PRINCIPLES OF TAXATION (AUTUMN 2014 TO SPRING 2017)

ICAP PAST PAPERS BANK

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The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examinations

9 September 2014
3 hours – 100 marks
Additional reading time – 15 minutes

Principles of Taxation

Q.1 Sultan is working as electronic engineer with Ansari Electrical Company Limited (AECL). He has provided you with the following information for the tax year ended 30 June 2014:

(a) His monthly cash remuneration in AECL is as follows:

	Rupees
Basic salary	480,000
Medical allowance	48,000
Utilities allowance	55,000
Market value of rent free accommodation	75,000

(b) He was also provided the following benefits in accordance with the terms of his employment:

(i) Leave encashment amounting to Rs. 300,000.
(ii) Hospitalization cost is covered by an insurance policy upto the amount of Rs. 1.5 million. The insurance premium relating to this benefit amounted to Rs. 55,000.
(iii) He is allowed to use his personal car for office use. Reimbursement of car running and maintenance expenses amounted to Rs. 550,000. 15% of these expenses pertain to personal use.

(c) Rs. 200,000 were received from a private limited company for attending board meetings.
(d) A lump sum amount of Rs. 1.2 million was received as the author of a literary work. Sultan took three years to complete this literary work.
(e) Sultan is also a part time singer and owns a studio. He sold the premises in which the studio was situated for Rs. 10 million and shifted his musical instruments to new premises which he purchased for Rs. 15 million. He received Rs. 2.5 million from his father in cash as loan to pay for his new studio. The previous premises was purchased several years ago for Rs. 1.4 million and had a tax written down value of Rs. 600,000 at the time of disposal.
(f) The net income from the studio for tax year 2014 was Rs. 990,000. The expenses include salaries of two workers at Rs. 15,000 and Rs. 18,000 per month and utility bills amounting to Rs. 110,000. All expenses were paid in cash.
(g) He won a car, in a competition held by Star Motor Limited for promotion of its sales. The fair market value of the car was Rs. 850,000.
(h) He gifted 40 fans having a fair market value of Rs. 100,000 to an approved charitable organisation.
(i) An amount of Rs. 500,000 was paid by him as contribution to an approved pension fund.

Required:
Under the provisions of the Income Tax Ordinance, 2001 compute the taxable income and tax thereon for the tax year 2014. ***Tax rates are given on the last page.*** **(20)**

Q.2 Briefly discuss the provisions of Income Tax Ordinance, 2001 in respect of the following situations:

(a) Farhan received Rs. 960,000 as his share of profit from AOP, during the tax year 2014. He also earns income from other sources. **(05)**

(b) ABC (Private) Limited has decided to provide a loan of Rs. 5 million to one of its shareholders, for the purchase of a house. **(04)**

Q.3 Zaman is working as the Chief Executive Officer in Yasir Limited (YL). Following are the details of sale and purchase relating to his capital assets during the tax year 2014.

(a) Under an employee share scheme, 25,000 shares of YL were allotted to Zaman, on 1 December 2011 for Rs. 25 each. According to the scheme, he was not allowed to sell/transfer the shares before completion of two years from the date of transfer. The face value of each share is Rs. 10 per share. Fair market value of the shares was as follows:
- Rs. 40 per share on 1 December 2011
- Rs. 48 per share on 30 June 2012
- Rs. 55 per share on 30 November 2013
- Rs. 61 per share on 30 June 2014

(b) He sold 24,000 shares of HQ (Pvt.) Limited on 30 June 2014 for Rs. 200 per share. He had acquired these shares as follows:
- 18,000 shares were purchased at Rs. 55 per share on 25 June 2013.
- 6,000 shares were allotted as bonus shares on 28 February 2014.

(c) A gain of Rs. 300,000 was realized on the sale of shares of Zeeshan Industries Limited (ZIL), a public listed company, in June 2014. The shares were acquired on 31 May 2013.

(d) Zaman sold a painting to his brother on 23 March 2014 for Rs. 1,800,000. Zaman had purchased this painting for his residence, in an auction for Rs. 2,000,000 on 10 July 2011.

(e) He sold his old furniture to Furqan for Rs. 285,000 on 25 June 2014. The furniture was purchased in 2012 for Rs. 250,000.

Required:
Compute the amount to be included in the taxable income of Zaman for the tax year 2014 and specify the head of income under which the income would be classified. **(10)**

Q.4 In Income Tax Ordinance, 2001 the term "disposal" has a wider connotation than sale because it includes exchange, relinquishment, and extinguishment.

List the situations under which an asset owned by a person shall be treated to have been disposed of. **(05)**

Q.5 (a) Under the Sales Tax Act, 1990 and Rules made thereunder:

(i) List the persons who are required to be registered. **(05)**
(ii) Change in rate of tax during a tax period **(04)**

(b) There are certain food items in the inventory of XY Limited (XYL) which were returned by the customers after the expiry date. Specify the procedure which must be followed under the Sales Tax Rules, 2006 if XYL wishes to destroy these items. **(03)**

Q.6 Ali Trading Company (ATC) is registered under the Sales Tax Act, 1990 and is engaged in the business of manufacture and supply of consumer goods. Following information has been extracted from the records of ATC for the month of August 2014.

	Rupees
Supplies	
Local supplies to wholesalers	14,500,000
Local supplies to distributors	10,254,980
Exports	18,650,000
Local supplies to registered retailers	980,000
Supply of exempted goods	5,500,000
Purchases	
Local purchases from registered persons	50,982,000
Local purchases from un-registered persons	9,200,000

Following additional information is also available:

(i) Supplies amounting to Rs. 540,000 were returned by registered retailers.
(ii) An early settlement discount of Rs. 250,000 was given to local distributors.
(iii) An amount of Rs. 500,000 was received from Imran Associates, representing 25% advance payment in respect of supply of a special order. ATC will supply this order in November 2014.
(iv) Goods pledged with a bank, were disposed of by the bank for Rs. 4 million in satisfaction of debt owed by ATC.
(v) Sales tax credit brought forward from previous month amounted to Rs. 854,700.
(vi) Proper debit and credit notes have been issued wherever necessary.

Sales tax is payable at the rate of 17%. All the above figures are exclusive of sales tax.

Required:
Under the provisions of the Sales Tax Act, 1990 compute sales tax payable/refundable and input tax credit to be carried forward, if any, for August 2014. **(14)**

Q.7 The primary objective of a taxation system is to collect revenue. You are required to list the other objectives (non-revenue) which a taxation system can achieve. **(10)**

Q.8 Briefly explain the ethical responsibilities of the tax implementing authorities. **(10)**

Q.9 (a) List the taxes which can be imposed by the Federal Government. **(06)**

(b) Briefly describe the duties of National Finance Commission. **(04)**

(THE END)

PRINCIPLES OF TAXATION
Suggested Answers
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Ans.1

Mr. Sultan
Computation of Taxable income and Tax thereon
For the tax period June 2014

(All amounts are in Rs.)

	Note	Rupees Taxable
Income from salary:		
Basic salary (480,000 × 12)		5,760,000
Medical allowance (48,000 × 12)		576,000
Utilities allowance (55,000 × 12)		660,000
Rent free accommodation [(45% x Rs. 5,760,000)= 2,592,000] or market value [75,000 x 12 = 900,000] which ever is higher.		2,592,000
Leave encashment		300,000
Reimbursement of personal car running & maintenance expenses (550,000 × 15%)		82,500
Total income from salary		9,970,500
Income from business:		
Income as a singer	1	1,206,000
Gain on sale of studio	2	800,000
Total Income from business		2,006,000
Income from other sources:		
Lumpsum amount received as author of literary work		1,200,000
Loan received in cash from father		2,500,000
Fee received for attending the BOD meetings		200,000
Won a car in competition		850,000
Total income from other sources		4,750,000
Total income		**16,726,500**
Less: Car won in competition taxed under FTR		(850,000)
Taxable income chargeable under NTR		**15,876,500**
Tax chargeable at normal rate		
Tax on Rs.7,000,000		1,425,000
Tax on balance (8,876,500 × 30%)		2,662,950
Tax on taxable income		4,087,950
Less: Tax credit on donation paid to a charitable organization (100,000/15,876,500 x4,087,950)		(25,748)
Less: Tax credit on amount paid to pension fund 500,000/15,876,500 x4,087,950		(128,742)
Tax payable		**3,933,460**
Note -1: Income from business		
Income as a singer		990,000
Add: Inadmissible expenses		
Salary Exceeding Rs. 18,000 paid in cash		216,000
Income from business		1,206,000
Salary of a worker who was paid in cash Rs. 15,000 is admissible		
Utility bills amounting to Rs. 110,000 paid in cash are also admissible.		
Note – 2: Sale of studio		
Sale proceed equivalent to cost		1,400,000
Less: WDV of studio (1.4-0.8)		600,000
Gain on disposal		800,000

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Ans.2 (a) An association of persons shall be liable to tax separately from its members and where the association of persons has paid tax on its income, the amount received by a member of the association in the capacity as member out of the income of the association shall be exempt from tax.

Therefore, the share of profit received from AOP by Mr. Farhan is exempt from tax.

However, the income from AOP will be included in Farhan's income for determining the rate of income tax. Accordingly, his tax liability would be computed by using the following formula:

$$(A/B) \times C$$

Where:

A is the amount of tax that would be assessed to the individual for the year if the amount of profit were chargeable to tax;

B is the taxable income of the individual for the year including the amount of the profit; and

C is the individual's actual taxable income for the year.

(b) The term dividend includes any payment by a private limited company by way of loan to its shareholder for the individual benefit of the shareholder to the extent of accumulated profit of the company.

The exception is available to those companies where the lending of money is a substantial part of the business of the company.

Therefore, amount received by the shareholder (director) shall be construed and treated as dividend, in the hands of the shareholder except as explained above.

Being a resident company, ABC (Private) Limited is responsible to deduct withholding tax on the payment of dividend in accordance with the rates specified in the First Schedule.

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Suggested Answers
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Ans.3

(All amounts are in Rs.)

			Taxable Income
(a)	**Share of YPL - Employees share scheme**		
	Fair market value of shares on 30 November 2013 (25,000× 55)		1,375,000
	Purchase price (25000*25)		625,000
	Income from salary	**A**	750,000
(b)	**Share of HQ Limited**		
	Sale price (24,000 × 200)		4,800,000
	Purchase price (18,000 × 55)		990,000
		-	3,810,000
	25% tax credit on original shares of YL as YL holds them for>12 months [(18,000÷24,000 ×3,810,000)×25%]		(714,375)
	Income from capital gain	**B**	3,095,625
(c)	**Share of Zeeshan Industries Limited**		
	Capital Gain on the sale of shares of ZIL (Exempt because holding period is greater than 12 months)		-
(d)	**Sale of painting**		
	Consideration received of painting on 23 March 2014		1,800,000
	Less : Cost of painting on July 10, 2001		(2,000,000)
	Loss on sale *(This loss shall neither be recognisable on disposal of a painting nor adjustable under any head of income.)*		-
(e)	**Personal assets (not taxable)**		-
			3,845,625

Ans.4 Under the following situations an asset shall be treated to have been disposed off:

(a) A person who holds an asset shall be treated as having made a disposal of the asset at the time the person parts with the ownership of the asset, including when the asset is:
  (i) sold , exchanged ,transferred or distributed; or
  (ii) cancelled, redeemed, relinquished, destroyed, lost, expired or surrendered.

(b) The transmission of an asset by succession or under a will shall be treated as a disposal of the asset by the deceased at the time asset is transmitted.

(c) The application of a business asset to personal use shall be treated as a disposal of the asset by the owner of the asset at the time the asset is so applied.

(d) Where a business asset is discarded or ceases to be used in business, it shall be treated to have been disposed of.

(e) Where a depreciable asset that has been used by a person in Pakistan is exported or transferred out of Pakistan, the person shall be treated as having disposed of the asset at the time of the export or transfer for a consideration received equal to the cost of the asset.

PRINCIPLES OF TAXATION
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Ans.5 **(a)** (i) The following persons engaged in making of taxable supplies in Pakistan, including zero-rated supplies are required to be registered:

- a manufacturer not being a cottage industry;
- a retailer whose value of supplies, in any period during the last twelve months exceeds five million rupees;
- an importer;
- a wholesaler including dealer and distributor;
- a commercial exporter, who intends to obtain sales tax refund against his zero-rated supplies
- a person required, under any other Federal law or Provincial law, to be registered for the purpose of any duty or tax collected or paid as if it were a levy of sales tax to be collected under the Act; and

(ii) If there is a change in the rate of tax,

- a taxable supply made by a registered person shall be charged to tax at such rate as in force at the time of supply.
- imported goods shall be charged to tax at such rate as is in force -
  - in case the goods are entered for home consumption, on the date on which a goods declaration is presented.
  - in case the goods are cleared from warehouse, on the date on which a goods declaration for clearance of such goods is presented.
- where a goods declaration is presented in advance of the arrival of the conveyance by which the goods are imported, the tax shall be charged as is in force on the date on which the manifest of the conveyance is delivered.
- where the tax is not paid within seven days of the presenting of the goods declaration the tax shall be charged at the rate as is in force on the date on which tax is actually paid.

If there is a change in the rate of tax during a tax period, a separate return has to be furnished in respect of each portion of the tax period showing the application of different rates.

(b) In order to destroy the goods, the following conditions must be fulfilled:

(i) Prior permission from the Collector of Sales Tax having jurisdiction.
(ii) Goods should be destroyed under the supervision of an inland revenue officer of Sales Tax not below the rank of an Assistant Collector as may be deputed by the Collector for the purpose.

PRINCIPLES OF TAXATION
Suggested Answers
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Ans.6

Ali Trading Company
Computation of Sales Tax Payable / Refundable
For the tax period August 2014

(All amounts are in Rs.)

	Taxable Value	Sales Tax @ 17%
Sales tax credits (input tax)		
Local purchases:		
- From registered person	50,982,000	8,666,940
- From un-registered person	9,200,000	-
Input tax attributable to both taxable and exempted supplies		8,666,940
(-) Unadjustable input tax **(working)**		(3,884,322)
Input tax for the month		**4,782,618**
(+) Previous month credit brought forward		854,700
Accumulated credit		5,637,318
Sales tax debits (output tax)		
Local supplies :		
Wholesalers	14,500,000	2,465,000
Distributors	10,254,980	1,743,347
Retailers	980,000	166,600
Exempted goods	5,500,000	-
Exports	18,650,000	-
Advance payment received	500,000	85,000
Goods disposed of by the bank	4,000,000	680,000
Output tax for the month		5,139,947
Early settlement discount to distributors		-
Supplies returned by regular retailers	(540,000)	(91,800)
Debit for the month		5,048,147
Admissible credit		
90 % of output tax i.e. Rs. 5,048,147 **OR** input tax whichever is lower		(4,543,332)
Sales tax payable		**504,815**
Input tax to be carried forward (5,637,318-4,543,332)		1,093,986
Input tax to be refunded (zero-rate supplies)		2,999,694

Working:
Apportionment of Input tax

	Amount	Unadjustable input tax
Total local supplies (14,500,000+10,254,980+980,000+4,000,000)/8,666,940	29,734,980	-
Zero rated supplies	18,650,000	2,999,694
Exempt supplies	5,500,000	884,628
Total sales	53,884,980	3,884,322

PRINCIPLES OF TAXATION
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Ans.7 The taxation system may also be utilized to achieve the following non revenue objectives as follows:

- To strengthen anemic enterprises by granting them tax exemptions or other conditions or incentives for growth;
- To protect local industries against foreign competition by increasing local import taxes;
- As a bargaining tool in trade negotiations with other countries;
- To counter the effects of inflation or depression;
- To reduce inequalities in the distribution of wealth;
- To promote science and invention, finance educational activities or maintain and improve the efficiency of local forces;
- To implement laws which eliminate discrimination among various elements in the markets/businesses.
- To discourage certain undesirable sectors and activities.
- To documentation of the economy.
- To promote export of the country.
- To promote investment in listed companies.
- To promote information technology specially software houses.
- To promote culture of payment of donation to only organized and regulated institutions.

Ans.8 A concise code which can enlist ethical responsibilities of Tax Administrators can be as under:

(i) Obey all laws relating to taxation and grant no exemptions, credit or advantage to any taxpayer that is not provided by the law;
(ii) Be dedicated to the highest ideal of honesty and integrity in all matters in order to maintain the respect and confidence of the government and taxpayers;
(iii) Strive to be impartial, fair, neutral and consistent in administering the law without regard to race, social or economic circumstance;
(iv) Provide prompt, efficient and quality service to all stakeholders in an effort to exceed their expectation;
(v) Refrain from actively participating in partisan political activities;
(vi) Accurately record proceedings and maintain taxpayer information in the strictest confidence and highest level of security;
(vii) Refrain from soliciting gifts for actions and non-actions;
(viii) Make reasonable effort to collect the proper amount of tax revenue due at the lowest possible cost to the state, and in a manner that warrants the highest degree of confidence in our integrity, efficiency, effectiveness and fairness;
(ix) Respond to valid taxpayer refund claims with the same diligence as employed in collection of taxes;
(x) Educate taxpayers on their rights and responsibilities to ensure the highest possible levels of voluntary compliance to the laws.

PRINCIPLES OF TAXATION
Suggested Answers
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Ans.9 **(a)** Following taxes can be imposed by the Federal Government

(i) Taxes on income other than agricultural income.
(ii) Taxes on corporations.
(iii) Taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed, except sales tax on services.
(iv) Taxes on the capital value of the assets, not including taxes on immovable property.
(v) Taxes on mineral oil, natural gas and minerals for use in generation of nuclear energy.
(vi) Taxes on the production capacity of any plant, machinery, undertaking, establishment or installation in lieu of any one or more of them.
(vii) Terminal taxes on goods or passengers carried by railway, sea or air; taxes on their fares and freights.

(b) The duties of the National Finance Commission to make recommendations to the President as to:

(i) The distribution between the Federation and the Provinces of the net proceeds of the taxes.
(ii) The making of grants-in-aid by the Federal government to the Provincial Governments.
(iii) The exercise by the Federal Government and the Provincial Governments of the borrowing powers conferred by the Constitution;
(iv) Any other matter relating to finance referred to the Commission by the President.

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN EXAMINERS' COMMENTS	
SUBJECT Principles of Taxation	**SESSION** Certificate in Accounting and Finance – Autumn 2014

General

Though several students produced sound and well-written answers, however, the majority seemed to suffer on account of the following:

- Selective study
- Lack of understanding of examination techniques
- Lack of understanding of requirement of the question
- Producing irrelevant material thereby creating time constraint
- Lack of communication and presentation skills.

Question 1

This was a practical question and required the candidates to compute the taxable income of an individual and tax thereon for the tax year 2014. Generally the candidates were aware of the tax treatment of various receipts, expenses and other income. Some of the mistakes that were more commonly observed were as follows:

- Many candidates were unaware that exemption of medical allowance up to 10% of the basic salary does not apply where medical benefit is provided in addition to the medical allowance. Consequently, medical allowance was incorrectly considered as exempt.

- Fair market value of accommodation amounting to Rs. 900,000 (Rs. 75,000 x 12) was included in taxable income which was incorrect because rent free accommodation is taxed at higher of fair market value or 45% of annual basic salary. Hence, Rs. 2,592,000 (being 45% of annual basic salary of Rs. 5,760,000) should have been included in taxable income.

- Leave encashment was treated as exempt.

- Fee received for attending the BOD meetings was treated as 'Income from Other Sources'. Since under section 12(a) directorship is covered under the definition of employment, such income is to be included in salary income.

- A number of candidates did not appreciate that salary expense exceeding Rs 18,000 paid in cash was inadmissible and salary expense upto Rs. 15,000 and utility bills paid in cash were admissible business expenses.

- Number of candidates simply ignored the loan received in cash from the father of the individual, whereas under Section 39(3) it was taxable under the head Income from Other Sources.

- Fair market value of car won in competition was considered as being subject to tax under the normal tax regime, whereas it is to be taxed under the Final Tax Regime.

- Many candidates did not claim tax credit on 'Donation' and 'Contribution to Approved Pension Fund'. Some calculated it incorrectly whereas there were a number of students who considered these as direct deductions from taxable income.

- Tax credit on contribution to approved pension fund was calculated after deducting tax credit on donation from taxable income, whereas both tax credit are calculated simultaneously i.e. on the basis of average rate of tax.

- Some candidates allowed tax credit on insurance premium paid in respect of medical insurance policy.

- Amount of gain on sale of studio was calculated by deducting tax written down value from sale proceeds. Whereas according to Section 22(13)(d) where the consideration received on the disposal of immovable property exceeds the cost of the property, the consideration received has to be treated as the cost of the property. Hence, the amount of accumulated depreciation becomes the gain.

  Further, many candidates treated it as capital gain or income from other sources whereas it should have been included in income from business.

- Income as singer was included under the head income from other sources instead of income from business.

Question 2(a)

This part was based on the requirement of Section 92 read with Section 88 of the Income Tax Ordinance, 2001 which describes the principles of taxation relating to association of persons [AOP] and the taxability of share of profit received by an individual, from the AOP, as a member of the association.

Though the question was quite straightforward and based on a situation which should be known to all students yet majority of the candidates failed to comment that shares of profit from AOP is included in the members income for rate purposes only. Many candidates confined their answers to the fact that share of profit from AOP is exempt from tax in the hands of a member or failed to correctly specify as to how the tax liability of the member is to be computed in case the member also earns income from other sources.

Question 2(b)

This part required the candidates to discuss the provisions of Income Tax Ordinance, 2001 where a private company provides loan to its shareholder for purchase of house. Many candidates failed to appreciate that the question was based on the definition of dividend which according to the Income Tax Ordinance, 2001 also includes loan advanced to a shareholder by a private company. Further, many of those who knew that the loan would be taxed as dividend did not highlight the following important points:

- Amount to be treated as dividend shall be limited to the extent of accumulated profits.

- That the company, being a resident, would be required to deduct tax at an appropriate rate as is applicable to dividends.

