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 Ismat

(a) (i) Salary income is taxable on the basis of receipt only and not on the basis of accrual. Therefore, because Ismat's salary for June 2018 was not received by 30 June 2018, it is not taxable in the tax year 2018. [s.12(1)] 2

(ii) The permissible limit for the deduction available in respect of the profit paid on a debt obtained for the acquisition of a house is the lesser of Rs. 2,000,000 or 50% of the taxable income in the relevant tax year. Any excess amount which is not permitted as a deduction in the relevant tax year cannot be carried forward to a subsequent tax year.[s.60C(3)] 2

(b) Taxable income and tax payable for the tax year 2018

		Rs.	
Salary			
Salary in cash (400,000 x 11)		4,400,000	0·5
Add:			
Perquisite on account of loan (working 1)	640,000		1·5
Income tax paid by employer [s.168 (1)(a)]	600,000		1
		1,240,000	
Taxable income before deductible allowance		5,640,000	
Less:			
Deductible allowance for profit on loan (working 2)		(160,000)	1·5
Taxable income		5,480,000	
Tax on taxable income			
[597,000 + ((5,480,000 – 4,000,000) x 27·5%)]			
[Para (1A) of Div. I of Pt. I of the 1st Sch.]		1,004,000	0·5
Less:			
	Rs.		
Tax paid on salary [s.149]	600,000		0·5
Tax collected by house registering authority [s.236k]	100,000		0·5
		(700,000)	
Tax payable with return		304,000	
			6
			10

Workings:

Working 1

		Rs.	
Total loan		8,000,000	
Benchmark rate of profit [s.13(14)(a)(ii)]	10% per annum		
Rate charged by the employer	2% per annum		
Value of the perquisite (10 – 2)% x 8,000,000 [s.13(7)]		640,000	

Working 2

	Rs.
Total loan	8,000,000
Profit paid at 2% per annum (8,000,000 x 2%)	160,000

Since the amount paid is less than both Rs. 2,000,000 and 50% of the taxable income of Rs. 5,640,000, the total is allowable. [s.60C(1) and (2)]

Marks

2 **(a)** Under the Income Tax Ordinance, 2001, a public company means a company:

(i) in which at least 50% of the shares are held by a provincial government or the Federal Government; or 1

(ii) in which at least 50% of the shares are held by a foreign government; or 1

(iii) in which at least 50% of the shares are held by a foreign company owned by a foreign government; or 1

(iv) whose shares were traded on a registered stock exchange in Pakistan and which remained listed on that exchange at the end of that tax year. 1

In addition the following trusts are also treated as a public company:

(1) a unit trust whose units are widely available to the public; and 1

(2) any other trust as defined in the Trusts Act, 1882. [s.2(47)] 1

6

(b) Saghir

(i) The amount of the loan of Rs. 170,000 will be treated as a dividend received by Saghir from Tracking Cars (Pvt) Ltd. 1

(ii) Tracking Cars (Pvt) Ltd should have deducted withholding tax at 15% on the amount treated as dividend, i.e. Rs. 25,500 (Rs. 170,000 x 15%) and deposited it in the Government treasury. 1

(iii) If the company did not have any accumulated profits, the amount of the loan cannot be treated as dividend, but will still be available to Saghir as a valid source of investment or expenditure. 1

(iv) The deeming provision treating the loan as a dividend is not applicable in the case of a loan made by a public company. Hence, the amount of the loan will not be treated as a dividend but will still be available to Saghir as a valid source of investment or expenditure. [s.2(19)] 1

4

10

3 Rameez

Total tax payable/refundable on taxable income for the tax year 2018 (accounting year ended 30 June 2018)

	Note	Capital gain/(loss) Rs.	Tax payable Rs.	
Tax payable on capital gains assessable as a separate block of income				
Tax payable on the disposal of municipal bonds	(1)	225,000	33,750	1·5
Tax payable on the disposal of shares in Shishamwood (Pvt) Ltd	(2)	60,000	7,500	2
Tax payable on disposal of land	(3)	1,100,000	82,500	1·5
Income assessable under the normal tax regime (NTR)				
Taxable gain on disposal of antique painting	(4)	300,000		1·5
Taxable gain on disposal of shares in Zahoor Textile Mills (Pvt) Ltd	(5)	80,000		1
Taxable income under NTR		380,000		
Tax on taxable income under NTR				
Being below taxable limit no tax is chargeable			0	0·5
Total tax payable			123,750	
Less:				
Tax collected at the time of purchase of car		190,000		0·5
Tax collected at the time of withdrawal of cash		4,500		0·5
			(194,500)	
Refundable amount of tax			(70,750)	

