

EXAMINER'S REPORT

Level III EXAMINATION - JULY 2024

(304) CORPORATE & PERSONAL TAXATION

Question No. 01**Part (a)****What was tested?**

This question was tested the residency status under Section 69 of the Inland Revenue Act No. 24 of 2017 of 3 different individuals.

According to the Section 69 (1) of the Act, an individual shall be a resident in Sri Lanka for a year of assessment if such individual,

- a) resides in Sri Lanka;
- b) is present in Sri Lanka during the year and that presence falls within a period or periods amounting in aggregate to 183 days or more in any 12 month period that commences or ends during the year;
- c) is an employee or an official of the Government of Sri Lanka and his spouse is posted abroad during the year; or
- d) is an individual who is employed on a Sri Lanka ship, within the meaning of the Merchant Shipping Act, during the period the individual is so employed.

Observations:

- a) Almost all candidates attempted the question.
- b) The majority applied the 183 day rule for **Ravi**, (1st sub question) concerning employment on a Sri Lankan ship, and correctly evaluated **Sarah's** (3rd sub question) residency status, considering her role at the UK High Commission.
- c) However, many students have provided incomplete answers by mentioning that the given 3 individuals were taxable or not taxable without explaining their residence status.
- d) Further, some candidates have lack of understanding regarding the residence rule as they have incorrectly mentioned the number of days required to be considered a resident in Sri Lanka.
- e) Also, certain candidates have identified **Ravi** (1st sub question) as a resident of Sri Lanka, but failed to mention that he works in a Sri Lankan ship. However, they have correctly identified his residency status.

Performance: The performances were in a satisfactory level.

Question No. 02

Part (a)

What was tested?

This part was tested the fundamental knowledge of Social Security Contribution Levy (SSCL), which was payable under Social Security Contribution Levy Act No. 25 of 2022 by every taxable person (individual or entity includes a body of persons corporate or unincorporated, an executor, non- governmental organization and charitable institution) who;

- a) Imports any article,
- b) Carries on the business of manufacture of any article,
- c) Carries on the business of providing a service of any description, or
- d) Carries on the business of wholesale or retail sale of any article including importation and sale of such article (other than a sale by the manufacturer of that article being a manufacture to whom item number (b) applies).

Observations:

- (1) Most of the candidates have failed to identify two taxable persons under SSCL Act.
- (2) Certain candidates have mentioned irrelevant answers such as disable people, people in army forces, retired people etc.
- (3) Further, most of the candidates incorrectly mentioned that sweet food manufacturers as a liable party under SSCL Act.

Performance: The performances were in a satisfactory level.

Part (b)

What was tested?

This part of the question was tested the knowledge on calculating SSCL liability of an entity, which was manufactured sweet food for the local market.

Observations

- a) Many candidates have used an incorrect SSCL rates instead of the correct 2.5%, when calculating the SSCL liability.
- b) Also, most of the candidates have applied 2.5% rate on the total turnover instead of charging 85% of total turnover when computing the SSCL liability.

Performance: The performances were in a satisfactory level.

Question No. 03

What was tested?

This question was based on the case law that emerged from the judgment of **Ram Iswara vs. CIR (3 CTC 184)**. The Assessee was a Proctor and his wife entered into an agreement with a landlord, Mrs. Thambayh to purchase her land of 433 perches on Alexandra Place, which was very close to St. Briget's Convent for Rs. 450,000. She has paid a forfeitable deposit of Rs. 45,000 and soon after the agreement they blocked the land in to 14 lots. Thereafter, one lot was reconvened to Mrs. Thambayh and two lots comprising 70 perches and another two lots covering the road reservations were transferred to the Assessee's wife. The balance nine lots were sold to others and earned a profit of Rs. 66,331 and paid only an amount of Rs. 15,275 for the 70 perches lots, which were worth of Rs. 87,040.

The Board of Review rejected the Assessee's claim that the dominant interest to live near the school to facilitate the children's education. Finally, the Supreme Court upheld the Board of Review's rejection of the Assessee's contention that the dominant interest to live near St. Bridget's Convent was to facilitate the children's education.

The fact of the given case is very similar to the decided case. Hence, the profit earned by Sarath is liable for Income Tax. The following fact must be taken into consideration in this regard.

- a) The Assessee has no money to pay for the land.
- b) The transaction was to conduct within a short time period.
- c) There was certain preparation for the transaction.
- d) Within a short time period the Assessee has earned a considerable profit.