Further, many candidates confused it with the situation where difference between actual and benchmark rate is applied to calculate the amount of deemed income, which was not relevant.

Question 3

This question consisted of five parts all of which pertained to transactions involving sale and purchase of assets. The candidates were required to compute the amount to be included in taxable income and to identify the head of income under which each gain would be classified. The performance in each part is discussed below:

(a) Gain on disposal of shares acquired under employee share scheme was tested. Majority of the students gave correct answer. However, some students classified the gain under the head 'Income from Capital Gains' instead of 'Income from Salary'.

(b) According to the scenario, 24000 shares had been sold. Out of these, 18000 were acquired in cash whereas 6000 shares had been received as bonus shares. This part was much easier and most of the students performed well. The most common error was that students failed to appreciate that the 25% reduction on gain chargeable to tax is to be computed only on originally purchased shares that were held for more than one year [i.e 18000 shares]. Some candidates allowed the reduction on entire gain from 24000 shares, which was incorrect because the bonus shares were held for less than one year. Some of the candidates assumed the cost of bonus shares as the face value i.e. Rs. 10 per share.

(c) This was the easiest of the five situations and most of the candidates secured full marks by specifying that gain on disposal of listed company's shares after one year holding period is exempt and hence the gain would not be included in taxable income.

(d) According to the given situation, a painting had been sold for a loss. A significant number of candidates erred in concluding that the loss on disposal of painting can be adjusted against gain on disposal of other capital assets whereas under Section 38(5) of the Income Tax Ordinance, 2001 such loss is not adjustable under any head of income.

(e) Most of the candidates did well in this part as they knew that furniture being a moveable asset and held for personal use does not fall under the definition of capital asset and therefore no capital gain arises on its disposal.

Note:

It may be noted that the above comments have been written in the context of rules that were applicable for the tax year 2014. However, those candidates who have solved the question in accordance with the rules applicable for tax year 2015 have also been marked as correct.

Question 4

This was a simple question in which the students were required to demonstrate their understanding of the term 'disposal' by listing the situations under which an asset owned by a person shall be treated to have been disposed of. The response was below average as many students tried to answer the question on the basis of their general knowledge. Only few students were able to list down all the situations contained in Section 75 of the Ordinance. Majority of them listed two or three points only.

Question 5 (a)

The requirement was to (i) list the persons who are required to be registered and explanation of the provisions relating to change in rate of tax during a tax period, under the Sales Tax Act, 1990 and Rules made thereunder. Candidates performed reasonably well on this part of the question. The common errors in each sub-part are discussed below:

(i)
- Majority of the students were unable to specify that registration is also mandatory for a person who is required under any other Federal or Provincial law, to be registered for the purpose of any duty or tax collected or paid as if it were a levy of sales tax to be collected under the Act.
- Most of the students were not careful in choosing the right words which is important because in many situations the meanings of legal provisions are substantially altered even with the change of a single word. For example, instead of specifying 'a retailer whose value of supplies in any period during the last twelve months exceeds five million rupees' many candidates just mentioned a retailer whose turnover exceeds five million rupees. Further, in the provision related to distributors many candidates used the term taxable supplies instead of taxable income.

(ii)
- Many candidates discussed the effect of change of rate of sales tax on taxable supplies but did not discuss the provisions related to import.
- Further, few candidates mentioned that sales tax should be charged at a rate which was applicable when the goods were made available to the buyer or at the time of payment whichever is earlier. This explanation was entirely irrelevant.

Question 5(b)

This part required procedure for destruction of goods under the Sales Tax Rules, 2006. It was well answered as there were only two requirements which most of the students knew. The only error which they made was that they did not specify the rank (not below Assistant Commissioner) of the officer in whose supervision the goods may be destroyed.

Question 6

This practical question required the candidates to compute the monthly sales tax payable / refundable and the unadjusted input tax to be carried forward to next month. The concepts tested in this question were almost the same as are tested in almost every attempt. The overall performance was good and majority of the candidates were able to secure good marks. However, as usual, many students were unable to handle some of the finer points as discussed below:

(i) Many candidates did not appreciate that advance payment of Rs 500,000 received for the supply to be made in subsequent period has to be accounted for in the current month's return.

(ii) Most candidates did not know that pledged goods disposed of by the bank in satisfaction of debt also constitute 'supply' and output tax has to be computed thereon.

(iii) A number of candidates wrongly assumed early settlement discount to be a 'trade discount' shown on invoice and therefore it was deducted in arriving at the value of taxable supplies.

(iv) Some candidates did not seem to have any idea of apportionment of input tax and adjusted the entire amount of input tax for the month against output tax, without apportioning the input tax between taxable, zero-rated and exempt supplies. Majority of the candidates failed to calculate the total sales correctly for the purpose of apportionment of input tax.

(v) While comparing input tax with 90% of the output tax, it is necessary that gross input tax should also include the input tax that has been brought forward from the previous month. This point was generally missed.

(vi) In some instances the candidates explained the relevant provision correctly instead of incorporating the effect in their calculations. It should be understood that when the requirement is to make calculations, mere explanation of the rule does not get any mark.

Question 7

This question carrying 10 marks required the students to demonstrate their understanding of the non-revenue objectives of a taxation system. This topic had been introduced in the syllabus for the first time. Most of the students had prepared it well and were able to secure high marks. However, some students used pure guesswork and presented replies which were entirely out of context. Some such statements are presented below:

- Non-revenue system applies to agriculture system.
- Non-revenue system applies to non-profit organizations.
- Non-revenue objectives do not apply to Federal Government.
- Non-revenue objectives is to provide exemptions to specific industries in particular area for the development of these industries.
- Non-revenue objective is to provide tax credit on donations and charitable institutions to develop the interest of public in public welfare.
- Tax incentives could encourage foreign investment in the country.

Question 8

This question tested the topic of ethics in taxation. The students were required to briefly explain the ethical responsibilities of the tax implementing authorities. Here also, many students were able to answer well, however, the performance of some candidates was rather poor, most probably due to selective studies.

Some candidates did not comprehend the question correctly and wasted their time in specifying the cannons of taxation which was entirely irrelevant. Many candidates confused it with the ethical responsibilities of tax legislating authorities. Some students also explained the powers of tax implementing authorities which was not asked for and they simply wasted their valuable time.

Surprisingly, considerable number of candidates explained the code of ethics for professional accountants as ethical responsibilities of tax implementing authorities.

Question 9(a)

This part was based on the constitutional provisions relating to taxation and required the candidates to identify the types of taxes which may be imposed as per the federal legislative list of taxes. Majority of the candidates knew the answer and secured full marks. However, some of the students ended up explaining the types of taxation including Direct/Indirect taxes or Progressive/Regressive taxation.

Question 9(b)

This part required the students to briefly describe the duties of National Finance Commission [NFC]. It was well answered by majority of the candidates. However, some candidates described the provisions relating to constitution and functionality of NFC which were not required. Some candidates considered National Finance Commission as being responsible to table the Annual Budget before the Parliament or to monitor the economic progress of Federation and Provinces.

(THE END)

The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examinations

7 March 2015
3 hours – 100 marks
Additional reading time – 15 minutes

Principles of Taxation

Q.1 On 1 July 20X4, Tahir commenced business of manufacturing garments. Income statement of the business for the year ended 30 June 20X5 is as follows:

	Notes	Rs. in 000
Sales		49,330
Less: Cost of sales	(i)	(39,150)
Gross profit		10,180
Less: Administrative and selling expenses	(ii)	(9,140)
Financial charges	(iii)	(2,500)
Other charges	(iv)	(1,358)
		(2,818)
Add: Other income		3,875
Profit before taxation		1,057

Notes to the income statement:

(i) On 15 July 20X4, used machinery was imported from China valuing Rs. 1,500,000. Depreciation @ 15% was charged on machinery for the whole year and is included in cost of sales.

(ii) Administrative and selling expenses include:
- Rs. 975,000 paid for the purchase of computer software. The software is likely to be used for twelve years.
- Cost of preparation of a feasibility study amounting to Rs. 250,000 which was issued prior to the commencement of business.
- Salary of Rs. 50,000 per month was paid to Tahir's brother who handles the financial matters of the business.

(iii) Financial charges include Rs. 80,000 pertaining to a vehicle obtained on lease from a leasing company. The cost of vehicle was Rs. 1,300,000. Depreciation of Rs. 260,000 has been included in administrative and selling expenses. Lease rentals paid during the year amounted to Rs. 300,000.

(iv) Other charges include:
- running and maintenance expenses of vehicle amounting to Rs. 295,450. Use of vehicle for personal purposes was approximately 20%.
- provision for bad debts amounting to Rs. 25,000.

Other information:

(i) Tahir was working in UAE for the past five years and had come back to Pakistan in April 20X4. He received an amount equivalent to Rs. 150,000 from his ex-employer as differential amount on his final settlement in August 20X4.

(ii) He sold a plot for Rs. 3,500,000 which was inherited from his father in 20X1. Fair market value of the plot at the time of inheritance was Rs. 1,500,000.

(iii) 5,000 shares were purchased for Rs. 600,000 from initial public offering of a new listed company.

(iv) Premium of Rs. 300,000 was paid on Tahir's life insurance policy.

Required:

Under the provisions of the Income Tax Ordinance, 2001 compute the taxable income and tax liability of Tahir for the tax year 20X5. Provide comments in respect of items which do not appear in your computation. ***(Tax rates are given on the last page)*** **(18)**

Q.2 (a) List the persons who are required to furnish a return of income for a tax year under the Income Tax Ordinance, 2001. **(06)**

(b) Specify the circumstances under which the Commissioner has powers to issue notice demanding a return of income from certain person(s) for less than one year. **(03)**

(c) State the powers of the Commissioner if a taxpayer fails to furnish return as required under part (b) above, within the specified time. **(04)**

Q.3 Munir resigned from his employment with Ali Industries Limited (AIL) with effect from 31 December 2014. He received following amounts in final settlement:

- Rs. 150,000 as Leave Encashment.
- Rs. 4,000,000 under a Golden Handshake Scheme.

Munir had received a salary of Rs. 350,000 per month for a period of six months upto December 2014. His taxable income and tax liability during the preceding five tax years were as under:

Tax year	**2010**	**2011**	**2012**	**2013**	**2014**
Total taxable income (Rs)	2,000,000	2,450,000	2,700,000	3,100,000	3,650,000
Total tax paid (Rs)	300,000	392,000	472,500	542,500	650,000

Required:
As a tax consultant, advise Munir about the amount of income tax payable by him for the tax year 2015, under the Income Tax Ordinance, 2001. ***(Tax rates are given on the last page)*** **(06)**

Q.4 (a) (i) Explain the term 'Rent' in context of 'Income from property'. **(02)**

(ii) Specify the head of income under which the following amounts would be chargeable to tax:
- rent from sub lease of a building.
- amount included in rent for the provision of amenities, utilities and any other service connected with renting of the building. **(02)**

(b) On 1 July 2014, Fahim agreed to rent out a house to Mirza at a monthly rent of Rs. 180,000 with effect from 1 August 2014 and received one year's rent in advance. He also received Rs. 800,000 as a security deposit which was partly used to repay the security deposit amounting to Rs. 400,000 received from the previous tenant in July 2010 and partly used for renovation of the house.

Fahim also incurred the following expenses in respect of the above house:
(i) property tax of Rs. 15,000.
(ii) payment of interest amounting to Rs. 200,000 to his friend against amount borrowed for renovation of the house.
(iii) insurance premium of Rs. 110,000.
(iv) Rs. 5,000 per month to Wasif for collection of rent.

Required:
Under the provisions of the Income Tax Ordinance, 2001 compute the taxable income of Fahim for tax year 2015 assuming he has no other income. **(07)**

Q.5 (a) Under the provisions of the Income Tax Ordinance, 2001 state the rules relating to residential status of an Association of Person (AOP). Also explain the taxability of income of AOP, in the hands of the firm and its members. **(05)**

(b) State the rules relating to set-off and carry-forward of losses of AOP and its members. **(02)**

Q.6 Aslam is a resident taxpayer who operates his business from Lahore (LHR) and Paris (PAR). In August 2014, he established a new branch in Berlin (BER).

Following information is available in respect of his business operations for tax year 2015:

	LHR	PAR	BER
	----- Rs. in million -----		
Income / (loss) from business	29	40	(15)
Advance taxes paid in respective countries during the year	10	5	3
Income from capital gain (net of income tax of Rs. 3 million)	-	27	-
Carried forward losses:			
Loss from business	-	55	-
Capital loss	-	6	-

The following amounts paid by Aslam in respect of BER have been charged to LHR:

(i) salaries for the first three months amounting to Rs. 5 million.

(ii) rent expense for the year amounting to Rs. 7 million.

Required:

Under the provisions of the Income Tax Ordinance, 2001 calculate the tax payable by Aslam in the tax year 2015 and foreign tax losses to be carried forward to next year, if any. **(09)**

Q.7 Bashir is registered under the Sales Tax Act, 1990 and is engaged in the business of export and supply of consumer goods. Following information has been extracted from his records for the month of February 2015.

	Rupees
Supplies	
To registered persons	25,980,000
To unregistered persons	2,500,000
Exempt supplies	1,874,000
Export to USA	2,000,000
Purchases	
Purchases from registered person	21,710,000
Import of a machine	2,500,000

Following additional information is also available:

(i) supplies to registered persons include goods amounting to Rs. 300,000 which were supplied to an associated company at a special discount of 25%.

(ii) input tax amounting to Rs. 55,900 was paid in January, 2015 but inadvertently it could not be claimed in the return for January 2015.

(iii) a registered supplier had supplied goods worth Rs. 500,000 to Bashir in February 2015. However, Bashir did not receive the sales tax invoice from the supplier.

(iv) the imported machine was put into operation during February, 2015.

(v) sales tax credit of Rs. 410,000 is to be brought forward from January 2015.

Sales tax is payable at the rate of 17%. All the above amounts are exclusive of sales tax, wherever applicable.

Required:

Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, compute sales tax payable/refundable and input tax credit to be carried forward, if any, for tax period February 2015. **(13)**

Q.8 Saleem is registered under the Sales Tax Act, 1990 and is engaged in the business of export and distribution of electronic appliances.

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, advise Saleem on the following matters:

(a) any **six** situations in which input tax is not allowed to be adjusted against the output tax liability. **(06)**

(b) exports which are outside the purview of zero rating. **(03)**

(c) eligibility for a refund if input tax is paid in excess of the output tax payable for the month. **(02)**

(d) concept of provisional and final adjustment in relation to 'Apportionment of input tax'. **(02)**

Q.9 State any **five** ways through which taxes can be used for development of the country. **(05)**

Q.10 Briefly explain any three indirect taxes applicable in Pakistan. **(05)**

(THE END)

EXTRACTS DROM THE FIRST SCHDULE OF THE INCOME TAX ORDINANCE, 2001
Rates of Tax for Non-salaried Individuals

S. No.	Taxable income	Rate of tax
3.	Where the taxable income exceeds Rs.750,000 but does not exceed Rs.1,500,000	Rs. 35,000 + 15% of the amount exceeding Rs. 750,000
4.	Where the taxable income exceeds Rs. 1,500,000 but does not exceed Rs.2,500,000	Rs. 147,500 + 20% of the amount exceeding Rs. 1,500,000
5.	Where the taxable income exceeds Rs. 2,500,000 but does not exceed Rs.4,000,000	Rs. 347,500 + 25% of the amount exceeding Rs. 2,500,000
6.	Where the taxable income exceeds Rs. 4,000,000 but does not exceed Rs.6,000,000	Rs. 722,500 + 30% of the amount exceeding Rs. 4,000,000
7.	Where the taxable income exceeds Rs.6,000,000	Rs. 1,322,500 + 35% of the amount exceeding Rs. 6,000,000

Rates of Tax for Salaried Individuals

S. No.	Taxable income	Rate of tax
4.	Where the taxable income exceeds Rs.1,800,000 but does not exceed Rs.2,500,000	Rs. 140,000 + 17.5% of the amount exceeding Rs. 1,800,000
5.	Where the taxable income exceeds Rs.2,500,000 but does not exceed Rs.3,000,000	Rs. 262,500 + 20% of the amount exceeding Rs. 2,500,000
6.	Where the taxable income exceeds Rs.3,000,000 but does not exceed Rs.3,500,000	Rs. 362,500 + 22.5% of the amount exceeding Rs. 3,000,000
7.	Where the taxable income exceeds Rs.3,500,000 but does not exceed Rs.4,000,000	Rs. 475,000 + 25% of the amount exceeding Rs. 3,500,000
8.	Where the taxable income exceeds Rs.4,000,000 but does not exceed Rs.7,000,000	Rs. 600,000 + 27.5% of the amount exceeding Rs. 4,000,000
9.	Where the taxable income exceeds Rs.7,000,000	Rs. 1,425,000 + 30% of the amount exceeding Rs. 7,000,000

Capital Gains on disposal of Immovable Property

S. No.	Period	Rate of tax
1.	Where holding period of immovable property is up to one year.	10%
2.	Where holding period of immovable property is more than one year but not more than two years.	5%
3.	Where holding period of immovable property is more than two year.	0%

PRINCIPLES OF TAXATION
Suggested Answers
Certificate in Accounting and Finance – Spring 2015

Ans.1

Mr. Tahir (Non-salaried individuals)
Computation of taxable income and tax payable
For tax year 20X5

	Rupees
Income from business	
Accounting profit before taxation	1,057,000
Add: Inadmissible expenses	
Accounting depreciation on imported machinery (1,500,000×15%)	225,000
Intangible assets - Cost of software	975,000
Pre-commencement expenditures – Cost of feasibility	250,000
Lease financial charges	80,000
Depreciation on leased asset	260,000
Personal car expenses (Rs.295,450 × 20%)	59,090
Provision for bad debts	25,000
	1,874,090
Less: Admissible expenses	
Initial allowance on imported machinery (1,500,000×25%)	375,000
Tax depreciation on imported machinery (1,500,000–375,000)×15%	168,750
Pre-commencement expenditures (250,000×20%)	50,000
Lease rentals paid	300,000
Intangible assets - Cost of software (975,000÷10)	97,500
	(991,250)
Income from business	1,939,840
Capital gain	-
Taxable income	1,939,840
Computation of tax Payable	
On (1,500,000)	147,500
On balance: (439,840 @ 20%)	87,968
	235,468
Tax credit allowed either for investment in shares [i.e. Rs. 47,094 **(W-1)**] or amount of life insurance premium paid [i.e. Rs. 36,415 **(W-1)**], whichever is higher.	(47,094)
Net tax liability	188,374

Explanations:

1 The amount received from employment in UAE is foreign source income and since Tahir is a citizen of Pakistan and was not resident in last four tax years, such income is exempt from tax in this and the next year.

2 Salary paid to Tahir's brother is an allowable expense as he is working as an employee in the business.

3 The plot is covered in the definition of immovable property. Since holding period of property is more than two years, the rate of tax would be zero.

W-1: Computation of tax credit	**Rupees**
Tax credit on purchase of shares (235,468÷1,939,840 ×387,968[*1])	47,094
[*1] The amount of tax credit will be computed at lower of actual cost of investment i.e. 600,000, 20% of taxable income i.e. 387,968 and Rs. 1 million whichever is lower.	
Tax credit on amount of premium paid (235,468÷1,939,840 ×300,000[*2])	36,415
[*2] The amount of tax credit will be computed at lower of actual amount of premium i.e. paid 300,000, 20% of taxable income i.e. 387,968 and Rs. 1 million whichever is lower.	

PRINCIPLES OF TAXATION
Suggested Answers
Certificate in Accounting and Finance – Spring 2015

Ans.2 **(a)** The following persons are required to furnish a return of income for a tax year:

(i) Every company.
(ii) Every person (other than a company) whose taxable income for the year is above the maximum amount not chargeable to tax.
(iii) Any non-profit organization.
(iv) Any welfare institution.
(v) Any person who has been charged to tax in respect of any of the two preceding tax years.
(vi) Any person who has a carried forward loss.
(vii) Owner of immovable property with a land area of 250 square yards or more.
(viii) owns immoveable property with a land area of five hundred square yards or more located in a rating area;
(ix) Owner of a flat having covered area of 2000 square feet or more located in a rating area;
(x) Owner of a motor vehicle having engine capacity above 1000cc.
(xi) Holder of National Tax Number.
(xii) Holder of commercial or industrial connection of electricity where the amount of annual bill exceeds five hundred thousand.
(xiii) A resident person registered with any chamber of commerce and industry or any trade or business association or any market committee or any professional body.
(xiv) Every individual whose income under the heading 'Income from business' is between Rs. 300,000 and Rs. 400,000

(b) In the following circumstances, the Commissioner may require a person or person's representative to furnish a return of income for a period of less than twelve months:

(i) the person who has died;
(ii) the person who has become bankrupt or gone into liquidation;
(iii) the person who is about to leave Pakistan permanently;
(iv) the Commissioner otherwise considers it appropriate to require such a return to be furnished.

(c) The Commissioner may, if a taxpayer fails to furnish return of income as required, based on any available information or material and to the best of his judgment, make a provisional assessment of the taxable income and issue a provisional assessment order specifying the taxable income and the tax due thereon.

