.

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

	Note	Rs.
Sales	1	150,000,000
Cost of sales	2	(90,000,000)
Gross profit		60,000,000
Administrative expenses	3	(16,000,000)
Distribution and selling costs	4	(13,000,000)
Other operating expenses	5	(11,000,000)
Other income	6	1,000,000
		(39,000,000)
Profit/(loss) from operations		21,000,000
Finance costs	7	(2,000,000)
Net profit		19,000,000

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

Notes:

Note 1

Sales include an advance amount of Rs. 500,000 received for sales to be made in July 2014. The directors decided to treat this amount as revenue in the year ended 30 June 2014 on the basis that the goods will definitely be manufactured in July 2014 and supplied to the customer.

Note 2

Cost of sales includes:

– Purchase of a trademark costing Rs. 3,285,000 and used from 2 January 2014 onwards. The useful life of this trademark cannot be ascertained.
– Cost of a new laptop of Rs. 200,000 purchased for and used in the production department. The company has a policy to charge capital expenditure up to Rs. 200,000 to the profit or loss account in full during the year in which it is purchased.
– Penalty imposed under the Sales Tax Act, 1990 of Rs. 100,000 paid for the late deposit of sales tax.

Note 3

Administrative expenses include:

		Rs.
(i)	Software installed which has a useful life of one year	200,000
(ii)	Donation paid to the central mosque of the city	50,000
(iii)	Expenditure incurred on entertainment at the annual general meeting of shareholders of the company	500,000
(iv)	Depreciation on fixed assets	4,500,000
(v)	Provision for gratuity (ACL does not maintain any approved gratuity fund)	1,400,000

Note 4

Distribution and selling costs include:

- A best performance reward of Rs. 400,000 paid in cash to an employee who surpassed the ambitious sales target fixed for the year. This amount was treated as a part of his salary and tax was duly deducted.
- A car having a fair market value of Rs. 1,500,000 was given as a prize to a dealer under a sales promotion scheme. No tax was collected from the dealer.
- Trade fair expenses of Rs. 400,000, 5% of which are not supported by documentary evidence.

Note 5

Other operating expenses include:

(i) A bad debt charge consisting of:

		Rs.
	Increase in general provision for bad debts	300,000
	Loan to an ex-employee – written off as being irrecoverable	119,000
	Trade debts written off as irrecoverable after exhausting all recovery measures	700,000
(ii)	Fair value adjustment in stocks and shares held by the company	800,000
(iii)	Charges for the installation of laboratory equipment paid in cash [see note 8]	26,000

Note 6

Other income of Rs. 1,000,000 consists of:

	Rs.
Profit received from a fixed deposit maintained with a bank	900,000
Tax deducted by the bank	100,000
	1,000,000

Note 7

The finance costs of Rs. 2,000,000 consists of:

	Rs.
– Profit paid on funds borrowed by ACL from a bank for the personal needs of a director of the company.	900,000
– Lease rentals paid during the year to an approved leasing company for a car taken on a finance lease. [see note 8]	280,000
– Profit paid to a bank on a loan taken for advancing concessional loans to ACL's staff as per the terms of their contracts of employment	820,000
	2,000,000

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	9,000,000
Building on freehold land	7,000,000
Plant, machinery and equipment	10,000,000
Computers and other IT related equipment	2,000,000
Furniture and fittings	3,000,000
Motor vehicles	3,500,000

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

Date	Description
15 August 2013	Acquired a new car having a fair market value of Rs. 3,000,000 under a finance lease from an approved leasing company [as in note 7].
1 September 2013	Sold a machine for a total consideration of Rs. 1,000,000. The machine had been purchased for Rs. 1,500,000 on 1 July 2012. The tax written down value of the machinery on 1 July 2013 was Rs. 900,000. No gain or loss has been recognised in the accounts as the sale proceeds were still receivable by the company on 30 June 2014.
19 April 2014	Purchased new laboratory equipment for Rs. 1,200,000. The sum of Rs. 26,000 was paid in cash to a technician for the installation of the equipment [as in note 5]. The equipment was put into use for the first time on 30 June 2014.
25 May 2014	Newly built residential quarters were handed over to the workers of the company. The total cost of the residential quarters was Rs. 5,000,000.

(iii) ACL has a brought forward business loss of Rs. 1,500,000 from the tax year 2010.

