Answers

Note: All references to legislation shown in square brackets are for information only and do not form part of the answer expected from candidates.

Section B *Marks*

1 (a) Cash-basis v accrual-basis of accounting

According to cash-basis accounting, for tax purposes, income is recognised when it is actually received and expenditure is recorded when it is actually paid [s.33]. 1

On the other hand according to accrual-basis accounting, income is accounted for when it becomes due to the person whether received or not and expenditure is recorded when it becomes payable by the person whether actually paid or not [s.34(1)]. 1

2

(b) Procedure for changing the method of accounting

A person can apply to the Commissioner Inland Revenue (the 'Commissioner') for a change in the method of accounting for computing their income chargeable to tax under the head 'Income from business' through a written application. 1

The applicant has to satisfy the Commissioner that the requested change is necessary to clearly reflect the applicant's business income chargeable to tax. If the Commissioner is satisfied, the change will be allowed [s.32(4)]. 1

Where a person is allowed to change their method of accounting, the applicant taxpayer will have to make adjustments to the items of income, deductions, credits, or other similar items to ensure that: 1

– no item is omitted from the computation of taxable income; and 0·5
– no item is taken into account more than once [s.32(5)]. 0·5

4

(c) Abid – Tax liability for the year 2017

	Rs.	Rs.	
Income from salary [s.11 and 56 (1)]		3,450,000	0·5
Income from other sources		550,000	0·5
Income from business in the tax year 2017	1,000,000		0·5
Less:			
Speculation business loss	0		1
Assessed business loss brought forward from the tax year 2016	(1,000,000)		1
		0	
Taxable income		4,000,000	
Tax on taxable income [Sr. No. 11 of Table to para 1A of Div. I of Pt. I of 1st Sch.]		597,000	0·5
			4
			10

Explanations:

1. A speculation business is treated as a separate head of income and a loss from a speculation business can only be set off against income from another speculation business [s.58(1)]. Therefore, the speculation loss of Rs. 500,000 must be carried forward to the next tax year 2018 for set off against income from a speculation business, if any [s.58(2)].
2. The assessed brought forward loss under the head 'Income from business' can be adjusted against 'Income from business' only. It cannot be set off against salary income or income from other sources [ss.56 and 57]. The amount of Rs. 500,000 which could not be set off in the tax year 2017, must be carried forward to the tax year 2018.

Marks

2 Durrani Chemicals Ltd

(a) A tax credit is available against taxable income for a period of five years beginning on the later of the date of setting up of the business or the commencement of commercial production. 1

Hence the initial date in this case is 1 July 2016 and the terminal date will be 30 June 2021 [s.65D(1)]. 1

2

(b) Tax credit available for the tax year 2017

	Rs.	
Taxable income	1,200,000	
Tax on taxable income at 31% (A)	372,000	0·5
Equity raised through the issuance of new shares (B)	6,000,000	0·5
Amount invested in the newly established undertaking (pesticide manufacturing unit) (C)	7,000,000	0·5

Amount of tax credit [s.65D(1A)] = A x (B/C)
= 372,000 x (6,000,000/7,000,000) 1·5
= 318,857

3

(c) (i) Situations in which the tax credit may be treated as wrongly allowed

(a) The business has been discontinued in the five years subsequent to the tax credit being allowed. 1

(b) Any of the conditions for granting the credit are subsequently proved to have not been fulfilled [s.65D(4)]. 1

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(ii) Consequences of the tax credit being deemed wrongly allowed

(a) The Commissioner shall re-compute the tax payable for the relevant tax years; and 1

(b) All the provisions of the Income Tax Ordinance, 2001, e.g. provisions relating to the recovery of tax, default surcharge, etc will be applied notwithstanding any other contrary provisions, if any [s.65D(4)]. 2

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3 Intisar

Total tax payable on taxable income for the tax year 2017 (accounting year ended 30 June 2017)

	Note	Capital gain/(loss) Rs.	Tax Rs.	
Tax payable on capital gains assessable as a separate block of income				
Tax payable on the disposal of unimproved land as a separate block	(1)	365,000	18,250	2
Tax payable on the disposal of guest house as a separate block	(2)	2,500,000	250,000	2
Tax payable on the disposal of commercial papers	(3)	130,000	19,500	1
Income assessable under the normal tax regime				
Taxable income/capital gains	(4)	744,000		1·5
Tax on taxable income [Rs. 7,000 + (Rs.744,000 – 500,000) x 10%]			31,400	0·5
Total tax payable			319,150	
Less:				
Advance tax paid in connection with guest house [ss.236K and 168]	(2)	200,000		0·5
Motor vehicle tax paid [ss.234 and 168]		18,000		0·5
			(218,000)	
Tax payable with return			101,150	