The provisional assessment order is treated to be as the final assessment orderafter the expiry of forty five days from the date of service of order of provisional assessment;

Ans.3 Following options are available to Munir (Salaried individual):

Option 1: By applying applicable tax rate to total taxable income

	Rupees
Salary (350,000 × 6)	2,100,000
Leave encashment	150,000
Golden Handshake scheme	4,000,000
Total taxable income	6,250,000

Tax computations:	**Rupees**
On Rs. 4,000,000	600,000
On balance (6,250,000 – 4,000,000)×27.5%	618,750
	1,218,750

Option 2: Tax on salary at applicable rate and final settlement amount at average rate of tax

	Rupees
Salary (350,000 × 6)	2,100,000
Leave encashment	150,000
	2,250,000

Tax computation – Salary	**Rupees**
On (Rs. 1,800,000)	140,000
On balance (2,250,000 – 1,800,000) × 17.5%	78,750
	218,750
Tax on amount received under Golden Handshake scheme [1,665,000 **(W-1)** ÷ 9,450,000 **(W-1)** × 4,000,000]	704,761
Total tax payable	923,511

W-1: Determination of preceding three years average rate of tax

Tax Year	Taxable income	Tax liability
2012	2,700,000	472,500
2013	3,100,000	542,500
2014	3,650,000	650,000
	9,450,000	1,665,000

Munir should select option 2 as it would result in tax saving of Rs. 295,239 (1,218,750 – 923,511)

Ans.4 (a) (i) 'Rent' means any amount received or receivable by the owner of land or a building as consideration for the use or occupation of, or the right to use or occupy, the land or building, and includes any forfeited deposit paid under a contract for the sale of land or a building.

Where the owner of the building receives from a tenant an amount which is not adjustable against the rent payable by the tenant, the amount shall be treated as rent.

(ii) The income given in the question would be chargeable under the head
- Income from other sources
- Income from other sources

(b) Computation of income from property

	Rupees
Rent received (180,000 × 11)	1,980,000
Un-adjustable advance rent $\left\{800{,}000 - \left(\frac{400{,}000}{10} \times 4\right)\right\} \div 10$	64,000
Total income from property	2,044,000
Less:	
Repair allowance upto 1/5th	408,800
Rent collection charges [6% (i.e. 122,640) or actual (i.e. 55,000) whichever is lower]	55,000
Property tax	15,000
Interest on loan from a friend	200,000
Insurance premium paid	110,000
Total expenses	788,800
Income from property	1,255,200

PRINCIPLES OF TAXATION
Suggested Answers
Certificate in Accounting and Finance – Spring 2015

Ans.5 (a) (i) Rules relating to residential states:
An association of person is treated as tax resident for a tax year if the control and management of its affairs is situated wholly or partly in Pakistan at any time during that tax year.

(ii) Taxability of income of AOP, in the hands of the firm
The income of an AOP is taxable at the prescribed rate.

(iii) Taxability of income of AOP, in the hands of its member
- The amount received by a member of the association in the capacity as member out of the income of the association shall be exempt from tax. However, such share of member is included in income of the member for determination of tax rate i.e. for rate purpose only.
- If member(s) of an AOP is a company, the share of such company(ies) shall be excluded for the purpose of computing the total income of the AOP and the company(ies) shall be taxed separately at the rates applicable to the companies, according to their share.

(b) Rules relating to set off and carried forward of losses of AOP:
The AOP is entitled to set off and carry forward its losses against its income only. However, share of loss from AOP is neither adjustable against the income of its members nor it is considered for rate purpose.

Ans.6

	Pakistan sourced income	Foreign sourced income		
		PAR		BER
	Business	Business	Capital gain	Business
	------------Rs. in million------------			
Income/(loss) for the year	29.00	40.00	30.00	(15.00)
Adjustment:				
Salaries	5.00			(5.00)
Rent expense	7.00			(7.00)
Income/(loss) before carried forward losses from previous year	41.00	40.00	30.00	(27.00)
Carried forward losses from previous year	-	(55.00)	(6.00)	-
Income/(loss)	41.00	(15.00)	24.00	(27.00)
Carried forward losses to next year		15.00		27.00
Taxable income	41.00		24.00	
Income tax on Pak source income **(W-1)**	13.57			
Proportionate Pak income tax **(W-2)**		-	7.94	-
Less: Already paid	(10.00)			
Less: Foreign tax credit [lower of foreign tax paid (i.e. Rs. 3m) or Pakistani tax payable (i.e. Rs. 7.94 m)]	-	-	(3.00)	
	3.57		4.94	
Total tax payable	8.52			

W-1: Computation of tax payable - Pakistan source income

	Rupees
On Rs. 6,000,000	1,322,500
On balance (41,000,000 – 6,000,000) × 35%	12,250,000
	13,572,500

W-2: Computation of tax payable - Paris

Taxable income	24,000,000
Tax payable at proportionate Pakistan income tax (13,572,000 ÷ 41,000,000 × 24,000,000)	7,944,878

Ans.7

Bashir
Computation of Sales Tax Payable / Refundable
For the tax period February 2015

	Taxable Value	Sales Tax
	Rupees	
Sales tax credits - Input Tax		
Purchases from registered suppliers [21,710,000-500,000]	21,210,000	3,605,700
Purchase of machinery	2,500,000	425,000
Tax not claimed for the tax period of January 2015		55,900
		4,086,600
Less : Inadmissible / un-adjustable input tax **(W-1)**		(487,813)
Input tax for the month		3,598,787
(+) previous month credit brought forward		410,000
Accumulated credit		4,008,787
Sales tax debit (Output Tax)		
Domestic supplies of manufactured goods:		
Local taxable supplies - registered suppliers [25,980,000-300,000]	25,680,000	4,365,600
- unregistered persons	2,500,000	425,000
- associated company- (300,000÷0.75)	400,000	68,000
Exempt supplies	1,874,000	-
Export to USA (Zero rated)	2,000,000	-
Output tax for the month		4,858,600
Admissible credit		
Input tax on fixed assets [(32,454,000 –3,874,000) ÷ 32,454,000 × 425,000]		(374,268)
90% of output tax (i.e. 4,372,740) or input tax excluding Fixed Assets (4,008,748 -374,268=3,634,480) whichever is lower		(3,634,480)
Sales tax payable		849,852
Input tax to be carried forward (4,008,748 - 3,634,480 - 374,268)		-
Refund claim (2,000,000÷32,454,000 × 4,086,600)		251,840

W-1 : Apportionment of input tax	
Total supplies (25,680,000 + 2,500,000 + 400,000 + 1,874,000 +2,000,000)	32,454,000
Exempt and zero rated supplies (1,874,000 + 2,000,000)	3,874,000
Inadmissible / unadjustable input tax (3,874,000 ÷ 32,454,000 × 4,086,600)	487,813

PRINCIPLES OF TAXATION
Suggested Answers
Certificate in Accounting and Finance – Spring 2015

Ans.8 **(a)** In the following cases a registered person shall not be entitled to adjust the input tax liability against output tax liability:

(i) Input tax on goods or services used or to be used for any purpose other than for taxable supplies.
(ii) Input tax on such goods or services which the Federal Government may specify through a Gazette notification.
(iii) The goods which are subject to extra tax in addition to normal tax payable at 17%.
(iv) Input tax on goods or services in respect of which sales tax has not been deposited into the government treasury, by the supplier.
(v) Purchases, in respect of which a discrepancy is indicated by CREST or input tax of which is not verifiable in the supply chain.
(vi) On fake invoices.
(vii) Input tax on purchases made by such person who fail to furnish the information required by the FBR.
(viii) Such proportion of the input tax which is attributable to non-taxable supplies.
(ix) If payment against purchases exceeding Rs. 50,000 is not made through proper banking channel.
(x) Vehicles falling in Chapter 87 of the 1st Schedule of the Customs Act,1969.
(xi) Tax on gifts and give aways.
(xii) If payment in case of a transaction on credit is not made within one hundred and eighty days of issuance of the tax invoice.

(b) Following exports are outside the purview of zero rating:
(i) Goods which are intended to be re-imported into Pakistan.
(ii) Goods which have been entered for export under Custom Act but are not exported.
(iii) Goods exported to a country specified by the Federal Government, by notification in the official gazette.

(c) Saleem, being a registered person, shall not be allowed a refund of input unless a statement along with annual audited accounts, duly certified by the auditors, showing value additions less than the limit prescribed.

The refund of input tax shall be made on yearly basis in the second month following the end of the financial year of Saleem.

In the case of unadjusted input tax related to zero rated and export made during that tax period, the excess amount of input tax shall be refunded not later than forty-five days of filling of refund claim in such manner and subject to such conditions as the Board may, by notification in the official gazette specify.

(d) Monthly adjustment of input tax claimed by a registered person is treated as a provisional adjustment and at the end of each financial year, a final adjustment is made on the basis of taxable and exempt supplies made during the course of that year.

PRINCIPLES OF TAXATION
Suggested Answers
Certificate in Accounting and Finance – Spring 2015

Ans.9 Following are the different ways by which taxes can be used for the development of country:

- The Government can declare some areas as free zone, industrial zone, and economic zone and provide tax incentives to such areas. Such incentives could attract businessman/industrialist who may opt to establish business concerns/industrial units that would bring employment, opportunities and overall prosperity in these under developed areas.
- Taxing the rich at higher rates while taxing the low income groups at lower tax rates.
- Imposition of high custom duty rates on luxury items or items which are also manufactured in Pakistan. This promotes local manufacturers and industry.
- Tax credits on charity/donations to promote welfare activities.
- Tax exemptions to charity organization /educational institutions to promote these activities.
- Tax incentives for agro based projects to promote agriculture.

Ans.10 Following are the indirect taxes under the Pakistani Taxation System.

(a) Custom Duty
Goods imported and exported from Pakistan are liable to rates of customs duties as prescribed in Pakistan Custom Tariff.

(b) Federal Excise Duty
Generally, federal excise duty is charged on the basis of excise value or retail price. However, some items are chargeable to duty on the basis of weight or quantity. All exports are liable to Zero per cent Federal Excise Duty.

(c) Sales Tax
Sales tax is levied on
- Import of goods into Pakistan, payable by the importers;
- Supplies made in Pakistan by a registered person in the course of furtherance of any business carried on by him;

A registered person can make adjustment of tax paid at earlier stages against the tax payable by him on his supplies.

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN EXAMINERS' COMMENTS	
SUBJECT Principles of Taxation	**SESSION** Certificate in Accounting and Finance – Spring 2015

General:

The overall performance was below average. The questions were easy and offered reasonable opportunity of passing the paper. However, the candidates could not come up to the desired level mainly because of inadequate knowledge and because they could not emphasize on the finer points tested in the questions. It was observed that a lot of students had memorized various provisions of the law but did not understand the crux. As in the past, it was also observed that while attempting the questions, the students seemed to disregard the specific requirements of the questions and produced a lot of irrelevant material.

At least as far as the practical questions on computation of taxable income and sales tax liability are concerned, most of the aspects that are tested are those that have previously been tested in the last 5 to 8 attempts. Therefore, even if the students study those questions in detail, they should be able to secure quite high marks in these questions which would help them in passing the paper.

Question wise comments are given below:

Question 1

This question required the computation of taxable income and tax liability of an individual involved in garment manufacturing business with income from other sources also. The candidates were also required to comment in respect of items which did not appear in their computation. The overall performance in this question was average as only few students could score high marks.

A major issue in the performance in this question was that students tried to reconstruct the profit and loss account of the business based on admissible expenses. This approach led to a number of mistakes as inadmissible expenses were added to cost of sales instead of being subtracted. The proper approach in such questions is to start from accounting profit before taxation and add inadmissible deductions and subtract admissible deductions to arrive at taxable income. This approach requires much lesser time and errors which occur on account of confusion with regard to the sign of the admissible/in-admissible expense are also avoided.

Some of the common mistakes were as follows:

- Initial depreciation was not calculated on imported machinery from China because it was 'used machinery' whereas this rule is applicable in case of machinery used in Pakistan.

- Normal depreciation on imported machinery was calculated on cost instead of cost less initial allowance.

- Some candidates calculated correct amount of initial allowance on imported machinery in notes / working of the question but this was not shown as a deduction/admissible expenditure in the main calculation.

- Some students with weaker concepts added the value of imported machinery to accounting profit in arriving at the taxable income.

- All sorts of errors were made in dealing with the leased vehicle. Very few students knew the correct treatment i.e. financial charges and depreciation claimed as an expense in the profit and loss account are to be added and rentals paid have to be deducted in arriving at the taxable income.

- Many candidates did not know that gain on sale of plot was exempt as the sale had taken place after more than two years from the date of purchase. On the other hand, many candidates mentioned that gain on sale of plot was not a capital gain and did not include it under any head.

- Some candidates considered salary paid to Tahir's brother as inadmissible. They failed to appreciate that the same was admissible as Tahir's brother was an employee in the business.

- Majority of the candidates were aware of the fact that cost of feasibility study was inadmissible. However, many candidates considered it as an 'intangible' instead of 'pre-commencement expenditure'. Consequently they allowed amortization at the rate of 10 per cent instead of 20 per cent.

- Cost of the computer software was treated as fixed asset instead of an intangible and depreciation was calculated thereon instead of amortizing it over 10-year period. Some candidates calculated amortization on the basis of twelve years.

- With respect to the amount received from employment in UAE, a number of candidates restricted their answers to the fact that such amount is exempt from tax being a foreign source income. They were expected to fully explain that since Tahir was a citizen of Pakistan and was a non-resident for the last four years, his foreign source salary is exempt from tax in the current as well as the next year.

- In respect of tax credit on investment in shares and life insurance premium, very few candidates knew about the following:

  - tax credit would be allowed on either premium or investment, whichever is the higher, and
  - In either case, the credit would be computed on the actual amount or 20 per cent of the taxable income or Rs 1,000,000 whichever is lower.

  Further, many candidates deducted the amount of investment in shares and premium paid on life insurance from the taxable income and did not know that tax credit was to be allowed at average rate of tax.

- Tax payable was calculated by applying rates of tax for salaried individuals.

- Majority of the students ignored an important requirement i.e. to comment on the items which did not appear in the computation; instead, items involved in calculation were explained which was not required.

Question 2(a)

This was a straightforward question requiring the candidates to list the persons who are required to furnish a return of income for a tax year under the Income Tax Ordinance, 2001. Majority of the students were able to recall the provisions of section 114(1) of the Ordinance and secured good marks; however, only few students could produce a complete list.

Question 2(b)

This part was based on the requirements of section 114 (3) of the Income Tax Ordinance which lists down situations where the commissioner may require a person to file a return of income for a period of less than one year.

The overall response to this part was very poor and most of the candidates misunderstood and wasted time in giving unnecessary and irrelevant details such as the provisions of section 118 and 119 of the Ordinance which pertain to discontinuance of the business and extension in the date of filing of return, respectively.

Question 2(c)

This part required the candidates to state the power of the Commissioner if a taxpayer fails to furnish a return when asked to do so, by the Commissioner under section 114(3).

Most of the candidates were able to specify that the Commissioner is empowered to make best judgment assessment of taxable income of the person. However, only few students could provide complete answers for which they should refer to ICAP's suggested answers that are available on the Institute's website.

Question 3

According to the scenario given in this question, an individual had received three types of payments from the employer i.e. normal monthly salary, leave encashment and amount of golden hand shake. In such situations, the tax payer has the option to either treat all the payments as income in the year of receipt or treat salary and leave encashment as current year's income and have the amount of golden handshake taxed at the average rate of tax of the preceding three years. The candidates were supposed to evaluate both options and advise the taxpayer about the better option.

The performance in this question was quite good. However, the major issue was that a significant number of candidates restricted their answers to the computation of tax liability under the latter option and did not give any advice. Following mistakes were also observed in the computations:

- Rate of tax for non-salaried individuals were applied.

- Average rate of tax was calculated on the basis of last five tax years instead of last three tax years.
- Leave encashment was considered as exempt from tax.
- Like Golden Handshake payment, leave encashment was also taxed by applying the preceding three years average rate.
- Some students were so confused that they added the tax liability calculated at the average rate, to the other salary income.

Question 4a(i)

This part was based on Section 15(2) and 16(1) of Income Tax Ordinance, 2001 and required the candidates to explain the term 'Rent' in the context of 'Income from property'. The performance was satisfactory as generally the candidates were able to reproduce the relevant provisions of the Income Tax Ordinance, 2001. A number of candidates, however, did not mention that the amount received by the owner of building from the tenant which is non-adjustable against the rent payable is also treated as rent.

Question 4a(ii)

This part was also well attempted as majority of the candidates knew that rent from sub-lease of a building and the amount included in rent for provision of amenities, utilities and any other service connected with renting of the building will be chargeable to tax under the head "Income from Other Sources".

Question 4(b)

This part required computation of income from property derived by an individual having no other income. This was a simple computational question and many candidates performed excellently and secured high marks. However, a number of candidates failed to seize this opportunity and made elementary mistakes. Few of the commonly observed mistakes are as under:

- Rent for the entire year i.e. 12 months was considered instead of 11 months only.
- Value of repair allowance has to be calculated as $1/5^{th}$ of the total rent chargeable to tax where total rent chargeable to tax also includes that part of the security deposit which is included in taxable income. Many candidates ignored the security deposit and computed repairs allowance as $1/5^{th}$ of the amount of monthly rent only.
- A number of candidates did not know that rent collection charges are admissible deduction at 6% of total income from property or actual, whichever is lower. They considered that actual charges are deductible in all cases.
- Interest on loan for renovation of the house was treated as inadmissible.
- Property tax of Rs. 15,000 paid was adjusted against total tax liability.
- Tax liability was also calculated whereas only the computation of taxable income was required.

Question 5(a)

This was a straightforward question requiring the candidates to state the provisions related to determination of the residential status of an Association of Persons [AOP]. Majority of the candidates did not know that residential status is always with reference to a 'tax year'. They also ignored a very important provision i.e. that an AOP is considered a resident even if the control and management of its affairs is situated in Pakistan 'at any time during the tax year' as many students stated incorrectly that an AOP would be considered as resident if its control and management is situated in Pakistan for more than 183 days.

Further, as regards taxability of income of AOP in the hands of its members, majority of the candidates confined their answers to the taxability of income received by individuals but did not mention the provisions of Income Tax Ordinance, 2001 regarding taxability of income of AOP where a company is a member of the AOP.

Majority of the candidates were aware of taxability of income of AOP in the hands of its members. However, they confined their answers to the taxability of income received by individual members of AOP. Only few candidates were able to elucidate the taxability of share of income received by a company in its capacity as member of the AOP.

Question 5(b)

In this part, rules relating to set-off and carried forward of losses of AOP were required to be explained. Candidates were generally aware that an AOP is entitled to set-off and carry forward its losses against its income only. However, many candidates also mentioned that losses of a member can be adjusted against the income of AOP and vice versa which was incorrect. Further, only few candidates were able to explain that share of loss from AOP is not considered even for rate purposes.

Question 6

This question pertained to a resident taxpayer who operates his business from Lahore and Paris and had established a branch in Berlin. The requirement was to calculate the tax payable by the resident taxpayer in the tax year 2015 and foreign losses to be carried forward to next year, if any.

A very poor performance was witnessed in this question as the candidates seemed to lack conceptual understanding of the related law. Few candidates did not attempt the question altogether. Following mistakes were commonly seen in the answer scripts of those who did attempt:

- Majority of the candidates did not appreciate that foreign source income under each head of income and for each city is a separate block and tax liability under each head for each city, if any, has to be worked out independently. Majority of the students calculated the business loss from Paris and Berlin and adjusted these against the capital gains from Paris and business income from Lahore Branch to determine the taxable income.

- According to the question salaries and rent expense of Berlin Branch had been charged to Lahore Branch. Only about 50% of the candidates made appropriate adjustments in the profits of the respective branches.

- Capital gains of Paris Branch were taken as Rs. 27 million i.e. the net amount after payment of tax amounting to Rs. 3 million, instead of taking the gross amount of Rs. 30 million.

Question 7

This was a routine question, as a major portion of the question pertained to very basic issues like working out input and output tax on the gross value of purchases and sales. Usual issues were addressed correctly but performance with respect to relatively finer points was as usual, of low quality and casual.

Major errors were as follows:

- Input tax on goods worth Rs 500,000 (for which invoice was not received) was inadmissible, therefore, Rs 500,000 was to be excluded from the purchases from registered person before computing input tax. A number of candidates did not make this adjustment. Some students deducted the entire amount from input tax.
- Input tax of Rs 55,900 which was not claimed in the previous month, was correctly added to input tax for the current month but was ignored while apportioning the input tax between taxable, zero rated and exempt supplies.
- A number of candidates did not know that value of goods supplied at special discount was to be grossed up to arrive at the value before discount for the purpose of determining output tax. On the other hand, some students grossed up the amount correctly to Rs. 400,000 (300,000 / 0.75) but added the entire amount to the amount of supplies which already included the amount of Rs. 300,000. Further, many students grossed up the amount to Rs. 375,000 (Rs. 300,000 x 1.25) instead of Rs. 400,000.
- Majority of the candidates applied additional tax of 1 per cent on supplies to unregistered persons. They failed to appreciate that Bashir is engaged in the supply of consumer goods on which additional sales tax is not applicable.
- Many students did not know that input tax on fixed assets would not be considered while applying the restriction of 90% of output tax.
- While comparing input tax with 90% of the value of supplies, it is necessary that gross input tax should also include the input tax that has been brought forward from the previous month. This point was missed by many students.
- Some students were not aware about the restriction imposed on input tax claim, under section 8B of Sales Tax Act, 1990, whereas few students reproduced the provisions of section 8B instead of computing the maximum allowable amount. Some students calculated the maximum amount without mentioning the law.

Question 8(a)

This part was based on the requirements of Section 8(1) of Sales Tax Act, 1990 in which candidates were required to identify six situations in which input tax was not allowed to be adjusted against output tax liability. This question proved quite easy as majority of the students were able to secure high or even full marks.

Question 8(b)

This part required the candidates to explain the exports which are outside the purview of zero rating. This part was based on the requirements of Section 4 of Sales Tax Act, 1990. The overall response to this part was also very encouraging as considerable number of candidates secured high marks. A common mistake observed in many answer scripts was that instead of export of goods specified by the Government, some candidates mentioned exports to the countries specified by the Board. Some candidates also used guesswork and mentioned conditions such as export of goods through land, export of goods to restricted countries and export of harmful drugs, computer software and luxury items etc.

Question 8(c)

This part required the candidates to explain the eligibility for refund if input tax was paid in excess of output tax payable for the month and was based on the requirements of section 8B(2) of Sales Tax Act, 1990. The overall response to this part was very poor as majority of the students failed to explain the relevant provisions. Most of the students stated the provisions related to input tax adjustment instead of commenting on the refund entitlement. The candidates are advised to seek guidance from suggested answers issued by the Institute.

