
Answers

(ii) Tax credit for the tax year 2016

| | Rs. | |
|---------------------------|-----------|-----------|
| Taxable income | 8,000,000 | |
| Tax (8,000,000 x 32%) | 2,560,000 | |
| Tax credit at 20% [s.65C] | 512,000 | 1.5 |
| | | <u>3</u> |
| | | <u>10</u> |

3 Iftikhar

Tax payable for the tax year 2016 (accounting year ended 30 June 2016)

| | Note | Capital gain/(loss) Rs. | Tax Rs. | |
|--|---------|----------------------------|--------------|-----|
| Income under the head 'capital gains' Chargeable to tax under the normal law tax regime | | | | |
| Sale of statue of Tipu Sultan | (1) | 225,000 | | 1.5 |
| Sale of 8,000 shares in MNO Ltd | (2) | 504,000 | | 3 |
| Gain on the sale of gold to Nabeel | (3)(i) | 30,000 | | 1 |
| Gain on gift of gold to his mother | (3)(ii) | 60,000 | | 1.5 |
| Income under 'capital gains' | | <u>819,000</u> | | |
| Tax: 32,000 + (819,000 – 750,000) x 15% | | | 42,350 | 0.5 |
| Less: | | | | |
| Tax paid on the registration of motor car [s.231B] | | | (35,000) | 0.5 |
| Tax payable with the return of income for the tax year 2016 | | | <u>7,350</u> | |

Items not included in the computation of capital gains

| | | | | |
|---|--|--|--|-----------|
| 1 Disposal of motor car | | | | |
| Since the motor car was in the personal use of Iftikhar, it does not fall within the definition of a capital asset. Therefore, the loss of Rs. 400,000 on the disposal of the motor car is not to be treated as capital loss. [s.37(5)(d)] | | | | 1 |
| 2 Gift of 150 grams gold to Muqaddis | | | | |
| Muqaddis, although residing in Saudi Arabia, is treated as a resident individual in Pakistan because she is an employee of the Government of Pakistan posted abroad. No gain or loss is recognised on the gift of an asset to a resident person in Pakistan. [s.79(1)(c)] | | | | <u>1</u> |
| | | | | <u>10</u> |

Notes:

Note 1

The cost of acquisition of the statue paid by his father is irrelevant. The fair market value (Rs. 250,000) at the time of inheritance is treated as the cost of the asset [s.37(4A)].

| | Rs. |
|------------------------|----------------|
| Consideration received | 550,000 |
| Cost of acquisition | (250,000) |
| Capital gain | <u>300,000</u> |

The taxable gain is reduced to 75% [Rs. 225,000] as the statue was sold after one year. [s.37(3)]

Note 2

The shares in MNO Ltd are not listed on any stock exchange, therefore, they do not fall within the definition of a security, so the capital gain accruing on the disposal of these shares is taxable along with other income under the normal tax law regime as part of taxable income.

| | |
|-----------------------------------|----------------|
| | Rs. |
| Consideration received | 1,000,000 |
| Cost of acquisition (see working) | (320,000) |
| Less: incidental charges | <u>(8,000)</u> |
| Capital gain | <u>672,000</u> |

The taxable gain is reduced to 75% [Rs. 504,000] because the shares were sold after one year.

Working:

Cost of 8,000 shares:

| | |
|---|----------------|
| | Rs. |
| 3,000 shares purchased on 14 April 2012 | 150,000 |
| 2,000 shares purchased on 17 August 2012 | 120,000 |
| 1,000 right shares at Rs. 90 per share on 18 December 2013 (90 x 1,000) | 90,000 |
| 3,000 bonus shares | <u>0</u> |
| Total cost of 9,000 shares | <u>360,000</u> |
| Cost of 8,000 shares sold (360,000/9,000 x 8,000) | 320,000 |

Note 3

(i) Gain on sale of 50 grams of gold sold to Nabeel

| | |
|---|------------------|
| | Rs. |
| Sale proceeds | 230,000 |
| Less: | |
| Cost of acquisition of 50 grams gold (40,000/10) x 50 | <u>(200,000)</u> |
| Capital gain | <u>30,000</u> |

(ii) Gain on disposal of 100 grams of gold gifted to Iftikhar's mother

When a person parts with an asset, it is treated as the disposal of the asset. [s.75] The gift of an asset to a non-resident person is a disposal on which a capital gain or loss is to be computed. In such a case, the market value of the asset disposed of is taken as the consideration received [s.68] which in this case can be determined from the rate of sale of gold to Nabeel. The capital gain is computed as follows:

| | |
|--|------------------|
| | Rs. |
| Deemed consideration for disposal of 100 grams gold to the mother (230,000/50) x 100 | 460,000 |
| Less: | |
| Cost of acquisition of 100 grams gold (Rs. 40,000/10) x 100 | <u>(400,000)</u> |
| Capital gain | <u>60,000</u> |

