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 A *Marks*

1 **A** Rs. 86,125 [Rs. 344,500/4] [s.147(4B)]

2 **C** Rs. 14,500 [Rs. 2000 + (750,000 – 500,000)5%] [Para (1A) of Div. I of Pt. I of 1st Sch. read with s.51(2)]

3 **D** 1, 2, 3 and 4 [s.37A(3A)]

4 **B** Rs. 79,500 Tax payable on Rs. (1,500,000 – 100,000) is computable as Rs. 14,500 + (1,400,000 – 750,000) x 10% = Rs. 79,500 [s.60]

5 **D** Rs. 24,000 [Rs. 1,600,000 x 1·5%] [s.147(5B)]

6 **B** Rs. 122,500 [Rs. (500,000 – 10,000) x 25%] [s.60A and Div. II of Pt. I of 1st Sch.]

7 **A** 30 June 2018 [s.221(3)]

8 **C** Rs. 4,300,000 [Rs. (4,000,000 + 100,000 + 200,000)] [s.77]

9 **B** Set aside the assessment order [s.129(1)(a)]

10 **C** Rs. 1,000,000 [Rs. (400,000 + 600,000)] [s.39(3)]

11 **A** Rs. 30,000 [(1,000,000) x 3%] [ss.68 and 111(4)(1)(c)]

12 **D** 2018 [s.74(2)]

13 **A** Rs. 75,000 [Rs. (3,100,000 – 2,700,000) x 75% x 25%] [s.37]

14 **C** Rs. 2,160 [Rs. 90,000 x 12% x 73/365] [s.205(1)(b)]

15 **B** Rs. 150,000 [Rs. (5,000,000 x 30%) x 10%] [s.65C]

2 marks each **30**

Section B *Marks*

1 **(a)** Naseer

Taxable income for the tax year 2018

Under normal tax regime

	Rs.	Rs.	
Income from salary	750,000		0·5
Income from business	200,000		0·5
Total income/taxable income		950,000	
Tax on taxable income			
[Rs. 14,500 + (950,000 – 750,000) x 10%]	34,500		0·5
Less:			
50% reduction in tax due to being over 60 years of age			
[34,500 x 50%] (Note 1) [para (IB)(ii) of Div. I, Pt. I, 1st Sch.]	(17,250)		0·5
		17,250	
Under final tax regime			
Income from dividend	450,000		0·5
Tax on dividend [450,000 x 15%]		67,500	0·5
Total tax		84,750	
Less tax paid			
Tax deducted from salary	14,500		0·5
Tax deducted from dividends	67,500		0·5
		(82,000)	
Tax payable with return		2,750	

Note 1

Naseer fulfils the following two conditions, making him eligible for 50% reduction in his tax liability under normal law:

(i) Income under normal tax regime does not exceed Rs. 1,000,000; and

(ii) His age is not less than 60 years.

Therefore, Naseer is eligible for reduction in his tax liability under normal law tax regime by 50%. [para (IB)(ii) of Div. I, Pt. I, 1st Sch.] 2

6

(b) If a gift is received from a person having their national tax number through a banking channel, such a gift is not to be treated as income. Because Naseer's son is a taxpayer in Pakistan and the amount has been received through a banking channel, it is not treated as his income. [s.39(3)] **2**

(c) Since Naseer's income from salary is more than 50%, he is treated as a salaried person. Salaried persons are required to file their returns of income by 31 August following the end of the tax year to which the returns relate. Hence, Naseer is required to file his return of income for the tax year 2018 by 31 August 2018. [s.118(3)(a)] **2**

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Marks

2 (a) Violet & Ching Limited

Taxable income and tax liability for the tax year 2018

	Rs.	Rs.	Marks
Pakistan source income			
Business income	6,000,000		1
Non-Pakistan source income			
Business income (1,000,000) x 3·8 [ss.11(5) and 71]	3,800,000		1
Total taxable income		9,800,000	
Tax on taxable income at 25% (9,800,000 x 25%)		2,450,000	0·5
Less tax credit:			
Advance income tax paid in Pakistan [s.147]	1,350,000		1
Tax paid in Taiwan is 1,000,000 x 3·8 x 28% = Rs. 1,064,000			
Admissible tax credit, however, will be 25% of Rs. 3,800,000 [s.103(1)]	950,000		1·5
		(2,300,000)	
Tax payable with return of income		150,000	
			5

