

EXAMINER'S REPORT

AA3 EXAMINATION - JULY 2016

(AA35) CORPORATE AND PERSONAL TAXATION

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

Five Principles of taxation was tested.

Performance: Very poor.

Reasons for unsatisfactory answers:

Candidates have not devoted adequate attention to this area, though it is a very basic part of taxation. If candidates have used study texts properly, this question could have been correctly answered. Areas such as equity, progression, certainty, simplicity, stability, economic efficiency, continuity were not touched by considerable number of candidates when giving the answers.

Question No. 02 (05 marks)

What Is Tested Briefly

Activities Chargeable under the value added tax Act has been tested.

Performance: Very poor.

Reasons for unsatisfactory answers:

Most of the Candidates have not understood the question properly. Value Added Tax Act has not been correctly studied by the candidates.

Section 83 of the Value added tax Act identifies following activities as the activities chargeable with VAT:

- (1) Any activity carried on a Trade business , Profession or vocation other than in the course of employment or adventure or concern in the nature of trade.
- (2) Provision of facilities to its members or activities for a consideration and the payment of subscription, in the case of clubs ,Association or organizations

- (3) Any activities made in (1) & (2) above for commencement or cessation of any activity.
- (4) Hiring and leasing or renting of any movable or immovable property.

Other than the above activities any activity which involves exempt supplies, hobby activities, private transactions such as sale of vehicle occasionally, are not chargeable with VAT.

Question No. 03 (05 marks)

What Is Tested Briefly

Basic knowledge of the ESC rates prevailing as at 31.03.2015 and turnover that is liable for ESC and turnover not liable for ESC has been tested.

Performance: Average.

Reasons for unsatisfactory answers:

Outdated knowledge of candidates regarding recent amendments to ESC Act was the main reason for unsatisfactory answers. Candidates should be aware of ESC Act amendments carried out periodically. Sale of capital assets and interest income should be excluded from the total turnover when computing ESC. It is important to have an overall basic knowledge of ESC when answering the above question.

Question No. 04 (05 marks)

What Is Tested Briefly

How the case of Hayley Vs C.G.I.R. is applied according to the Inland Revenue Act No.10 of 2006 and subsequent amendments to the Act in the given practical situation.

Performance: Very poor.

Reasons for unsatisfactory answers:

Not remembering the facts of the decided cases and not applying the substance of these cases in to practical scenarios were the main reasons for the poor answers of majority of candidates.

There were only 8 decided cases outlined in the new syllabus. Hence candidates should be able to understand the above situation and should be able to apply the knowledge accordingly to build a good answer. Further under section 25, all outgoings are allowed if incurred in the production of income. Cash loss incurred in the Hayley Vs C.G.I.R. case which was to be used next day is pertaining to circulatory capital. As same the stocks destroyed due to floods in the given scenario is also a part of circulatory capital of inventory outgoing which could be deducted.

Question No. 05 (10 marks)

What Is Tested Briefly

It was required to calculate the divisible profit and Income tax liability of the partnership and to prepare the statement of distribution of profits and other income of the partners arising from the partnership.

Performance: Average.

Reasons for unsatisfactory answers:

It was noted that many candidates were not aware of the fact that the rate applicable for partnership is 8% and the allowance for partnership as Rs. 1 million for the year of assessment 2014/15.

Further capital allowance for equipment should be 33 1/3%. Practicing similar questions and up-to-date knowledge in respective area will secure adequate marks.

Question No. 06 (10 marks)

What Is Tested Briefly

Assessing the balance amount of VAT payable for the quarter ended 31st March 2015, for the Spicy World (Pvt) Ltd. has been tested.

Performance: Satisfactory.

Reasons for unsatisfactory answers:

Not having up-to-date knowledge on VAT Act was the main reason for unsatisfactory answers. For exports VAT is zero rated. For liable turnover, applicable VAT rate is 11% for the quarter ended 31st March 2015. It is required to mention that only 100% of output VAT is permitted to deduct as the input VAT inclusive of b/f input VAT amount. Suspended supplies should be taxed at 11% amounts to Rs.92,950/- which should be considered as an output VAT and SVAT credit voucher for Rs.92,950/- should be deducted in arriving at the balance VAT payable amount.

