

EXAMINER'S REPORT
FINAL EXAMINATION - JANUARY 2015
(58) Taxation

Question No. 01 - (Marks Allotted 35)

1.1. WHAT IS TESTED:

Basic knowledge of the Corporate Tax Law prevailing according to the Inland Revenue Act No.10 of 2006 and subsequent amendments up to year of assessment 2013/2014 were tested.

1.2. PERFORMANCES BRIEFLY:

It was moderate but not very satisfactory.

1.3. REASONS FOR UNSATISFACTORY ANSWERS:

1. DEPRECIATION ALLOWANCES:

- (a) Industrial Research of Rs.150,000/- payment made to a private institution 3 times the value i.e. Rs.450,000/- was allowed to **Good life (Pvt) Ltd.** But a lot of candidates had allowed only Rs.150,000/- yet others have allowed 2 times the value. Valuable marks were lost by the candidates due to this mistake. The correct adjustment for this should have been as follows:

	+	-
Add back	150,000	
3 times research value allowed (150,000/- x3)		450,000

- (b) Considerable number of candidates had used incorrect depreciation allowances rates and due to that they have lost valuable marks. For land there is no depreciation allowance. But this was not mentioned in the answer scripts. For Buildings constructed in 2009/2010, 6 2/3% is allowed. For the building whose construction completed in year of assessment 2011/2012 10% depreciation allowance was allowed. But some candidates have applied depreciation allowance of 10% for all the buildings. For furniture and fittings, 20% depreciation allowance rate to be used. But some candidates have used the depreciation allowance rate of 25% incorrectly. For office equipment and plant & machinery purchased after 01.04.2009, 12.5% depreciation allowances should be used and from Y/A 2011/2012 33 1/3% to be used. But number of candidates had used various other rates of depreciation allowances incorrectly to compute depreciation allowances for PPE.

Further, for computer hardware, depreciation allowance of 25% has been fully claimed for 4 years commencing from Y/A 2009/2010. This fact has not been mentioned by many candidates. For locally developed computer software, 100% depreciation allowance is used by many candidates. But few candidates have used incorrectly 25% depreciation allowance rate on computer software.

- (c) Majority of candidates have not correctly carried out adjustment regarding the replacement of machinery.

2. ALLOWABLE & DISALLOWABLE EXPENSES

(a) Gratuity

Provision is disallowed and gratuity paid is allowed. But some candidates have not stated the gratuity paid amount of Rs.875,000/- as allowed in the computation.

(b) Advertising

For TV commercials 25% of Rs.1,520,000/- = Rs.380,000/- is disallowed. Cost of paper notice of Rs.25,000/- is allowed. But some have disallowed 50% on cost of TV commercials incorrectly.

(c) Legal fees

Legal fees of Rs.52,000/- incurred on labour case is allowed, but some candidates have incorrectly disallowed the same.

(d) Fines

Rs.150,000/- paid as fines is a disallowed expenditure. But some have allowed the same.

(e) Donations

Donations to unapproved charity is disallowed. But some candidates have considered it as a qualifying payment incorrectly.

(f) Foreign Travelling

Foreign travelling cost of Rs.325,000/- for the inspection of machines in Malaysia is disallowed, as it is restricted to 2% of the previous year profit. But, some candidates have allowed the same.

(g) Income Tax

Income tax of Rs.236,000/- paid by the company on behalf of Senior Managers is disallowed when computing adjusted profits. But some candidates have allowed the same.

(h) General Provision for bad debts

Rs.675,000/- provision to be disallowed. But some candidates have allowed it incorrectly.

(i) Lease interest

It is disallowed and Rs.91,600/- should be added back. Though some candidates have mentioned that lease interest should be disallowed, they have not added back it to the adjusted profit computation.

(j) Overdraft

As this was incurred in the production of income, overdraft interest of Rs.245,000/- is allowed and no adjustment is required in the computation. But some candidates have disallowed this expense.

(k) Lease adjustment

Lease paid for the year $12 \times 68,000 = \text{Rs.}816,000/-$

Lease allowance $48 \times 68,000 \times 20\% = \text{Rs.}652,800/-$

Hence, lease allowable (whichever is lower) is Rs.652,800/-

Some candidates have calculated the gross lease for 11 months and compared it with the 1/5th restriction. Some candidates have incorrectly considered the higher figure among gross lease paid for the year and the 1/5th restriction as the lease allowance.