(b) (i) Aliya Enterprises (Pvt) Limited

Minimum tax on turnover

	Rs.	Marks
Gross turnover	100,000,000	
Tax at 1·25% of turnover (100,000,000 x 1·25%)	1,250,000	1
Corporate tax on the basis of taxable income		
Taxable income	5,000,000	
Tax at 30% of taxable income	1,500,000	0·5
Alternative corporate tax		
Profit before tax	9,500,000	
Less:		
Exempt income [s.113C(8)(i)]	(500,000)	1
Income for alternative corporate tax	9,000,000	
Tax at 17% of alternative corporate tax [s.113C(2)(b)]	1,530,000	0·5
		3

(ii) Since the amount of alternative corporate tax is higher than tax computed on the basis of minimum tax on turnover and tax computed on the basis of rate applicable to taxable income, the same is payable at Rs. 1,530,000. [s.113C(1)] **2**

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3 Raza

Total tax payable on taxable income for the tax year 2018

	Note	Capital gain/(loss) Rs.	Tax Rs.	Marks
Tax payable on capital gains assessable as a separate block of income				
Tax payable on the disposal of plot in Nespak as a separate block	(1)	200,000	15,000	1·5
Tax payable on the disposal of farmland as a separate block	(2)	2,125,000	159,375	2
Tax payable on the disposal of shares in Yoglicious Pakistan Limited	(3)	796,400	119,460	2·5
Income assessable under the normal tax regime				
Sale of 4,000 shares in Bright Light Ltd.	(4)	432,000		2·5
Tax on taxable income under normal law				
[(Rs. 432,000 – 400,000) x 7%]			2,240	0·5
Total tax payable			296,075	

Marks

Items not included in the computation of capital gain/loss

Disposal of house furnishings

The definition of a capital asset does not include a movable asset [except for a few given in s.38(5)] held by a person for the person's own use or for the use of the person's family members. The gain on the disposal of house furnishings (Rs. 400,000 – 250,000 = 150,000) is, therefore, not taxable as a capital gain. [s.37(5)(d)] 1

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Notes:

Note 1

Since Raza sold his plot for Rs. 800,000 which was below the fair market value of the plot, the fair market value of the plot is taken as the sale proceeds received by him. [s.77(1)]

	Rs.
Deemed consideration received	900,000
Less:	
Cost of acquisition on 1 December 2016 [s.76(2)]	(700,000)
	200,000
Tax at 7·5% (Rs. 200,000 x 7·5%)	15,000

Note 2

	Rs.	Rs.
Consideration received on 1 January 2018		15,525,000
Less:		
Cost of purchase of the farmland on 15 January 2016 [s.76(2)(1)]	11,000,000	
Incidental costs of sale [s.76(2)(b)]	900,000	
Expenditure incurred to improve drainage resulting in enhanced productivity of the farmland. [s.76(2)(c)]	1,500,000	
		(13,400,000)
Capital gain		2,125,000
Tax at 7·5% (2,125,000 x 7·5%)		159,375

Note 3

	Rs.	Rs.
Consideration received on 15 March 2018		1,800,000
Less:		
Price of shares purchased on 1 September 2016 (Rs. 200 x 5,000)	1,000,000	
Capital value tax paid at 0·01% of Rs. 1,000,000 (0·01% x 1,000,000)	100	
Brokerage fee at the time of purchase at Rs. 0·3 per share (0·3 x 5,000)	1,500	
Brokerage fee at the time of sale at Rs. 0·4 per share (0·4 x 5,000)	2,000	
		(1,003,600)
		796,400
Tax at 15% (15% x 796,400)		119,460

Note 4

The shares in Bright Light Limited are not listed on Pakistan Stock Exchange, therefore, the capital gain accruing on the disposal of these shares is taxable under the normal tax regime.

	Rs.
Consideration received for sale of 4,000 shares on 1 June 2018	800,000
Cost of acquisition (see working)	(224,000)
Capital gain	576,000

The taxable gain will be reduced to 75% [Rs. 432,000] as the shares were sold after one year. [s.37(3)]

Marks

Working: Cost of 4,000 shares in Bright Light Limited

	Rs.
2,000 shares purchased on 15 April 2011	90,000
2,000 shares purchased on 20 August 2013	150,000
1,000 rights issue shares at Rs. 40 per share	40,000
Total cost of 5,000 shares	280,000
Cost of 4,000 shares sold (280,000/5,000 x 4,000)	224,000

4 (a) Masood Enterprises Ltd (MEL)