Marks

Items not included in the computation of capital gain/loss

Disposal of antique coin

No loss is recognised on the disposal of certain movable capital assets, e.g. a coin, an antique, etc [s.38(5)(e) and (f)]. Because the disposal of the antique coin has resulted in a loss of Rs. 27,000 (100,000 – 125,000 – 2,000), it is not to be recognised in the computation of net taxable capital gains. 1

Brought forward loss on the disposal of shares in a listed company

Shares in a listed company fall within the definition of securities and any loss on the disposal of a security cannot be carried forward from a previous year for set off against the capital gains of the current tax year. Therefore, the loss of Rs. 350,000 brought forward from the tax year 2016 cannot be set off against the capital gains of the tax year 2017. 1

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Notes:

Note 1

Unimproved land is not eligible for tax depreciation, hence it is to be treated as a capital asset [s.37(5) read with s.22(15)].

	Rs.	Rs.
Consideration received on 15 December 2016		1,765,000
Less cost:		
Purchase price paid on 10 January 2016	1,365,000	
Capital value tax	35,000	
		(1,400,000)
Capital gain		365,000
Tax at 5% (365,000 x 5%)		18,250

	Rs.	Rs.
Consideration received on 31 December 2016		10,000,000
Less cost:		
Purchase price paid on 1 July 2016	7,000,000	
Minor repairs of Rs. 50,000 do not add to the value of the property, hence not part of cost	0	
Major renovation of the guest house [s.76(2)(c)]	500,000	
		(7,500,000)
Capital gain		2,500,000
Tax at 10% (2,500,000 x 10%)		250,000

The tax collected by the registration authority of Rs. 200,000 is advance tax and not allowable as an expenditure [s.21 and 37(4)(b)]. However, a credit will be given when computing the tax liability.

Note 3

Commercial papers are debt securities. A capital gain/loss on the disposal of a security is treated as a separate block.

	Rs.
Consideration received on 15 January 2017	1,240,000
Less:	
Purchase price paid on 20 April 2016	(1,110,000)
Capital gain	130,000
Tax at 15% (130,000 x 15%)	19,500

Note 4

A car when in the personal use of a taxpayer is not treated as a capital asset . However, where a car is held as an antique, it is treated as a capital asset [s.37(5)(d)]. Any gain or loss is to be treated as taxable income and taxed under the normal law.

	Rs.	Rs.	Marks
Consideration received on 31 March 2017		2,500,000	
Less cost:			
Purchase price paid on 1 April 2010	1,500,000		
Commission paid to a car dealer [s.76(2)(c)]	8,000		
		(1,508,000)	
Capital gain		992,000	

Since the disposal was made after a holding period of more than one year, only 75% of the capital gain is taxed, i.e. Rs. 744,000.

4 (a) Business bank account

A business bank account for the purposes of sales tax means a bank account:

	Marks
– which is utilised by the registered person for business transactions; and	1
– the same is declared as such by the registered person to the Commissioner in whose jurisdiction they are registered [Explanation to s.73].	1
	2

(b) Badar – Sales tax payable for February 2017

Output tax	Rs.	Rs.	Marks
– On local supplies to un-registered persons (Rs. 4,000,000 x (17 + 2)%)) [s.3(1) and (1A)]		760,000	1
– On local supplies to registered persons (Rs. 5,000,000 x 17%) [s.3(1)]		850,000	0·5
– On local supplies to diplomats in Islamabad (Rs. 1,000,000 x 0%) [s.4 and 5th Sch.]		0	1
– On exports to Dubai with the intention of re-importing the same to Pakistan by a registered person [Cl. (1) of 1st proviso to s.4] (Rs. 3,000,000 x 17%)		510,000	1
Add back the input tax claimed earlier on purchases from Ilyas to whom payment has not been made for 181 days (1,053,000 x 17/117) [s.73(2)]		153,000	1
		2,273,000	
Input tax			
Sales tax paid on purchase of raw materials:			
– On purchases from Manahil (Rs. 46,800 x 17/117) [s.7 and 73(1)]	6,800		0·5
– On purchases from Zahid (Rs. 3,510,000 x 17/117) = 510,000 but not admissible being payment from the personal bank account of Badar [proviso to s.73(1)]	0		1
– On purchases from Nazir [online payment admissible mode because verified from bank statements] (Rs. 8,190,000 x 17/117) [proviso to s.73(1)]	1,190,000		1
Sales tax paid along with electricity bills in cash	114,000		1
		(1,310,800)	
Sales tax payable		962,200	
			8
			10