Items not included in the computation of capital gain/loss

Disposal of antique manuscript

No loss is recognised on the disposal of certain movable capital assets, e.g. a manuscript, an antique, etc [s.38(5)(e) and (f)]. Because the disposal of the manuscript has resulted in a loss of Rs. 95,000 (5,000 – 100,000), it is not to be recognised in the computation of net taxable capital gains. 1

10

Note 1

Municipal bonds issued by a local authority are debt securities. A capital gain/loss on the disposal of a security is treated as a separate block.

	Rs.	Rs.
Consideration received on 5 August 2017		2,500,000
Less:		
Purchase price paid on 1 April 2017	2,250,000	
Bank charges	25,000	
		(2,275,000)
Capital gain		225,000
Tax at 15% (225,000 x 15%)		33,750

Note 2

Since 50% of the shares in both Shishamwood (Pvt) Ltd (SPL) and Interworld Travels (Pvt) Ltd (ITPL) are held by the Federal Government, they each fall within the definition of a public company and so their shares are 'securities' under the Income Tax Ordinance, 2001. Any gain or loss arising from the disposal of securities is taxable as a separate block.

	Rs.
Consideration received on the disposal of 5,000 shares in SPL on 10 August 2017	
Equal to fair market value of 4,000 shares in ITPL (4,000 x 90)	360,000
Less:	
Cost of 5,000 shares in SPL on 20 June 2016 (5,000 x 60)	(300,000)
Capital gain	60,000
Tax at 12·5% (60,000 x 12·5%)	7,500

Note 3

Since the proceeds of the compulsorily acquired land were not invested in the purchase of a similar asset, any gain is taxable as a separate block.

	Rs.	Rs.
Consideration received from the Government of Punjab on 15 March 2018		47,000,000
Less:		
Cost of land acquired on 1 January 2017	45,000,000	
Stamp duty paid	900,000	
		(45,900,000)
Capital gain		1,100,000
Tax at 7.5%		82,500

Note 4

	Rs.
Consideration received on the sale of a painting on 20 March 2018	1,500,000
Less cost of the painting (being market value on 10 November 2010 on the date painting was inherited)	(1,100,000)
Capital gain	400,000

Since the asset was held for more than a year, only 75% capital gain Rs. 300,000 [400,000 x 75%] will be taxable.

Note 5

Rameez's son is not tax resident in Pakistan during the tax year 2018, so the capital gain on the gift of shares in Zahoor Textile Mills (Pvt) Ltd to his son will be a taxable event.

	Rs.
Consideration deemed to have been received on 30 April 2018 (2,000 x 50)	100,000
Less cost of the shares on 1 January 2018 (2,000 x 10)	(20,000)
Taxable capital gain	80,000

Marks

4 **(a)** Documents required for the deduction of input tax

(i) To deduct input tax in respect of a supply of goods, the registered person making the taxable supply must hold a tax invoice bearing his name and registration number in respect of the supply made for which a return is furnished. [s.7(2)(i)] 1

(ii) To deduct input tax in respect of goods imported into Pakistan, the registered person must hold a bill of entry or a goods declaration showing his name and registration number. The bill of entry or the goods declaration should be duly cleared by the Custom authorities. [s.7(2)(ii)] 1

(iii) To deduct input tax for goods purchased in an auction, the registered person should hold the treasury receipt showing his name, registration number and the payment of sales tax. [s.7(2)(iii)] 1

3

(b) Omar Ltd

Sales tax payable for the tax period May 2018

	Rs.	
Output tax		
On the sale of zero rated goods to registered persons (Rs.4,700,00 x 0%)	0	0·5
On the sale of exempt goods to unregistered persons	––	0·5
On the sale of taxable goods to unregistered persons (Rs.6,000,000 x (17 + 2)%))	1,140,000	1
On the advance payment received in May 2018 for the supply of taxable goods to a registered persons in August 2018 (Rs. 2,500,000 x 17%)	425,000	1
	1,565,000	
Input tax		
(i) On payment for raw materials purchased for making taxable supplies through:		
Cash payment (not admissible)	0	1
Credit card (Rs. 585,000 x 17/117)	85,000	0·5
Online transfer of funds from business bank account (468,000 x 17/117) [proviso to s.73(1)]	68,000	0·5
Crossed cheque from the personal bank account of a director (not admissible) [s.73(1)]	0	1
(ii) On purchase of raw materials used exclusively in the making of exempt supplies [s.7]	0	0·5
(iii) On raw material purchased exclusively for the making of zero rated supplies (Rs.1,755,000 x 17/117)	255,000	0·5
	408,000	
Tax payable with the return of sales tax for the tax period May 2018	1,157,000	
		7
		10