Sales tax payable/(refundable) for May 2018

	Rs.	Marks
Output tax		
Sale of taxable goods in Pakistan to registered persons		
Rs. 20,000,000 x 17% [s.3(1)]	3,400,000	0·5
On sale of taxable goods in Pakistan to unregistered persons (see explanation 1)		
Rs. 25,000,000 x (17% + 2) [s.3(1A)]	4,750,000	0·5
On sale of goods exported to Egypt		
Rs. 18,000,000 x 0% [s.4(a)]	0	0·5
On goods given to the executive director free of cost (see explanation 2)		
Rs. 100,000 x (17 + 2%)	19,000	0·5
Total output tax	8,169,000	
Input tax		
Purchases of raw materials for manufacturing goods (see working)	7,352,100	1·5
Purchase of new machinery		
(11,700,000 x 17/117)	1,700,000	1
Total input tax	9,052,100	
Tax payable/(refundable)		
Output tax	8,169,000	
Input tax	(9,052,100)	
Input tax pertaining to January 2018 (see explanation 3)	0	
Tax refundable [s.7(1)]	(883,100)	0·5

Working:

A registered person is not allowed to adjust input tax for a tax period in excess of 90% of the output tax for that tax period. [s.8B]

Further, since the record of purchases of Rs. 351,000 is not available with the taxpayer, input tax paid on it cannot be claimed in the return for the month of May 2018.

	Rs.
On payment for purchases of raw material for manufacturing goods (exports as well as local supplies) [(Rs. 70,000,000 – 351,000) x 17/117]	10,119,940
Restricted to 90% of output tax for May 2018 (90% of Rs. 8,169,000)	7,352,100

Explanations:

Explanation 1

Total supplies to unregistered persons are Rs. 25,000,000. The value of a supply can be reduced by a trade discount only if:

– the trade discount is in conformity with the normal business practices; and
– is shown on the sales tax invoices.

In this case, the second condition is not fulfilled; therefore, the value of the supply is not reduced for the purposes of charging sales tax despite the rate of discount being well below the normal rate prevalent in the similar business. [s.2(46)(b)] 1

Explanation 2

The goods given to the executive director fall within the definition of a supply and are therefore liable to sales tax. Further, since the executive director is not a registered person, 2% further tax is also charged. [s.3(1) and (1A)] 1

Marks

Explanation 3

The input tax of Rs. 200,000 pertaining to the raw materials purchased in January 2018 was not admissible originally in that month because it was used for the manufacture of exempt goods. Hence, it cannot be claimed in May 2018 either. 1

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(b) Tax period

For the purposes of The Sales Tax Act, 1990, a tax period means:

– a period of one month; or
– such other period as the Federal Government may, by notification in the official Gazette, specify. [s.2(43)] 2

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5 (a) Nafees (Pvt) Limited ('NPL')

Taxable income for the tax year 2018 (accounting year ended 30 June 2018)

	Note	Rs.	Rs.	
Income from business				
Profit before tax			15,320,000	0·5
Less income from rent of a warehouse assessable under 'income from property'	(1)		(1,000,000)	0·5
			14,320,000	
Add:				
Work in progress for construction of a warehouse	(2)	900,000		0·5
Commission paid to dealers	(3)	500,000		0·5
Cost of pesticides used in demonstration	(4)	225,000		0·5
Donations to a local charity	(5)	490,000		0·5
Sales tax penalty for late payment	(6)	450,000		0·5
Depreciation in the accounts	(7)	1,250,000		0·5
Provision for estimated bad debts	(8)	600,000		0·5
Rent collection charges	(9)	80,000		0·5
			4,495,000	
Less:				
Tax depreciation	(7)	2,292,500		2·5
Initial allowance	(7)	125,000		1
			(2,417,500)	
Income from business (A)			16,397,500	
Income from property				
Annual rent			1,000,000	
Less:				
Rent collection charges	(9)	60,000		1
1/5th repair allowance	(10)	200,000		0·5
			(260,000)	
Income from property (B)			740,000	
Total taxable income (A + B)			17,137,500	

Items not included in the computation of taxable income

1. Expenditure of Rs. 375,000 incurred on technical literature distributed to customers regarding safe use of pesticides is admissible being for the purposes of business and suffering from no legal disability. [s.20] 1
2. The cars given to the executives are in accordance with the terms of their employment. Their use for personal purposes will be treated as a perquisite for taxation of the employees but for NPL, it is fully admissible expenditure. [ss.20 and 12] 1
3. Running finance facility costs paid to a schedule bank are for the purpose of business. No tax is required to be deducted on payments to a scheduled bank. Hence, the expense is admissible. [ss.20 and 151] 1

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Notes

Note 1

Income from rent is assessable under the head 'Income from property'. Therefore, it is deducted from profit before tax to arrive at income under the head 'Income from business'. [s.11]

