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) Standard Services (Pvt) Ltd

Conditions to be fulfilled to prevent the provisional assessment becoming a final assessment

(i)	The return of income for the tax year 2016 should be filed electronically within 45 days of the service of provisional assessment order, i.e. by 30 July 2017.	2
(ii)	The return should be accompanied with audited accounts or final accounts as the case may be.	1
(iii)	The company should present its accounts and documents to the Commissioner Inland Revenue on its own initiative for the purpose of conducting an audit of its tax affairs for the tax year 2016.	2
		5

(b) Nawazish

Taxable income	Rs. 750,000	
Tax [para (1) Div. I, Pt. I of 1st Sch.]	Rs. 32,000	0·5

Penalty for late filing of return:

Number of days late:	10 days	0·5
Penalty is the higher of:		
(i) Rs. 20,000; or		
(ii) 0·1% of the tax per day of default (32,000 x 0·1% x 10) = Rs. 320 [Sr. No. 1 of Table to s.182]		1

Hence Nawazish is liable to pay Rs. 20,000 as the penalty for the late filing of his return of income by ten days. 1

Default surcharge:

Number of days of default	20 days	0·5
Default surcharge at 12% per annum (32,000 x 12% x 20/365) [s.205(1)(a)]	Rs. 210	1·5
		5
		10

2 (a) Tanveer

Income from property for the tax year 2017

	Rs.	
Annual rent (30,000 x 12) [s.15]	360,000	0·5
Taxable income under the head 'income from property'	360,000	1
Tax (360,000 – 200,000) x 5% [Div. VIA of Pt. I of 1st Sch.]	8,000	0·5
		2

Tutorial notes:

1. *Income under the head 'income from property' is assessable as a separate block [with effect from the tax year 2017] at the prescribed rates, provided that the income from the property is more than Rs. 200,000.*
2. *No expenditure or deduction, including collection charges, are admissible against the income from property of an individual taxpayer or in the case of an association of persons. [s.15(6) read with amended s.15A]*

(b) Salma and Shumaila – jointly owned house

(i) Salma and Shumaila have definite and ascertainable shares in the jointly owned house. Therefore, according to the tax law [s.66], each of them will be assessed separately in respect of their respective shares in the income from property. 2

Marks

(ii) Income from property for the tax year 2017

	Rs.	
Annual rent of the property	600,000	
Salma		
Share of Salma (600,000 x 70%)	420,000	0·5
Tax on the income of Salma ((420,000 – 200,000) x 5%) [Div. VIA of Pt. I of 1st Sch.]	11,000	0·5
The Rs. 500 paid to her banker is not an admissible deduction.		1
Shumaila		
Share of Shumaila (600,000 x 30%)	180,000	0·5
Since Shumaila's income does not exceed Rs. 200,000 and she has no other income, no tax is payable by her. [s.15(7)]		0·5
		3

(c) Landowner (Pvt) Ltd

Income from property for the tax year 2017

	Rs.	Rs.	
Annual rent of the building		600,000	
Less:			
Repair allowance (1/5 x 600,000) [s.15A(1)(a)]	120,000		0·5
Collection charges [s.15A(1)(h)]	36,000		0·5
Profit paid to bank on loan for the house [s.15A(1)(e)]	25,000		0·5
Repair and maintenance expenditure (not included in the list of admissible deductions)	0		1
		(181,000)	
Income from property/Taxable income		419,000	
Tax at 31%		129,890	0·5
			3
			10

3 Shafi

Total tax payable on capital gains for the tax year 2017 (accounting year ended 30 June 2017)

	Note	Capital gain/(loss) Rs.	Tax Rs.	
Income under the head 'capital gains'				
Chargeable to tax under the normal law tax regime				
Sale of a postage stamp	1	120,000		2
Gain on gift of shares in Din Textile Mills (Pvt) Ltd	2	405,000		2
Income under capital gains		525,000		
Tax payable (7,000 + (525,000 – 500,000) x 10%)			9,500	0·5
Capital gains assessable as a separate block				
Gain on disposal of land to the Punjab government	3	1,640,000	164,000	2
Gain disposal of shares in PPL (Pvt) Ltd	4	450,000	67,500	1·5
Gain on Pakistan WAPDA sukuk bonds	5	1,500,000	0	1
Total tax payable on capital gains			241,000	

Item not included in the computation of capital gains

Disposal of house

According to the non-recognition rules [s.79(1)(a)] where a person disposes of an asset to his wife (and *vice versa*) under an agreement to live apart, no gain or loss is taken to arise on such a disposal. 1

10

Marks

Notes:

Note 1

The fair market value of the postage stamp on the date of inheritance is treated as the cost of the asset [s.37(4A)].