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

	Rs.
Advance tax paid in cash in four equal instalments on the due dates	3,000,000
Advance tax on cash withdrawals from bank accounts	100,000
Tax deducted by companies from payments made to ACL for the supply of goods	5,000,000
Total	8,100,000

Required:

(a) Compute the taxable income of Anwar Chemicals Ltd (ACL) 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 ACL for the tax year 2014 based on the taxable income computed in part (a).

Note: Ignore workers' welfare fund and 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.

Ms Xiang, a Chinese citizen born on 8 January 1973, came to Pakistan on 20 June 2013 on her appointment as an engineer by Midea Appliances (Pvt) Ltd (MAPL), a company incorporated under the Companies Ordinance, 1984. Ms Xiang started her employment with MAPL on 1 July 2013. For the year ended 30 June 2014, her income/receipts are as detailed below:

(a) Basic salary of Rs. 200,000 per month. Other perquisites given in cash or kind were:

(i) MAPL paid her fixed medical costs of Rs. 400,000 for the whole year in cash (regardless of her actual expenditure on medical treatment).

(ii) MAPL provided her with a car for business and personal use. MAPL had obtained the car under a finance lease and its fair market value at the time of lease was Rs. 1,800,000. The total amount of lease rentals to be paid over the whole lease term was Rs. 2,000,000. Lease rentals paid during the year ended 30 June 2014 were Rs. 250,000. Ms Xiang was also provided with a fuel allowance of Rs. 25,000 per month to cover fuel expenses for her company allocated car. 50% of her travelling was directly related to the business of her employer.

(iii) MAPL provided her with accommodation. Had she not been provided with the accommodation she would have been entitled to receive a house rent allowance at 40% of her basic salary. MAPL also provided her with the services of a security guard for which MAPL paid Rs. 18,000 per month. Rs. 10,000 was deducted every month from Ms Xiang's salary to pay for the security guard.

(iv) She received 50,000 shares in MAPL on 1 July 2013 under an employee share scheme at Rs. 10 per share against a fair value of Rs. 15 per share. She had the option to transfer the shares on or after 1 June 2014 on which date the fair value was Rs. 30 per share. However, she did not sell any of the shares during the year ended 30 June 2014.

(v) MAPL reimbursed her Rs. 25,000 per month for nine months during the year, being the school fees of her child. The school also collected tax at Rs. 15,000 which was paid by Ms Xiang from her own pocket and a tax payment challan was provided to her.

(vi) MAPL gave her a loan of Rs. 500,000 on 1 August 2013 at a markup of 6% per annum. She used the loan for furnishing her apartment in China.

(vii) MAPL provided her with a return ticket to Beijing on the eve of Chinese new year in February 2014. The total cost incurred by MAPL on this account was Rs. 150,000.

Additional information about Ms Xiang's employment

(i) She paid Rs. 50,000 for her annual subscription to the Institute of Engineers in China.

(ii) MAPL deducted tax of Rs. 940,000 from her salary during the year.

(b) Ms Xiang earned Rs. 300,000 during the year by delivering lectures in a Chinese language coaching centre at the weekends. Ms Xiang spent Rs. 50,000 on the preparation of these lectures but she has not kept any documentary evidence of these expenses. The coaching centre is owned by a sole proprietor whose annual turnover is Rs. 3,000,000.

(c) Ms Xiang received Rs. 800,000 in rental income for the letting of her apartment in Zhangshen in China. She has not brought this amount into Pakistan.

(d) On 1 August 2013, she imported Chinese food supplements valued at Rs. 400,000 and sold the same to a health club in Pakistan on 10 September 2013 for Rs. 550,000. The custom authorities collected advance tax of Rs. 22,000 at the import stage. She paid Rs. 20,000 to a salesman through a crossed cheque.

(e) On 15 September 2013, she imported Chinese toys valued at Rs. 500,000. The custom authorities collected advance tax of Rs. 27,500 at the import stage. The toys were not popular in Pakistan and consequently were sold on 15 December 2013 at Rs. 350,000. No other expenditure was incurred in this transaction.

Other information

(i) Ms Xiang donated Rs. 100,000, through a crossed cheque drawn on her foreign currency account in Pakistan, to the Beijing University, China.

(ii) Advance tax of Rs. 15,000 was collected from pre-paid cards used for her mobile telephone.