Question 8(d)

The performance in this part was also very poor. Very few students could precisely distinguish between provisional and final adjustment in relation to the 'Apportionment of input tax' in terms of provisions contained in Rule 25(4) of Sales Tax Rules, 2006. Majority of the candidates used guesswork and in most cases the answers contained the following types of statements:

- Apportionment of input tax could be made if income was under more than one head of income. Such candidates did not even seem to know whether the question was based on Income tax or Sales tax.
- Adjustment of input tax against output tax at the end of the financial year is called final adjustment. No further explanation was provided.
- Formula for the apportionment of residual input tax was mentioned.
- At the end of each month every taxpayer should make provisional adjustment of sales tax payable.

Question 9

This question required the candidates to explain five ways through which taxes could be used for development of the country. The overall performance was very poor as vast majority of candidates were not prepared for this topic which has been introduced in the new syllabus which became applicable from the last attempt. Most of the candidates started explaining either the 'Canons of Taxation' or used pure guess work and presented replies which were entirely out of context such as:

- High import duty should be imposed on imports to protect local industry.
- Govt. could promote savings by introducing tax credits.

- Govt. could promote industry by making free zones for industry.
- By levying reduced rates of taxes for exports Govt. could promote exports.
- By introducing initial allowance and tax credit on new plants and machinery Govt. could promote production sector.
- Taxes are part of fiscal policy and taxation could be a tool for improving economy.

Question 10

This question required the candidates to explain the concept of indirect taxes in Pakistan. The response was mixed. Generally, the candidates correctly identified the three indirect taxes i.e. Custom Duty, Federal Excise Duty and Sales Tax but failed to explain them correctly. Some of the common mistakes were as under:

- Many candidates mentioned that withholding tax, VAT and provincial sales taxes are indirect taxes applicable in Pakistan.
- Many candidates mentioned tax on dividend and capital gains as indirect taxes.
- Many candidates mentioned that the government can either impose sales tax on a product or excise duty.
- Many candidates mentioned that excise duty is to be paid by industries.

(THE END)

The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examinations

7 September 2015
3 hours – 100 marks
Additional reading time – 15 minutes

Principles of Taxation

Q.1 Mukarram is working as a Commercial Manager in Airmen Engineering Limited (AEL), an unlisted public company, for the past many years. He derived following emoluments during the tax year ended 30 June 20X5:

	Rupees
Basic salary (per month)	250,000
Medical allowance (per month)	37,500
Housing allowance (per month)	25,000
Travel allowance (per month)	11,500

In addition to above, Mukarram was also provided the following:

(i) A used company maintained car for both business and personal use. This car was provided to him on 1 July 20X4 in replacement of his previous car. This car was purchased three years ago at a price of Rs. 1,000,000. However, the fair market value of the car on 1 July 20X4 was Rs. 800,000. On 1 September 20X4, in accordance with the terms of his employment, AEL transferred the previous car to Mukarram free of cost. The market value of the car at the time of transfer was Rs. 400,000 whereas its book value was Rs. 200,000. On 1 June 20X5, Mukarram sold this car to his neighbour at a price of Rs. 350,000.

(ii) Performance related bonus of Rs. 500,000. The bonus was however, paid to him on 5 July 20X5.

(iii) Two free buffet dinner coupons per month, one each for Mukarram and his wife in a five star hotel. The coupons were provided in line with AEL's policy for its management employees. The dinner costs AEL Rs. 2,000 per person.

(iv) Reimbursement of Rs. 20,000 in respect of telephone and internet charges. 20% of this amount was spent by Mukarram in performance of his official duties.

(v) Two air-conditioners and a washing machine for use at home. The combined book value of these appliances was Rs. 300,000. The appliances are returnable to AEL after three years' time. AEL charged 10% depreciation on these appliances.

(vi) An option to purchase 20,000 shares in AEL on 1 May 20X5 at Rs. 25 per share. The break-up value of AEL on that date was Rs. 85 per share.

Other information relevant to tax year 20X5 is as under:

(i) On 1 April 20X5, Mukarram sold a diamond ring to his brother Zohaib for Rs. 250,000. The ring was purchased on 1 January 20X3 at a price of Rs. 280,000.

(ii) Mukarram has 65 acres of agricultural land in Badin and a building in immediate vicinity of the land. Mukarram rented out 30 acres of his land along with the building to Dino who is a cultivator. Dino uses the building as a store house. Mukarram received annual rents of Rs. 750,000 and Rs. 325,000 in respect of the land and building respectively.

Mukarram is also running a small rice husking unit in Badin. He uses entire agricultural produce in the husking unit which is grown on the remaining portion of his land. During the year he brought 5,000 kilograms of raw rice from his land to the unit for husking. He would have earned Rs. 2,500 per 40 kilogram of raw rice had he sold it directly to the market. His sales from rice husking unit stood at Rs. 850,000 whereas other operating expenses were of Rs. 400,000.

(iii) On 31 May 20X5 a painting was destroyed by heavy rains. Mukarram had purchased the painting on 30 June 20X2 for Rs. 100,000. However, due to constant increase in the value of the painting, he had insured it at a premium of Rs. 15,000. He received insurance claim of Rs. 275,000 on 15 June 20X5.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute the taxable income of Mukarram for tax year 20X5. **(20)**
Note: show all relevant exemptions, exclusions and disallowances.

Q.2 Under the provisions of the Income Tax Ordinance, 2001 what would be the cost of an asset for the purpose of depreciation deduction in each of the following circumstances?

(a) Mr. Aamir acquired a new machine partly in exchange for an old machine. He paid freight to bring the old machine to the seller's location and also purchased cooling equipment which was attached to the new machine for its smooth functioning. **(04)**

(b) Mr. Saulat acquired production machinery by utilizing a loan repayable in euro. The loan is expressed in rupees and is repayable in two years' time. Mr. Saulat also received 20% subsidy on such machinery from the Provincial Government. **(04)**

(c) On 1 July 2015 Mr. Talha started using his personal computer for business purposes. He also had to upgrade the operating system to comply with his business needs. **(02)**

(d) Mr. Rahi constructed a furnace for his factory in Korangi Industrial Area. **(02)**

Q.3 (a) Mr. Baqir was working in Pakistan Embassy in United Kingdom for the past ten years. He returned back to Pakistan five months back and is now working with a British conglomerate in Islamabad. He is in the process of filing his return of income for tax year 20X5 and has sought your advice on the following matters:

(i) Whether I would be a non-resident for tax year 2015 as my period of stay in Pakistan is less than 183 days under the Income tax Ordinance, 2001? **(02)**

(ii) Whether I can claim a foreign levy paid on my foreign income, equivalent to PKR 150,000, as foreign income tax in my return of income to avoid double taxation under the Income Tax Rules, 2002? **(03)**

(iii) Whether I would be required to file a wealth statement and what particulars should I disclose in the statement under the provisions of the Income Tax Ordinance, 2001? **(05)**

(iv) For the purpose of disclosure of securities in wealth statement, what would be regarded as supportive evidence in respect of securities I acquired after my return to Pakistan under the Income Tax Rules, 2002? **(03)**

(v) I jointly with my brother Owais own a two story house in Lahore. Each story of the house has been rented out to two separate families. What would be the tax treatment of income from such property under the Income Tax Ordinance, 2001? **(02)**

(b) Under the provisions of the Income Tax Ordinance, 2001 determine the date by which appeal can be filed with the Commissioner (Appeals) in the following cases:

(i) Assessment order for tax year 2014 was made on 31 December 2014. Demand notice was served on 1 January 2015. **(02)**

(ii) Refund application was filed on 18 April 2015 but no refund order was passed within 60 days. **(02)**

Q.4 (a) What do you understand by the terms 'Security' and 'Derivative products' as provided in the Income Tax Ordinance, 2001 and Rules made thereunder? **(03)**

(b) Under the provisions of the Income Tax Ordinance, 2001 compute taxable gain or loss, under the correct head of income, in each of the following cases. Also identify, giving reasons, whether the company is a public or private company for tax purposes:

(i) Ashiq has 5,000 shares in Rumi (Pvt.) Limited (RPL). 52% of the shares of RPL are held by Delta Plc. which is owned by the British Government. Ashiq inherited these shares from his father on 1 January 2014. His father had purchased these shares on 31 May 2012 at a price of Rs. 250 per share. The market value of these shares at the time of inheritance was Rs. 300 per share.

On 30 June 2015 Ashiq sold 2,500 shares in RPL at a price of Rs. 325 per share when the break-up value of RPL was Rs. 350 per share. **(04)**

(ii) What would be your answer in (i) above, if 40% of the shares of RPL were held by the Provincial Government, 48% by the British Government and 12% by individual investors. **(03)**

Q.5 Rahbar is registered under the Sales Tax Act, 1990 and is engaged in the business of manufacture and supply of specialized equipment. Following information has been extracted from his records for the month of August 2015.

	Rupees
Supplies:	
to corporate customers – registered	20,000,000
to Government hospitals – un-registered	3,780,000
Purchases - Raw material:	
from cottage industry	550,000
from local registered persons	25,800,000

Following information is also available:

(i) Purchases from local registered persons include the following:
- Material worth Rs. 1,600,000 against which a discrepancy has been indicated by the CREST.
- Raw-material of Rs. 2,000,000 purchased from AB Enterprises on 2 August 2015.The payment was made on the same day by pay order. On 15 August 2015, AB Enterprises informed Rahbar that with effect from 1 August 2015 their registration has been suspended by the Commissioner Inland Revenue.
- Wires and cables of Rs. 500,000 and electrical and sanitary fittings of Rs. 900,000. These items were used in the renovation of a factory building.

(ii) An electronic cash register was purchased from High Tech Limited at Rs. 250,000.
(iii) On 18 August 2015 Rahbar acquired a machine on operating lease from Aroma Limited. The total lease rentals payable over the lease term of two years are Rs. 3,500,000. The fair value at the inception of the lease amounted to Rs. 3,100,000.
(iv) On 28 August 2015, Rahbar paid sales tax of Rs. 170,000 on electricity bill.
(v) Own manufactured equipment worth Rs. 375,000 was used for internal testing purposes in R&D department.
(vi) Rahbar made free replacement of faulty parts on request from three of his customers. These parts were covered under warranty and had a market value of Rs. 175,000.

All the above figures are **exclusive of sales tax**, wherever applicable. Sales tax is payable at the rate of **17%**.

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, compute the amount of sales tax payable by or refundable to Rahbar and the amount of sales tax to be carried forward, if any, for the tax period August 2015. **(18)**
Note: show all relevant exemptions, exclusions and disallowances.

Q.6 (a) Under the provisions of the Sales Tax Act, 1990 explain the following:

(i) Input tax in relation to a registered person **(03)**
(ii) Supply **(04)**

(b) Baber Associates, who is registered with the Inland Revenue Department for sales tax purposes, has supplied a heavy duty motor to Mubarak Enterprises on one month's credit. However, due to sharp decline in petroleum prices, the price of the motor has reduced by 10% in the local market. Upon request from Mubarak Enterprises, Baber Associates has finally agreed to reduce the price of motor by 8%.

In view of the Sales Tax Rules, 2006 describe the procedure which may be followed by both the parties to give effect to the above price change. **(03)**

Q.7 Briefly describe any three main canons of taxation which can be helpful in formulating a good tax system. **(03)**

Q.8 What do you understand by 'Federal consolidated fund'? Enumerate the expenditures which are charged upon the Federal consolidated fund. **(08)**

(THE END)

PRINCIPLES OF TAXATION
Summary of Marking Key
Certificate in Accounting and Finance – Autumn 2015

Note regarding marking scheme:
The marking scheme is given as a guide. However, markers were also advised to award marks for alternative approaches to a question and relevant/well-reasoned comments/explanations.

A.1

		Mark(s)
▪	Computation of income from salary	9.0
▪	Computation of gain on disposal of painting	2.0
▪	Computation of income from business	3.0
▪	01 mark for showing each correct exemption/inadmissible deduction	6.0

A.2 (a)

▪	Up to 01 mark for inclusion of the following into cost of machine:	
	–	cash given for the asset
	–	fair market value of old machine
	–	freight and other incidental expenditure
	–	purchase – cooling equipment

(b)

			Mark(s)
▪	Explaining the treatment of:		
	–	subsidy received	1.5
	–	exchange rate fluctuation	2.5

(c)

▪	01 mark each for identification of each of the following components of cost of asset:	
	–	fair value and date on which it is to be determined
	–	up-gradation cost

(d)

▪	01 mark for inclusion of following into cost of machine:	
	–	construction cost
	–	incidental expenditure

A.3 (a) (i)

		Mark(s)
▪	Correct identification of the residential status with reasons	2.0

(ii)

		Mark(s)
▪	01 mark for stating each condition under which the foreign levy may be treated as foreign income tax	3.0

(iii)

		Mark(s)
▪	Discussion with regard to need for filing of wealth statement	2.5
▪	0.5 mark for each particular to be disclosed in the wealth statement	2.5

(iv)

		Mark(s)
▪	Up to 0.5 mark for identifying each item of evidence in respect of acquisition of securities other than mutual fund	2.0
▪	Up to 0.5 mark for identifying each item of evidence in respect of acquisition of items of mutual fund	1.0

(v)

		Mark(s)
▪	Comment on basis of assessment	1.0
▪	Tax treatment of share in the income from the said property	1.0

PRINCIPLES OF TAXATION
Summary of Marking Key
Certificate in Accounting and Finance – Autumn 2015

(b)

Marking plan:		Mark(s)
▪	02 marks for determining the appeal filing date under each situation	**4.0**

A.4 (a)

		Mark(s)
▪	1.5 marks for each definition	**3.0**

(b) (i)

		Mark(s)
▪	Identification of the correct head of income	**1.0**
▪	Identification of type of company, whether public or private	**1.0**
▪	Computation of taxable gain on sale of securities	**2.0**

(ii)

		Mark(s)
▪	Identification of the correct head of income	**1.0**
▪	Identification of type of company, whether public or private	**1.0**
▪	Computation of taxable gain on sale of securities	**2.0**

A.5

		Mark(s)
▪	Computation of input tax	**3.0**
▪	Computation of output tax	**2.0**
▪	Computation of admissible credit and sales tax payable	**3.0**
▪	01 mark for showing each exemption/exclusion/disallowances	**7.0**
▪	Computation of inadmissible input tax	**1.5**
▪	Computation of the amount of sales tax to be carried forward	**1.5**

A.6 (a) (i)

		Mark(s)
▪	Up to 01 mark for each correct point	**3.0**

(ii)

		Mark(s)
▪	Up to 01 mark for each type of activity included in the definition of supply	**4.0**

(b)

		Mark(s)
▪	Description of the correct procedure to be followed in the given situation	**3.0**

A.7

		Mark(s)
▪	0.5 mark for identification of each canon of taxation	**1.5**
▪	0.5 mark for brief description of each canon of taxation	**1.5**

A.8

		Mark(s)
▪	Definition of Federal consolidated fund	**2.0**
▪	01 to 02 marks for stating each expenditure which is charged upon the Federal consolidated fund	**6.0**

(THE END)

The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examinations

7 March 2016
3 hours – 100 marks
Additional reading time – 15 minutes

Principles of Taxation

Q.1 Wajahat, aged 48 years, is a marketing manager in Nayaab (Pvt.) Limited (NPL), a company engaged in the manufacture and supply of tissue papers. The details of his monthly emoluments during the year ended 30 June 20X6 are as under:

	Rupees
Basic salary	70,000
Dearness allowance	10,000
Conveyance allowance	8,000

In addition to the above, Wajahat was also provided the following:

(i) Provident fund (PF) contribution of Rs. 8,400 per month. An equal amount per month was contributed by Wajahat to the fund. Interest income of Rs. 391,000 at the rate of 20% of accumulated balance of PF was credited to his PF account.
(ii) Reimbursement of electricity bills during the year amounting to Rs. 60,000.

Following further information is also available:

(i) Wajahat received net dividend of Rs. 78,200 from BEE Limited, a company listed on Pakistan Stock Exchange Limited. Withholding tax and zakat deducted from dividend amounted to Rs. 9,200 and Rs. 4,600 respectively. He also received dividend of Rs. 65,000 from a company in U.A.E through normal banking channels. However, no tax was withheld either in Pakistan or U.A.E.
(ii) Wajahat contributed Rs. 890,000 in an approved pension fund under the Voluntary Pension System Rules, 2005.
(iii) On 1 September 20X5, Wajahat started a tuition centre for the students of finance in a posh locality. He received tuition fees of Rs. 2,198,000 and incurred following expenses:
- Monthly salary of Rs. 50,000 paid to himself and Rs. 35,000 to his friend Yousuf who taught financial accounting at the centre.
- Travelling, boarding and lodging expenses of Rs. 300,000. These expenses were incurred by Wajahat in Sri Lanka for attending teachers training workshop.
- Rs. 250,000 against purchase of used computers for the centre.
- Other miscellaneous expenses amounting to Rs. 195,000.

(iv) Wajahat's total taxable income during the previous tax year was Rs. 1,850,000.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute the total income, taxable income and net tax payable by/refundable to Wajahat during the tax year 20X6. **(16)**
Note: Show all relevant exemptions, exclusions and disallowances. Tax rates are given on the last page.

Q.2 Akram has recently established an advertising agency in the name and style of Azad Advertising. For introducing his business to both international and local clients, he has allocated considerable chunk of his marketing budget to entertainment expenditures. Under the Income Tax Ordinance, 2001 and Rules made thereunder, advise Akram about the prescribed limits/conditions for the deduction of entertainment expenditure. **(07)**

Q.3 Under the provisions of the Income Tax Ordinance, 2001 explain the following:

(a) Special tax year **(03)**
(b) Transitional tax year **(03)**
(c) Order of application of various tax credits while computing the tax liability of the taxpayer **(03)**
(d) General provisions/rules which may apply to income subject to final tax. **(06)**

Q.4 Lone Traders (LT), a sole proprietorship, is engaged in the business of buying and selling of Maize and Wheat in bulk quantities. Following information has been extracted from LT's records for the year ended 31 December 2015:

(i) Wheat sold to food companies in Punjab amounted to Rs. 13,000,000. The sale was made after allowing discount of Rs. 680,000 to some of the new customers. The gross profit margin was 25% on gross sales.
(ii) LT paid Rs. 600,000 to a research institute for the development of a formula which is likely to improve the quality of wheat it purchases from the growers.
(iii) In August 2015, LT signed a future contract with Mubarak Enterprises (ME) for the purchase of 500 metric tons of maize at Rs. 15,800 per metric ton. The delivery was expected to be made in October 2015. ME also agreed to repurchase the entire lot at the price prevailing on the date of sale.
(iv) In October 2015 price of maize increased to Rs. 18,240 per metric ton and LT sold the entire lot to ME without taking delivery.
(v) LT incurred expenditure of Rs. 25,000 in respect of above future contract.
(vi) Administrative, selling and distribution expenses amounted to Rs. 2,500,000. These included a penalty of Rs. 45,000 which was imposed due to late payment of sales tax on wheat.
(vii) Assessed losses brought forward from previous year were as follows:

	Rupees
Trading business loss	550,000
Speculation business loss	300,000
Capital loss	250,000

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute LT's taxable income/(loss) and the amount of loss to be carried forward, if any, for tax year 2016. **(10)**

Q.5 Mulaqat Associates (MA), an association of persons, is registered under the Sales Tax Act, 1990 and is engaged in the business of manufacture and distribution of various products. Following information has been extracted from MA's records for February 2016:

	Rupees
Supplies:	
Jet fuel to Pak Airways proceeding to Oslo	800,000
Taxable goods to registered customers	500,000
Taxable goods to un-registered customers	375,000
Purchases:	
Taxable goods from registered suppliers	650,000
Taxable goods from un-registered suppliers	150,000
Exempt goods from registered suppliers	100,000
Imports – raw material	280,000

Following information is also available:

(i) Taxable goods purchased from registered suppliers include furniture of Rs. 45,000 which was acquired for use in the office of marketing manager.

(ii) Imports include raw materials worth Rs. 125,000 for the manufacture of shaving cream, covered under Third Schedule. However, en route from port to MA's warehouse in Uthal a serious damage was caused to the consignment. MA received insurance claim of Rs. 90,000 after surrendering the right of disposal of consignment in favour of the insurance company.

(iii) MA purchased 150 bags of cement, covered under Third Schedule, for the construction of a bungalow for managing partner. Cement was purchased at the wholesale price of Rs. 400 per bag. However, the retail price was Rs. 500 per bag.

(iv) Advance of Rs. 268,000 was made to Nomi Corporation for the purchase of packing materials.

(v) Taxable goods to un-registered customers include goods worth Rs. 200,000 sold to cottage industry in Bela. The rest of the goods were sold to educational institutions in Zhob.

(vi) On 15 February 2016 MA signed an agreement with Bali Traders (BT), a registered customer, for the sale of goods worth Rs. 290,000. On 20 February 2016 the goods were made available to BT. However, BT took the delivery of goods on 5 March 2016.

(vii) MA sold goods worth Rs. 52,000 to one of its customers on two months credit. The amount was inclusive of 4% mark-up.

(viii) MA distributed free samples of one of its new detergents Zeta among corporate clients. The value of these samples amounted to Rs. 65,000.

(ix) MA issued a debit note of Rs. 35,000 to Hali Brothers to rectify a mistake in MA's sales invoice. The invoice was originally raised in November 2015.

(x) On 1 February 2016 MA sold 4,000 packs of a new caramel ice cream, covered under Third Schedule, at a discounted price of Rs. 100 per litre pack. The retail price of the ice cream was Rs. 160 per litre pack.

(xi) Sales tax credit brought forward from January 2016 amounted to Rs. 245,000. This amount was inclusive of input tax of Rs. 120,000 paid on a chemical which could not be used before the expiry date and was consequently destroyed in February 2016.

