

**EXAMINER'S REPORT**  
**AA2 EXAMINATION - JULY 2015**  
**(AA24) 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 2013/2014 and NBT, ESC and VAT Acts were tested.

Overall, performance was not that satisfactory.

**Question No. 01** - (Marks Allotted 20)

This question consisted of 10 OTQ's for 20 marks. Almost all the candidates had attempted this question. However, the performance was not that satisfactory and the examples are given below:

- **Q. No. 1.2** required candidates to compute the income tax liability of **Silva** for the year of assessment 2013/14. Though, this was a simple question, most of the candidates have gone wrong in arriving at the correct answer.
- **Q. No. 1.6** required candidates to compute the ESC payable by **Sun Ray PLC** for the quarter ended 31<sup>st</sup> March 2014. For this question, most of the candidates have mistakenly selected the answer (4) thinking that ESC is also exempt during the period of 5 years tax holiday without applying 0.25% to the given turnover which is the correct ESC rate that should be applied for income tax exempted companies.

**Question No. 02** - (Marks Allotted 05)

This question was set to test the knowledge of candidates regarding the depreciation allowance applicable for different classes of assets. Majority of the candidates have attempted and scored well for this question. However, least number of candidates have mistakenly applied 33 1/3% for high-tech machineries, though the correct rate that would have been applied is 50%.

Further, some candidates have not mentioned the reason for not considering the photocopy machine obtained under finance lease for the calculation of depreciation allowance.

Fewer number of candidates had considered photocopy machine for their depreciation allowance calculation.

**Question No. 03** - (Marks Allotted 05)

This question required candidates to assess the statutory income from employment of **Maliyedda** for the Year of Assessment 2013/14 and to state the reasons for not considering certain income (if any) in their computation. From the answers given for this question, it was noted that majority of the candidates have considered the travelling allowance of Rs.40,000/- per month in the computation of Employment Income, though it should have been considered as an exempt benefit for employment income since travelling allowance is exempt up to Rs.50,000/- per month.

Also 50% of his telephone bills needed to be disallowed in this computation, however, majority have mistakenly included the entire bill amount of Rs. 64,500/- to their computation.

**Question No. 04** - (Marks Allotted 05)

This question required candidates to identify the due dates for the payment of income tax for the Year of Assessment 2013/14 under the self-assessment scheme and to state the minimum payment payable for each quarter. Considerable number of candidates have gone wrong in identifying those due dates and they lost some marks which would have been scored very easily. However, majority of the candidates have correctly computed the minimum tax payable for each quarter and scored marks easily.

**Question No. 05** - (Marks Allotted 05)

This question required candidates to access the balance NBT payable for the quarter ended 31<sup>st</sup> December 2014 by **Busy Bees (Pvt) Ltd.** Though, the correct NBT rate applicable for manufacturing company was 2%, some have mistakenly applied 1% which is applicable for wholesale & retail of NBT on sales.

Further, considerable number of candidates has deducted NBT on maintenance expenses in arriving at the balance NBT payable, though it is not allowed to deduct from a manufacturing company.

**Question No. 06** - (Marks Allotted 05)

This question required candidates to state the meaning of "Time of Supply" in respect of goods, according to the provisions of VAT Act. Considerable number of candidates have correctly defined the same and scored marks very easily. However, there were some candidates who have just written unnecessary things without knowing the correct meaning of the same and without referring to the VAT Act.

Some other candidates had scored only a part of the marks allocated due to provision of incomplete answers.

**Question No. 07** - (Marks Allotted 10)

This question was set to test the knowledge of candidates regarding assessment of statutory Income of a business for tax purposes for the Year of Assessment 2013/14. Some of the mistakes identified from the answers given to this question are as follows:

- Though, the correct depreciation allowance rate applicable for imported software is 25%, majority of the candidates have mistakenly applied 100% which was the rate applicable for locally developed software.
- Considerable number of candidates have mistakenly applied 33 1/3% for computers, instead of the correct depreciation rate of 25%.
- Majority of the candidates have not done the rent adjustment correctly. Though, the correct adjustment is to add the prepaid rent amount of Rs.15,000/- and the lump-sum payment of Rs.60,000/- to the profit and deduct the allowable portion of lump-sum payment from the profit, majority of the candidates have not done this adjustment correctly.
- Though, it is required to deduct interest income from the profit to arrive at the adjusted profit for tax purposes, considerable number of candidates have not deducted this in their computation.

