The Institute of Taxation of Pakistan
CTA – Application Level
January 2022 Attempt
DIRECT TAX

Question # 1 **[10 marks]**

Mr. Nawaz is operating a business of wedding event Planner since last 12 years. He had not filed his complete return of income for the tax year 2021.

Advise Mr. Nawaz about

- When a Person will be automatically selected for audit of its Income Tax Affairs? [2 marks]
- When can a person avoid automatic selection for audit? [3 marks]
- Authority which can select a taxpayer for audit if not automatically selected [2 marks]
- How can a retailer save himself from automatic selection of Audit? [3 marks]

Question # 2 **[5 marks]**

With reference to the Income Tax Ordinance, 2001, state how a matter would be decided in case of difference in opinion on any point amongst the members of a bench constituted by the chairperson of an Appellate Tribunal Inland Revenue.

Question # 3 **[10 marks]**

Hamza is a director in Shehbaz (Pvt) Ltd, a company incorporated under the Companies Act 2017 wherein the liability of owners is limited up to relevant shareholding. Hamza hold 5 % shares in the paid-up capital of Shehbaz (Pvt) Ltd. Hamza is served with a demand notice by the Commissioner Inland Revenue holding jurisdiction over recovery of tax payable by Shehbaz (Pvt) Limited.

Hamza feels that demand notice is ab-initio void however being tax advisor you feel that the notice is valid. Please explain being a tax advisor that why Hamza's understanding is incorrect.

In case Hamza owns 8 % shareholding in Shehbaz (Pvt) Ltd but he is not a director in the company and the demand notice is served on him for recovery of tax payable by Shehbaz (Pvt) Limited. What would be your opinion being tax advisor to Hamza?

Your reply should be in the form of a letter from the tax advisor.

Question # 4 **[13 marks]**

(a) Identify any four powers of the Federal Board of Revenue (FBR) with respect to collection of tax. What consequences/hardships may be faced by taxpayer if such powers are misused by any officer(s) of FBR? ***[3 marks]***

(b) Bilal, Sameel and Azhar are planning to commence a business venture selling chemicals to corporate clients. They are however not certain whether the business venture should be in theform of partnership or a limited company. They intend to make investment and share profit in the ratio of 3:2:1 respectively. Further in case of limited company they would distribute 30% of the after tax profits as dividends. Projected results for the current year ending are given as follows:

Particular	Rupees
Sales	15,000,000
Profit before Tax	1,095,000

Profit before tax has been calculated after deducting salaries and wages of Rs. 500,000, Rs.700,000 and Rs. 600,000 to be paid to Bilal, Sameel and Azhar respectively. Assume that all other expenses deducted in calculating profit after tax are also admissible under the Income Tax Ordinance, 2001.

Required

Under the provisions of the Income Tax Ordinance, 2001 advise Bilal, Sameel and Azhar on the preferable structure of their business, whether it should be a partnership or a limited liability company. ***[10 marks***]

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Question # 5 **[22 marks]**

For the purpose of this question, assume that the date today is 30 September 2021.

Bilawal (Pvt) Limited (BPL) is engaged in various business activities. The company has a paid-up capital of Rs. 52 million. Following information has been extracted from BPL's records for tax year 2021:

	Rupees
Total turnover	215,520,000
Cost of goods sold	171,412,000
Gross Profit	44,108,000
Administrative and selling expenses	10,425,000
Financial Charges	3,120,000
Other income	5,975,000
Profit before taxation	36,538,000
Taxation	4,228,938
Profit after taxation	32,309,062

Additional information:

Total turnover includes:

1. Sale of Rs. 21,750,000 (inclusive of sales tax at the rate of 17%) to one of the customers in Balakot. A special discount of 30% of the gross value of sales was offered to the customer in defiance of normal business practices.
2. Sale of surgical gloves of Rs. 14,931,000 to a government hospital in China. BPL realized the entire sale proceed during the year after deduction of 1% withholding tax by the authorized dealer
3. Rs. 2,000,000 for providing engineering services to Qamar enterprises (QE) in Islamabad. Withholding tax was deducted u/s 153 at the rate of 8%. BPL has not submitted any undertaking under clause 94 of Part IV of the Second Schedule.
4. Share of profit of an AOP (People's Associates) amounting to Rs. 875,000. BPL holds 40% interest in the AOP. The gross turnover of the AOP during tax year 2021 amounted to Rs. 18,600,000

Cost of goods sold includes

1. Purchase of raw material of Rs. 3,500,000 from a grower of agricultural produce. No tax was deducted from payments made to the grower. BPL received prescribed certificate from the grower under Part IV of the Second Schedule.

Administrative and selling expenses include:

- Bad debt of Rs. 175,000 being the write off of a loan granted in 2019 to one of BPL's shareholders.
- Penalty of Rs. 75,000 against non-payment of sales tax in time. The amount was paid in cash.
- Rs. 5,150,000 spent on the construction of a library building for an educational institution established by the Local Government in Larkana under BPL's CSR scheme.

Financial charges include:

- Rs. 50,000 incurred on securing overdraft facilities for working capital requirement.

Other income includes:

- Rs. 1,800,000 on account of export of IT services, as defined in Part I of the Second Schedule, to a company in Sri Lanka. 70% of the export proceeds were brought into Pakistan in foreign exchange through normal banking channels whereas balance was adjusted against technical assistance received with regard to BPL's manufacturing processes. Tax deductible on receipt of technical assistance at the rate of 15% was paid by BPL and is included in administrative expenses. The debtor balance relating to the above technical assistance remained un-adjusted at the end of financial year.

- Rs. 2,600,000 in respect of unrealized gain arising on revaluation of foreign currency debtors.

- Dividend-in-specie received on 01 July 2020 in the form of 25,000 listed shares in Asif Limited (AL). The dividend income was recorded by BPL at Rs. 35 per share. Tax of Rs. 131,250 was collected from BPL in respect of dividend-in specie. On 01 March 2021 BPL sold 10,000 shares in AL at a negotiated price of Rs. 38 per share to a local institutional investor. The market value of these shares at the time of sale was Rs. 36 per share. The gain on sale amounting to Rs. 30,000 is included in other income.

- Rs. 300,000 earned on trading of borrowed shares. BPL borrowed 15,000 shares of a listed company from Asifa Limited (AL) for four months. The agreed value of the borrowed shares was Rs. 120 per share on which mark-up for four months was to be paid by BPL @ 10% per annum. BPL sold such borrowed shares at Rs. 125 per share and subsequently on the agreed date of return of shares, BPL re-purchased 15,000 shares at Rs. 105 per share. At the time of settlement, BPL also paid the mark up on borrowed shares as agreed. The mark-up is included in financial charges.

  i. For tax year 2021, BPL declared and paid 10% dividend to its shareholders.

  ii. BPL has filed an option u/s 154 to opt out of the final tax regime (FTR).

  iii. Tax paid by BPL u/s 147 amounted to Rs. 2,860,000.

  iv. Accounting depreciation charged during the year is the same as tax depreciation.

Required:

Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute, under the correct head of income, the total income, taxable income and net tax payable by or refundable to BPL for tax year 2021.

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Question # 6 **[6 marks]**

Insaf Limited (IL) is an unlisted public company engaged in the business of manufacture and sale of sugar. IL's income year ends on 30 September each year. In tax year 2021, following taxes were deducted/paid by IL:

	Rupees
Advance tax paid under section 147	20,500,000
Paid on import of machinery	2,250,000
Deducted by banks on profit on debt	250,000

IL filed its return of income for the tax year 2021 on the due date for filing of return with a gross tax liability of Rs. 32,500,000.

Required:

In view of the provisions of the Income Tax Ordinance, 2001 explain whether the advance tax paid quarterly by IL under section 147 could result in any further tax liability to the company, if yes, compute the amount of such additional tax liability.