4 Shiraz

Sales tax payable for April 2016

| | Rs. | Rs. | |
|--|-----------|--------------------|-----------|
| Output tax | | | |
| – On supplies to registered persons (Rs. 5,000,000 x 17%) | | 850,000 | 1 |
| – On supplies to a teaching hospital of a statutory university having 100 beds – a registered person (Rs. 4,000,000 x 17%) | | 680,000 | 1 |
| – Supplies for consumption aboard an airplane proceeding to London (Rs. 1,000,000 x 0%) [s.4(b)] | | 0 | 1 |
| – Exports to Malaysia (Rs. 2,000,000 x 0%) [s.4(a)] | | 0 | 1 |
| | | <u>1,530,000</u> | |
| Input tax | | | |
| Sales tax on purchase of raw materials | | | |
| – from Khadim ((Rs. 8,190,000 x 100/117) x 17%) | 1,190,000 | | 1 |
| – from Hakim [not admissible u/s.73] | 0 | | 1 |
| – from Sahil [not admissible u/s.8(1)(ca)] | 0 | | 1 |
| – from Qamar [not admissible u/s.21(3)] | 0 | | 1 |
| Sales tax paid along with sui gas bill | 120,000 | | 1 |
| Sales tax paid relating to July 2015 | <u>0</u> | | 1 |
| | | <u>(1,310,000)</u> | |
| Sales tax payable | | <u>220,000</u> | <u>10</u> |

Tutorial notes:

1. According to Sr. No. 52A of Table-1 to the 6th Schedule, goods supplied to a teaching hospital of a statutory university are only exempt when the hospital has 200 or more beds.
2. Sales tax in Pakistan is levied based on the principle of taxation at destination. Goods consumed in Pakistan or to be consumed in Pakistan are taxed. The supply of stores and provisions for consumption aboard a conveyance proceeding to a destination outside Pakistan (as specified in s.24 of the Customs Act, 1969 (IV of 1969)) are to be taxed at the zero rate. [s.4(b)]
3. When a registered person has not deducted input tax within the relevant period, he is allowed to deduct it in the return for any of the six succeeding tax periods, but not thereafter. Hence, input tax pertaining to the tax period July 2015 is not admissible in the period April 2016. [proviso to s.7(1)]

5 Beautiful Toys Ltd (BTL)

(a) Taxable income for the tax year 2016 (accounting year ended 30 June 2016)

| | Note | Rs. | Rs. | |
|--|------|------------------|--------------------------|-----|
| Income from business | | | | |
| Profit before tax | | | 18,552,000 | |
| Less: | | | | |
| Accounting profit on the sale of machine | (1) | | (95,000) | 0·5 |
| Add: | | | | |
| Administrative expenses | (2) | 75,000 | | 1 |
| Depreciation | (3) | 1,200,000 | | 0·5 |
| Repairs and maintenance | (4) | 350,000 | | 0·5 |
| Research and development expenditure | (5) | 500,000 | | 1 |
| Interim dividend paid | (6) | 593,000 | | 0·5 |
| Outstanding credit amount | (7) | 460,000 | | 1 |
| Taxable gain on the sale of machine | (1) | <u>150,000</u> | | 0·5 |
| | | | <u>3,328,000</u> | |
| Less: Admissible deductions | | | | |
| Royalties paid | (8) | 150,000 | | 1 |
| Initial allowance | (9) | 52,500 | | 1 |
| Tax depreciation | (9) | <u>1,404,750</u> | | 2·5 |
| | | | <u>(1,607,250)</u> | |
| Income from business/Taxable income | | | <u><u>20,177,750</u></u> | |

Items not included in the computation of taxable income

| | | |
|----|---|-----------|
| 1. | Rs. 160,000 paid as compensation to a customer for breach of a contract is for the purpose of business and is not a penalty for violation of any law, hence it is allowable expenditure. | 1 |
| 2. | Rs. 400,000 paid as a donation to the Fund for Retarded and Handicapped Children through a crossed cheque, though not for the purposes of business, is admissible as a straight deduction when computing taxable income provided that it does not exceed 20% of the taxable income. Since all the conditions are fulfilled, the deduction is allowed. [Cl. (61)(iv) of Pt. I of 2nd Schedule] | 1 |
| 3. | Rs. 150,000 paid to an employee in lieu of notice for termination of services falls within the definition of salary and is admissible expenditure incurred in connection with carrying on the business of the company. | 1 |
| | | <u>13</u> |