Marks

5 Pakistan Technologies Ltd (PTL)

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

	Note	Rs.	Rs.	Marks
Income from business				
Profit before tax			4,000,000	
Add:				
Instalments of plot paid	(1)	400,000		0·5
Interest paid to a non-resident	(2)	300,000		0·5
Salary paid in cash	(3)	150,000		0·5
Scientific research expenditure	(4)	700,000		1
Expenses of marriage	(5)	250,000		1
Expenditure to increase authorised capital	(6)	850,000		0·5
Fine for violation of local law	(7)	50,000		0·5
Over-paid expenditure on advertising	(8)	66,667		1
Bad debt	(9)	650,000		1
Accounting depreciation	(10)	1,800,000		0·5
			5,216,667	
Less:				
Net income from rendering technical services	(11)	1,000,000		1
Tax depreciation	(12)	1,938,500		2·5
Initial allowance	(12)	25,000		0·5
Loss on sale of computer	(13)	26,000		1
			(2,989,500)	
Income from business/Taxable income			6,227,167	

Items not included in the computation of taxable income

The damages of Rs. 50,000 received from one of PTL's suppliers of raw material as damages for delayed supplies is incidental to such business and is taxable as income from business. No adjustment is required. [general principles of taxation] 1

13

Notes

Note 1

Any amount paid to acquire a plot of land is capital expenditure under the Income Tax Ordinance, 2001 irrespective of the treatment by the taxpayer of such an amount in its accounts. [s.37] Therefore, this capital expenditure is not deductible.

Note 2

Tax at source is to be withheld from the interest paid to a non-resident. In the case of default, the expenditure becomes inadmissible. [s.21(c)]

Note 3

A salary above Rs. 15,000 per month, paid in cash is inadmissible. There is no exception in this regard catering for urgencies or compelling circumstances like the one given in the question. [s.21(m)]

Note 4

Scientific research expenditure is an allowable expense provided that it is revenue in nature and the research is carried out in Pakistan. Hence, the amount of scientific expenditure incurred in China is not an allowable expenditure, but the other in-house expenditure is allowed. [s.26]

Note 5

The expense incurred on the marriage of a daughter of an employee is not in accordance with the terms of the employee's employment and hence is not incurred for the purpose of business. Therefore it is not allowable for tax purposes. [s.20]

Note 6

Expenditure incurred to increase the authorised capital of a company is of a capital nature and not admissible irrespective of whether the increase was voluntary or in compliance with any law of the land. [s.21(n)]

[**Tutorial note:** *It is also not allowable for amortisation as a preliminary expense, because it does not relate to the period before commencement of the business of the company. s.25*]

Marks

Note 7

The amount of Rs. 50,000 being a fine for violation of a local law is not admissible under the Income Tax Ordinance, 2001. [s.21(g)]

Note 8

The expenditure incurred on advertising was not in accordance with the arm's length principle. Hence, the amount paid in excess of the fair market rate of Rs.66,667 (Rs.400,000/120 x 20) is disallowed. [s.108]

[**Tutorial note:** *The commissioner shall reduce the amount of receipt of the associate company Kiran Ltd to the extent the claim of PTL is reduced.*]

Note 9

PTL is not a financial institution. In the case of taxpayers other than financial institutions, the amount of any bad debt claimed must previously have been included in the person's income from business chargeable to tax. [s.29(1)(a)(i))] This condition is not fulfilled in the case of the loan to Kiran Ltd so the claim is not admissible.

Note 10

Tax depreciation is allowed in accordance with the provisions of the Income Tax Ordinance, 2001 and any claim for depreciation in the accounts is added back to the taxable income of the taxpayer. [s.22 read with 3rd sch.]

Note 11

Income earned from technical services rendered to an entity abroad is exempt from tax in Pakistan if it is brought into Pakistan in accordance with the law for regulating payments and dealings in foreign exchange. Since all the necessary conditions are fulfilled, the income amount is treated as exempt and excluded from the taxable income of PTL. [cl. (131) of Pt. I of the 2nd Sch.]