(l) Business loss B/fd

It was noted from the answers that majority have computed and claimed 35% of the B/fd business loss, instead of computing 35% of the Total Statutory Income, when setting off of the B/fd losses.

(m) Tax rates

As this company is engaged in the business of dairy farming, the applicable tax rate for the Y/A 2013/14 was 10%. However, majority of the candidates have considered the normal tax rate of 28% for the entire taxable income.

1.4. HINTS TO IMPROVE THE PERFORMANCE:

- Candidates must well prepared with the recent amendments of the Income tax law.
- They must apply the correct income tax rates.
- Income sources have to be identified properly.
- Candidates should familiar with the presenting format of the income tax computation .

Question No. 02 - (Marks Allotted 30)

2.1. WHAT IS TESTED:

The liability to income tax on the profit and income of a resident individual was tested.

Accordingly the following has been tested:

- Statutory income from each source of income.
- Total statutory income.
- Assessable income.
- Taxable income.
- Gross income tax payable.
- Balance income tax payable/refund due.

2.2. PERFORMANCES BRIEFLY:

The performance was not very satisfactory. However, majority scored less marks mainly for the computation of income from profession and rental income.

2.3. REASONS FOR UNSATISFACTORY ANSWERS:

1. It seems that the candidates were unaware of the difference between **income from employment** and the income from **trade, business, profession or vocation** of an individual.
2. Some were confused with the above two different sources of income and they tried to combine both the sources together and to arrive at the total figure as "income from employment".
3. Most of the candidates were unable to treat "Rates" correctly in arriving at the "net rent" from the "gross rent".
4. It seems that they were not clear about the difference of **NAV** and the "**Rating Assessment**" and ascertaining rating assessment from NAV.

5. As this question required candidates to compute item (a) - (g), some candidates have computed each source separately and have repeated the same workings when giving the full computation. Actually it is not required from the question and it is only required to show how you have arrived at a particular figure and to give a reference in doing the full computation.

Further, following mistakes were also noted:

- Capital payment of housing loan not mentioned.
- Travelling allowance has been considered as a liable income.
- Maximum amounts applicable for qualifying payments has not been considered.
- Wrong tax rates have been used.

2. 4. HINTS TO IMPROVE THE PERFORMANCE:

- Candidates should know how to analyze each source of income and how to present them.
- If any income is exempted candidates should give the reasons rather than just writing that it is exempted.
- They should apply the correct income tax rates applicable for Year of Assessment 2013/14.

Question No. 03 - (Marks Allotted 15)

3.1. WHAT IS TESTED

Computation of VAT payable for a quarter. This includes local sales, Zero rated supplies, Suspended supplies, lease rentals, etc.

3.2. PERFORMANCES BRIEFLY

This question contains 15 marks. Some of the candidates have not answered this question. Overall performance was not satisfactory.

3.3. REASONS FOR UNSATISFACTORY ANSWERS:

Vanamal (Pvt) Ltd.

Some candidates were not able to identify the relevant turnover and the output VAT at various rates. The correct position is as follows:

	Excluding VAT Output turnover (Rs.)	VAT rate	Output VAT (Rs.)
Sales to local market	12,200,000	12%	1,464,000
Direct exports	15,775,000	0%	Nil
Sales made to exporters as suspended supplies	10,625,000	12%	1,275,000
Sale of Machine	9,500,000	12%	1,140,000
	48,100,000		3,879,000

A common mistake that was seen is for exports 12% VAT was charged though it was zero rated. Though, sale proceed of Rs.10,640,000/- is inclusive of VAT, some candidates have incorrectly computed 12% VAT on the sale proceed of Rs.10,640,000/-.

Input VAT

Lack of understanding regarding the direct exports and the Suspended VAT proportion of turnover from the total turnover in order to apportion against the total allowable input VAT.

	<u>Input value</u>	<u>VAT rate</u>	<u>Input VAT</u>
1. Imports	4,326,459	12%	519,175
2. Local purchases	13,210,000	12%	1,585,200
3. Lease rent car used		Disallowed	<u>64,800</u>
Total Allowable Input VAT =			<u>2,104,375</u>

Direct export turnover + suspended turnover/total turnover*total allowable input VAT

$$(15,775,000 + 10,625,000)/48,100,000 * 2,104,375 = 1,155,000$$
$$\text{Balance VAT up to a limit of 100\% of output VAT or actually incurred} = \underline{949,375}$$
$$\mathbf{\underline{2,104,375}}$$

Very few candidates have done this adjustment correctly, thus others lost valuable marks.