Notes:

Note 1 (i) The accounting profit or loss on the sale of an asset subject to tax depreciation is ignored and a gain or loss on the asset's tax written down value is taken into consideration for tax purposes

(ii) Taxable gain on the sale of machine:

| | |
|---|------------------|
| | Rs. |
| Consideration received on sale of machine | 350,000 |
| Tax written down value of the machine | <u>(200,000)</u> |
| | <u>150,000</u> |

Note 2 When a business asset is discarded, it is treated as having been disposed of [s.75(3A)]. The fair market value of the asset is treated as the consideration received and the income or loss is computed on this basis, which in the case of delivery van discarded during the year is:

| | |
|--|------------------|
| | Rs. |
| Consideration received | 75,000 |
| Tax written down value of the car | <u>(300,000)</u> |
| Loss to be charged in the income statement | <u>(225,000)</u> |

Therefore the excess amount charged as an expense/loss of Rs. 75,000 (300,000 – 225,000) is disallowed and added back to income.

Note 3 Accounting depreciation is not to be considered. Instead tax depreciation is allowed in accordance with the third schedule to the Income Tax Ordinance, 2001 (as computed in note 9).

Note 4 Expenditure incurred on the construction of a small security room is capital in nature and disallowed. [s.21(n)] However, initial allowance and depreciation are admissible (as per note 9).

Note 5 Scientific research expenditure incurred on any research undertaken outside Pakistan is not deductible. [s.26(2)]

Note 6 A dividend [whether interim or final] is a distribution of income and not an expense to earn income, hence, not deductible. [general principle of taxation – s.20]

Note 7 Where any expenditure is allowed in a tax year on an accruals basis, which is necessarily the case with companies earning income from business, and it is not paid within three years of the end of the tax year in which it was allowed, such an unpaid amount is taxed in the next tax year. Hence, the expenditure allowed in the tax year 2012 and not paid before 30 June 2015 is to be added back in the tax year 2016.

Note 8 An annual royalty paid for the use of a trade name is an admissible expenditure. The total amount of the expenditure was Rs.1,000,000, i.e. including the tax of Rs. 150,000 deducted. Since the amount claimed as a deduction was net of tax, the Rs. 150,000 deducted is admissible expenditure in the computation of taxable income.

Note 9 Computation of initial allowance and tax depreciation

| Asset | (TWDV) on 1 July 2015 | Addition/ (deletion) during the year | Initial allowance 15% | TWDV for depreciation | Rate of depreciation | Depreciation |
|-----------------------------------|--------------------------|---|-----------------------------|-----------------------------|-------------------------|------------------|
| (1) | (2) | (3) | (4) | 5 = (2 + 3) - (4) | (6) | (7) |
| | Rs. | Rs. | | Rs. | | Rs. |
| Factory building on freehold land | 4,000,000 | | | 4,000,000 | 10% | 400,000 |
| Office building on freehold land | 1,500,000 | 350,000 (see note 4) | 52,500 | 1,797,500 | 10% | 179,750 |
| Plant and machinery | 3,200,000 | (200,000) | | 3,000,000 | 15% | 450,000 |
| Delivery vans | 1,900,000 | (300,000) | – | 1,600,000 | 15% | 240,000 |
| Office furniture | 900,000 | | | 900,000 | 15% | 135,000 |
| Total | | | <u>52,500</u> | | | <u>1,404,750</u> |

Sub-note (a)

The addition to the office building in the form of a small security room is an eligible asset for initial allowance and depreciation for computing taxable income. [s.23(5)]

(b) Tax payable/(refundable) for the tax year 2016

| | Rs. | Rs. | |
|---|------------------|--------------------|------------------|
| Taxable income for the tax year 2016 (from (a)) | | 20,177,750 | |
| Tax at 32% | | 6,456,880 | 0·5 |
| Less: | | | |
| Tax paid along with electricity bills | 120,000 | | 0·5 |
| Tax paid with telephone bills | 40,000 | | 0·5 |
| Advance tax paid under s.147 | <u>6,400,000</u> | | 0·5 |
| | | <u>(6,560,000)</u> | |
| Tax refundable to be claimed in return | | <u>(103,120)</u> | |
| | | | <u>2</u> |
| | | | <u>15</u> |

