

**EXAMINER'S REPORT**  
**AA3 EXAMINATION - JANUARY 2016**  
**(AA35) CORPORATE AND PERSONAL TAXATION**

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Basic knowledge of the Corporate and Personal Tax Laws prevailing according to the Inland Revenue Act No.10 of 2006 and subsequent amendments up to the year of assessment 2014/2015 and NBT, ESC and VAT Acts were tested.

Overall, performance was not that satisfactory.

**Question No. 01** (05 marks)

**What Is Tested Briefly**

It was required to identify the resident status of Supertec (Pvt) Ltd. and Jayasuriya, referring to the scenario given.

**Performance:** Average.

**Reasons for unsatisfactory answers:**

**1 (a)** Common mistake that was seen is applying this rule of more than 183 days in relation to Supertec (Pvt) Ltd. which should have been applied in the case of an individual. If a candidate has mentioned that the overseas company is registered in Sri Lanka and the registered or primary office is in Sri Lanka or operations and financial controls are carried out in Sri Lanka, then it is a resident company. In the same manner if a candidate has assumed that the overseas company is registered or primary office is not in Sri Lanka or financial and operational controls are carried out not in Sri Lanka and overseas company has been incorporated outside Sri Lanka then it could be considered as a non-resident company as per the Companies Act No.07 of 2007.

**1 (b)** It was necessary to ascertain whether Jayasooriya has lived for more than 183 days in Sri Lanka in order to identify the residency status of him. But some candidates have mentioned the rule as more than 180 days.

**Question No. 02** (05 marks)

**What Is Tested Briefly**

It was required to explain the term "Child" for the purpose of the Inland Revenue Act No. 10 of 2006 and to identify the person to whom Nethmi's income to be aggregated.

**Performance:** Satisfactory.

**Reasons for unsatisfactory answers:**

**2 (a)** Most of the candidates have mentioned that to be a child, he/she should be under 18 years of old. However, most of the candidates have not mentioned that under the adoption law of the country, a child could be adopted. Further, for the purpose of the Act, married child, illegitimate child are not considered as a child. However, only a very few candidates have explained these points correctly.

**2 (b)** Most of the candidates have written that, since Mrs. Soysa has borne all the expenses of the child., Child's income should be aggregated to her. But that answer is incorrect as the year in which the divorced has occurred i.e. in June 2014, for the year of assessment 2014/2015, although the expenses has been borne by Mrs. Soysa, it should be aggregated to child's father, Mr. Soysa.

**Question No. 03** (05 marks)

**What Is Tested Briefly**

It was required to explain the chargeability of this payment for income tax of Perera based on the provisions of the Inland Revenue Act, referring to case laws in Sri Lanka.

**Performance:** Satisfactory

**Reasons for unsatisfactory answers:**

Most of the candidates have not mentioned the case "Craig Vs C.I.T."

This payment is not a part of employment income as it has been paid to Perera to undergo a heart surgery considering his long years of service at AB Ltd. Therefore it should be considered as a gift given by the company and not a bonus.

**Question No. 04** (05 marks)

**What Is Tested Briefly**

It is required to state the activities chargeable with NBT, according to the provisions of the Nation Building Tax Act.

**Performance:** Satisfactory

**Reasons for unsatisfactory answers:**

This question tested regarding the activities chargeable according to N.B.T. The correct answer would be,

- (1) Manufacturing activities.
- (2) Service activities.
- (3) Imports.
- (4) Whole sale & retail sales.

However, some candidates have not answered this question correctly. some have mentioned only the "Manufacturing Activities" as chargeable to NBT.

**Question No. 05** (10 marks)

**What Is Tested Briefly**

It was required to calculate divisible profit and tax payable by the partnership and to prepare the statement of profit distribution.

**Performance:** Average.

**Reasons for unsatisfactory answers:**

Common mistake that was seen when computing the divisible profits is that no adjustment has been done for depreciation by adding back the book depreciation and deducting the depreciation allowance. Further, under Section 13, any foreign currency earned as professional fees and remitted through a bank after deducting reasonable expenses is exempted from tax. But this exempted profit has not been adjusted when computing the income tax. Tax rate relevant for a partnership is 8% for the year of assessment 2014/2015, but some candidates have applied 10%. Partnership tax allowance applicable for the year of assessment 2014/2015 is Rs.1 million. But the previous tax allowance of Rs.600,000/- has been considered by number of candidates.