Marks

5 Plastic Goods (Pvt) Ltd (PGPL)

(a) PGPL will be treated as a company resident in Pakistan during the tax year 2017 because it is incorporated under the Companies Ordinance [s.83]. 2

(b) Taxable income for the tax year 2017 (accounting year ended 30 June 2017)

	Note	Rs.	Rs.	
Income from business				
Profit before tax			24,500,000	
Less other income	(8)		(1,500,000)	1
			23,000,000	
Add:				
Amortisation of intangible	(1)	2,000,000		0·5
Accounting depreciation	(2)	2,500,000		0·5
Reserve for the welfare of staff	(3)	1,400,000		0·5
Payment of salary in cash	(4)	750,000		0·5
Car prize without tax collection	(5)	1,700,000		1
Legal fees regarding an increase in share capital	(6)	900,000		0·5
Provision for bad debts	(7)	700,000		0·5
			9,950,000	
Less:				
Amortisation of intangible	(1)	3,000,000		0·5
Initial allowance	(9)	35,000		1
Tax depreciation	(9)	1,934,500		2·5
			(4,969,500)	
Income from business/Taxable income			27,980,500	

Items not included in the computation of taxable income

1. Entertainment expenditure of Rs. 400,000 incurred at the time a new sales outlet was opened is allowable because the law considers it to be for the purposes of business [s.20(1) and Rule 10(1)(e) of Income Tax Rules, 2002]. 1
2. Lease rentals of Rs. 350,000 consisting of the principal amount plus a mark up are admissible expenditure because the asset is used for business purposes. However, no depreciation will be allowable on this asset (see note 9) [s.28(1)(b)]. 1

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Notes

Note 1

Any expenditure on a process which provides an advantage or benefit for a period of more than one year is included in the definition of an intangible which is to be amortised over its useful life [s.24 (11)]. Where the useful life is not ascertainable or it is more than ten years for tax purposes, it is amortised over ten years [s.24(3) and (4)]. Hence, the expenditure of Rs. 2,000,000 incurred by PGPL on the amortisation of the cost of the manufacturing process is added back and the proportionate amount on the basis of its ten years life is allowed: Rs. (2,000,000/10) x 15 = Rs. 3,000,000.

Note 2

Accounting depreciation is not a deductible charge. Tax depreciation and initial allowances 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

The transfer of 1% of sales revenue being Rs. 1,400,000 to a reserve for the welfare of PGPL's staff is not allowable being only a reserve and not actual expenditure [s.21(j)].

Note 4

Any salary paid in cash, whether to a regular employee or a temporary worker, if it is in excess of Rs. 15,000 per month is inadmissible for the purposes of the computation of taxable income [s.21(m)].

Note 5

The non-collection of tax from the person, whether a filer or non-filer, to whom a car costing Rs. 1,700,000 was given as a prize for the promotion of sales makes the expenditure inadmissible [s.21(c) read with s.156(1)].

Marks

Note 6

Expenditure incurred to increase the share capital of a company is a capital expenditure which is inadmissible [s.21(n)].

Note 7

A provision for bad debts made at 0·5% of sales is inadmissible because no amount of debt is yet established to be irrecoverable which is a pre-requisite for a bad debt to be eligible as an admissible deduction [s.29(1)].

Note 8

Since the investment is still held by PGPL, the income cannot be said to have accrued as yet. Hence this notional gain of Rs. 1,500,000 resulting from the mark to market price is not income and is not taxable in this tax year [s.34].

Note 9

Computation of initial allowance and tax depreciation

Asset	Tax written down value (TWDV) on 1 July 2016	Additions in the year	Initial allowance at 25% of the value of eligible assets in Column (3)	TWDV for tax depreciation	Rate of depreciation	Depreciation
(1)	(2)	(3)	(4)	(5) = (2) + (3) – (4)	(6)	(7)
	Rs.	Rs.	Rs.	Rs.		Rs.
Building on freehold land	4,000,000	–	–	4,000,000	10%	400,000
Plant and machinery	7,000,000	–	–	7,000,000	15%	1,050,000
Trucks	1,000,000	See sub-note (a)	–	1,000,000	15%	150,000
Computer hardware	560,000	140,000	35,000	665,000	30%	199,500
Furniture and fixture	800,000	100,000	Not eligible	900,000	15%	135,000
Total			35,000			1,934,500

Sub-note (a)
The addition to trucks of Rs. 3,700,000 is on a finance lease basis. Since the truck is not owned by the taxpayer company, it is not entitled to an initial allowance or tax depreciation. However, the lease rentals are allowed as a deduction as explained in the 'Items not included in the computation of taxable income'.