Note 2

Work in process is not revenue expenditure and is still not used for the purposes of carrying on business. Hence it is not an admissible deduction during the tax year 2018. [s.21(n)]

Note 3

The commission has been paid to dealers in cash. Any individual payment of an expenditure above Rs.10,000 [Rs. 15,000 in case of salary] otherwise than through the prescribed method is not admissible. Payment in cash is not the prescribed method. Hence, it is disallowed. [s.21(l)]

Note 4

Because evidence of the cost of pesticides used in demonstration sprays for showing efficacy of pesticides is not available, the expenditure is not allowable. [s.174(2)]

Note 5

Donation to a local charity is not necessary or related to the carrying out of the business. Hence it is not admissible. Further the donation being not to any approved institution is also not eligible for tax credit. [ss.20 and 61]

Note 6

Any fine or penalty paid or payable by the person for the violation of any law, rule or regulation is not admissible under the law. Hence penalty for late payment sales tax is inadmissible. [s.21(g)]

Note 7

Capital allowances are allowed as prescribed in the third schedule. Therefore the accounting depreciation is added back and capital allowances are allowed as computed below:

Asset	Tax written down value (TWDV) on 1 July 2017	Additions during the year	Initial allowance at 25% of the value of the eligible assets in Column (3)	TWDV for tax depreciation	Rate of tax depreciation	Depreciation
(1)	(2)	(3)	(4)	(5) = (2) + (3) – (4)	(6)	(7)
	Rs.	Rs.	Rs.	Rs.		Rs.
Buildings	5,000,000	–	–	5,000,000	10%	500,000
Plant and machinery	3,000,000	–	–	3,000,000	15%	450,000
Computers	2,000,000	500,000	125,000	2,375,000	30%	712,500
Vehicles	1,000,000	2,500,000 (See sub-note (a))	Not eligible	3,500,000	15%	525,000
Furniture and fittings	500,000	200,000	Not eligible	700,000	15%	105,000
Total			125,000			2,292,500
			[s.23 and 3rd sch.]			[s.22 and 3rd sch.]

Sub-note (a)
The value of the car is to be taken exclusive of the advance income tax of Rs. 200,000. Hence, the value of the car is Rs. 3,300,000. Further, the value of a car not plying for hire, for tax depreciation purposes is to be restricted to Rs. 2,500,000. [s.122(13(a)]

Note 8

In the case of taxpayers other than financial institutions, for admissibility of a bad debt, the following conditions are to be fulfilled:

(a) The amount representing the debt has already been offered for tax;
(b) The debt is written off in the accounts of the taxpayer; and
(c) There are reasonable grounds for believing that the debt is irrecoverable.

Marks

A debt is not allowed as a bad debt merely on the basis of estimation or historical pattern. Hence the amount is added back. [s.29(1)]

Note 9

Administrative and rent collection charges are admissible on actual payment basis up to maximum of 6% of the amount of rent. Hence only amount of Rs. 60,000 (Rs. 1,000,000 x 6%) is an admissible deduction. [s.15A(1)(a)]

Note 10

Against rental income for repairs a statutory allowance at 20% of the rent is admissible irrespective of the actual amount of expense incurred on the repairs. Therefore Rs. 200,000 (1,000,000 x 20%) is allowed as repair allowance. [s.15A(1)(a)]

(b) Tax payable/(refundable) for the tax year 2018

	Rs.	Rs.	
Taxable income for the tax year 2018 from (a) above		17,137,500	
Tax at 30%	5,141,250		
Since tax at 30% is higher than minimum tax at 1·25% of the turnover Rs. 65,000,000 x 1·25% = Rs. 812,500; hence tax liability is		5,141,250	1
Less:			
Advance income tax paid in four quarterly instalments [s.147]	5,000,000		0·5
Advance income tax at the time of purchase of vehicle [s.231B(3)]	200,000		0·5
		(5,200,000)	
Refundable amount of excess tax paid		(58,750)	
			2
			15

6 Anwar

Taxable income and tax payable for the tax year 2018 (accounting year ended 30 June 2018)

	Note	Rs.	Rs.	
Income from business				
Profit before tax			1,100,000	
Less:				
Advance against future sales	(1)		(200,000)	1
Agricultural income	(2)		(200,000)	1
			700,000	
Add:				
Sewing machines	(3)	1,500,000		0·5
Computer software	(4)	970,000		0·5
Interest paid on loan	(5)	180,000		0·5
			2,650,000	
Less:				
Amortisation of computer software	(4)	221,904		1
Initial allowance	(6)	952,500		1·5
Tax depreciation	(6)	1,223,625		2·5
			(2,398,029)	
Income from business/Taxable income			951,971	