	Rs.
Consideration received	200,000
Cost of acquisition	(40,000)
	160,000

The taxable gain is reduced to 75% [Rs. 120,000] because the postage stamp was sold after holding it for more than one year. [s.37(3)]

Note 2

Since Shafi's daughter was a non-resident, the disposal of shares by way of gift is a taxable event and not covered under the non-recognition rules [s.79(1)(a)]. The fair market value at the time of disposal is treated as the consideration received [s.77(1)].

	Rs.
Consideration deemed to have been received	900,000
Cost of acquisition	(360,000)
	540,000

The taxable gain is reduced to 75% [Rs. 405,000] because the shares were gifted after holding them for more than one year. [s.37(3)]

Note 3

Shafi has not invested the proceeds from the plot acquired from him by the government in a similar asset to that which was compulsorily acquired. In such a case, the capital gain, if any, is taxable. [s.79(1)(d)]

	Rs.	Rs.
Consideration received		20,000,000
Less:		
Cost of acquisition	18,000,000	
Capital value tax	360,000	
		(18,360,000)
		1,640,000
Tax at 10% [Rs. 1,640,000 x 10%] [Div. VIII, Pt. I, 1st Sch.]		164,000

Note 4

Because 50% of the shares in PPL (Pvt) Ltd are held by the government of Punjab, it is treated as a public company [s.2(47)]. Shares of a public company are treated as securities for the purpose of calculation of capital gain and taxable as a separate block.

	Rs.
Consideration received	950,000
Cost of the shares sold	(500,000)
Capital gain	450,000
Tax at 15% [Div. VII, Pt. I, 1st Sch.]	67,500

Note 5

Since the securities in the form of Pakistan WAPDA sukuk bonds were purchased prior to 1 July 2012, the capital gain is taxable at a zero rate. Hence tax on the capital gains of Rs. 1,500,000 (3,500,000 – 2,000,000) is zero. [s.37A(3A)(a) and Div. VII , Pt. I, 1st Sch.]

			Marks
4 (a) Nasir			
Sales tax payable for the tax period September 2016			
		Rs.	
Output tax			
On supplies to registered persons (Rs. 2,500,000 x 17%)		425,000	0·5
On supplies to unregistered persons (Rs. 1,500,000 x (17 + 2)%)		285,000	1
On exports to Malaysia (Rs. 5,500,000 x 0%)		0	0·5
On exempt supplies (Rs. 1,000,000)		0	0·5
On goods consumed at home by Nasir (Rs. 150,000 x 17%)		25,500	1
		735,500	
Input tax			
On payments to unregistered persons (Rs. 1,000,000 x 0)		0	0·5
On payments to registered persons for raw material used for taxable and exempt supplies			
	Rs.		
Total payments	4,680,000		
Less payment in cash	(100,000)		1
Net payments on which input tax is to be considered for claim	4,580,000		
Tax paid (4,580,000 x 17/117)	665,470		0·5
Admissible input tax relating to the purchase of raw material used for making taxable supplies: (Taxable supplies/Total supplies) x Tax paid on raw material used for making both taxable and exempt supplies ((9,650,000/10,650,000) x 665,470) = 602,985			1
Since the amount of admissible input tax is not above 90% of the output tax the full amount is admissible.		602,985	1
		602,985	
Tax payable with return of sales tax for the tax period September 2016		132,515	0·5
			8

(b) Items chargeable to sales tax at the rate of 17% of their retail price (as per the Third Schedule of the Sales Tax Act 1990)

1. Fruit juices and vegetable juices
2. Ice cream
3. Aerated waters or beverages
4. Syrups and squashes
5. Cigarettes
6. Toilet soap
7. Detergents
8. Shampoo
9. Toothpaste
10. Shaving cream
11. Perfumery and cosmetics
12. Tea
13 Powder drinks
14. Milky drinks
15. Toilet paper and tissue paper
16. Spices sold in retail packing bearing a brand name and trademarks
17. Shoe polish and shoe cream
18. Fertilizers
19. Cement sold in retail packing
20. Mineral/bottled water