**Question No. 08** - (Marks Allotted 10)

From this question it was expected to assess the taxable income of **Perera** for the Year of Assessment 2013/14. Considerable number of candidates have scored very good marks for this question. However, some candidates have gone wrong in the following areas:

(1) Monthly travelling allowance of Rs.70,000/- in lieu of a vehicle:

This is exempt up to Rs.50,000/- per month, i.e. for the annum Rs.600,000/- should be removed from the employment income of **Perera**. However, majority of the candidates have considered entire Rs.840,000/- as the travelling benefit.

(2) Additional allowance of Rs. 100,000/- deductible from employees:

However, considerable number of candidates have not considered this.

(3) House provided by the company:

Higher value of gross rent paid by the employer or rental value should be considered as the benefit from employment. However, it is limited to Rs.180,000/-. This has not been done correctly by majority of the candidates.

(4) Rental income of the owned house:

Net rent of Rs.189,000/- should be compared with the NAV of Rs.90,000/- and whichever is highest should be considered as the Income from property. This is also another area where majority of the candidates made mistakes.

(5) Deduction of qualifying payments:

Life insurance premium of Rs.86,000/- and donation amounting to Rs.50,000/- can be deducted as qualifying payments. However, it should be noted that total statutory income consists of Rs.2,000,000/- from employment income & Rs.189,000/- from other income and we have already deducted housing loan interest of Rs.125,000/- from total statutory income as deductions under section 32. So the remaining statutory income available for us to deduct the qualifying payments is Rs.64,000/-. i.e. [Rs.189,000/- – Rs.125,000/- = Rs. 64,000/-] as no deduction is permitted against Employment Income. Therefore, the maximum that we can claim against statutory income as qualifying payments is Rs.64,000/-.

However, only a handful of candidates have done this adjustment correctly. All others have deducted (Rs.86,000/- + Rs.50,000/-) Rs.136,000/- as qualifying payments.

**Question No. 09** - (Marks Allotted 10)

This question required candidates to compute the divisible profit, income tax liability of the partnership and income from business of each partner. Most of the candidates have well performed this question. However, following mistakes were observed:

- Though the salaries paid to partners should be added back in computing divisible profit, some have not added back the same.
- Amount paid to daughter of **Mrs. Fonseka** for the preparation of accounts of the partnership is deductible in computing divisible profits. However, some have added back it.
- Also, rent paid to **Mrs. Perera** is deductible, but some have added back it to their calculations.

- Further, tax free allowance applicable for a partnership is Rs.1,000,000/- whereas, majority of the candidates have deducted Rs.600,000/- as tax free allowance which was the amount before the amendments of the Act.
- Also, the income tax rate applicable for a partnership is 8%. However, majority of the candidates have applied 10% instead.

**Question No. 10** - (Marks Allotted 25)

This question tested computation of income tax liability and dividend tax for an export company.

The performance of candidates was satisfactory but some had poorly answered due to lack of knowledge in basic principals and lack of experience in answering this type of questions.

Lack of understanding of the basic concepts and lack of understanding of the detail presentation were the major reasons for obtaining lower marks for this question. Technical knowledge of the candidates were very poor. Some were not familiar with the formats and headings. However, a large number of candidates were aware of the presentation of tax computation and build up the answers in compliance with those requirements.

Few candidates had attempted the question with a plan and accordingly built up the answer correctly. They had selected the correct format and presented the answer appropriately. They could avoid double work and managed their time effectively. They had presented relevant workings to the extent the examiner could give marks to the correct figure.

Staff welfare expenses – Majority of the candidates have done correct adjustment i.e. disallowed the same and added back in the calculation.

Provision for gratuity – A considerable number of candidates have adjusted correctly the provision and payment of gratuity.

Legal fees – Legal expenses incurred in connection with recovery of bad debts should be allowed, however, some candidates have disallowed the same.