All the above figures are **exclusive of sales tax**, wherever applicable. Sales tax is payable at the rate of **17%**.

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, compute the amount of sales tax payable by/refundable to MA and the amount of sales tax to be carried forward, if any, for the tax period February 2016. **(18)**
Note: show all relevant exemptions, exclusions and disallowances.

Q.6 Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, briefly describe the following:

(a) How and under what circumstances the Inland Revenue Department may recover the amount of sales tax from a person without issuing him a show cause notice. **(04)**

(b) Rule relating to change in the particulars of registration other than the change of business category. **(05)**

(c) What evidence(s) a person may be required to submit if he is applying for registration as a manufacturer on shared premises. **(02)**

Q.7 (a) Under the provisions of Article 160 of the Constitution of Pakistan, briefly describe the formation of National Finance Commission. Who may be the member(s) of such Commission? **(03)**

(b) 'Besides financing government operational expenditures, taxation is also utilized as a tool to carry out the national objective of social and economic development.' List any **five** non-revenue objectives of taxation. **(05)**

(c) List any **six** ethical issues which may be faced by tax administration authorities while discharging their duties under the four pillars of tax administration. **(03)**

Q.8 Baqir, Asad and Rahi are members of an association of persons (BAR) and share profits and losses in the ratio of 5:3:2 respectively. BAR is engaged in the business of trading consumer electronics and has two independent branches one each in Tehran and Dubai. Following information has been extracted from BAR's profit and loss account for the year ended 31 December 2015:

	Rupees
Sales	30,000,000
Cost of sales	(20,500,000)
Gross profit	9,500,000
Administrative and selling expenses	(4,732,000)
Financial charges	(980,000)
Other income	1,700,000
Profit before taxation	5,488,000

Additional information:
Cost of sales includes:

(i) Closing stock which has been valued at net realizable value of Rs. 1,820,000. The cost of closing stock under absorption costing was Rs. 1,950,000.
(ii) Provision of Rs. 75,000 against slow moving stores and spares.
(iii) Freight charges of Rs. 160,000. These were paid in cash to Momin Goods Transport for transporting goods to customers in Multan.

Administrative and selling expenses include:

(i) Commission of Rs. 290,000 paid to Baqir, annual performance award of Rs. 310,000 paid to Rahi and Rs. 455,000 paid to AB Bank Limited in final settlement of a loan obtained by Asad for the construction of his house in Muree.
(ii) Provision for bad debts of Rs. 735,000. The opening and closing balances of provision for bad debts amounted to Rs. 1,100,000 and Rs. 1,435,000 respectively. Bad debts written off include a loan of Rs. 280,000 provided to a supplier.
(iii) Sales promotion expenses of Rs. 275,000. These expenses were paid by Rahi through his personal credit card.
(iv) Rs. 86,000 paid to an institution operated by Federal Government for the training of industrial workers in Punjab.

Further information:
For the year ended 31 December 2015 Dubai branch made a profit of Rs. 1,500,000 and Tehran branch made a loss of Rs. 1,800,000. These figures are not included in the above profit and loss account.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute the taxable income, net tax payable by BAR and the amount to be carried forward, if any, for tax year 2016. Assume tax and accounting depreciation is same. **(12)**

Note:
- ***Your computation should commence with the profit before tax figure of Rs. 5,488,000.***
- ***Show all relevant exemptions, exclusions and disallowances.***
- ***Tax rates are given on the last page.***

(THE END)

EXTRACTS FROM THE INCOME TAX ORDINANCE, 2001
THE FIRST SCHEDULE
Tax Rates for Every Individual and Association of Person Except for Salaried Taxpayer

S. No.	Taxable income	Rate of tax
1.	Upto Rs. 400,000	0%
2.	Exceeds Rs. 400,000 but does not exceed Rs. 500,000	7% of the amount exceeding Rs. 400,000
3.	Exceeds Rs. 500,000 but does not exceed Rs. 750,000	Rs. 7,000 + 10% of the amount exceeding Rs. 500,000
4.	Exceeds Rs. 750,000 but does not exceed Rs. 1,500,000	Rs. 32,000 + 15% of the amount exceeding Rs. 750,000
5.	Exceeds Rs. 1,500,000 but does not exceed Rs. 2,500,000	Rs. 144,500 + 20% of the amount exceeding Rs. 1,500,000
6.	Exceeds Rs. 2,500,000 but does not exceed Rs. 4,000,000	Rs. 344,500 + 25% of the amount exceeding Rs. 2,500,000
7.	Exceeds Rs. 4,000,000 but does not exceed Rs. 6,000,000	Rs. 719,500 + 30% of the amount exceeding Rs. 4,000,000
8.	Above Rs. 6,000,000	Rs. 1,319,500 + 35% of the amount exceeding Rs. 6,000,000

Rates of Tax for Salaried Individuals

S. No.	Taxable income	Rate of tax
1.	Upto Rs. 400,000	0%
2.	Exceeds Rs. 400,000 but does not exceed Rs. 500,000	2% of the amount exceeding Rs. 400,000
3.	Exceeds Rs. 500,000 but does not exceed Rs. 750,000	Rs. 2,000 + 5% of the amount exceeding Rs. 500,000
4.	Exceeds Rs. 750,000 but does not exceed Rs. 1,400,000	Rs. 14,500 + 10% of the amount exceeding Rs. 750,000
5.	Exceeds Rs. 1,400,000 but does not exceed Rs. 1,500,000	Rs. 79,500 + 12.5% of the amount exceeding Rs. 1,400,000
6.	Exceeds Rs. 1,500,000 but does not exceed Rs. 1,800,000	Rs. 92,000 + 15% of the amount exceeding Rs. 1,500,000
7.	Exceeds Rs. 1,800,000 but does not exceed Rs. 2,500,000	Rs. 137,000 + 17.5% of the amount exceeding Rs. 1,800,000
8.	Exceeds Rs. 2,500,000 but does not exceed Rs. 3,000,000	Rs. 259,500 + 20% of the amount exceeding Rs. 2,500,000
9.	Exceeds Rs. 3,000,000 but does not exceed Rs. 3,500,000	Rs. 359,500 + 22.5% of the amount exceeding Rs. 3,000,000
10.	Exceeds Rs. 3,500,000 but does not exceed Rs. 4,000,000	Rs. 472,000 + 25% of the amount exceeding Rs. 3,500,000
11.	Exceeds Rs. 4,000,000 but does not exceed Rs. 7,000,000	Rs. 597,000 + 27.5% of the amount exceeding Rs. 4,000,000
12.	Exceeds Rs. 7,000,000	Rs. 1,422,000 + 30% of the amount exceeding Rs. 7,000,000

Rate of Dividend Tax

10% in case of dividend received by a person from a mutual fund.
12.5% in all other cases.

THE THIRD SCHEDULE
Part I
Depreciation Rates

1.	Building (all types)	10%
2.	Furniture and fittings	15%
3.	Plant and machinery	15%
4.	Motor vehicles (all types)	15%
5.	Computer hardware	30%

Part II
Initial Allowance and First Year Allowance

The rate of initial allowance for eligible depreciable assets shall be 25%.

PRINCIPLES OF TAXATION
Suggested Answers
Certificate in Accounting and Finance – Spring 2016

Ans.1

Wajahat
Computation of income tax liability
For the tax year 20X6

		Rupees
Income from Salary:		
Basic salary (70,000×12)		840,000
Dearness allowance (10,000 × 12)		120,000
Conveyance allowance (8,000 × 12)		96,000
PF contrib. [(8,400 × 12) – (lower of Rs. 100,000 or 1/10th of basic + DA)]		4,800
Working: (100,800) or (lower of Rs.100,000 or (840,000+120,000)/10= 96,000		
Interest on PF [391,000 – (higher of: interest @16% or 1/3rd of basic + DA)]		71,000
Working: (391,000/20% × 16% = 312,800 or ((840,000+120,000)/3= 320,000)		
Reimbursement of electricity bill		60,000
Total income under the head salary		1,191,800
Income from business:		
Tuition fees (for ten months ended 30 June 20X6)		2,198,000
Less: Admissible expenses:		
Salaries paid: Wajahat (inadmissible being the owner of the centre)		-
Friend (35,000 × 10)		(350,000)
Training expenses		(300,000)
Dep.: Computers (250,000 × 30%) [no initial allowance is admissible]		(75,000)
Other misc. expenses		(195,000)
		1,278,000
Income (Separate block):		
Dividend received from BEE Limited (78,200 + 9,200 + 4,600)		92,000
Dividend received from a company in U.A.E		65,000
		157,000
Total income		**2,626,800**
Less: Separate block income -		(157,000)
Less: Zakat		(4,600)
Taxable income		**2,465,200**
Since salary income is less than 50% of the taxable income, therefore, the slab applicable to non-salaried individuals shall be applied:		
Computation of net tax liability:		
Tax on Rs. 1,500,000		144,500
Tax @ 20% on the amount exceeding Rs. 1,500,000 (i.e. on 965,200)		193,040
Tax payable under NTR		337,540
Less: Tax credit on investment in pension: (887,472 × 337,540/2,465,200)		(121,514)
Which is lesser of (A), (B) or (C):		
▪ Total contribution paid by Wajahat **(A)**	890,000	
▪ 20% of taxable income (2,465,200 × 20%)	493,040	
Add: 2% add. for each year of age above 40 years (2%×8×2,465,200)	394,432	
(B)	887,472	
▪ 50% of last assessed taxable income (1,850,000 × 50%) **(C)**	925,000	
		216,026
Add: Tax payable on dividend income (157,000 × 12.5%) (FTR)		19,625
Total tax liability for the year		235,651
Less: Tax withheld at source (Dividend)		(9,200)
Net tax payable for tax year 2016		**226,451**

PRINCIPLES OF TAXATION
Suggested Answers
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Ans.2 Entertainment expenditure:

Akram would be allowed a deduction for entertainment expenditure if the following conditions are satisfied:

The expenditure should be incurred in deriving income from business chargeable to tax and should be limited to expenditure incurred which satisfies the following conditions:

- expenditure incurred outside Pakistan on entertainment in connection with business transactions or is allocated as head office expenditure;
- expenditure incurred in Pakistan on entertainment of foreign customers and suppliers;
- expenditure incurred on entertainment of customers and clients at the person's business premises;
- expenditure incurred on entertainment at a meeting of shareholders, agents, directors or employees; or
- expenditure incurred on entertainment at the opening of branches.

A deduction shall only be allowed for expenditure incurred on the entertainment of persons related directly to Akram's business.

Ans.3 (a) **Special tax year:**

Where a person's income year is different from the normal tax year, or where, by an order, a person has been allowed by the Commissioner Inland Revenue to use a twelve months' period different from normal tax year, such income year or such period shall be that person's special tax year and shall be denoted by the calendar year relevant to normal tax year in which the closing date of the special tax year falls.

The Board has authority to prescribe any special tax year in respect of any particular class of taxpayers.

(b) **Transitional tax year:**

Where the tax year of a person changes as a result of an order by the Commissioner of inland revenue either from the normal tax year to special tax year or vice versa, the period between the end of the last tax year prior to change and the date on which the changed tax year commences shall be treated as a 'transitional tax year'.

(c) **Application of tax credits while computing the tax liability of the taxpayer:**

If a taxpayer is allowed more than one tax credit for a year, the credits shall be applied in the following order:

(i) Any foreign tax credit; then
(ii) Any tax credit allowed under Part X of Chapter III; such as
  - Charitable donations
  - Investment in shares and insurance
  - Contribution to an approved pension fund
  - Tax credit for employment generation by manufacturer u/s 64B
(iii) Second schedule credits e.g. reduction in tax liability due to full time teacher allowance etc.
(iv) Any tax credit allowed for quarterly advance tax paid u/s 147 and for tax collected / deducted at source u/s 168

(d) **General provisions/ rules apply to income subject to final tax:**

Following rules apply to income subject to final tax:

(i) Tax imposed is a final tax
(ii) Such income is not chargeable to tax under any head of income in computing the taxable income of the person
(iii) No deduction is allowed for any expenditure incurred in deriving such income
(iv) The amount of such income is not reduced by:
  - Any deductible allowance
  - The set off of any loss

(v) The final tax payable is not reduced by any tax credit allowed (foreign tax credit or tax credits on donations, investments etc.)

(vi) The liability of the recipient of such income is discharged to the extent that:
- In the case of shipping and air transport income, the tax is paid in accordance with relevant sections of the Ordinance; or
- In any other case, the final tax payable has been deducted at source

Ans.4

Lone Traders (LT)
Computation of Taxable income / (loss)
For the tax year 2016

Rupees

Particulars		Speculation Business	Trading Business	Total
Gross sales [18,240 × 500] & [13,000,000 + 680,000]		9,120,000	13,680,000	22,800,000
Less: Discount		-	(680,000)	(680,000)
Net sales		9,120,000	13,000,000	22,120,000
Gross profit [9,120,000 – 7,900,000] & [13,680,000 × 25%]		1,220,000	3,420,000	4,640,000
Less: Exp. - Direct				
▪ Scientific research		-	(600,000)	(600,000)
▪ Expenditure in respect of future contract		(25,000)	-	(25,000)
Less: Exp.- Common [gross sales basis i.e. 40:60]				
Admin., selling and distrib.	2,500,000			
Less: inadmissible - penalty	(45,000)			
Allowable common expenses	2,455,000			
Admin., selling and distrib. [2,455,000 × 40% & 60%]		(982,000)	(1,473,000)	(2,455,000)
Net business income		213,000	1,347,000	1,560,000
Brought forward losses		(300,000)	(550,000)	
Taxable income/(loss) for the year		(87,000)	797,000	

- Speculation loss of Rs. 87,000 would be carried forward to the next year.
- Speculation loss cannot be set off against trading business income of Rs. 797,000.
- Similarly capital loss of Rs. 250,000 would be carried forward to next year as it cannot be set off against any other head of income.

PRINCIPLES OF TAXATION
Suggested Answers
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Ans.5

Mulaqat Associates (MA)
Computation of Net Sales Tax Liability
For the tax period February 2016

SALES TAX CREDIT (INPUT TAX)	**Taxable Value**	**Sales Tax Rate**	**Amount of Sales Tax**
Taxable goods from registered suppliers [650,000 – 45,000]	605,000	17%	102,850
Furniture for use in marketing manager's office	45,000	inadmissible	-
Taxable goods from un-registered suppliers	150,000	inadmissible	-
Exempt goods from registered suppliers	100,000	-	-
Import of raw material	280,000	17%	47,600
Purchase of cement [being personal in nature] [150x500]	75,000	inadmissible	-
Advance against purchase of packing material	268,000	17%	45,560
			196,010
Add: Credit brought forward from previous month			245,000
Less: input tax on chemicals destroyed			(120,000)
			125,000
Input Tax for the month (Accumulated credit)			**321,010**
SALES TAX DEBIT (OUTPUT TAX)			
Jet fuel to Pak Airways	800,000	0%	0
Taxable goods to registered customers	500,000	17%	85,000
Taxable goods to Cottage Ind. In Bela	200,000	17%	34,000
Taxable goods to un-registered -end consumers	175,000	17%	29,750
Raw material to insurance company [treated as supply]	90,000	17%	15,300
Taxable goods to Bali Traders	290,000	17%	49,300
Taxable goods on two months credit	52,000	17%	8,840
Free samples of detergent Zeta	65,000	17%	11,050
Debit note issued to Hali Brothers	35,000	17%	5,950
Caramel ice cream [4,000 x 160]	640,000	17%	108,800
Output tax for the month			**347,990**
Further tax on supplies to cottage Ind. [200,000 × 2%]			4,000
Further tax on supplies to un-registered end consumers-Exempt [175,000 × 0%]			0
Admissible credit (lower of 321,010 or 90% of 347,990 = 313,191			(313,191)
Sales tax payable (347,990 – 313,191 = 34,799) + (4000)			**38,799**
Input tax to be carried forward [321,010 – 313,191]			**7,819**

Page 4 of 6

Ans.6 (a) **Short paid amounts recoverable without notice:**

Where a registered person pays the amount of tax less than the tax due as indicated in his return, the short paid amount of tax along with default surcharge shall be recovered from such person by stopping removal of any goods from his business premises and through attachment of his business bank accounts, without giving him a show cause notice and without prejudice to any other action prescribed under section 48 of this Sales Tax Act or the rules made thereunder:

(b) **Change in the particulars of registration (other than change of business category):**

(i) In case there is a change in the name, address or other particulars as stated in the registration certificate, the registered person shall notify the change in the Form STR-1 to the computerized system, within fourteen days of such change.

(ii) In case of approval of the change applied for, a revised registration certificate shall be issued through computerized system, which shall be effective from the date the person applied for the change.

(iii) Where a person is unable to file application for change in particulars of registration directly in computerized system, he may submit the prescribed application and required documents to the concerned Commissioner Inland Revenue at RTO, who shall ensure entry of the application and documents in computerized system within three days.

(iv) The commissioner may, based on available information or particulars and after making such inquiry as he may deem necessary and after providing reasonable opportunity of being heard to a person, by an order in writing, make modifications in registration of the person.

(c) In case the person applying for registration as manufacturer is sharing the premises, he shall provide evidence of:

(i) demarcation of manufacturing premises for registration, and

(ii) installation of sub-meter by the relevant utility company, in case he does not have independent industrial utility connection but is using electricity or gas through sub-meter.

Ans.7 (a) **National Finance Commission:**

Within six months of the commencing day and thereafter at intervals not exceeding five years, the President shall constitute a National Finance Commission consisting of the Minister of Finance of the Federal Government, the Ministers of Finance of the Provincial Governments, and such other persons as may be appointed by the President after consultation with the Governors of the Provinces.

(b) **Non-revenue objectives:**

Following are the five non-revenue objectives of taxation:

(i) To strengthen anaemic enterprises by granting them tax exemptions or other conditions or incentives for growth;

(ii) To protect local industries against foreign competition by increasing local import taxes;

(iii) As a bargaining tool in trade negotiations with other countries;

(iv) To counter the effects of inflation or depression;

(v) To reduce inequalities in the distribution of wealth;

(vi) To promote science and invention, finance educational activities or maintain and improve the efficiency of local forces;

(vii) To implement laws which eliminate discrimination among various elements in the markets/businesses.

(viii) To discourage certain undesirable sectors and activities.

PRINCIPLES OF TAXATION
Suggested Answers
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(c) Following are the six ethical issues faced by tax administration authorities under the four pillars of tax administration:
(i) Acceptance of gifts
(ii) Conflict of Interest
(iii) Selective application of the law/ or inconsistency in applying the law
(iv) Political influence
(v) Confidentiality/secrecy
(vi) Discretion
(vii) Corruption
(viii) Lack of Autonomy

Ans.8

BAR (AOP)
Computation of income tax liability
For the tax year 2016

		Rupees
Accounting profit before taxation		5,488,000
Add: Inadmissible expenses:		
Closing stock-in-trade adj. [1,950,000 – 1,820,000]		130,000
Provision for slow moving stock		75,000
Freight charges paid in cash		-
Commission paid to Baqir		290,000
Annual performance award – Rahi		310,000
Bank loan of Asad paid by BAR		455,000
Provision for bad debts		735,000
Sales promotion expenses		275,000
Employee training and facilities (FG run institution)		-
Loss from Tehran branch	1,800,000	
Profit from Dubai branch	(1,500,000)	
Net loss from foreign source (to be carried forward for adjustment against foreign source income of the following tax year, if any.)	300,000	
		2,270,000
		7,758,000
Less: Admissible expenses:		
Bad debts written off	**(W-1)**	(120,000)
Net taxable income		7,638,000
Tax on Rs. 6,000,000		1,319,500
On balance Rs. 1,638,000 tax @ 35%		573,300
Net Liability		1,892,800

		Rupees
W-1:	Computation of bad debts written off:	
	Opening balance of provision for bad debt account	1,100,000
	Add: provision during the year	735,000
		1,835,000
	Less: Closing balance of provision for bad debt A/c	(1,435,000)
	Debts written off during the year	400,000
	Less: loan to supplier written off **[W-1(a)]**	(280,000)
	Bad debt written off allowed for tax purpose	120,000

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN EXAMINERS' COMMENTS	
SUBJECT Principles of Taxation	**SESSION** Certificate in Accounting and Finance – Spring 2016

General

The overall performance of the students was relatively better than in the previous attempt. The paper was quite simple and was designed to test the candidates' knowledge and understanding of some basic concepts of Income Tax and Sales Tax laws. Many candidates were therefore able to produce sound and well-written answers, by attempting all the questions and displaying a clear understanding of the various parts of the syllabus.

On the contrary, some candidates could not articulate and communicate their answers clearly. Inadequate presentation was a major concern with these candidates. It is advisable for candidates to earmark some time for planning the format and contents of their answers.

Poor hand writing remained a serious issue with some of the students. In several cases marks could not be given because the words/figures were completely illegible. Overwriting should be avoided and the incorrect figures must be crossed and the correct figures / words should then be written separately.

Question-wise comments are as under:

Question 1

This practical question carrying 16 marks required the students to compute the total income, taxable income and net tax payable in case of a salaried individual. Most of the students performed well and secured good marks. Some students made unnecessary and illogical assumptions which changed the context of the question altogether. Such assumptions are not acceptable. Some of the common mistakes are discussed below:

- Dearness and Conveyance allowances were considered to be exempt.
- Interest on provident fund @ 16% or 1/3rd of Basic Salary plus Dearness Allowance whichever is lower was considered as exempt whereas the higher of the two is actually exempt.
- Initial allowance was claimed on computers. Many candidates did not appreciate the fact that initial allowance is only admissible on such depreciable assets which have not been previously used in Pakistan. Moreover, in case of additions during the year, normal tax depreciation was computed for proportionate period in which the asset remained in use, instead of the full year.