**Question No. 06** (10 marks)

**What Is Tested Briefly**

It was required to assess the balance amount of VAT payable and to state the due dates for the payment of VAT for the quarter ended 30<sup>th</sup> June 2015.

**Performance:** Average.

**Reasons for unsatisfactory answers:**

- (a) (1) When computing output VAT, the rate of 11% should be used for the quarter ended 30<sup>th</sup> June 2015. But fair number of candidates have applied 12% for the services provided to local clients (i.e. for 4,250,000\*12%) erroneously.
- (2) Further, for the services provided to non-resident foreign clients for payment in foreign currency should be taxed at zero rate. But some candidates have charged incorrectly 11% or 12% erroneously. Correct scenario should be as follows, US \$ 6,500 \* 141 \* 0% = Nil.
- (3) Sale of photo copy machine to a non VAT registered person for Rs.166,500/- contains VAT of Rs.166,500 \* 11/111 = 16,500. But some candidates have incorrectly mentioned Rs.18,315/- (166,500\*11%) as the VAT of this transaction.
- (4) When considering input VAT on office expenses the entire Rs.130,000/- should be considered. Though it is clearly mentioned in the question that this Rs.130,000/- is the 11% i.e. the input VAT amount, some candidates have incorrectly computed input VAT for that Rs.130,000/-. This clearly shows lack of understanding of candidates regarding the computation of VAT.
- (5) Input VAT on the repair cost of the vehicle used for travelling is disallowed. But most of the candidates have allowed it and considered it in their calculations.

(b) Due dates for the payment of VAT for the quarter ended 30.06.2015 are as follows:

Period	Due Dates
01 <sup>st</sup> April 2015 to 15 <sup>th</sup> April 2015	30 <sup>th</sup> April 2015
16 <sup>th</sup> April 2015 to 30 <sup>th</sup> April 2015	15 <sup>th</sup> May 2015
01 <sup>st</sup> May 2015 to 15 <sup>th</sup> May 2015	30 <sup>th</sup> May 2015
16 <sup>th</sup> May 2015 to 31 <sup>st</sup> May 2015	15 <sup>th</sup> June 2015
01 <sup>st</sup> June 2015 to 15 <sup>th</sup> June 2015	30 <sup>th</sup> June 2015
16 <sup>th</sup> June 2015 to 30 <sup>th</sup> June 2015	15 <sup>th</sup> July 2015

Very few candidates have given exact correct answer for this question.

**Question No. 07** (10 marks)

**What Is Tested Briefly**

It was required to state the,

- (a) Requirements of a valid income tax appeal. (04 marks)
- (b) Instances where Commissioner General of Inland Revenue may entertain a late appeal. (03 marks)
- (c) Next step on receipt of a valid appeal that will be taken by the Commissioner General of Inland Revenue in respect of such appeal. (03 marks)

**Performance:**

Answers for part (a) and (b) were fairly good as these questions were direct theory based questions from the IR Act. Majority of the candidates were able to obtain the maximum possible marks for the above 2 parts.

**Reasons for unsatisfactory answers:**

- Lack of knowledge of the theory based areas. Eg. Administrative Provisions.
- Write lengthy irrelevant answers rather than giving short answers with important points.
- Writing the questions as answers.
- Writing totally irrelevant answers.
- Repeating similar points again and again.

**Question No. 08** (25 marks)

**What Is Tested Briefly**

It was required to assess the Total Statutory Income, Assessable Income, Taxable Income, Gross Income Tax payable and Balance Tax payable.

**Performance:** Good.

**Reasons for unsatisfactory answers:**

- (1) When incorporating the company, legal charges incurred of Rs.235,000/- is an allowable expense. Though, share issue expenses incurred at the time of incorporating the company are allowed, some have incorrectly disallowed the same.
- (2) Legal expenses of Rs.128,000/- incurred for manipulation of custom duty is a disallowed expense. But some candidates have allowed the same.
- (3) Advertising: Cost of paper advertisement to recruit workers is a 100% allowed expense. 25% of the cost of advertising in electronic media, is to be disallowed. However, some candidates have disallowed 25% on the total advertising cost of Rs.475,000/.
- (4) Lease interest is a disallowable expense and loan interest is also disallowed when computing the adjusted profits, but under section 32 when computing the assessable income it could be deducted. Fewer number of candidates have done the above adjustment correctly.

(5) The correct treatment for lease rentals would be as follows:

Gross rentals paid  $7600 \times 9 = \text{Rs.}68,400/-$   
 Lease Allowance  $24 \times 7600 \times 25\% = \text{Rs } 45,600/-$   
 Whichever is lower  $= \text{Rs.}45,600/-$   
 $\therefore \text{Rs.}45,600/-$  should be allowed.