Note 12

Tax depreciation and initial allowance

Asset	Tax written down value (TWDV) on 1 July 2017	Addition/ (deletion) during the year	Initial allowance 25% on addition	TWDV for depreciation	Rate of depreciation	Depreciation
(1)	(2)	(3)	(4)	(5) = (2 + 3) – (4)	(6)	(7)
	Rs.	Rs.	Rs.	Rs.		Rs.
Buildings	3,500,000	–	–	3,500,000	10%	350,000
Plant and machinery	6,000,000	–	–	6,000,000	15%	900,000
Motor cars	2,500,000	–	–	2,500,000	15%	375,000
Computer hardware	1,000,000	(30,000)		970,000	30%	291,000
	–	100,000	25,000	75,000	30%	22,500
Total			25,000			1,938,500

[s.22 read with 3rd sch.]

Note 13

When a business asset is discarded, it is treated as disposed of. [s.75(3A)] The fair market value of the asset at the time of disposal is taken as the consideration received. [s.77(1)] Hence, the amount of business loss shall be computed as Rs. 26,000 [Rs. 4000 – 30,000)]. [s.22(8)(b)]

(b) Tax liability for the tax year 2018

	Rs.	Rs.	Marks
Taxable income for the tax year 2018 (from part (a))		6,227,167	
Tax at 30%		1,868,150	0·5
Less: Tax already paid			
Advance tax [s.147]	1,200,000		0·5
On cash withdrawals [s.231A]	35,000		0·5
On supplies [s.153]	600,000		0·5
		(1,835,000)	
Tax payable with the return of income		33,150	
			2
			15

			Marks
6 Ambreen			

(a) **Taxable income and tax payable for the tax year 2018 (accounting year ended 30 June 2018)**
Income from business

	Rs.	Rs.	Marks
Net income declared		638,500	
Less:			
Salary receipts from APWA [s.11 and 12)	1,005,500		0·5
Tax refund [s.2(29)]	575,000		0·5
Additional payment on delayed refund [s.39(1)(cc)]	75,000		0·5
		(1,655,500)	
Add:			
Rent of beauty parlour (inadmissible) [s.21(c) read with s.155(3)(via)]	800,000		1
Purchase of equipment [s.21(n)]	90,000		0·5
Wages paid to employees in cash [s.21(m)	1,000,000		1
Income tax paid with telephone bills (inadmissible as expense) [s.21(b) and s.168]	25,000		1
		1,915,000	
Less admissible deductions:			
Initial allowance on new equipment (Rs.90,000 x 25%) [s.23]	22,500		0·5
Tax depreciation on new equipment (Rs. 90,000 – 22,500) x 15% [s.22]	10,125		0·5
Tax depreciation on brought forward equipment Rs.(2,860,000 – 1,360,000) x 15% [s.22]	225,000		0·5
Lease rentals (320,000 (250,000 + 70,000) x 50%) [s.28]	160,000		1
		(417,625)	
Income from business		480,375	
Income from salary			
Amount received from APWA inclusive of amount of tax Rs. (1,005,500 + 44,500) [s.12]		1,050,000	1
Income from other sources			
Additional payment on delayed refund [s.39(1)(cc)]		75,000	1
Total income/Taxable income		1,605,375	
Tax on taxable income			
Rs. 92,000 + (1,605,375 – 1,500,000) x 15% [Para (1A) of Div. I of Pt. I of 1st sch.]		107,806	0·5
Less tax already paid:			
Tax on salary [s.149 and 168]	44,500		0·5
Tax with telephone bills [s.236 and 168]	25,000		0·5
		(69,500)	
Tax payable with return of income		38,306	

Explanation of items not included in the computation of taxable income

1. Destruction of expired chemicals
   The Rs. 45,000 cost of the chemicals destroyed after their expiry date is a normal business expense and allowable. No adjustment is required. 1
2. A loss from speculation business can only be set off against income from speculation business. As there is no such income in the tax year 2018, the loss cannot be set off. 1

13

(b) A deductible allowance on account of tuition fees paid by a taxpayer for the education of their children is admissible subject to certain limitations and restrictions provided the taxable income of the taxpayer is less than Rs. 1,500,000. Since Ambreen's taxable income is above this threshold in the tax year 2018, she is not entitled to any allowance. [s.64AB] **2**

15