(c) Tax payable/(refundable) for the tax year 2017

	Rs.	Rs.	
Taxable income for the tax year 2017 from (b) above		27,980,500	
Tax at 31%		8,673,955	0·5
Less:			
Advance tax paid in four quarterly instalments [s.147]	7,000,000		0·5
Income tax paid with electricity bills [s.235(1) and (4)(c)]	400,000		0·5
Tax paid at the time the motor vehicle was taken on lease [s.231(1A)]	111,000		0·5
		(7,511,000)	
Tax payable with return		1,162,955	
			2
			15

			Marks

6 Ejaz

Taxable income and tax payable for the tax year 2017 (accounting year ended 30 June 2017)

	Rs.	Rs.	
Basic salary (25,000 x 12) [s.12(2)(a)]		300,000	0·5
Utility allowance (5% x (25,000 x 12)) [s.12(2)(c)]		15,000	0·5
Commission earnings [s.12(2)(a)]		375,000	0·5
Training allowance (10,000 x 12) [s.12(2)(c)]		120,000	0·5
Value of salesman of the year award [s.12(2)(b)]		450,000	1
Perquisite of car (working 1)		57,500	1
Perquisite of running expenses of car (working 2)		46,000	1
Medical allowance ((25,000 x 12) x 9%) [Cl. 139(b) of Pt. I of the 2nd Sch.]		27,000	0·5
Perquisite on account of concessional rate of mark up (working 3)		80,000	1
Benefit under employee share scheme (working 4)		400,000	1·5
Dangerous working condition supplement [s.12(2)(a)]		50,000	0·5
Labour court award [s.12(2)(e)(iii)]		900,000	1
Taxable income under the head 'Salary'		2,820,500	
Tax on taxable income			
(259,500 + (2,820,500 – 2,500,000) x 20%) [Para (1A) of Div. I of Pt. I of 1st Sch.]		323,600	0·5
Tax already paid			
Tax deducted by FPPL [ss.149 and 168]	190,000		0·5
Tax deducted by former employer [ss.149 and 168]	90,000		0·5
Tax on telephone bills [ss.168 and 236]	3,000		0·5
Tax collected at the time of function [ss.168 and 236D]	8,000		0·5
Total tax paid		(291,000)	
Tax payable with return		32,600	

Explanation of items not included in the computation of taxable income

1 Reimbursement of medical expenses

The reimbursement of medical expenses of Rs. 430,000 is not taxable when received in accordance with the terms of Ejaz's employment contract. [However, in the presence of this facility, the medical allowance which otherwise is exempt up to 10% of the basic salary becomes taxable.] [Cl. (139)(a) of Pt. I of the 2nd Sch.] 1

2 Contribution to the recognised provident fund

The contribution of Rs. 2,500 per month by Ejaz is already taxed and need not be taxed again. As regards the contribution of FPPL, this is exempt because the provident fund is a recognised provident fund. The accumulated balance due and becoming payable to an employee participating in a recognised provident fund is exempt [Cl. (23) of Pt. I of the 2nd Sch.]. 1

3. Fee paid to lawyer

The amount received from a former employer is treated as salary. No deduction from earned income under the head 'Salary' is admissible. The fee of Rs. 80,000 paid to the lawyer cannot, therefore, be deducted. 1

15

Workings:

Working 1

Where a car is provided partly for personal and partly for business use, 5% of the cost of the car incurred by the employer is treated as salary income on account of this perquisite.

	Rs.
Purchase cost	1,150,000
5% to be treated as the value of the perquisite (1,150,000 x 5%) [s.13(3) read with rule 5(i) of the Income Tax Rules, 2002]	57,500

Working 2

	Rs.
Total running expenses of the car	230,000
Prorated expenses relating to personal use of the car estimated to be 20% (230,000 x 20%) [s.13(3) and 12(2(d)]	46,000

Marks

Working 3

	Rs.
Loan amount	1,000,000
Bench mark rate [s.13(14)(ii)]	10%
Mark up rate charged by FPPL	2%
Perquisite on account of beneficial rate of mark up ((10 – 2)% x 1,000,000) [s.13(7)]	80,000

Working 4

Where shares are issued with a restriction on their transfer/sale, the fair market value on the date of removal of the restriction as reduced by the cost of the acquisition of the shares is chargeable to tax under the head 'Salary' [s.14(3)(b)].

	Rs.
Fair market value on 1 April 2017	800,000
Cost incurred to acquire the shares under the scheme	(400,000)
Benefit assessable under the head 'Salary'	400,000

The actual sale being after the close of the tax year is not relevant for the tax year 2017. Similarly, the fair market value on the last day of the tax year is also not relevant.