Donations – Some of the candidates have not read the question carefully. Though there were two conditions to consider a donation as a qualifying payment, majority of the candidates were not able to understand that fact and instead they have treated the entire Rs.125,000/- as qualifying payments.

To consider a donation as a qualifying payment it should be made by money to a charity which is established for the provision of institutionalized care for the sick or needy.

A considerable number of candidates were unaware of the fact that the donations made to government should be treated as qualifying payments. However, only a handful of candidates have done this adjustment correctly.

Advertising - Most of the candidates had correctly adjusted foreign and local advertising for adjusted profit. However, some candidates have ignored the company's business (exporting) and disallowed all foreign advertising. Also some candidates have computed 25% of disallowed portion based on the foreign advertising expenses.

Provision for Bad and Doubtful Debts – Bad debts actually incurred during the year should be allowed. It was given in the question that Panda Enterprises is a bankrupt customer. It was an allowable expense. However, some candidates had disallowed the same. In addition, some candidates had ignored the following:

*“Bad debts written off and claimed for tax when recovered subsequently and any excess provision for doubtful debts should be treated as income”*

Therefore, no need to make any adjustment when calculating adjusted profit for tax purposes. However, some candidates have done this adjustment correctly as expected.

Finance Lease – Some of the candidates had done this finance lease adjustment incorrectly.

For the photocopy machine purchased under finance lease agreement, deduction can be made based on the lease rentals paid during the year of assessment as follows:

Up to 1/5<sup>th</sup> of the total rental payable as per the agreement. The excess over these limits will be disallowed. However, some candidates have mistakenly applied 1/4<sup>th</sup> (for IT equipment) of it.

Disposal of Assets – This was a simple and straight forward adjustment. If candidates had applied correct format and capital allowance rate they could have easily scored marks.

Eg:-

	Rs.	Rs.
Sales		120,000
(-) Tax WDV		
Cost	450,000	
(-) Capital All. Claimed (450,000 X 12.5% X 4 years)	225,000	(225,000)
Profit / (Loss) on disposal for the tax purpose		(105,000)

Some candidates applied different rates for each of the years subject to IRD amendments and incorrect rates for claiming capital allowance.

Tax loss – the aggregate of adjusted loss for any year of assessment and the tax loss brought forward can be set off against the total statutory income of that year in arriving at the assessable income up to an extent of 35% of the total statutory income in excess of the aggregate of the statutory income from sources on which final tax has been deducted. The amount which not set off can be carried forward to the subsequent years of assessment until fully set off.

The correct adjustment would have made as follows:

Loss BF from the YA 2012/13	3,223,500	
Less: Maximum claimable upto 35% of TSI	<u>(2,986,942)</u>	(8,534,120 x 35%)
Loss CF to 2014/15	<u>236,558</u>	

Majority of the candidates failed to give above correct presentation in their tax computation. Marks had been allocated for deduction of 35% of statutory income and loss CF to 2014/15. Some candidates applied 35% deduction based on the loss BF from the YA 2012/13. i.e. 35% from 3,223,500.

Tax Rate – Candidates should have understood that it was the adjusted profit from a business of export (statutory income) and it should be taxed at the concessionary rate. The applicable tax rates for the YA 2013/14 were 10% or 12%. However, majority of the candidates have applied the normal rate of 28%. In addition some candidates were unable to identify the difference between company taxation and personal taxation. They have applied individual tax rates for this question.

#### **Common Mistakes Noted:**

- Some adjustments had been made without workings, when the answer is incorrect there was no way to giving pro-rata marks for any correct parts of the adjustments.
- Untidy workings and illegible hand writing.
- Failure to update themselves with the latest amendments to the Inland Revenue Act.
- Candidates had wasted time by repeating the same adjustment over and over again.
- Some candidates had lack of knowledge in sections 25 and 26 of the IRD Act making additions and deductions in arriving at the adjusted profit for tax purpose.

**Hit to Improve Performance:**

1. Time allocation must be considered before start answering the question. Most of the candidates have ignored the weightage of this question according to the new syllabus. The weight was maximum 30% of total marks.
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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