Observations:

- a) Most of candidates have not understood how to apply the facts of a given question to a decided case law.
- b) Even though the question was required to answer with reference to the decided case, the most of candidates were failed to fulfill the requirement of the question itself.
- c) The majority of candidates have not adequately described the given case.
- d) Some of the candidates have identified the profit earned from this transaction, but it has been categorized as a capital gain.
- e) Further, many candidates have misunderstood facts of the given case by refereeing to some similar cases.
- f) Many candidates simply repeated the question rather than providing the substantive answer, and some candidates have written long paragraphs and question repeatedly, but the important points that should be included in the answer were completely missing from the answer.
- g) Certain candidates have concluded that the particular profit is taxable without proper justification or explanation.

Performance: The case law knowledge of the candidates was not in a satisfactory level.

Question No. 04

Part (a)

What was tested?

This question was tested the fundamental knowledge of Capital Gain Tax (CGT), which is charged under Section 7 (2) (b) of the Act. The transactions included gain from disposing,

- a) Permanent resident constructed,
- b) Office building, and
- c) Rented out building

Accordingly, gain from disposing the permanent resident is exempted from CGT, whereas gain from disposing office building is not subjected to CGT as such asset is a depreciable asset. The rented out building was subject to 10% CGT.

Observations:

- a) Most of the candidates have incorrectly calculated the CGT for the residence house constructed.
- b) Further, many candidates have failed to identify the office building as a depreciable asset and have calculated the CGT for the same.
- c) Some candidates have calculated capital gain for the rented building also.
- d) In few instances, some candidates have used 30% rate to calculate the CGT for the rented building.
- e) In most instances, candidates have calculated the capital gain by adding together the costs of three properties and their considerations received also together when calculating the capital gain.

Performance: The overall knowledge on CGT was poor.

Question No. 05

What was tested?

This question was required to calculate the balance Value Added Tax (VAT) payable/ (over paid) for the quarter ended 31.03.2024 by an entity, which was engaged in buying and selling textiles in the local market by consider the standard VAT rate as 18%.

Observation:

- a) Majority of candidates attempted the question, they have scored a higher marks.
- b) Few candidates have still answered the question using ledger account mode by disregarding the correct format of the VAT return.
- c) Certain candidates have arrived at the correct answer without following all the steps outlined in the marking scheme. In such cases, Marking Examiners were unable to allocate full marks

- d) The majority of candidates have incorrectly treated locally manufactured handloom textile as taxable, even though it is exempt under recent amendments. This confusion has been taken place due the word "textile."
- e) The most candidates have incorrectly claimed the transport cost, which was incurred on locally manufactured handloom textiles as input tax. This indicates a lack of understanding regarding the exemption and how to apportion general expenses to calculate the allowable portion for deduction. Only a few candidates computed this adjustment correctly.
- f) Many candidates have failed to identify disallowable expenses, such as repairs to a motor car used by the Chief Executive Officer. Some are included in input tax but are not explicitly stated as disallowed. Additionally, some are erroneously mentioned as exempt.
- g) The excess input tax brought forward from the previous quarter and installment payment were deducted by the majority of candidates.
- h) The knowledge pertaining to input-output mechanism of VAT was understood by the majority.

Performance: The knowledge pertaining to VAT was good.

Question No. 06

What was tested?

This question was tested the fundamental knowledge on partnership taxation in terms of Section 53 to 56 to the Act. The question was required to calculate the Income Tax payable by a partnership for the Y/A 2023/24, which included,

- a) Partners' salaries,
- b) Bookkeeping fees to partner's sister,
- c) Interest on loan provided by a partner,
- d) Office rent paid to a partner, and
- e) Donation made to the National Hospital in Colombo.

Observation:

- a) Majority of candidates have attempted the question, and they secured a higher mark allocated to the question.
- b) Many candidates are consistently confused by business profit adjustments. They often add income that should be deducted and deducted expenses that should be added back to the profit.
- c) Most of candidates did not add back donations to the accounting profit but incorrectly deducted them as qualifying payments.
- d) A significant number of candidates made errors when adjusting loan interest provided by partners to the business.