Required:

(a) Compute Ms Xiang's taxable income and income taxable under the final tax regime (FTR), and her total tax payable for the tax year 2014. Give brief reasons for the treatment of any items excluded from taxable income or for which no expense/deduction is allowed. (23 marks)

(b) State by which statutory date Ms Xiang should file her return of income for the tax year 2014 in order to avoid any penal action. (1 mark)

(c) State whether Ms Xiang, being a foreign national, will be required to file a wealth statement on 30 June 2014. (1 mark)

(25 marks)

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

(a) **(i)** **State when two persons can generally be treated as associates for the purposes of proceedings under the Income Tax Ordinance, 2001.** (2 marks)

(ii) **State the powers of the Commissioner where a transaction between associates is not considered to be an arm's length transaction.** (2 marks)

(b) The following information relates to Mr Shehzad for his accounting year ended 30 June 2014.

(1) 15 July 2013: Disposed of a house in Islamabad for Rs. 20,000,000. A commission of Rs. 100,000 was paid to a broker for this deal. The house had been acquired by him on 1 January 2012 for Rs. 15,000,000. Registration charges of Rs. 800,000 were paid in cash to the government authorities at the time of acquisition of the property. On 1 November 2012, structural improvements were carried out in the house at a total cost of Rs. 1,000,000. The withholding agent transferring the property forgot to collect any tax from Shehzad on the sale proceeds declared by him.

(2) 30 August 2013: Sold ten acres of agricultural land along with a tube well for Rs. 9,000,000. Shehzad had bought the land on 1 February 2013 for Rs. 8,000,000. Costs incurred by him on levelling the land and the installation of the tube well were Rs. 900,000. A valuation fee of Rs. 50,000 was paid in cash for the valuation of the property. Rs. 45,000 was collected by the Collector effecting the transfer of the land into the name of the purchaser.

(3) 20 November 2013: Exchanged 6,000 shares in Balochistan Minerals (Pvt) Ltd (BMPL) acquired by him on 20 December 2012 for Rs. 540,000. In exchange, he received a plot of land with a fair value of Rs. 850,000. 50% of the shares in BMPL are held by the Balochistan government.

(4) 15 December 2013: Sold 10,000 shares in Mushtaq (Pvt) Ltd for Rs. 425,000. The shares had become Shehzad's property on 1 July 2008 on the distribution of assets on the liquidation of Access (Pvt) Ltd in which he was a shareholder. The fair market value of the 10,000 shares on 1 July 2008 was Rs. 200,000.

(5) 26 December 2013: Sold 6,000 preference shares in Sindh Fisheries Ltd (SFL) for Rs. 650,000. SFL is a non-listed company incorporated under the Companies Ordinance, 1984. 45% of the shares in SFL are held by the Sindh government. Shehzad had originally purchased these shares on 1 January 2010 for Rs. 700,000. Prior to the disposal, he had received a net dividend of Rs. 81,000 on 1 October 2013 after deduction of tax at source.

(6) 31 December 2013: Sold 9,000 shares in Computer Technologies (Pvt) Ltd (CTPL) for US$ 36,000. These shares had been acquired by him on 15 January 2013 for US$ 36,500. The relevant rates of exchange are to be taken as:

15 January 2013	US$ 1 = Rs. 90
31 December 2013	US$ 1 = Rs. 100

(7) 1 January 2014: Theft of his wife's jewellery. The jewellery had been purchased by him on 1 January 2008 for Rs. 400,000. The insurance company paid him Rs. 350,000 on 15 January 2014.

(8) 17 February 2014: Sold antique coins for Rs. 300,000 to his younger brother. He had purchased these coins from abroad on 20 June 2013 for Rs. 270,000 and paid custom duties and other indirect taxes of Rs. 30,000. The coins could have fetched a price of Rs. 550,000 in the nearby open market for antiques.

Additional information:

(1) Unless stated otherwise, Shehzad paid for all the expenses through crossed cheques and tax was deducted and deposited by Shehzad as required under the law.

(2) During the year ended 30 June 2014, Shehzad suffered a net loss of Rs. 50,000 in the money market on forward contracts for the purchase and sale of US dollars. All the contracts were settled by Shehzad other than by actual delivery or transfer of US dollars.

(3) Shehzad has a brought forward capital loss of Rs. 150,000 sustained under the head of income 'Capital gains' for the tax year 2008 on account of a disposal of shares in a private limited company.