FOUR items only required, ½ mark each, maximum 2

10

Marks

5 Bashir Energy Ltd (BEL)

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

	Note	Rs.	Rs.	Marks
Income from business				
Profit before tax			121,000,000	0·5
Less:				
Income from other sources	(1)		(1,000,000)	0·5
Add:				
Accounting depreciation	(2)	2,000,000		0·5
Raw material without tax deduction	(3)	20,000,000		1
Security deposit to LESCO	(4)	300,000		0·5
Fee paid to architects	(5)	420,000		0·5
Transfer to contingency reserve	(6)	700,000		0·5
Purchase of trademark	(7)	2,900,000		0·5
Expenses incurred on failed takeover	(8)	800,000		0·5
Tax withheld at source	(10)	1,300,000		0·5
			28,420,000	
Less admissible deductions				
Amortisation of trademark	(7)	119,178		1·5
Tax depreciation	(9)	5,870,000		2
			(5,989,178)	
Income from business			142,430,822	
Income from other sources	(1)		1,400,000	1
Total/Taxable income from all sources			143,830,822	

Items not included in the computation of taxable income

1. Rs. 600,000 paid to employees as an annual allowance for their leave fare assistance is part of their salary and admissible expenditure of the employer company. [ss.12 and 20] 1
2. Rs. 450,000 incurred as a professional fee paid to an arbitrator for resolving a trade dispute is for the purposes of business and admissible under the law. [s.20(1)] 1

12

Notes

Note 1

Profit on tax in the case of a company is assessable under the normal tax regime under the head 'income from other sources' as a separate and distinct head of income from 'income from business'. [s.39(1)(c)]

The rate of profit charged is 5% which is not an arm's length transaction. Since the payer of profit was an associate of BEL, the fair market rate of 7% is to be applied for determining the taxable income of BEL. Therefore, Rs. 1,400,000 [(1,000,000/5%) x 7%] is the taxable income on this account. [ss.68 and 108]

Note 2

Accounting depreciation is not to be considered. Instead, depreciation is allowed in accordance with the Third Schedule to the Income Tax Ordinance, 2001 as computed in note 9.

Note 3

[According to amendment in the Finance Act, 2016] where tax on a payment for the purchase of raw materials is not deducted and deposited, the expenditure incurred is to be disallowed subject to the condition that the disallowance shall not exceed 20% of the purchases of raw materials and goods.

BEL has not deducted tax on a total payment of Rs. 100,000,000 paid to a non-filer for the supply of raw material and goods used in the manufacturing process, hence, Rs. 20,000,000 (being 20% of Rs. 100,000,000) is disallowed and added back. [s.21(c)]

Note 4

The unadjustable security deposit paid to Lahore Electricity Supply Company (LESCO) is not expenditure for the year. It is also not to be capitalised as the transformer is not the asset of BEL. Hence, it is also not eligible for depreciation.

Note 5

The architects' fees paid in respect of a site which has not yet been acquired or used for the business of the taxpayer, is not a deductible expenditure. [s.20(1)]

Marks

Note 6

An amount transferred to a contingency reserve is not an admissible deduction because under the accrual system of accounting it has not yet become payable. [ss.34(3) and 21(i)]

Note 7

A trademark is an intangible asset for the purposes of the computation of income tax and a capital asset. It cannot be deducted in full in one year. Hence the total price of the trademark claimed as an expenditure is disallowed and amortisation is allowed as admissible under the law.

The cost is to be amortised over its useful life and where the life is more than ten years or is not determinable, it is deemed to be ten years. [s.24]

Total cost of the trademark	Rs. 2,900,000
Deemed useful life of the trademark [instead of actual 14 years] [s.24(4)]	10 years
Per year amortisation (2,900,000/10) [s.24(3)]	Rs. 290,000
Restricted for the year 2017 in proportion to the period of its use in days ((150/365) x 290,000) [s.24(6)]	Rs. 119,178

Note 8

Expenditure incurred to take over a rival business is a capital expenditure and not for the purposes of carrying on business of the taxpayer, hence it is not allowable. Further, it does not give rise to any asset eligible for tax depreciation. [ss.20 and 22]

Note 9

Computation of tax depreciation

Asset (1)	TWDV on 1 July 2016 (2) Rs.	TWDV for depreciation (3) Rs.	Rate of depreciation (4)	Depreciation Depreciation (5) Rs.
Buildings	23,000,000	21,500,000 (note (a))	10%	2,150,000
Plant and machinery	17,000,000	17,000,000	15%	2,550,000
Computer hardware and printers	900,000 (note (b))	900,000	30%	270,000
Motor cars	6,000,000	6,000,000	15%	900,000
Total				5,870,000

Sub-notes

(a) The value of land Rs. 1,500,000 is not eligible for depreciation. The rate of tax depreciation is the same for both the office and factory buildings.

(b) The rate of tax depreciation for computer hardware and printers, etc is the same.