	Rs.	Rs.	*Marks*
Tax on taxable income			
Rs. 32,000 + (951,971 – 750,000) x 15%		62,296	0·5
[Para 1 of Div. I of Pt. I of 1st Sch.]			
Less:			
Tax paid at the time of import of machinery [s.148]	90,000		0·5
Tax on cash withdrawals [s.231A]	5,000		0·5
Tax paid along with fee of educational institution [s.236I]	30,000		0·5
Tax paid with telephone bills [s.236]	4,000		0·5
		(129,000)	
Tax refundable		(66,704)	

Explanation of items not included in the computation of taxable income

1. Salary paid to Anwar's brother (Rs. 15,000 x 12 = Rs. 180,000) is on account of employment. The salary paid is below the taxable limit, hence, no tax was required to be deducted. Further, the monthly salary paid in cash is also admissible because it does not exceed Rs. 15,000 per month. [ss.20 and 21(l), 149] 1
2. Rs. 350,000 paid to a client on the court's orders for damages to a client on account of defective supply of goods is incidental to the carrying on of the business and is admissible. [s.20] 1
3. Lease rentals paid to an approved leasing modaraba on account of the car taken on a finance lease are admissible. However, no depreciation is allowable on the asset. [s.28] 1
4. Anwar was not resident in any of the four tax years preceding the tax year 2018. In such a situation, foreign source income received in the tax year 2018 shall be exempt from tax in Pakistan. [s.51(1)] 1

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Notes:

Note 1

Anwar is preparing his accounts on the accrual based system of accounting. Since the amount of Rs. 200,000 has been received in advance and not yet accrued, the same is not income for the purposes of income tax law during the tax year 2018. [s.34]

Note 2

Agricultural income is exempt from Federal income tax but liable to provincial agricultural income tax. [s.41] A credit for agricultural income tax is not allowable against income assessable under the Income Tax Ordinance, 2001.

Note 3

Sewing machines are capital assets. The amount spent on their acquisition being capital expenditure is disallowed. However, capital allowances are being allowed separately as per note 6. [ss.21, 22 and 23]

Note 4

The computer software is an intangible asset for which the useful life is estimated to be four years. Its cost is allowable by its amortisation over its useful life and not in one year alone. Where an intangible asset is not used for a whole year, the amortisation is allowed proportionately for the period it is used during the year.

	Rs.	Rs.
Allowable amortisation per year (Rs. 970,000/4)	242,500	
Allowable amortised amount for 334 days (from 1 August 2017 to 30 June 2018) during the tax year 2018 Rs. 242,500 x 334/365 [s.23]		221,904

Note 5

The amount of profit paid is on a loan taken for the personal use of Anwar and not for the purposes of business. Any profit paid on any debt including a loan which is not used for the purposes of the business is not an admissible deduction. [s.28(1)(a)]

Note 6

Initial allowance and tax depreciation

Assets acquired and used during the year	Value of the asset	Rate of initial allowance on the value of assets given in column (2)	Initial allowance	TWDV for tax depreciation	Rate of tax depreciation	Depreciation
(1)	(2)	(3)	(4)	(5) = (2) – (4)	(6)	(7)
	Rs.		Rs.	Rs.		Rs.
Used sewing machines imported from China	1,410,000 (See sub-note (a))	25%	352,500	1,057,500	15%	158,625
Machinery previously used in Pakistan	3,500,000 (See sub-note (a))	Not eligible	–	3,500,000	15%	525,000
Computers and printers	1,500,000	25%	375,000	1,125,000	30%	337,500
Furniture	500,000	Not eligible	–	500,000	15%	75,000
New building	1,500,000 (See sub-note (b))	15%	225,000	1,275,000	10 %	127,500
Total			952,500			1,223,625

[ss.22 and 23 read with 3rd Sch.]

Sub-notes:

(a) Cost of the used machines imported from China is Rs. 1,500,000 inclusive of income tax of Rs. 90,000 paid at import stage. The base value of the asset eligible for capital allowances is, therefore, Rs. 1410,000. Plant and machinery which has not been previously used in Pakistan is eligible for initial allowance on its first use in Pakistan.

However, purchase and use of machinery which has previously been used in Pakistan is not eligible for initial allowance.

(b) The value of the new building of Rs. 2,500,000 is inclusive of the value of the land at Rs. 1,000,000. The value of the land is not eligible for initial allowance or depreciation. The value of Rs. 1,500,000 (Rs. 2,500,000 – Rs. 1,000,000) is, therefore, eligible for capital allowances.