- e) Many candidates were unaware of where to indicate correctly partnership allowances.
- f) Partner's salary have correctly added back to the accounting profit when arriving at the business profit of the partnership by the majority.
- g) However, some candidate forgot to claimed donation under qualifying payments and relief in arriving at Taxable Income.
- h) Taxing first Rs.1,000,000/- at 0% and balance at 6% were correctly done by many candidates. However, some candidates were not updated with tax rates because of some candidates have used progressive rates and company tax rate 30% to tax the partnership.
- a) Some candidates have incorrectly claimed Rs.1,000,000/- as partnership allowance without taxing at 0%.

Performance: The performances in relation to partnership taxation were good.

Question No. 07

What was tested?

This question was tested the fundamental knowledge in relation to tax administration, which included return submission, administrative review (appeal), and refund.

Observation:

- a) A very few number of candidates have fully answered this question.
- b) Most of candidates have failed to answer the due date for filling the Income Tax return despite this question being tested in a previous examination as well.
- c) Many candidates were unaware of the proper steps for requesting an "administrative review" and misunderstood it with an appeal hearing.
- d) Majority of candidates did not attempt this question and shown a lack in knowledge of the refund claim procedure and the time frame that is associated with refund procedure.

Performance: The performances in relation to tax administration was very poor.

Question No. 08

What was tested?

The fundamental knowledge on corporate taxation for the Y/A 2023/24 was tested by this question. Accordingly, the question was required to,

- a) Compute the Assessable Income, Taxable Income, Gross Income Tax payable, and balance tax payable by a resident company, which was engaged in manufacturing herbal products for the export market.
- b) To decide the Income Tax rate for a company is engaged in the business of manufacturing and export.
- c) To evaluate the practical aspect of applying general deductions (Section 10), main deductions (Section 11), and specific deductions (Section 12 to 19) of the act in ascertaining the business profit.

Observations:

(1) Average marks secured:

Almost all candidates attempted the question, and majority of candidates have secured a mark above average mark.

(2) Presentation format:

The presentation and identification of statutory contents of the corporate Income Tax computation have been understood by the most of candidates. However, few candidates who are still experiencing difficulties to keep up with statutory contents and presentation of corporate Income Tax computation.

(3) Other income:

The majority has eliminated the interest income, dividend income, and profit from disposal of fixed assets as separate sources of income when arriving at the business income.

(4) Book depreciation, asset disposal and capital allowances:

Book depreciation has been added back to the accounting profit by almost all candidates. Further, the majority have applied the correct rates of 5 years to claim capital allowances for motor lorries, plant and machinery, office equipment, and computers, which were purchased after Y/A 2018/19. Building, which was purchased during 2016/17 was subject to 10% capital allowance, but the most of candidate have incorrectly applied 20%, which is applicable at present.

Majority of candidates were properly identified and calculated assessable charges on disposal of machinery and added back to the accounting profit. Even though, some candidates have correctly calculated the assessable charges, same amount was not added to the accounting profit in arriving at the Assessable Income from business.

(5) Disallowable expenses:

Provision for gratuity, donation, and entertainment expenses have been correctly added back to the accounting profit by the majority. But, claiming finance cost for loan on the basis of stated capital and equity was very poor. Only very few candidates have properly calculated the tax treatment of finance expenses, and disallowable portion added back to the accounting profit.

(6) Allowable expenses:

Payment of gratuity was claimed by the majority.

(7) Investment income:

Interest from fixed deposit was correctly treated as investment income by many candidates. The dividend income out of dividend received has not been exempted by many candidates. However, some candidates have erroneously included the profit on disposal of vehicle in investment income.

(8) Qualifying payments and reliefs:

The donation made to the government in kind have fully claimed by many candidates. But, donation to a past employee incorrectly claimed by certain candidates.

(9) Identification of tax rate:

Identifying the correct tax rate of 30% was done by the majority. However, few candidates have still applied the individual progressive rates (6% to 36%) to tax a company.

(10) Identification of tax credit:

Quarterly installment payment was claimed as a tax credit by the majority. However, withholding tax on interest was not claimed by many candidates.

Performance: The overall performances were good.

Question No. 09

What was tested?

This question was required to ascertain personal Income Tax for the Y/A 2023/24 of a resident individual who worked as a Senior Tax Manager. The sources of income included income from employment, business, and investment.

Observations:

The question was attempted by almost all candidates, and the fundamental knowledge of candidates pertaining to the individual taxation was in a satisfactory level. Majority of candidates have secured marks above average level. The observations are listed below:

(a) Employment income:

- (1) The majority of candidates have included the gross salary in the employment income. However, some candidates have considered only monthly salary for their computation.
- (2) Rs.40,000/- has been taken as vehicle benefit by many candidates.
- (3) Residence benefit and 50% of mobile bill reimbursement have included in the employment by the most of candidates.
- (4) Considerable number of candidates have incorrectly taken into account the medical bill reimbursement as employment income.