- Zakat was deducted from tax liability instead of deducting it while computing taxable income. Some candidates were of the view that since Zakat has already been deducted from dividend, it cannot be deducted from normal income.
- Tax rates for non-salaried individuals were applied even though the salary income exceeded 50% of taxable income.
- Salary received by Mr. Wajahat from his own business, i.e. the tuition center was treated as salary for income tax purposes also and the amount was claimed as a business expense.
- Tax on dividend was computed @ 10% instead of 12.5%. Moreover, a significant number of candidates did not gross up the net amount of dividend by adding withholding tax and zakat deducted at source, whereas, many students considered dividend received from a company in UAE as being exempt from tax. Furthermore, many students did not treat dividend income as a separate block of income under the final tax regime and considered it as taxable under the normal tax regime.
- Tuition fee received was treated as income from other sources instead of income from business.
- Withholding tax deducted from the dividend received from BEE Limited was treated as full and final discharge of tax liability.
- Tax credit on investment in pension fund should have been calculated at average rate applied on the lower of (i) actual contribution, (ii) 20% of taxable income plus 2% for each year of age above 40 and (iii) 50% of last tax assessed income. Most of the students ignored the third point. Many candidates missed the additional 2% as mentioned in point (ii). Further, many students included dividend income in determining the average rate of tax.

Question 2

This question carrying 7 marks was designed to examine the students' understanding of the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, regarding the admissibility of entertainment expenditure incurred by a taxpayer. The candidates were generally able to respond well to this question and the response was above average. However, three important conditions, i.e. entertainment expenditure is admissible as a deduction only when it is incurred on (i) deriving business income chargeable to tax (ii) entertainment of persons directly related to the business (iii) entertainment of foreign customers and suppliers in Pakistan only, were missed by a number of candidates. Further, many candidates failed to appreciate the importance of the words contained in the law and used inappropriate replacements thereof which often conveyed a very different meaning. They are advised to be careful in the choice of words in such questions.

Question 3

This question consisted of four parts. The overall performance in the question as a whole was below average. Part-wise comments are provided below:

Question 3(a)

In this part the students were required to explain the concept of special tax year and the question was based on section 74(2) of the Income Tax Ordinance, 2001. A mixed response was witnessed as several students secured full marks but a number of errors were observed also, as many answers included the following incorrect statements:

- Special tax year is a tax year of a person which ends other than in June and December.
- A person may apply to the Commissioner for a tax period of twelve months other than economic tax year or calendar year.
- If a person chooses a tax year other than that specified in the Income Tax Ordinance, 2001, the year is called special tax year.
- The Federal Government has the authority to prescribe any special tax year in respect of any tax payer. In fact, this authority rests with the FBR.

Question 3(b)

In this part, the students were required to explain the concept of transitional tax year and it was based on section 74(9) of the Income Tax Ordinance, 2001. The overall response to this part was average. The common errors were as follows:

- Many candidates failed to appreciate that transitional tax year also applies where a taxpayer changes its tax year from special to normal and not only when the tax year changes from normal tax year to special tax year.
- Many students mentioned that period between the end of normal and special tax year is known as transitional tax year or that it is a tax year which ends between June and December and has a duration of less than twelve months or that transitional tax year is the period from special tax year to the tax year relevant to the calendar year.

Question 3(c)

In this part of the question, the requirement was to specify the order of application of various tax credits while computing the tax liability of a taxpayer and was based on section 4(3) of the Income Tax Ordinance, 2001. The overall response to this part was mixed. About 20% of the candidates gave the correct answer. Rest of them somehow inserted various irrelevant/incorrect assumptions at various positions, such as:

- Brought forward tax losses.
- Senior citizen and disabled person allowance.
- Tax credit for teacher or researcher and foreign currency.
- Tax credit for charitable donations and contribution to approved fund.

Some of the answers also included the following:

- The application for various tax credits can be filed to different tax authorities for approval of procedures to get the benefit of different tax credits.
- A tax payer is entitled to various tax credits while computing his tax liability for which approval of Commissioner is required.

Question 3(d)

This part of the question required the students to explain general provisions / rules which may apply to income subject to final tax regime. The requirements of this part were based on section 8 of the Income Tax Ordinance, 2001. Surprisingly, a large number of the students were not aware of the related provisions and resorted to guesswork. Many students missed this part altogether. Some common mistakes observed were as under:

- Examples of income subject to final tax were given rather than explaining general provisions / rules applicable to income subject to final tax regime.
- Some students tried to relate it to sales tax, i.e. when input tax is greater than output tax.
- Some candidates stated that income subject to final tax means net income received after deduction of tax.
- Some students tried to relate it to discontinuation of business and mentioned that final tax is payable within fifteen days of such discontinuation.
- Many students mentioned that such income is added to taxable income for rate purposes.

Question 4

This practical question carrying 10 marks required the students to compute the taxable income and brought forward losses under various heads of a trader who was also involved in speculative business. The overall performance was below average. The layout and presentation was also disappointing. Some of the common mistakes were as follows:

- Sale of maize should have formed part of speculative business but was treated as part of trading business.
- All the expenditures were deducted from trading business income.
- Loss against trading business was adjusted against speculative business income.
- Rs. 600,000 paid to research institute for development of formula was treated as intangible asset whereas it was an admissible expense.
- Speculative loss and capital loss were added together and carried forward as a single item.

Question 5

This practical question carrying 18 marks required computation of monthly sales tax payable by or refundable to a registered person. Overall performance of the students in this question was satisfactory. Common mistakes were as under:

- Input tax was claimed on purchases of taxable goods from unregistered persons and exempt goods from registered persons
- Many candidates considered input tax on furniture as admissible despite the fact that it was for use in marketing manager's office and was therefore not directly related to furtherance of taxable activity.
- Input tax was claimed on cement used for bungalow of managing partner although this activity was of a personal nature.

- No tax was charged on free samples and taxable goods sold to cottage industry in Bela.
- Many candidates did not know that output tax on items falling under Third Schedule (Ice cream in this case) is charged on retail price.
- Many candidates did not apportion common input tax between taxable and zero-rated supplies.
- 2% further tax on supplies to cottage industry was ignored.
- 2% further tax was also charged on goods sold to educational institutions who were end consumers. Further, tax is not charged from end-consumers even if they are unregistered.
- Output tax was not computed on goods handed over to the insurance company. Also, the input tax on such raw materials was not claimed.
- While comparing input tax with 90% of the value of supplies, it is necessary that gross input tax should also include the input tax that has been brought forward from the previous month, less input tax on chemicals destroyed. This point was missed by many students. Moreover, further tax was also included as part of output tax in such calculation.
- Some students calculated minimum value added tax at the rate of 3% assuming MA as a commercial importer.
- Input tax on advance against purchases of packing material was not claimed.
- Value of goods sold on credit was taken at Rs. 50,000 instead of Rs. 52,000, i.e. the amount of mark-up charged was ignored.
- Explanatory notes were given in respect of various items instead of including them in the computations.
- Few students directly assumed 10 percent of output tax as sales tax liability without comparing 90 percent of output tax with actual admissible input.
- Amount of sales tax calculated on the basis of the debit note was shown as a reduction in input tax instead of an addition to output tax.

Question 6(a)

This part carrying 4 marks required the candidates to identify the situation in which the Inland Revenue Department may recover the amount of sales tax without issuing a show-cause notice. Most of the students did not have knowledge of relevant provisions and ended up explaining provisions which were not relevant. Many candidates who were aware that Inland Revenue Department may recover the amount of sales tax without issuing a show-cause notice by stopping removal of any goods from business premises and through attachment of business bank accounts, didn't know that such action may be taken only when a registered person fails to pay the amount of sales tax which is payable as per the sales tax return filed by himself/herself. Many candidates used simple guesswork and mentioned points such as when a person is blacklisted, when the department has reasonable evidence that tax has been evaded, etc.

Question 6(b)

This part carrying 5 marks required the candidates to explain the rules relating to change in the particulars of registration other than change in business category; instead, many candidates mentioned rules for change in business category. Most candidates did not know that the request for change in particulars is required to be submitted through the FBR's computerized system in the prescribed form. Many candidates described the outdated procedure involving 'Local Registration Office' and 'Central Registration Office' for the change process.

Question 6(c)

This part carrying 2 marks required the candidates to identify the evidence a person is required to submit when applying for registration as a manufacturer on shared premises. The response to this part was good as majority of the candidates were able to identify correctly that under the Sales Tax Rules, the evidence of demarcation of shared manufacturing premises as well as the evidence of installation of sub-meter by relevant utility company are required to be submitted for registration as a manufacturer in shared premises. However, many students gave incorrect answers such as copy of lease agreement, copy of lessor's CNIC and copies of utility bills of such premises, GPS tagged photographs of the business premises/machinery, etc.

Question 7(a)

In this question carrying 3 marks the students were required to briefly describe the provisions of Article 160 of the Constitution of Pakistan relating to formation of National Finance Commission and its members. The overall performance of the candidates was satisfactory. However, some of the common mistakes are listed below:

- Some candidates described the provisions relating to functionality of NFC which was not required.
- A large number of students were not aware of the members of NFC and included President, Prime Minister, Chief Ministers, secretaries of Federal and Provincial Government, Chartered Accountants, etc. as the members.

Question 7(b)

This question carrying 5 marks required the students to state any five non-revenue objectives of a taxation system. This topic has recently been introduced in the syllabus. Most of the students had prepared it well and were able to secure high marks. However, some students used pure guesswork and presented replies which were entirely out of context as they tried to link these to agricultural income, export processing zones, rebates on donations, charity and welfare work, infrastructure development, non-profit organizations, foreign investment, etc.

Question 7(c)

This part of the question carrying 3 marks required the candidates to list six ethical issues faced by tax administration authorities in discharging their duties. Majority of the candidates were aware of the issues and were able to list them correctly. However, similar to part (b) many students discussed irrelevant material also such as lack of professional skills, knowledge of the standards, and code of ethics for professional accountants.

Question 8

This practical question carrying 12 marks required the students to compute taxable income, net tax payable and the amount to be carried forward by an AOP having two independent branches, one each in Tehran and Dubai. The overall performance was good. However, some of the common mistakes are discussed below:

- An important instruction in the question is that the computation should commence with the profit before tax figure was ignored. Instead, adjustments were made in various line items and the entire Profit & Loss Account was prepared which was a time consuming exercise.
- Profit and loss of foreign branches were combined with profit from Pakistan source income. Some student adjusted Dubai branch profit against Pakistan source profit and carried forward Tehran branch loss whereas profit of one foreign branch could have been adjusted from the loss of the other foreign branch to arrive at net loss from foreign operations; and carried forward. Some students mentioned that profit and loss of Dubai and Tehran branch could not be adjusted because they would be subject to final tax.
- Many students rightly mentioned that freight charges could be paid in cash without any limit and expenses incurred on training of employee to Federal Government run institution were allowable but deducted these expenses from profit as admissible expense as they did not realize that these expenses had already been deducted from income. Some students treated Rs. 86,000 paid to an institution operated by the Federal Government for training of industrial workers in Punjab as donation and calculated tax credit thereon.
- Majority of the students failed to calculate the amount of bad debt written off and allowed for tax purpose. Most of those who calculated them correctly, did not realize that loan to the supplier written off was not an admissible expense as it had not been included in business income previously.
- Difference between the value of stock under absorption costing and net realizable value was deducted from accounting profit instead of treating it as an addition.
- Surprisingly, some students could not apply the income tax slabs correctly.

(THE END)

GC Consultants

PRINCIPLES OF TAXATION
Summary of Marking Key
Certificate in Accounting and Finance – Spring 2016

Note regarding marking scheme:
The marking scheme is given as a guide. However, markers also award marks for alternative approaches to a question and relevant/well-reasoned comments/explanations.

			Mark(s)
A.1		▪ Computation of income from salary	5.5
		▪ Computation of income from business	3.0
		▪ Computation of dividend income (separate block)	2.0
		▪ Computation of taxable income	1.0
		▪ Determination of net tax payable	4.5
A.2		▪ 01 mark for explaining each condition under which entertainment expenditure would be allowed under the head income from business	7.0
A.3	(a)	▪ Explanation of the term 'Special Tax Year'	3.0
	(b)	▪ Explanation of the term 'Transitional Tax Year'	3.0
	(c)	▪ 01 mark for identification of each tax credit while computing the tax liability of the tax payer	3.0
	(d)	▪ 01 mark for identification of each general provision /rule applicable to income subject to final tax	6.0
A.4		▪ Computation of income from trading business	2.5
		▪ Computation of income from speculation business	2.0
		▪ Apportionment of common expenses	2.5
		▪ Determination of taxable income / (loss) for the year	1.0
		▪ Determination of the amount of loss to be carried forward	2.0
A.5		▪ Computation of input tax for the month	5.0
		▪ Apportionment of input tax	2.0
		▪ Computation of output tax for the month	7.0
		▪ Computation of further tax	2.0
		▪ Computation of admissible credit and sales tax payable	1.0
		▪ Determination of refund claim and input tax to be carried forward	1.0
A.6	(a)	▪ Describing the circumstances under which the Inland Revenue Department may recover the amount of sales tax from a person without issuing him a show cause notice	1.0
		▪ Method of recovering the short paid amount	3.0
	(b)	▪ Up to 1.5 marks for describing each rule relating to change in the particulars of registration other than change of business category	5.0
	(c)	▪ 01 mark for identification of each evidence that a person may be required to submit if he is applying for registration as a manufacturer on shared premises	2.0

PRINCIPLES OF TAXATION
Summary of Marking Key
Certificate in Accounting and Finance – Spring 2016

				Mark(s)
A.7	**(a)**	▪	Describing the formation of the National Finance Commission	**1.5**
		▪	Identification of the members of the National Finance Commission	**1.5**
	(b)	▪	01 mark for identification of each non-revenue objectives of taxation	**5.0**
	(c)	▪	0.5 mark for listing each ethical issue faced by the tax administration authorities	**3.0**

				Mark(s)
A.8	▪	Computation of the admissible / inadmissible expenses		
		–	Bad debts expense	**3.0**
		–	Stock	**1.5**
		–	Up to 01 mark each for other items	**4.5**
	▪	Foreign loss to be carried forward		**2.0**
	▪	Determination of net tax liability		**1.0**

(THE END)

The Institute of
Chartered Accountants
of Pakistan

Certificate in Accounting and Finance Stage Examinations

5 September 2016
3 hours – 100 marks
Additional reading time – 15 minutes

Principles of Taxation

Q.1 Bader is working as General Manager Finance with HiFi Limited (HFL) for the past two years. The details of his monthly emoluments during the year ended 30 June 2016 are as under:

	Rupees
Basic salary	250,000
Medical allowance	28,000
House rent allowance	120,000

In addition to above, Bader was also provided the following:

(i) Rs. 900,000 for signing a bond with HFL. According to the bond Bader would not resign from his employment before the expiry of 30 June 2019.

(ii) Company maintained car for both official and private use. The car was purchased on 1 August 2015 at a fair market value of Rs. 1,500,000.

(iii) On 1 January 2016 HFL sold an item of inventory to Bader for Rs. 12,000. The net realizable value of the item of inventory at the end of 31 December 2015 and 30 June 2016 was Rs. 22,000 and Rs. 24,000 respectively. HFL had acquired it in July 2014 at a cost of Rs. 35,000.

(iv) An option was granted to Bader in August 2014 to acquire 2,500 shares in HFL's parent company, Mamoo plc. (MP), listed on Hong Kong stock exchange. However, the option was exercisable after completion of one year of service with HFL. Bader paid an amount equivalent to PKR 200,000 to acquire the option when the fair market value of the option was PKR 250,000.

On 1 September 2015 he paid an amount equivalent to PKR 300,000 to acquire the shares in MP. The shares were issued to him on 15 September 2015 when the market value of each share was equivalent to PKR 375.

On 15 June 2016 Bader sold 2,000 shares in MP and received net proceeds equivalent to PKR 875,000 in his bank account in Pakistan. This amount was received after deduction of bank charges of PKR 5,000 and brokerage commission equivalent to PKR 10,000.

Other information relevant to tax year 2016 is as under:

(i) On 1 July 2015 Bader received following payments from his previous employer Sultan Hospital Limited:
- Rs. 600,000 in respect of termination benefits under an agreement.
- Rs. 485,000 against gratuity under an unapproved scheme.

(ii) On 1 November 2015 Bader fell ill and was admitted to Sultan Hospital Limited. The hospital incurred Rs. 65,000 on his treatment but did not charge anything to Bader.

(iii) On 1 December 2015 he paid a premium of Rs. 300,000 on a life insurance policy.

(iv) On 1 January 2016 Bader purchased 35,000 listed shares in Muft Limited (ML) at a price of Rs. 25 per share. On 20 March 2016 he fully subscribed 15% right shares offered by ML to its existing shareholders at a price of Rs. 20 per share.

(v) Withholding tax deducted from Bader's salary during tax year 2016 amounted to Rs. 1,105,000.

(vi) His total assessed taxable income and total taxes paid thereon during the three preceding tax years amounted to Rs. 10,500,000 and Rs. 1,260,000 respectively.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute the taxable income and net tax payable by or refundable to Bader for tax year 2016. **(15)**
Note: Show all relevant exemptions, exclusions and disallowances. Tax rates are given on the last page.

Q.2 Maroof filed his return of income for tax year 2015 on 30 September 2015. On 15 August 2016 he received a show cause notice from the Commissioner Inland Revenue u/s 122 for amendment of the assessment order issued on self-assessment basis.

Required:
Under the provisions of the Income Tax Ordinance, 2001 briefly describe:
(a) the circumstances under which an assessment order treated as issued on self-assessment basis may be amended by the Commissioner. **(04)**
(b) the situations in which the Commissioner may be barred from amending the original assessment order. **(04)**

Q.3 (a) The Income Tax Department initiating a proceeding against Mobeen, issued a demand note requiring him to pay the outstanding amount of his tax liability for tax year 2015 along with default surcharge. However, before settlement of his tax liability, Mobeen died in a car accident.

Required:
Under the provisions of the Income Tax Ordinance, 2001:
(i) describe whether tax authorities would be able to recover the amount of tax after Mobeen's death and what would be the extent of such recovery. **(03)**
(ii) comment on the status of the proceedings initiated against Mobeen. **(02)**

(b) Under the provisions of the Income Tax Ordinance, 2001 describe the following:

(i) meaning of the term 'Associates'. **(02)**
(ii) circumstances in which a member of an association of persons and the association may be regarded as associates. **(02)**
(iii) situation in which members of an association of persons may not be regarded as associates. **(02)**

(c) List the persons who may be granted immunity from filing of tax return u/s 114 of the Income Tax Ordinance, 2001 solely by reason of owning immovable property with a land area of two hundred and fifty square yards or more or any flat located in areas falling within the municipal limits. **(03)**

Q.4 On 1 July 2015 Farrukh borrowed Rs. 8,000,000 from Star Bank Limited and acquired a plot of land in Hub Industrial Zone for Rs. 6,500,000. He invested the rest of the loan in a business venture with his friend. The above loan carries mark-up at a rate of 12% per annum and is repayable in eight equal quarterly instalments starting from 1 July 2016. On 1 August 2015 Farrukh decided to sell the plot of land to Zulfiqar Motors for Rs. 10,000,000 and received a deposit of Rs. 500,000 from them. On 15 August 2015 Farrukh forfeited the deposit on refusal of Zulfiqar Motors to purchase the plot of land.

On 1 September 2015 Farrukh let out the plot of land to his friend Atif at a monthly rent of Rs. 150,000. He received an un-adjustable deposit of Rs. 200,000 from Atif and paid Rs. 80,000 for levelling the ground, Rs. 50,000 as ground rent, Rs. 12,000 as insurance premium against the risk of damage or destruction by water logging and Rs. 140,000 against rent collection charges. Farrukh had paid Rs. 25,000 to a firm of professional valuers which determined the annual rental value of the plot of land at Rs. 2,160,000.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute under the relevant head of income, taxable income of Farrukh for tax year 2016. **(12)**

Q.5 Samaaj Associates (SA) is registered under the Sales Tax Act, 1990 and is engaged in the business of manufacturing, trading and export of electronic, chemical and other consumer goods. Following information has been extracted from SA's records for the month of August 2016:

	Rupees
Supplies:	
To registered persons	2,500,000
To un-registered persons	875,000
To persons registered as exporter	625,000
Purchases:	
Raw material from registered persons	930,000
Finished goods from un-registered persons	725,000
Packing material from registered persons	510,000
Local machinery from un-registered persons	360,000
Imports – finished goods	472,000

Packing material from registered persons include material worth Rs. 150,000 which was used for packing electric motors. On 31 August 2016 these motors were still part of SA's unsold stock.

Following transactions pertaining to August 2016 are not included in the above table:

(i) Sales tax of Rs. 70,000, Rs. 45,000 and Rs. 68,000 was paid in cash on electricity, gas and telephone bills respectively.

(ii) SA purchased high quality cables and wires worth Rs. 250,000 from a registered supplier for the installation of local machinery purchased from un-registered suppliers.

(iii) Three cartons of imported shampoo, falling under third schedule, were supplied to un-registered distributors at a price of Rs. 110,000 per carton. The distributors normally supply such shampoo to retailers at a price of Rs. 135,000 per carton.

(iv) Five electric kettles worth Rs. 75,000 were purchased for use in the offices of factory manager and first line-supervisors of production workers.

(v) On 5 August 2016 SA received advance of Rs. 600,000 against supply of electric shavers to Bari Electronics. SA agreed to deliver the goods in September 2016.

(vi) On 25 August 2016 SA issued discount coupons worth Rs. 450,000 to its customers for participating in grand annual sales exhibition to be held in December 2016.

Other related information is as under:

(i) On 10 February 2016 SA purchased liquid nitrogen worth Rs. 300,000 from Mughal Chemicals (MC), a registered supplier, on credit. On 15 August 2016 SA paid the outstanding amount to MC by way of a crossed cheque drawn on SA's bank account.

(ii) In April 2016 SA inadvertently charged sales tax of Rs. 58,000 instead of 85,000 on supply of chemicals to one of its registered customers. So far, SA has not obtained permission from the Commissioner Inland Revenue for revision of return.