(4) Income tax paid by Shehzad during the year ended 30 June 2014 was:

(i) Rs. 2,000 paid at the time of payment of motor vehicle tax to the Excise and Taxation Department of the Punjab;

(ii) Rs. 140,000 paid as advance tax in four quarterly instalments.

Required:

Compute Mr Shehzad's taxable income and income assessable under the final tax regime (FTR) and his total tax payable/refundable for the tax year 2014. Give brief reasons for your treatment of each item.

(16 marks)

(20 marks)

4 **(a)** Advance tax for the tax year 2014 was payable by Mr Fahim in four equal instalments of Rs. 50,000 each.

However, he actually paid his advance tax as below:

Instalment	Amount paid Rs.	Date of payment
1st instalment	0	–
2nd instalment	50,000	26 December 2013
3rd instalment	50,000	31 March 2014
4th instalment	40,000	30 June 2014

Required:

Calculate the default surcharge payable by Mr Fahim for the late payment or non-payment of his advance tax liability. (5 marks)

(b) Mr Zulqarnain, a non-salaried individual, filed his return of income for the tax year 2014, which was due on 30 September 2014, on 30 October 2014. He declared a taxable income of Rs. 6,000,000 and paid the due amount of tax.

Required:

(i) Compute the amount of penalty which can be imposed on Mr Zulqarnain for the late filing of the return. (4 marks)

(ii) Explain whether a penalty can be imposed for the late filing of a return of income when there is no tax liability to be paid with the return. (2 marks)

(c) An amount of Rs. 5,000,000 has been found credited in the bank account of Mr Basharat on 31 December 2013. When asked by the Commissioner of Inland Revenue, he explained the source of the amount as follows:

(1) Rs. 1,000,000 – foreign exchange remitted to him by his friend from the UK through normal banking channels and cashed into Pakistan rupees.

(2) Rs. 2,000,000 – cash borrowed from his uncle. His uncle has declared these funds in his wealth statement and is a regular taxpayer.

(3) Rs. 2,000,000 – derived from agricultural income during the year ended 30 June 2013. He has complete evidence to prove this agricultural income. He has also paid provincial agricultural tax of Rs. 22,500 which under the relevant law is the amount payable on an agricultural income of Rs. 300,000.

All documentary evidence in support of the above assertions is available with Mr Basharat.

Required:

(i) In the case of each of the amounts (1) to (3), state, giving brief reasons, whether they will or will not be taxable as income from unexplained sources under s.111 of the Income Tax Ordinance, 2001. (3 marks)

(ii) State whether any of the amounts, even though explained for the purposes of s.111 (as in your answers in (i)), can still be taxed as 'Income from other sources'. (1 mark)

(15 marks)

5 **For the purpose of this question, you should assume that today's date is 10 February 2014.**

Rameez Enterprises Limited ('REL'), a manufacturer and supplier of electrical goods, is registered under the Sales Tax Act, 1990.

REL's summarised business transactions for the month of January 2014 are as follows:

	Rs.
Purchases of raw materials from unregistered persons	2,000,000
Purchases of raw materials from registered persons	8,190,000
Taxable sales made in the local market to registered persons	4,000,000
Taxable sales made in the local market to unregistered persons	6,000,000
Export of taxable goods to Hong Kong	2,000,000

Additional information:

(i) All payments for purchases made are stated inclusive of sales tax at the rate of 17%, where applicable.

(ii) All amounts for the sale of electrical goods (including exports) are stated exclusive of sales tax.

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

(iv) REL has a sales tax credit brought forward from December 2013 of Rs. 300,000.

(v) Supplies of Rs. 500,000 were returned by a registered person in January 2014. Proper debit and credit notes were issued in this regard.

(vi) Electrical goods having a list price of Rs. 600,000 were given to an executive director of REL, free of charge. The director is not a registered person under the Sales Tax Act, 1990.

Required:

(a) Compute the sales tax liability of Rameez Enterprises Limited ('REL') in respect of its sales tax return for the month of January 2014. (7 marks)

(b) State the statutory date(s) for filing the sales tax return for the month of January 2014. (2 marks)

(c) State the time limit in which a sales tax return can be revised in order to correct any omission or wrong declaration made therein. (1 mark)

(10 marks)

End of Question Paper