Note 10

Tax withheld at source is not a deductible expenditure, though it is to be allowed against the tax liability finally determined on the basis of the taxable income of the taxpayer. [ss.21 and 168]

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

	Rs.	Rs.	Marks
Taxable income for the tax year 2017 (from (a))		143,830,822	
Tax at 31%		44,587,555	0·5
Less tax credit on account of listing on the Karachi Stock Exchange (44,587,555 x 20%) [s.65C]		(8,917,511)	1
Tax payable for the tax year 2017		35,670,044	
Less tax already paid:			
Tax collected by clients on supplies made by BEL [ss.153 and 168]	1,300,000		0·5
Advance tax in four instalments [ss.147 and 168]	30,000,000		0·5
Tax paid along with electricity bills [ss.168 and 235]	1,200,000		0·5
		(32,500,000)	
Tax payable with return of income		3,170,044	
			3
			15

Marks

6 Saima

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

	Rs.	Rs.	
Basic salary ((180,000 – 18,000) x 12) [s.12(2)(a)]		1,944,000	0·5
Medical allowance ((18,000 – (10% x 162,000)) x 12)) [Cl. (139) of Pt. I of 2nd Sch. and s.12(2)(c)]		21,600	1
Ex-gratia payment [s.12(2)(a)]		360,000	0·5
House rent allowance (60,000 x 12) [s.12(2)(a)]		720,000	0·5
Perquisite representing the use of a car (Working 1)		100,000	1
Payment of medical expenses to a clinic on behalf of Saima		75,000	0·5
Perquisite of annual membership of Royal Palm Club [s.13(10) and (13)]		200,000	1
Encashment of earned leave		120,000	0·5
Perquisite on account of services of security guard ((20,000 x 12)/2) [s.13(5)]		120,000	1
Income under the head 'salary'/assessable under the normal tax regime		3,660,600	
Less deductible allowance			
Deductible allowance on account of profit paid on loan for the acquisition of the house [s.64A] (Working 2)		(500,000)	1·5
		3,160,600	
Tax on taxable income (359,500 + (3,160,600 – 3,000,000) x 22·5%) [Para (1A) of Div. I of Pt. I of 1st Sch.]		395,635	0·5
Less:			
Tax credit on donation given to a school (Working 3)		(6,259)	1·5
Tax on taxable income under the normal law		389,376	
Tax on income assessable under the final tax regime (FTR):			
Tax on winning first prize in quiz competition (Working 4)		200,000	1
Total tax payable		589,376	
Tax already paid:			
Tax paid at the time of payment of tuition fee for son [s.236I]	35,000		0·5
Tax deducted by employer (ISL) at source [s.149]	300,000		0·5
Tax deducted from prize money [s.156]	200,000		0·5
Tax collected by hotel [s.236D]	15,000		0·5
Total tax paid		(550,000)	
Tax payable with return/statement of FTR		39,376	

Explanation of items not included in the computation of taxable income/tax credit

1 Agricultural income of Rs. 800,000 and agricultural income tax of Rs. 97,500

Agricultural income is not taxable under the Income Tax Ordinance, 2001 (the 'Ordinance').

Similarly, provincial agricultural tax paid is not to be deducted from the tax liability under the Ordinance. 1

2 Tuition fee for son of Rs. 700,000

Since the taxable income of Saima is more than Rs. 1,000,000, she is not eligible for any deductible allowance on account of the tuition fee for her son paid to his medical college. [s.64AB] 1

15

Workings:

Working 1

Where a car is provided for personal as well as business use, 5% of the cost of the car accrued to ISL is treated as salary income on account of this perquisite. The value of the car on 30 June 2017 is irrelevant.

	Rs.
Purchase cost	2,000,000
5% to be treated as the value of the perquisite (2,000,000 x 5%) [s.13(3) read with rule 5 of the Income Tax Rules, 2002]	100,000

Marks

Working 2

		Rs.
Taxable income		3,660,600
(a) Maximum ceiling in terms of 50% of taxable income	(a)	1,830,300
(b) Maximum ceiling in absolute terms	(b)	2,000,000

Since the amount of profit paid by Saima at Rs. 500,000 does not exceed either of the limits at (a) or (b) above, the full amount is allowable as a deductible allowance. [s.64A(2)]

Working 3

	Rs.
Taxable income	3,160,600
Tax on taxable income	395,635
Donation paid	50,000
Since the tax donation paid at Rs. 50,000 is less than the ceiling of 30% of taxable income, a tax credit is allowable on the full amount of Rs. 50,000 at the average rate of tax, i.e. (395,635/3,160,600) x 50,000	6,259

Working 4

The prize money won from the quiz competition is taxable under the final tax regime (FTR).

	Rs.
The prize money including tax (800,000 + 200,000)	1,000,000
No expense is allowable against this income, hence the gross amount is chargeable to tax at 20% [s.156]	200,000