(iii) In July 2016 SA claimed input tax of Rs. 80,000 on purchase of hydrochloric acid from JB Traders. The supplier has not yet deposited the amount of sales tax collected from SA in Government treasury.

In July 2016 the excess of input tax over output tax amounted to Rs. 20,000. Whereas, unadjusted input tax in excess of 90% of output tax amounted to Rs. 10,000.

All the above figures are **exclusive of sales tax**, wherever applicable. Sales tax is payable at the rate of **17%**.

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, compute the amount of sales tax payable by or refundable to SA and the amount of sales tax to be carried forward, if any, for the tax period August 2016. **(18)**

Note: ***Show all relevant exemptions, exclusions and disallowances.***
Ignore value addition tax payable at import stage.

Q.6 (a) Under the Sales Tax Act, 1990 and Rules made thereunder, briefly describe the concept of 'Residual input tax'. How it differs from 'Residual input tax credit'? **(03)**

(b) Under the provisions of the Sales Tax Act, 1990 enumerate any **four** features distinguishing the concept of 'Zero rating' from 'Exempt supply'. **(04)**

(c) Identify the records which a registered person making taxable/exempt supplies is required to maintain at his business premises or registered office under the Sales Tax Act, 1990. ***(Note: details of contents not required)*** **(04)**

Q.7 (a) List any **seven** responsibilities of tax administrators emanating from best ethical practices. **(07)**

(b) List any **five** types of taxes which can be imposed by the Federation as provided in the Federal legislative list under the Constitution of Pakistan. **(05)**

Q.8 On 1 July 2015 Mehreen joined a local newspaper as an investigative journalist at a salary of Rs. 300,000 per month. Tax deducted u/s 149 from her salary amounted to Rs. 40,000 per month.

Following are the details of her income received from Germany; tax paid thereon and brought forward foreign losses for tax year 2016:

Heads of income	Foreign income/ (loss)	Foreign tax paid	Foreign losses brought forward
	-------------------- Rupees --------------------		
Speculation business	600,000	110,000	(380,000)
Non-speculation business	1,480,000	187,600	-
Other sources	(1,500,000)	-	-
Capital gain	950,000	76,000	(1,800,000)

On 1 May 2016 Mehreen resigned from her current job and joined Akhbar Merhaba (AM), an Arabic newspaper in Dubai, as editor-in-chief on a monthly salary equivalent to PKR 1,200,000. AM paid 50% of her salary in Dubai and remitted the remaining 50% to her bank account in Pakistan through normal banking channel. Mehreen remained in Dubai during the rest of the tax year 2016.

Required:

Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute the taxable income, net tax payable by or refundable to Mehreen for tax year 2016 and the amount of foreign losses or foreign tax credit, if any, to be carried forward. **(10)**

Note: Show all relevant exemptions, exclusions and disallowances. Tax rates are given on the last page.

(THE END)

PRINCIPLES OF TAXATION
Suggested Answers
Certificate in Accounting and Finance – Autumn 2016

Ans.1

Bader
Computation of income tax liability
For the tax year 2016

			Rupees
Income from Salary:			
Basic Salary (250,000 × 12)			3,000,000
Medical allowance (28,000 × 12 – 3,000,000 × 10%)			36,000
House rent allowance (120,000 × 12)			1,440,000
Consideration for Bader's agreement to condition of employment			900,000
Perquisite representing car	**W-1**		68,648
Benefit on purchase of item of inventory (22,000 – 12,000)			10,000
Share option scheme [(375 × 2,500)– 200,000 – 300,000]			437,500
Termination benefits			600,000
Unapproved gratuity (485,000 – 75,000 exempt			410,000
Free medical treatment by SHL – exempt			-
Total income under the head salary			6,902,148
Capital Gain:			
Sale of 2,000 shares in MP (875,000 + 5,000 + 10,000)			890,000
Less: Cost of acquisition of shares [(200,000+300,000+437,500) × 0.8]			(750,000)
Net gain on disposal of shares			140,000
Taxable income			7,042,148
Computation of net tax liability:			
Total taxable income			7,042,148
Less: Separate block			
▪ Termination benefits			(600,000)
▪ Unapproved gratuity			(410,000)
(assuming Bader, by notice in writing to the Commissioner, would elect to be taxed on the basis of average rate of tax)			
Taxable income (excluding separate block income)			6,032,148
Tax on Rs. 4,000,000			597,000
Tax @ 27.5% on the amount exceeding Rs. 4,000,000 (6,032,148 – 4,000,000)			558,841
Total gross tax payable under NTR			1,155,841
Tax on termination benefits @ average rate (1,260K / 10,500K = 12% × 600,000)			72,000
Tax on unapproved gratuity @ average rate (1,260K / 10,500K = 12% × 410,000)			49,200
Total tax liability			1,277,041
Less: Tax credit: either of the following two amounts would be claimed			
Right shares in ML [(35,000 × 15% × 20) × 1,155,841 ÷ 6,032,148]		20,119	-
Investment in life insurance [(300,000 × 1,155,841 ÷ 6,032,148]		57,484	(57,484)
Total tax payable			1,219,557
Less: Taxes withheld at source from salary			(1,105,000)
Net tax payable			114,557

W-1 Perquisite representing car:

The perquisite shall be computed as below:	
FMV of the car	1,500,000
5% of the FMV (1,500,000 × 5%)	75,000
Restricted to the number of days it was used in the tax year (335 ÷ 366)	68,648

PRINCIPLES OF TAXATION
Suggested Answers
Certificate in Accounting and Finance – Autumn 2016

Ans.2 (a) Revision of assessment by the Commissioner:

An assessment order shall only be amended by the Commissioner where, on the basis of definite information acquired from an audit or otherwise, the Commissioner is satisfied that:-

(i) any income chargeable to tax has escaped assessment; or
(ii) total income has been under-assessed, or assessed at too low a rate, or has been the subject of excessive relief or refund; or
(iii) any amount under a head of income had been mis-classified.

The Commissioner may also amend the assessment if after making necessary enquiries he considers that the assessment order is erroneous in so far it is prejudicial to the interest of revenue.

(b) Situations in which the Commissioner may be barred from revising the assessment order.

The Commissioner shall not revise any assessment order:-

(i) after the expiry of five years from the end of the financial year in which the order was issued or treated as issued.
(ii) if an appeal against the order lies to the Commissioner (Appeals) or to the Appellate Tribunal and the time within which such appeal may be made has not expired; or
(iii) The order is pending in appeal before the Commissioner (Appeals) or has been made the subject of an appeal to the Appellate Tribunal.

Further an assessment shall not be amended unless the taxpayer has been provided with an opportunity of being heard.

Ans.3 (a) (i) Deceased individual:

Yes, the tax authorities would be able to recover the amount of outstanding liability from the legal representative of Mobeen.
The legal representative is liable for:-

- any tax that Mobeen would have become liable for if he had not died; and
- any tax payable in respect of the income of Mobeen's estate.

The liability of the legal representative shall be limited to the extent to which Mobeen's estate is capable of meeting the liability and such liability shall be the first charge on Mobeen's estate, in preference to any other outstanding liability of the deceased.

(ii) **Comment on the status of the proceedings:**

Any proceeding taken against Mobeen before his death shall be treated as taken against the legal representative and may be continued against him from the stage at which the proceeding stood on the date of Mobeen's death.

(b) (i) **Associates:**

Two persons are associate where the relationship between the two is such that one may reasonably be expected to act in accordance with the intentions of the other, or both persons may reasonably be expected to act in accordance with the intentions of a third person.

(ii) **Circumstances in which a member of an association of persons and the association may be regarded as associates:**

Where the member, either alone or together with an associate or associates under another application of section 85 of the Income Tax Ordinance, 2001, controls fifty per cent or more of the rights to income or capital of the association;

PRINCIPLES OF TAXATION
Suggested Answers
Certificate in Accounting and Finance – Autumn 2016

(iii) **Situation in which members of an association of persons may not be regarded as associates:**
Members of an association of persons may not be regarded as associates where the Commissioner is satisfied that neither person may reasonably be expected to act in accordance with the intentions of the other.

(c) Persons not liable to file tax return:
The following persons may be granted immunity from filing of tax return u/s 114 of the Income Tax Ordinance, 2001 solely by reason of owning immovable property with a land area of two hundred and fifty square yards or more or any flat located in areas falling within the municipal limits:
(i) a widow;
(ii) an orphan below the age of twenty-five years;
(iii) a disabled person; or
(iv) a non-resident person.

Ans.4

Farrukh
Computation of taxable income
For the tax year 2016

	Rupees
Income from property:	
Forfeiture of deposit	500,000
Rent of plot of land [higher of (2,160,000 ÷ 12 × 10) or (150,000 × 10)]	1,800,000
Gross rent	2,300,000
Amount not adjustable against the rent	-
(Nothing is to be included in the chargeable income as this provision of law is attracted where the owner of building and not land receives such amount.)	
Less:	
Repairs 1/5th of rent (leveling of ground)	-
(Admissible only against the rent of the building)	
Interest on loan [6,500,000 × 12%] × [10 ÷ 12]	(650,000)
(interest on only that portion of the loan which is utilized for the acquisition of land is admissible)	
Ground rent	(50,000)
Insurance premium *[not available on land]*	-
Rent collection charges (2,300,000 × 6%)	(138,000)
(Lower of actual expenditure or 6% of rent is admissible)	
Fee paid to professional valuer- inadmissible	-
	(838,000)
	1,462,000

PRINCIPLES OF TAXATION
Suggested Answers
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Ans.5

Samaaj Associates (SA)
Computation of Net Sales Tax Liability
For the tax period August 2016

SALES TAX CREDIT (INPUT TAX)	**Taxable Value**	**Sales Tax Rate**	**Amount of Sales Tax**
Raw material from registered persons	930,000	17%	158,100
Finished goods from un-registered persons	725,000	inadmissible	-
Packing material from registered persons	510,000	17%	86,700
Local machinery from un-registered persons	360,000	inadmissible	-
Imports – finished goods	472,000	17%	80,240
Sales tax paid on utility bills [70,000+45,000+68,000]	-	-	183,000
Purchase of cables and wires	250,000	17%	42,500
Purchase of electric kettles	75,000	inadmissible	-
Purchase of liquid nitrogen [more than 180 days]	300,000	inadmissible	(51,000)
Input tax claimed on HCL			(80,000)
			419,540
Add: Credit brought forward from previous month	[20,000+10,000]		30,000
Input Tax for the month (Accumulated credit)			**449,540**
SALES TAX DEBIT (OUTPUT TAX)			
Taxable goods to registered persons	2,500,000	17%	425,000
Taxable goods to un-registered persons	875,000	17%	148,750
Taxable goods to registered exporters	625,000	17%	106,250
Self-consumption of packing material	150,000	-	-
Shampoo to un-registered distributors [3 × 110,000]	330,000	17%	56,100
Advance against supply of electric shavers	600,000	17%	102,000
Discount coupons to customers (actionable claims)	450,000	inadmissible	-
Short payment of sales tax in April 2016	-	-	27,000
Output tax for the month			**865,100**
Further tax on supplies to un-registered persons [875,000 × 2%]			17,500
Further tax on supply of shampoo to un-registered distributors [3rd schedule item] [330,000 × 0%]			-
Admissible credit (lower of 449,540 or 90% of 865,100 = 778,590			(449,540)
Sales tax payable			**433,060**
Input tax to be carried forward			**Nil**

Ans.6 (a) **Residual input tax Vs. Residual input tax credit:**

"Residual input tax" means the amount of tax paid on raw materials, components and capital goods being used for making taxable as well as exempt supplies but does not include the input tax paid on raw materials used wholly for making taxable or exempt supplies; Whereas

"Residual input tax credit" is that amount of residual input tax which is apportioned to the value of taxable supplies using the following formula:

$$\text{Residual Input Tax Credit on taxable supplies} = \frac{\text{Value of taxable supplies}}{(\text{Value of taxable + exempt supplies})} \times \text{Residual Input Tax}$$

(b) **Features distinguishing the concept of 'Zero rating' from 'Exempt supply':**

Distinction points	**Zero Rated Supply**	**Exempt Supply**
Definition	"Zero rated supply means a taxable supply which is charged to tax at the rate of zero per cent.	"Exempt Supply means a supply which is exempt from tax.
Products covered	Goods exported as notified by FBR or listed in the Fifth Schedule are charged to sales tax at the rate of zero per cent.	Goods specified by Federal Government and FBR and goods listed in Sixth Schedule are exempt supplies.
Invoicing Requirements	Invoice shall be raised for the goods supplied but sales tax shall be charged at the rate of zero per cent	No sales tax invoice shall be raised.
Registration	A person engaged in zero rated supplies has to be registered with the Sales tax department.	A person engaged exclusively in the exempt supplies is not liable to be registered.
Input tax credit	Input tax paid related to zero rated supplies is refundable.	Input tax paid related to exempt supplies is inadmissible, therefore, neither adjustable nor refundable.

(c) **Records:**

A registered person making taxable/exempt supplies shall maintain the following records of goods (including zero rated and exempt supplies):

(i) records of supplies;
(ii) records of goods purchased;
(iii) records of goods imported;
(iv) records of zero-rated and exempt supplies;
(v) double entry sales tax accounts;
(vi) Following further records is desired:
Tax invoices, Credit notes, debit notes, Bank statements, Banking instruments in terms of section 73, Inventory records, Utility bills, Salary and labour bills, Rental agreements, Sale-purchase agreements, Lease agreements, Record relating to gate passes, inward or outward, and transport receipts.
(vii) Such other records as may be specified by the Board.
(viii) The Board may specify to use such electronic fiscal cash registers as are approved by the Board.

PRINCIPLES OF TAXATION
Suggested Answers
Certificate in Accounting and Finance – Autumn 2016

Ans.7 (a) **Responsibilities of the tax implementing authorities:**

A concise code which can enlist responsibilities of Tax Administrators can be as under:

(i) Obey all laws relating to taxation and grant no exemptions, credit or advantage to any taxpayer that is not provided by the law;
(ii) Be dedicated to the highest ideals of honesty and integrity in all matters in order to maintain the respect and confidence of the government and taxpayers;
(iii) Strive to be impartial, fair, neutral and consistent in administering the law without regard to race, social status or economic circumstances;
(iv) Provide prompt, efficient and quality service to all stakeholders in an effort to exceed their expectations;
(v) Refrain from actively participating in partisan political activities;
(vi) Accurately record proceedings and maintain taxpayer information in the strictest confidence and highest level of security;
(vii) Refrain from soliciting gifts for actions and non-actions;
(viii) Make reasonable effort to collect the proper amount of tax revenue due at the lowest possible cost to the state, and in a manner that warrants the highest degree of confidence in our integrity, efficiency, effectiveness and fairness;
(ix) Respond to valid taxpayer refund claims with the same diligence as employed in collection of taxes;
(x) Educate taxpayers on their rights and responsibilities to ensure the highest possible levels of voluntary compliance to the laws.

(b) **Taxes which can be imposed by the Federation:**

Following are the types of taxes which can be imposed by the Federation as provided in the Federal legislative list under the Constitution of Pakistan:

(i) Duties of customs, including export duties.
(ii) Duties of excise, including salt, but not including alcoholic liquors, opium or other narcotics;
(iii) Taxes on income other than agricultural income;
(iv) Taxes on corporations.
(v) Taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed, except sales tax on services.
(vi) Taxes on the capital value of the assets, not including taxes on immovable property.
(vii) Taxes on mineral oil, natural gas and minerals for use in generation of nuclear energy.
(viii) Taxes and duties on the production capacity of any plant, machinery, undertaking, establishment or installation in lieu of any one or more of them.
(ix) Terminal taxes on goods or passengers carried by railway, sea or air; taxes on their fares and freights.

PRINCIPLES OF TAXATION
Suggested Answers
Certificate in Accounting and Finance – Autumn 2016

Ans.8

Mehreen
Computation of taxable income and income tax liability
For the tax year 2016

	---------------- Rupees ----------------		
	Pakistan source	**Foreign source**	**Total**
Income from salary:			
Salary[300,000 × 10], [1,200,000 × 2] **(a)**	3,000,000	2,400,000	5,400,000
Income from business:			
Speculation business	-	600,000	600,000
Less: brought forward speculation loss	-	(380,000)	(380,000)
Net income from speculation business	-	220,000	220,000
Non-speculation business	-	1,480,000	1,480,000
Net business income **(b)**		1,700,000	1,700,000
(Loss) from other source (Carried forward)	-	(1,500,000)	(1,500,000)
Capital gain	-	950,000	950,000
Less: brought forward loss	-	(1,800,000)	(1,800,000)
Net capital loss **(Carried forward)**		(850,000)	(850,000)
Total income **(a+ b)**	3,000,000	4,100,000	7,100,000
Less: exempt income			
salary received from AM	-	(2,400,000)	(2,400,000)
Taxable income	**3,000,000**	**1,700,000**	**4,700,000**

Since salary income is more than 50% of the taxable income, therefore, the slab applicable to salaried individuals shall be applied.

Computation of net-tax liability:

Tax on Rs. 4,000,000			597,000
Tax @ 27.5% on the amount exceeding Rs. 4,000,000 (i.e. on 700,000)			192,500
Tax payable			789,500
Less: Tax credit			
Which is lesser of (A) or (B):	**Business**		
	Speculation	**Non-Speculation**	
Foreign taxes paid **(A)**	110,000	187,600	
Proportionate Pakistan tax [(789,500÷4,700,000) × 220,000] **(B)**	36,955	-	(36,955)
Proportionate Pakistan tax [(789,500÷4,700,000) × 1,480,000] **(B)**	-	248,609	(187,600)
			(224,555)
Total tax liability for the year			564,945
Less: Tax withheld at source (40,000 × 10)			(400,000)
Net tax payable for tax year 2016			**164,945**

Un-adjusted foreign tax credit shall not be refunded, carried back to preceding year or carried to the following year.

(THE END)

<table>
<tr><td colspan="2">THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS</td></tr>
<tr><td>SUBJECT
Principles of Taxation</td><td>SESSION
Certificate in Accounting and Finance – Autumn 2016</td></tr>
</table>

General

The overall performance was slightly below the level achieved in the previous attempt. However, the main reasons for failure were almost the same i.e. selective study, lack of knowledge and failure to understand the practical application of the law.

The candidates are advised to carry out a thorough study without which they cannot pass the examination. Moreover, they should read and try to understand the requirements of the questions carefully. Furthermore, they should take into account the mark allocation for each question and should apportion their time and effort accordingly.

Question 1

This practical question carrying 15 marks required the students to compute the taxable income and net tax payable or refundable in case of a salaried individual. Most of the students performed fairly and secured reasonable marks. However, the following errors were observed in many scripts:

- Medical allowance up to 10% of the basic salary is exempt. Majority of the candidates ignored this rule and treated the entire amount of medical allowance as taxable.
- Candidates appreciated that 5 per cent of the FMV of the perquisite representing car for both official and private use is to be included in the taxable income. However, the amount to be included in the taxable salary was to be restricted with reference to number of 'days' it was used in the tax year. Almost all candidates wrongly restricted the same with reference to the number of 'months', rather than 'days'.
- Free medical treatment was provided by the hospital (employer) to the employee by virtue of his employment; the same was exempt from tax. Many candidates did not appreciate this fact.
- Amount chargeable under the head salary on acquisition of shares in MP was not calculated correctly. Rs. 200,000 paid to acquire the option and Rs. 300,000 paid to acquire the shares was not deducted from market value of shares. Market value of shares was not calculated by multiplying market value of each share of Rs. 375 with number of 2,500 shares acquired.
- Amount taxable on account of unapproved gratuity was not considered as a separate block of income, to be taxed on the average rate of tax for the three preceding tax years.
- In respect of tax credit on investment in shares and life insurance premium, very few candidates knew about the following:
  - for determining the average rate of tax, income and tax liability in respect of separate block of income were to be excluded; and

- for investment in shares, tax credit was to be calculated only on fully subscribed right shares and not on the entire shareholding.

Question 2

This question consists of two parts. Performance in each part is discussed below:

Question 2(a)

The requirement of this part was based on section 122(5)(5A) of Income Tax Ordinance, 2001 and the candidates were required to describe the circumstances under which an assessment order treated as issued could be amended. A large number of students seemed totally confused or lacked the required knowledge. Their answers were based on guesswork and included irrelevant material like the following:

- Due to non-availability of source of acquisition of asset or transfer of asset.
- Failure to file a complete return of income.
- Many candidates even discussed matters related to sales tax.

Question 2(b)

This part of the question was based on the requirements of section 122(2) and 122A (4) of Income Tax Ordinance, 2001 and candidates were required to briefly describe situations where Commissioner-IR might be barred from revising the assessment order. The performance was average. In this part also many students resorted to just guesswork and produced totally irrelevant answers. Many students were even unaware of the meaning of the word 'barred' and gave points similar to those mentioned in response to part (a).

Question 3(a)(i)

This part of the question was based on the requirements of section 87 of the Income Tax Ordinance, 2001. In this part, the candidates were required to describe how tax authorities would recover the amount of tax after the death of a taxpayer. The performance was above average. Some of the discrepancies observed were as follows:

- A significant number of students stated correctly that legal representative of the deceased would be liable to pay the tax payable by the deceased but failed to clarify that such liability would be limited to the amount recoverable from the estate of the deceased.
- A number of candidates used the term 'legal heirs' in place of 'legal representative'.
- Some of the students were of the opinion that the tax authorities would not be able to recover any amount due from a dead person.
- Some students gave totally absurd answers such as, the tax department should issue notice for his outstanding amount from his major guardian but would not be able to recover his unpaid tax from minor guardian.

Question 3(a)(ii)

In this part of the question the candidates were required to comment on the status of tax proceeding that were pending at the time of the death of the tax payer. The common mistakes were as under:

- Many candidates explained that there would be no proceedings against Mobeen because he was dead.
- Some students stated that the legal representative is liable for tax assessment proceedings pending/arising against the deceased individual without elaborating any further.
- Some students misunderstood the entire question and discussed Section 140 according to which Commissioner can give notice to a person who owes money to a person or holds money on behalf of a person from whom tax is due.