Some candidates have considered 20% as the lease allowance for laptop incorrectly. Some others have considered whichever is higher i.e. between gross lease and lease allowance as the lease allowance incorrectly.

(6) Qualified payments

Donation of Rs.100,000/- to Api Wenuwen Api is an allowable qualified payment and it should be added back when computing adjusted profit and should be deducted as a qualified payment prior to arriving at the taxable profit.

(7) Dep. allowance

Due to lack of understanding of rate of depreciation allowances for the year of assessment 2014/2015, various incorrect rates were applied by some candidates. However, the correct rates would have been as follows:

Category	Rate
Land	Not Applicable
Office equipment	33 1/3%
Lorry	20%
Furniture	20%
Computer equipment	25%
Computer Software developed in Sri Lanka	100%
Laptop computer leased	N/A

(8) Treasury bills

Gross	Notional Credit of 10%	Net
270,000/-	27,000/-	243,000/- (100*243,000/90) = 270000

Notional credit of Rs.27,000/- has not been computed correctly by majority of the candidates and Rs.243,000/- has been considered separately under the sources of income as it is. Further, Notional Credit of Rs.27,000/- has not been deducted in arriving at the balance tax payable, by some of the candidates though they have correctly computed it.

(9) Foreign travelling is a disallowed expense since the company is not existed in the previous year and hence the statutory income of the previous year is not available for the comparison.

(10) There were considerable number of candidates who have applied incorrect rates in computing the tax liability though the correct rate applicable is 28%.

The common mistake that were seen from the answers is that not mentioning the reason for allowing or disallowing a particular item.

**Question No. 09** (05 marks)

**What Is Tested Briefly**

It was required to assess the Taxable Income, Gross Income Tax payable and Balance Tax payable of an individual.

**Performance:** Good.

**Reasons for unsatisfactory answers:**

- (1) Some of the candidates have not considered the bonus received by Ratnayake in December 2014 into their tax computation.
- (2) As he has not maintained proper records on the usage of the Motor Bike, which was provided with the fuel, the value of the conveyance should have been computed as  $5,000 * 12 = \text{Rs.}60,000/-$ . Since Rs.50,000/- per month in lieu of a vehicle is exempted, it should not be taken into consideration as an income from employment. However, this adjustment has not been done correctly by majority.
- (3) Additional benefit of Rs.100,000/- on employment Income has not been deducted by majority.
- (4) Almost all the candidates have exempted the NAV of the house where he lives.
- (5) Rent income should have been computed as follows:

Gross rent	600,000
(-) rates paid	(27,000)
	573,000
(-) 25% of allowance on repair	(143,250)
net rent	429,750
<b>Comparison</b>	
Annual Value	135,000
(-) 25% of allowance	(33,750)
	<b>101,250</b>

∴ Net Rent > NAV, Rs.429,750/- should be considered as the Net Rent.

However, considerable number of candidates have not done this adjustment correctly.

- (6) Interest of FD for which WHT has been deducted, should added in arriving at the total statutory Income and it should be deducted in arriving at the Assessable income. This adjustment has not been correctly done by majority of the candidates.
- (7) Fewer number of candidates have deducted the capital repayment of housing loan as a qualifying payment, whereas the correct treatment would have been to not to deduct it.
- (8) Handful of candidates have forgotten to deduct the tax free allowance of Rs.500,000/- in arriving at the taxable income.
- (9) There were considerable number of candidates who have applied incorrect rates in computing the tax liability.
- (10) Only a few candidates have deducted the PAYE as a tax credit in arriving at the balance tax payable amount.

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**Hints to Improve Performance:**

- (1) Time allocation must be considered before start answering the question. Most of the candidates have ignored the weightage of these questions according to the new syllabus.
- (2) In order to improve these skills candidates must practice more past papers, read the study Pack and practice past papers of the equal examinations before sitting the examination. This also assists candidates to be thorough with the subject area and the scope of the syllabus.
- (3) Candidates should practice a method to analyze a question to understand the question. Some candidates had done this analysis while they are reading the question. This will help them to properly understand the question and select the correct format to present the answer. For an example, if the question expects them to prepare adjusted profit for taxation, they need two columns for additions and deductions from net profit before tax. Selecting the correct format will assist candidates to produce a clear and complete answer and reduce mistakes. This will help marking examiner also to give allocated marks to each point without any ambiguity.

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