(b) Business income:

- (1) Staff salary and professional charges were treated as allowable expenditure by many candidates in arriving at profit from business.
- (2) Adding back depreciation to book profit and claiming capital allowance on furniture were correctly done by many candidates.
- (3) Rent related to private residence has been added back to book profit as disallowable expenditure by the majority.

(c) Investment income:

- (1) Gross interest on fixed deposit and treasury bills have considered as investment income by the most of candidates.
- (2) Gain from sale of quoted public company shares and dividend income (net) received from the quoted public companies erroneously taken as investment income by considerable number of candidates.

(d) Common omissions and mistakes:

- (1) Rs.1,200,000/- was not claimed as personal relief by many candidates.
- (2) Rent relief, 25% of gross rent was claimed by many candidates in arriving at Taxable Income.
- (3) Certain candidates incorrectly claimed tax credits from Taxable Income directly without computing the tax liability.
- (4) Certain candidates have applied progressive rate ranging from 6% to 60%, and some candidates have combined progressive rates with 30% for business profit.
- (5) Advanced Personal Income Tax (APIT) and self-assessment payment were deducted as tax credit by the majority. However, WHT on interest was ignored by most of candidates.
- (6) Some candidates have not applied the correct flow of the individual return of income when reaching total Assessable Income, qualifying payment and relief, Taxable Income, gross tax liability, tax credits, and balance tax payable. For example, qualifying payments and quarterly installments payments have been claimed prior to the Assessable Income.
- (7) Some candidates have stopped tax computation at Taxable Income without completing the rest of the answer.

Performance: The performances were good.

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The Overall Performance:

The majority of candidates have secured a good mark for VAT, partnership taxation, corporate taxation, and individual taxation. However, certain poor performances have been displayed in the areas of residency rule, case law, and tax administration. Particularly, the knowledge pertaining to return submission, administrative review, and tax refund were extremely poor position.

Common Reasons for Certain Poor Performances:

- (1) Devoting too much attention on arithmetical calculation rather than fundamental principles in taxation and respective taxing laws.
- (2) Lack of awareness on relevant taxing laws and its subsequent amendments.
- (3) Poor attention to read the question paper properly before starting to answer the questions. This resulted to forget certain important requirements of the question due to misunderstanding.
- (4) Not devoting enough attention to past question papers and model answers that help to improve the examination skills.

- (5) Less attention on the study pack in which the most of fundamental principles and taxing laws have been properly explained.
- (6) Poor time management in answering the question paper, and some candidates have written lengthy answers for small marks.
- (7) Certain realistic assumptions were missing while unrealistic assumptions were made.
- (8) Failing to understand the actual requirement of each question properly that permits candidate to organize the answer including the format and presentation.
- (9) Illegible handwriting that created difficulties for examiners to understand the facts of answers. Sometime, answers were impossible or almost impossible to read because of being very untidy or not clear.
- (10) Some candidates did not show the proper workings to support their figures, which they have arrived in the process of calculation.

Suggestions for Improvements:

- (1) Paying attention on time management before answering to the question paper, which allows candidates to understand the certain important requirements of the questions. It is utmost important to summarize the answer as much as possible based on the requirement of the questions and marks allocated.
- (2) Answering the past question papers and check with suggested answers in order to improve the examination skills.
- (3) Devoting full attention to the self-study text because of all areas in the question paper.
- (4) Stating clear and realistic assumptions, which are useful in granting certain marks for answers. It is important to remind that candidates are not allowed to make unrealistic assumption to alter the given facts of the questions itself.
- (5) Focusing on basic fundamental principles of taxation rather than arithmetical accuracy of calculations.
- (6) Providing appropriate workings for each and every calculations whenever necessary and link them properly with relevant answers.
- (7) Answering the question paper with legible handwriting that allows the Examiners to understand the facts clearly.
- (8) Answering a new question on a new page of the answer booklet.
- (9) Candidates are advised to read the question paper more than once to understand the requirement clearly and avoid writing irrelevant answers and calculations that will save time.
- (10) Always use the reading time 15 minutes to read the question paper fully and then start to answer questions based on the confident level of each question.

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