Question No. 07 (10 marks)

What Is Tested Briefly

Due date of filing the income tax return, benefits of submitting on or before the due date and action for non-compliance of filing of income tax return on time and the instances where the C.G.I.R. may reduce or wave off penalties in respect of non-submission of a return on the due date were tested.

Performance:

Not Satisfactory.

Reasons for unsatisfactory answers:

Lack of practical knowledge of the subject area was the main reason for unsatisfactory answers. It is expected that level 3 candidate should be aware that the income tax return for the year of assessment 2014/15 should be filed on or before 30th November 2015. Also, some candidates have wasted their time in writing lengthy irrelevant answers rather than giving short answers with important points.

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 of a resident company.

Performance: Good.

Reasons for unsatisfactory answers:

- (1) Cost of Production Manager's tour to India to study new production techniques should be allowed up to the limit of 2% of the business profit of the previous year. However, majority of the candidates have not understood this treatment and have either allowed or disallowed the full amount of Rs.265,000/-.
- (2) Cost of the paper advertisement to sell machinery should be treated as a disallowed expense whereas the cost of advertisements in foreign media should be treated as a 100% allowed expense as incurred for the promotion of exports. However, there were candidates who got confused with the correct treatment.
- (3) Although the Research and Development expenses should be treated as a 300% allowed expense, only a handful of candidates have made the correct treatment.
- (4) Royalty paid to the parent company should be deducted under section 25, but it is not allowed under Section 32 after 01.04.2014.
- (5) Depreciation allowance applicable for the new machinery acquired during the year is 50% as more than 60% of the proceeds of the company represented by exports. However, majority of the candidates have not performed this treatment properly.
- (6) Donations to the Ministry of Health to be treated as 100% allowable qualifying payment, whereas fewer numbers of candidates have not correctly treated for the same.
- (7) Taxable business loss brought forward from previous year of assessment 2013/14 could be deductible subject to a maximum of 35% of the current year Total statutory Income. However, there were considerable numbers of candidates who have deducted 35% of the carried forward business loss.
- (8) The income tax rate of 12% applicable for Export Company has not been applied by majority.

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 a resident individual.

Performance: Good.

Reasons for unsatisfactory answers:

- (1) Value of the conveyance, i.e, the Motor car with engine capacity of 2000cc provided by the employer should be considered as exempt benefit as the Rs.50,000/- per month for one vehicle is exempted from Income tax. However, considerable numbers of candidates have considered this benefit as taxable.
- (2) There were fewer number of candidates who have considered monthly rent of Rs.40,000/- instead of the monthly residence allowance of Rs.50,000/- in arriving at the benefit from employer provided residence.
- (3) Moreover, rent income from house rented has not been correctly computed by considerable number of candidates.
- (4) Although the interest on Minor's Savings Account needed to be aggregated with the Statutory Income of Mr. Ranasinghe, there were handful of candidates who have aggregated the value of the gift received by his son with Mr. Ranasinghe's Statutory Income.
- (5) Most of the candidates have forgotten to deduct the additional allowance of Rs.100,000/- from employment income of Mr. Ranasinghe other than the Tax free allowance of Rs.500,000/-.
- (6) Donations to "Api Wenuwen Api" Fund, an approved charity to be treated as 100% allowable qualifying payment, subject to lower of $\frac{1}{3}^{\text{rd}}$ of Assessable Income or Rs.75,000/- whichever is lower or the actual.
- (7) Interest paid on Personal Loan cannot be deducted under section 32, whereas considerable numbers of candidates have deducted the same in arriving at the Assessable Income.
- (8) There were considerable numbers of candidates who have applied incorrect rates in computing the tax liability.
- (9) 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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