6 Humair

Taxable income and tax payable for the tax year 2016 (accounting year ended 30 June 2016)

| | Rs. | Rs. | |
|---|-----------|-------------|-----|
| Income from salary | | | |
| Basic salary [Rs. 300,000 x 12] [s.12(2)(a)] | 3,600,000 | | 0.5 |
| Meal allowance [Rs.30,000 x 12] [s.12(2)(c)] | 360,000 | | 0.5 |
| Annual accretion to the balance at the credit of Humair in the recognised provident fund [Rs. 200,000 – 100,000] [rule 3(a) of Pt. I of Sixth Sch.] | 100,000 | | 1 |
| Exercise of option under the employee share scheme (Rs. 70 x 20,000) – (Rs. 20 x 20,000) [s.14(2)] | 1,000,000 | | 1 |
| Perquisite of rent free accommodation (working 1) | 1,620,000 | | 1.5 |
| Perquisite of car for personal use of Humair (working 2) | 75,000 | | 1.5 |
| Perquisite of the concessional loan (Rs. 1,700,000 x (10 – 2)%) [s.13(14)(b)] | 136,000 | | 1.5 |
| Fee of directorship (Rs. 80,000 + Rs.20,000) [s.2(22)(a), s.12 and s.149(3)] | 100,000 | | 1 |
| | <hr/> | | |
| Income from salary | | 6,991,000 | |
| Income from other sources | | | |
| Remuneration from delivering lectures (Rs. 7,000 x 4) | | 28,000 | 1 |
| | | <hr/> | |
| Total/Taxable income | | 7,019,000 | |
| | | <hr/> <hr/> | |
| Tax on taxable income | | | |
| (Rs. 1,422,000 + (7,019,000 – 7,000,000) x 30%) [Para (1A) of Div. I of Pt. I of 1st Sch.] | | 1,427,700 | 0.5 |
| Less: Tax already paid | | | |
| Tax deducted by the employer [s.149 and 168] | 1,140,000 | | 0.5 |
| Tax deducted from directorship fee [s.149(3) and (4)] | 20,000 | | 0.5 |
| Tax deducted on cash withdrawal from bank | 8,000 | | 0.5 |
| | <hr/> | | |
| | | (1,168,000) | |
| | | <hr/> | |
| Tax payable with return of income | | 259,700 | |
| | | <hr/> <hr/> | |

Explanation of items not included in the computation of taxable income:

- 1 Reimbursement of expenses on business trips for Power Production Limited (PPL) – Rs. 80,000
Reimbursement of expenditure incurred on behalf of the employer in the performance of the employee's duties of employment does not form part of salary of the employee. [exception provided in s.12(2)(d)] 0.5
- 2 Year-end bonus received on 5 July 2016 – Rs. 250,000
Unless specified otherwise in the law, the general rule of taxation of salary income is on a receipts basis. Since the bonus was not received during the tax year 2016, it is not to be added as part of the taxable income in that tax year. 1
- 3 IT enabled engineering services – Rs. 700,000
Any income earned from IT enabled services is exempt from tax in the tax year 2016. [Cl. (133) of Pt. I of the 2nd Schedule] 1
4. Loss from solitary trading activity – Rs. 600,000
An adventure in the nature of trade is covered under the head 'Income from business', therefore, a loss from such an activity is a loss under the head 'Income from business'. However, the law debar the set off of a loss from business against salary income [or against income from house property] [s.56(1)]. 1

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Workings:

1. Where a rent free accommodation is provided to an employee by an employer, the value of accommodation provided is equal to the amount which would have been paid by the employer subject to a minimum of 45% of the basic salary.

| | Rs. |
|---|-----------|
| Annual rental value of the accommodation (a) | 1,500,000 |
| 45% of basic salary (Rs. 3,600,000 x 45%) (b) | 1,620,000 |

The higher amount (b) of Rs. 1,620,000 is treated as salary of Humair being the value of the perquisite provided to him in the form of accommodation. [s.13(12) and rule 4 of Income Tax Rules, 2002]

2. Where a car is provided to an employee partly for his personal and partly for official use, 5% of the cost of the car incurred by the employer is treated as salary income on account of this perquisite. Other factors like the return of the car after a specified period of time or the rate of depreciation used are not relevant for this purpose.

| | |
|--|------------|
| | Rs. |
| Cost of the car | 1,500,000 |
| 5% to be treated as the value of the perquisite (Rs. 1,500,000 x 5%) | 75,000 |
| [s.13(3) read with rule 5 (i)(b) of the Income Tax Rules, 2002] | |