Question 3(b)(i)

This part required the students to describe the term "Associate". Majority of the students described the term correctly as provided in Section 85 of the Income Tax Ordinance, 2001 and secured full marks.

Question 3(b)(ii)

This part was based on the requirements of Section 85(3)(c) of Income Tax Ordinance, 2001 And the candidates were required to describe the circumstances whereby the member of an association of persons and the association of persons may be regarded as associates. The common mistakes were as under:

- Many candidates were of the view that they would always be considered as associates.
- Many candidates described the definition of associate as has been given in Companies Ordinance, 1984.
- Some students produced totally irrelevant answers which appeared to be guesswork on their part.

Question 3(b)(iii)

In this part, candidates were required to identify the situation in which members of an AOP are not to be considered as associates. Few students were able to correctly answer this part as most of them failed to mention about condition regarding the role of Commissioner Inland Revenue.

Question 3(c)

The overall performance in this part was good as most of the students were able to list the persons who may be granted immunity from filing the tax return under section 114 of the Income Tax Ordinance, 2001. A common mistake was that it was mentioned that the aforesaid immunity is also available to a 'minor'.

Question 4

This computational question offered 12 marks and was aimed at testing the concepts of the students relating to taxation of income under the head "Income from Property". The overall performance was average. The commonly observed mistakes were as under:

- Some candidates classified the whole stream of income as "Income from Other Sources" instead of "Income from Property".
- Forfeiture of deposit was considered taxable over a period of ten years.
- Higher of fair market rent or actual rent received is to be treated as income. Many candidates considered actual rent received as taxable. Moreover, in many cases, rent for the entire year i.e. 12 months was calculated instead of 10 months.
- Many candidates included the un-adjustable deposit received on renting of plot of land in computing income from property. They failed to realize that nothing was to be included in the chargeable income as this provision of law is attracted where the owner of a building receives such amount and this rule is not applicable in case of land.
- Repairs allowance at 1/5th of gross rent was considered admissible. Candidates did not appreciate that such allowance was admissible only against the rent of a building not land.
- Allowable interest expense was wrongly calculated in many of the scripts. Candidates calculated interest on entire amount of loan, ignoring that interest is admissible only on that portion of the loan which is utilized for the acquisition of land. Many students also failed to apportion the interest over 10 months.
- Insurance premium is not an admissible deduction in case of land; most of the candidates were not aware of this fact.
- A number of candidates did not know that rent collection charges are admissible at 6% of gross rent or actual, whichever is lower. They considered that actual charges are deductible in all cases. While few candidates inflated the actual collection charges by the amount of other expenses, such as ground rent, insurance premium, etc., for comparison purposes.
- Fee paid to professional valuer was wrongly considered as admissible deduction.

Question 5

The requirement of this question was to calculate the amount of sales tax payable / refundable and the sales tax to be carried forward for an enterprise engaged in the business of manufacturing, trading, and export of electronic, chemical and other consumer goods. The common mistakes were as follows:

- Input tax was also claimed on finished goods and local machinery purchases from unregistered persons.
- Input tax on purchase of liquid nitrogen, the payment of which remained outstanding for more than 180 days, was required to be deducted from the total admissible input tax for the month. However, a number of candidates added the same.
- Many candidates failed to offer back the input tax claimed on purchase of HCL for which the sales tax had not yet been deposited in the Government Treasury by the supplier.
- No treatment was required in respect of packing material used for packing of electric motors whereas many candidates wrongly considered that input tax relating thereto was not admissible.
- Supplies to persons registered as exporters were treated as exports.
- Further tax on supplies to unregistered persons was included in the total output tax prior to the adjustment of input tax.
- Many candidates failed to appreciate that supply of shampoo being a third schedule item would not be subject to further tax.
- Output tax was charged on issuance of discount coupons.
- Majority of the students did not calculate input tax on the purchase of cables and wires.
- Input tax was claimed on purchase of machinery from unregistered person.
- The rule whereby input tax is restricted to 90% of output tax was not applied.
- Majority of the students rightly explained that SA could not take input tax credit, where supplier had not deposited the amount of sales tax in Government treasury but they did not deduct the amount of Rs. 80,000 in calculating the input tax credit.
- Excess of input tax over output tax of Rs. 20,000 and un-adjusted input tax in excess of output tax pertaining to the previous month was ignored.

Question 6(a)

This part of the question required the candidates to briefly describe the concept of 'residual input tax' and how it differs from 'residual input tax credit' and was based on Rule 2(xlvii) and Rule 25 of Sales Tax Rules, 2007. Most of the students had a fair idea of the term residual input tax but failed to explain the term residual input tax credit.

Question 6(b)

This part was generally well answered as most of the candidates were able to explain the features distinguishing the concept of 'zero-rating' from 'exempt supply'.

Question 6(c)

This part required candidates to identify the records that a registered person making taxable / exempt supply is required to maintain at his business premises under the Sales Tax Act, 1990. It was disappointing to note that most of the students failed to secure good marks in this easy question. Many students reproduced particulars to be mentioned on sales tax invoices instead of records to be maintained or just referred to the record as invoices of purchases and supplies.

Question 7(a)

This part required the students to list responsibilities of tax administrators emanating from best ethical practices. The overall performance of the candidates was very encouraging and many candidates secured full marks. However, many candidates discussed cannons of taxation which was totally irrelevant. Some students used pure guesswork and made the following types of statements:

- Tax administrator must keep eye on person's foreign accounts and suspect any possible ways of tax evasion by the individuals paying tax.
- Tax administrator should collect tax from rich rather than concentrating on collecting more tax from poor.
- Tax administrator should collect tax at the time and manner convenient to the people.

Question 7(b)

This part was based on the constitutional provisions relating to taxation and required the candidates to identify the five types of taxes which may be imposed as per the federal legislative list of taxes. Majority of the candidates knew the answer and secured goods marks. However, some of the students ended up explaining the types of taxation including Direct/Indirect taxes or Progressive/Regressive taxation. Some students mentioned the names of Statutes / Acts legislated by the Federal Government.

Question 8

The question pertained to an individual who had earned Pakistan source as well as foreign source income under four different heads of income. The requirement was to compute the taxable income, net tax payable or refundable and the amount of foreign losses or foreign tax credit, if any, to be carried forward. Poor performance was witnessed in this question as the candidates seemed to lack conceptual understanding of the related law. The common mistakes were as follows:

- Pakistan source salary was computed for 12 months instead of 10 months.
- Only 50% of the foreign source salary was considered exempt; salary remitted to Pakistan was considered taxable, which was incorrect. The entire foreign source salary was exempt from tax by virtue of section 51 of the Income Tax Ordinance, 2001.

- Foreign loss under other sources was required to be carried forward. Candidates wrongly adjusted the same against foreign source non-speculative business income. Candidates did not realize that loss under specific foreign source head can only be adjusted against income under the same head and not with income under any other head.
- Some candidates treated foreign tax paid as an expense.
- Since salary income was more than 50% of the taxable income, therefore, the slab applicable to salaried individual should have been applied. Many candidates applied the non-salaried slab.
- Many candidates did have a fair idea that tax credit was to be allowed on an amount equal to the lesser of the foreign income tax paid, or the amount arrived at by applying the average rate of tax (applicable to Pakistan source income) on foreign source income. However, they struggled / failed to apply these concepts practically.
- In many scripts, proportionate Pakistan tax on foreign source income was calculated on aggregate basis for comparison with total foreign taxes paid, instead of calculating the Pakistan tax in respect of each foreign source and comparing the same with foreign tax paid under each head separately.

(THE END)

PRINCIPLES OF TAXATION
Summary of Marking Key
Certificate in Accounting and Finance – Autumn 2016

Note regarding marking scheme:
The marking scheme is given as a guide. However, markers also award marks for alternative approaches to a question and relevant/well-reasoned comments/explanations.

				Mark(s)
A.1	▪	Computation of income from salary:		
		–	Termination benefits	2.0
		–	Share options scheme	2.0
		–	Other computations of income from salary	3.0
	▪	Computation of income from capital gain		3.0
	▪	Computation of tax credit		2.0
	▪	Determination of net tax payable		3.0

A.2	(a)	Up to 01 mark for identification of each circumstances under which an assessment order issued on self-assessment basis may be amended by the Commissioner		4.0
	(b)	Up to 1.5 marks for identification of each situation in which the Commissioner may be barred from amending the original assessment order		4.0

A.3	(a)	(i)	▪	Identification of the persons from whom tax authorities would be able to recover the amount of tax after Mobeen's death	1.0
			▪	Description of the extent of amount that would be recovered after Mobeen's death	2.0
		(ii)		Comment on the status of the proceedings initiated against Mobeen	2.0
	(b)	(i)		Explanation of the term 'Associates'	2.0
		(ii)		Description of the circumstances under which a member of an association of persons and the association may be regarded as associates	2.0
		(iii)		Description of the situation under which a member of an association of persons and the association may not be regarded as associates	2.0
	(c)			0.75 mark for identification of each person who is granted immunity from filing of tax return u/s 114 of the Income tax Ordinance, 2001	3.0

A.4	▪	Computation of gross rental income	3.0
	▪	Determination of the amount not adjustable against the rent	1.5
	▪	Treatment of various expenses related to the property income.	7.5

A.5	▪	Computation of input tax for the month	8.0
	▪	Computation of output tax for the month	7.0
	▪	Computation of further tax	2.0
	▪	Computation of admissible credit and sales tax payable	0.5
	▪	Determination of input tax to be carried forward.	0.5

A.6	(a)	Describing the difference between 'Residual input tax' and 'Residual input tax credit'.	3.0
	(b)	01 mark for identification of each feature that distinguish the concept of 'Zero rating' from 'Exempt supply'.	4.0

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PRINCIPLES OF TAXATION
Summary of Marking Key
Certificate in Accounting and Finance – Autumn 2016

			Mark(s)
	(c)	0.5 mark for identification of each record of goods required to be maintained by a registered person.	4.0
A.7	(a)	01 mark for description of each responsibility of the tax implementing authorities	7.0
	(b)	01 mark for identification of each tax that can be imposed by the Federation.	5.0

A.8	▪	Computation of income from salary – Pakistan as well as foreign source	1.0
	▪	Computation of income from business – Foreign source	1.5
	▪	Computation of loss from other sources – Foreign source	1.0
	▪	Computation of income from capital gain – Foreign source	2.5
	▪	Computation of tax credit for foreign taxes paid	2.0
	▪	Computation of tax liability and net tax payable	2.0

(THE END)

The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examinations

6 March 2017
3 hours – 100 marks
Additional reading time – 15 minutes

Principles of Taxation

Q.1 Mushtaq is a sole proprietor of Mushtaq Enterprises (ME) engaged in the business of manufacturing of different products. ME's profit and loss account shows profit before taxation of Rs. 1.8 million for the year ended 30 June 20X7. A review of ME's records has revealed the following information.

(i) ME employs five salesmen. Rs. 22,000 per month were paid to each salesman in cash which includes reimbursement of Rs. 6,000 per month incurred on entertainment of customers at the business premises.

(ii) Administrative expenses include Rs. 150,000 which were paid to a research institute in China for the purpose of developing a new product.

(iii) Accounting loss on the sale of patents was Rs. 65,000. The tax written down value of these patents at the beginning of the year was Rs. 430,000 and these were sold for Rs. 524,000. Amortization charged to the profit and loss account on these patents for the current year was Rs. 25,000.

(iv) Receivables from Atif and Aslam which had been written off in the previous year were recovered. Details are as follows:

	Atif	Aslam
	------ Rupees ------	
Claimed bad debts in last tax return	800,000	1,200,000
Allowed by tax authorities last year	550,000	600,000
Amount recovered during the year	700,000	400,000

(v) ME has opened a sales office in Dubai. In this respect, furniture costing Rs. 850,000 with written down value (WDV) of Rs. 650,000 was shifted to Dubai office. The tax WDV of the furniture at the beginning of the year was Rs. 610,000.

(vi) Accounting depreciation for the year is Rs. 580,450. However, no depreciation has been provided on the following fixed assets purchased on 1 March 20X7:

	Rupees
Furniture	200,000
Used machinery imported from Germany	500,000

(vii) Tax depreciation for the year, prior to the adjustments mentioned in (vi) above, amounted to Rs. 456,400.

(viii) Advance tax paid u/s 147 was Rs. 200,000.

(ix) The assessed business losses of tax year 20X1 brought forward in year 20X7 are Rs. 830,000. These include unabsorbed tax depreciation amounting to Rs. 705,000.

Other transaction of Mushtaq

On 1 June 20X7, he sold 6,000 shares for Rs. 432,000 out of 15,000 shares which he received on 1 May 20X4, on the death of his father. The fair market value of shares on the date of transfer to Mushtaq was Rs. 25 per share.

Required:

Under the provisions of Income Tax Ordinance, 2001 and rules made thereunder, compute taxable income and net tax payable by or refundable to Mushtaq for the year ended 30 June 20X7. **(16)**

Q.2 (a) Explain the term 'disposal of assets' as referred to in the Income Tax Ordinance, 2001. **(05)**

(b) Saleha is a resident person. She disposed of the following assets during the tax year 20X7.

(i) A painting which she inherited from her father was sold for Rs. 1,250,000. The market value of the painting at the time of inheritance was Rs. 1,550,000. The painting was purchased by her father for Rs. 1,000,000. **(02)**

(ii) She sold jewellery for Rs. 2,300,000 which was purchased by her husband in March 20X5 for Rs. 1,300,000 and gifted to her on the same date. **(02)**

(iii) She disposed of her car for Rs. 1,800,000. The car was being used for the purposes of her business. The tax written down value of the car at the beginning of tax year 20X7 was Rs. 1,600,000. The rate of depreciation for tax purposes is 20%. **(02)**

(iv) On 20 October 20X6 she sold a dining table to Faheem for Rs. 18,000 which she had purchased on 15 May 20X5 for Rs. 15,000 for her personal use. **(02)**

Required:
Under the provisions of the Income Tax Ordinance, 2001, discuss the taxability of each of the above transactions in the context of capital gain/loss.

Q.3 (a) On 1 June 20X6 Dawood and Dewan jointly purchased a bungalow for Rs. 35 million. They paid the amount in the ratio of 65:35 respectively. To arrange funds for the deal, Dawood borrowed Rs. 3,000,000 in cash from Shameem who is in the business of lending money. The rate of interest is agreed @ 20% per annum.

On 1 July 20X6, the house was let out to a company at annual rent of Rs. 4,500,000 inclusive of an amount of Rs. 75,000 per month for utilities, cleaning and security. For providing these services Dawood and Dewan paid Rs. 35,000 per month. During the tax year 20X7 they also paid Rs. 10,000 as collection charges and Rs. 230,000 for administering the property.

Required:
Compute taxable income of Dawood and Dewan under appropriate heads of income for the tax year 20X7. **(08)**

(b) Najam had purchased a house in 20X2 for Rs. 20 million.

On 1 July 20X6, Najam entered into an agreement with Zameer for sale of the house for Rs. 25 million. As per the terms of the agreement, Najam received Rs. 5 million on the day the contract was signed and balance amount was to be paid on 30 September 20X6. However, due to financial difficulties, Zameer failed to pay the balance amount on the due date and consequently, Najam forfeited the advance in accordance with the terms of the agreement.

On 15 February 20X7 Najam sold the house to Farid for Rs. 30 million.

Required:
Advise Najam about the taxability of the above transaction under the Income Tax Ordinance, 2001. **(04)**

Q.4 (a) State the duties of National Finance Commission. **(04)**

(b) List the taxes and duties which may be raised under the authority of Parliament. Also list various types of taxes which are covered under the scope of legislation of the Provinces. **(06)**

Q.5 (a) List the persons who are required to file a tax return under the provisions of the Income Tax Ordinance, 2001. **(06)**

(b) In the light of the provisions of the Income Tax Ordinance, 2001:

(i) Identify the circumstances under which the Commissioner of Income Tax may require a person to furnish a return of income for a period of less than twelve months. **(03)**

(ii) State the consequences if a person fails to furnish the return as required in (i) above. **(03)**

Q.6 Zahid, the sole proprietor of FG and company, is a resident individual and is in the process of filing his wealth statement for the tax year 20X7. The relevant information is as under:

(i) Assets and liabilities disclosed in the wealth statement for the tax year 20X6 were as follows:

	Rupees
Assets	
Agriculture land in Hyderabad	5,000,000
Residential property in DHA Karachi	3,000,000
Investment in shares of listed companies	1,100,000
Business capital – FG & Co.	4,000,000
Motor vehicle	1,540,000
Cash at bank	600,000
Cash in hand	300,000
	15,540,000
Liabilities	
Bank loan	(1,500,000)
Net assets	**14,040,000**

(ii) Details relating to FG & Co. are as follows:

	Rupees
Income from business for the tax year 20X7	2,540,000
Drawings during the year	450,000

(iii) Balance of cash in hand and at bank, as on 30 June 20X7 amounted to Rs. 157,500 and Rs. 730,000 respectively.

(iv) Transactions carried out by Zahid during the year were as follows:

- Paid an advance of Rs. 1,000,000 against purchase of a bungalow for Rs. 10,000,000.
- Sold shares of a listed company for Rs. 350,000. The shares were purchased on 1 May 20X6 for Rs. 50,000. Capital gain tax collected by NCCPL amounted to Rs. 37,500.
- Gifted shares of a listed company to his brother. The shares were purchased by Zahid in 20X2 at a cost of Rs. 100,000 whereas market value of the shares at the time of gift was Rs. 150,000.
- Paid Rs. 200,000 towards principal amount of the bank loan.
- Personal expenses amounted to Rs. 2,075,000.
- Net receipts against agricultural income amounted to Rs. 2,500,000.

Required:
Prepare Zahid's wealth statement and wealth reconciliation statement for the tax year 20X7. **(07)**

Q.7 Jahangir Ali (JA) is registered under the Sales Tax Act 1990. JA runs multiple businesses. Following information has been extracted for the month of February 2017:

	Rupees
Supplies	
Taxable goods exported to Qatar	100,000
Taxable goods to registered customers	750,000
Taxable goods to unregistered customers	550,000
Purchases	
Taxable goods from registered suppliers	3,000,000
Exempt goods from registered suppliers	70,000
Taxable goods from unregistered suppliers	95,000

The following further information is available:

(i) Taxable goods supplied to registered customers include goods amounting to Rs. 300,000 supplied to an associated company at a special discount of 25%.

(ii) Taxable goods supplied to unregistered customers include goods worth Rs. 100,000 supplied to Saleem Brothers (SB). JA did not charge any sales tax from SB as it has submitted an undertaking that it is a cottage industry and exempt from sales tax under the Sixth Schedule of the Sales Tax Act, 1990.

(iii) Taxable goods purchased from registered suppliers include:
- goods worth Rs. 320,000 purchased from Akram Limited who was blacklisted on 25 February 2017 due to issuance of flying invoices.
- goods purchased from ZA Traders amounting to Rs. 30,000. ZA Traders did not declare this amount in its tax return for the month of February 2017.
- a new machine purchased for Rs. 500,000 which was commissioned into operation during February 2017.
- office equipment of Rs. 200,000, purchased for the warehouse.

(iv) Goods pledged with a bank were sold by the bank in an auction for Rs. 1,000,000. The normal selling price of these goods was Rs. 1,200,000.

(v) Excess of input tax over output tax brought forward from January 2017 was Rs. 110,000.

Rate of sales tax is **17%**. All figures are exclusive of sales tax.

Required:
Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, compute the amount of sales tax payable by or refundable to JA and the amount of sales tax to be carried forward, if any, for the tax period February 2017. **(17)**

Q.8 (a) Under the provisions of Sales Tax Act, 1990 and Rules made thereunder, identify the circumstances in which:

(i) a registered person is not allowed to reclaim or deduct input tax paid. **(06)**

(ii) a registered person may be liable for deregistration. **(03)**

(b) On 2 June 2016, Abid Limited inadvertently issued a tax invoice with an incidence of sales tax amounting to Rs. 25,000 as against the applicable tax of Rs. 45,000. The error was detected on 15 February 2017 i.e. after expiry of 180 days.

Advise Abid Limited in the light of Sales Tax Rules, 2006. **(04)**

(THE END)

EXTRACTS FROM THE INCOME TAX ORDINANCE, 2001
THE FIRST SCHEDULE
Tax Rates for Every Individual and Association of Person Except for Salaried Taxpayer

S. No.	Taxable income	Rate of tax
3.	Exceeds Rs. 500,000 but does not exceed Rs. 750,000	Rs. 7,000 + 10% of the amount exceeding Rs. 500,000
4.	Exceeds Rs. 750,000 but does not exceed Rs. 1,500,000	Rs. 32,000 + 15% of the amount exceeding Rs. 750,000
5.	Exceeds Rs. 1,500,000 but does not exceed Rs. 2,500,000	Rs. 144,500 + 20% of the amount exceeding Rs. 1,500,000
6.	Exceeds Rs. 2,500,000 but does not exceed Rs. 4,000,000	Rs. 344,500 + 25% of the amount exceeding Rs. 2,500,000

Capital Gains on disposal of Securities

S. No.	Period	Rate of tax
1.	Where holding period of a security is less than twelve months	15%
2.	Where holding period of a security is twelve months or more but less than twenty-four months	12.5%
3.	Where holding period of a security is twenty-four months or more but the security was acquired on or after 1st July, 2012	7.5%

Capital Gains on disposal of Immovable Property

S. No.	Period	Rate of tax
6.	Where holding period of immovable property is up to three years	5%
7.	Where holding period of immovable property is more than three years	0%

THE THIRD SCHEDULE
Part I
Depreciation Rates

1.	Building (all types)	10%
2.	Furniture and fittings	15%
3.	Plant and machinery	15%
4.	Motor vehicles (all types)	15%
5.	Computer hardware	30%

Part II
Initial Allowance and First Year Allowance

The rate of initial allowance shall be 25% for plant and machinery and 15% for building.