Question # 7 **[10 marks]**

On 15-02-2020 Income Tax Department initiated proceedings against Jahangir Enterprises (Pvt) Ltd (JEL) for monitoring of withholding taxes. After examining the statement filed up to January 2010 and the information submitted by JEL, the commissioner has issued a show cause notice in respect of the following:

i. No tax was deducted on payment of Rs.7.5 million made to Mahmood & Co who is one of the main suppliers of packing material to JEL. Mahmood & Co, import and sells the imported product in local market in the same condition in which they are imported.
ii. JEL deducted withholding tax from the payment made to Asfand sons against supplies of various accessories, however, withholding tax was deducted on amount excluding sales tax of Rs.192,000.
iii. Rs.50,000 was paid to Fawad engineering as advance against services but no tax was deduced at the time of payment.
iv. JEL deducted tax @ 12% from payment of commission to its sales staff.

Required:

Draft reply to the commissioner's show-cause notice in the light of Income Tax Ordinance 2001.

Question # 8 **[8 marks]**

Mr. Sahil, a resident individual, owns a building in Clifton area of Karachi. On 1 October 2020, he rented out the building to Mr. Bari at an annual rent of Rs. 1,200,000. This amount included Rs. 15,000 per month for arranging two security guards for the building. Following expenses were incurred by Mr. Sahil on the building during the tax year 2021.

	Rupees
Repairs and renovation	35,000
Property tax	20,000
Insurance premium	10,000

Mr. Sahil also paid a salary of Rs. 4,000 per month to each of the two security guards at the building.

Required:

Under the provision of Income Tax Ordinance, 2001 calculate the taxable income of Mr. Sahil under both options available for the tax year 2021 and tax payable thereon. Comment on which option is suitable to Mr. Sahil.

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Question # 9 **[8 marks]**

Sunshine Limited (SL), an unlisted public company, is engaged in the manufacture and sale of Talc both locally and in international markets. The company has two overseas branches located in Korea and China. Following information has been extracted from company's records for the year ended 31 March 2021:

	Pakistan Operation		**Overseas Branches**	
	Local	**Export**	**Korea**	**China**
	-------------------- Amount in Rupees --------------------			
Sales	10,000,000	7,000,000	6,000,000	8,000,000
Profit before taxation	4,000,000	3,500,000	800,000	1,000,000
Taxes paid during the year	1,600,000	70,000	250,000	400,000

SL's net profit from local operation includes the following:

(i) Profit on debt amounting to Rs. 1,000,000 paid by SL to a Swiss bank against a short term loan obtained to meet the working capital requirements of its China branch.
(ii) Rs. 100,000 written back on account of excess provision for bad debts, made last year.
A donation of Rs. 600,000 deposited to Prime Minister's Flood Relief Fund has been erroneously excluded from the computation of income.

Required:
Under the provisions of Income Tax Ordinance, 2001 compute the taxable income and net tax payable / refundable for the tax year 2021.

Question # 10 **[8 marks]**

Moosa Limited (ML) is a resident company engaged in the business of construction for the past many years. In July 2019, the company was awarded a contract for the construction of roads in district Bahawal Nagar at a total contract price of Rs. 100,000,000. ML estimated to incur total cost of Rs. 60,000,000 on the project.

Work on the project started in September 2019 and was completed in November 2020. ML received following amounts after deduction of 7% withholding tax:

Months	Feb. 2020	May 2020	Sep. 2020	Dec. 2020
Amount received (Rs.)	12,622,000	15,760,000	35,000,000	30,118,000

The actual costs incurred by ML for the tax years 2020 and 2021 were Rs. 33,000,000 and Rs. 27,000,000 respectively.

Required:

Under the provisions of Income Tax Ordinance, 2001 calculate ML's taxable income and withholding tax credit, if any, for the tax years 2020 and 2021.