Total output VAT	3,879,000
Ded. Input VAT	<u>2,104,375</u>
BALANCE	1,774,625

Deduct SVAT

SVAT Credit vouchers	<u>1,275,000</u>
Net bal. VAT due	<u>499,625</u>

Some candidates have not deducted the SVAT credit vouchers thus lost marks.

3.4. HINTS TO IMPROVE THE PERFORMANCE

- Candidates should practice VAT related questions.
- Candidates should apply the correct percentages.
- Candidates should know how to present the answer giving special attention to the quarterly VAT returns.

Question No. 04 - (Marks Allotted 08)

4.1. WHAT IS TESTED:

Calculation of ESC liability and knowledge of due dates for the payment of ESC of each quarter were tested.

4.2. PERFORMANCES BRIEFLY:

Overall performance was satisfactory.

4.3. REASONS FOR UNSATISFACTORY ANSWERS

Soorya (Pvt) Ltd.

ESC threshold for Y/A 2013/2014 was Rs.50 Million per quarter. The rate of ESC for lighting Equipment was 0.25%. But some candidates have mechanically computed ESC for all 4 quarters applying the same rate. For the q/e 30.09.2013 though the turnover was Rs.39,600,000/- and for the quarter ended 31.12.2013 turnover was only Rs.24,500,250/- which were less than the threshold turnover of Rs.50 Million, some candidates have computed ESC thereon. Valuable marks were lost due to this reason.

Correct ESC payment due dates are as follows:

ESC Payment Dates:	Q/E 30 th June 2013	Due date 20 th July 2013
	Q/E 30 th Sept 2013	Due date 20 th October 2013
	Q/E 31 st Dec 2013	Due date 20 th January 2014
	Q/E 31 st March 2014	Due date 20 th April 2014

Some candidates have incorrectly shown payment due dates as 15th of each subsequent month and yet others as 30th of each subsequent month incorrectly.

4.4. HINTS TO IMPROVE THE PERFORMANCE:

- Candidates should understand the ESC thresholds.
- Practice related questions.
- Candidates should understand the due dates of payment of ESC.

Question No. 05 - (Marks Allotted 12)

5.1. WHAT IS TESTED

This question was tested the employer's liability in the operation of PAYE system and the applicable tax rates on the directors remuneration when those are not included in the payroll prepared for PAYE purposes. Further, it required candidates to name two persons who can act as authorized representatives under the Inland Revenue Act.

5.2. PERFORMANCE BRIEFLY

Only a few has given the correct answer. Majority have given answers on general terms, without referring to Inland Revenue Act.

5.3. REASONS FOR UNSATISFACTORY ANSWERS

The question on duties of employer on PAYE system has not been answered correctly by many candidates.

Though there were number of points to give under this, candidates have not mentioned those. Following are some of the points which could have been given under this question:

- Submit the PAYE annual return of 31st March by 30th April.
- T-10 certificate has to be issued every year on or before 30th April after completing the financial year as at 31st March.
- Previous month PAYE payments to be settled on or before 15th of next month through the bank.
- All payee documents to be kept safely for the inspection of the officers of IRD as and when required.

When the Directors are not included in the payroll prepared for PAYE purposes, applicable rate of tax has been tested from this question. However, candidates have given various incorrect rates and limits, though the correct answer is 10%, when the remuneration is less than Rs.25,000/- and 16%, when the remuneration is more than Rs.25,000/-.

5(b) A member of the Institute of chartered accountants, AAT members with 10 years' post qualifying experience, Relative of the taxpayer, director of a company could be an authorized representative. But some candidates have written Auditor General, Commissioner General of Inland Revenue as authorized representatives erroneously.

5.4. HINTS TO IMPROVE THE PERFORMANCE

- Candidates should look in to the practical aspect of PAYE procedure.
- They must study the rates applicable for Directors salaries & the lower and the upper limits applicable.

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General Comments:

- 1. Students should know the changes in tax law.**
- 2. Should read and understand properly the contents of the administrative provisions.**
- 3. Should closely work in application of administrative provisions.**
- 4. Generally candidates tend to cover certain portion of the syllabus especially under tax administration, and write “Umbrella answers”, i.e., what is known to them rather than answering the questions set. Tax questions are specific and therefore need specific answers. Filling pages will not be secured marks. Candidates should keep that in mind.**

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