

EXAMINER'S REPORT**AA3 EXAMINATION - JULY 2017****(AA35) CORPORATE AND PERSONAL TAXATION**

Question No. 01 (05 marks)

From part (a) of the question, it was required candidates to explain the rule applicable to a company in Sri Lanka in the determination of tax residency status and from part (b), it was required to state the due date to submit the return of income of the given company for the year of assessment 2015/16.

Most of the candidates have written about the "183 Days Rule" applicable for a person for the part (a) instead of referring to a company in Sri Lanka. Further, majority of the candidates have not mentioned the fact that management and administrative control should be within the country. For the part (b) majority of the candidates have mentioned the self-assessment dates for income tax and final payment date applicable to individual instead of mentioning the due date for the submission of income tax return of a company, i.e on or before 30th November 2016.

The performance for this question was at an average level.

Question No. 02 (05 marks)

This question required candidates to assess the balance Nation Building Tax payable for the quarter ended 31st March 2016. This question was very poorly answered by majority of the candidates. Instead of charging 2% of NBT for the 50% of the sales from imported goods and sale of locally purchased goods, considerable number of candidates have charged 2% NBT from 25% of sales.

Further, almost all the candidates have deducted NBT paid on imported goods and local purchases in their computations, however those payments are not allowed to deduct in computing the balance NBT payable.

The performance for this question was not satisfactory.

Question No. 03 (05 marks)

This question required candidates to assess the income tax liability of a Non-Governmental Organization (NGO) for the year of assessment 2015/16. This question also very poorly answered by majority of the candidates. Specially, when computing the income tax of a NGO, 3% of the total grants received should be taxed at 28%. However, it was noted from the answers that majority of the candidates did not aware of this fact. Further, the interest income received on Fixed Deposit should not be considered in computing the total grant due to WHT has been already deducted at 8% from the said income. However, there were considerable number of candidates who have considered interest income also in their income tax computations.

Further, the fees for Resource persons and Administration expenses have been deducted in computing the income tax by majority of the candidates erroneously.

The performance for this question was at a very poor level.

Question No. 04 (05 marks)

It was required to explain whether whole of the profit share would be considered as the income of Ahamed for tax purposes referring to the decision given in the case of Davoodbhoy Vs Commissioner General of Inland Revenue. To evaluate this, it was required to have facts, reasons and the court decision of the related case. However, most of the candidates were unable to explain this properly and they could not score high marks for this question due to not having adequate knowledge and understanding of the decision given in the said case.

It was expected to mention the decision of the original case, however majority has not done it. Also the fact that the original decision has been amended with the introduction of the Section 217 of the Inland Revenue Act has not been mentioned by majority of the candidates. This was a very poorly answered question by the candidates.

The performance for this question was at a very poor level.

Question No. 05 (10 marks)

This question required to assess the balance payable /(overpaid) of Value Added Tax (VAT) for the quarter ended 31st March 2017. For exports VAT should be charged at 0%, however, some of the candidates have mentioned that exports are exempt from VAT. The difference between the two concepts have not been identified by most of the candidates. It should be noted that zero rated input could be claimed, whereas input related to exempt items could not be claimed. Though the VAT rate applicable for local sales is 15%, some have applied VAT at 12%. Sale proceeds from the computer disposal will not be liable for VAT, but some have charged VAT for that as well. Input VAT paid on insurance premium of motor car used by CEO is not claimable, however some candidates have claimed that as well.

Input VAT applicable to Zero rated supplies to be computed separately. However, this adjustment has not been correctly done by majority of the candidates.

The performance for this part of the question was not that satisfactory.

Question No. 06 (10 marks)

It was required to compute the Distributable profit of the company for the year of assessment 2014/15, Minimum amount of dividends to be distributed to avoid the Deemed Dividend Tax and Deemed Dividend Tax for the year of assessment 2015/16. It was noted from the answers that most of the candidates were not aware of the computation of Distributable profit and Deemed Dividend Tax. They have merely started with Profit before tax and tried to adjust allowable and disallowable expenses and at the end have applied incorrect tax rates to compute the question requirements.

Candidates should study and be aware of the adjustments in computing the distributable profit. Further, it should be noted that 10% of the distributable profit should be declared as dividends in order to avoid Deemed Dividend Tax. If the actual amount of dividend declared is less than the minimum amount of Dividend to be declared, then Deemed Dividend Tax should be computed as follows.

33 1/3% of Distributable Profit	xxxx
Less: Actual Dividend declared	<u>(xxx)</u>
	xxxx
Deemed Dividend Tax @ 15%	<u>xxxx</u>

The performance for this question was not that satisfactory.

Question No. 07 (10 marks)

The knowledge on partnership taxation was tested from this question. Considerable number of candidates have secured at least 6 to 8 marks out of 10. This question was attempted by majority of the candidates and scored very good marks.

Most of the candidates have gone wrong by considering David's wife Rose's salary as a disallowed expense in computing the divisible profit of the partnership whereas it was an allowable deduction. Further, some candidates have applied 10% as the tax rate of partnership instead of applying 8% tax rate. Moreover, there were few candidates who forgot to deduct the tax free allowance of Rs.1,000,000/- in arriving at the taxable divisible profit.

The performance for this question was at a very satisfactory level.

Question No. 08 (25 marks)

Computation of corporate income tax according to the Inland Revenue Act No. 10 of 2006 and subsequent amendments up to 31st March 2016 was tested. For the computation of the Total Statutory Income, Assessable Income, Taxable Income, Gross Income Tax Payable and Balance Tax Payable marks were allocated separately.

Considerable number of candidates has applied correct formats in doing computations, while a fewer number of candidates have not applied the correct formats. Common mistakes identified are given below:

- Management fee paid should be allowed upto a maximum of Rs, 2,000,000/- comparing 1% of the turnover and the actual amount paid. The excess amount paid as Management fee should be disallowed. However, this adjustment has not been correctly done by majority of the candidates.
- From advertising cost of Rs.500,000/- incurred outside Sri Lanka, 25% (500,000*25%= Rs.125,000/) should be disallowed. From local advertising also 25% should be disallowed. However, only a handful of candidates have correctly done this adjustment.
- Considerable number of candidates have incorrectly computed depreciation allowances. Some have applied incorrect rates to compute depreciation allowances. Some other candidates have incorrectly computed the taxable profit on disposal. It was noted from the answers that most of the candidates do not have clear understanding on this area.
- Considerable number of candidates have deducted entire donation of Rs.1,000,000/- as a qualifying payment in arriving at the taxable income without concentrating on the limitation of Rs.500,000/- or

1/5th of Assessable Income, whichever is lower. However, similar adjustment has been tested in the previous examination also.

- Economic Service Charge of Rs, 4,000,000/- written off due to lapse of claimable period for tax credit should be disallowed and need to added back in the computation of adjusted trade profit. However, considerable number of candidates have not done this adjustment correctly.
- Candidates have incorrectly applied tax rates to compute income tax payable whereas the correct tax rate is 28%.

The performance for this question was at a satisfactory level.

Question No. 09 (05 marks)

Personal income tax computation for the year of assessment 2015/16 was tested. Most of the candidates have approached the question really well. However, they have lost marks due to not mentioning the reasons for exempting certain income such as value of conveyance, NAV of the apartment etc. Common mistakes identified are as follows:

- 50% of the telephone bill re-imburement is not taxable. However, majority of the candidates have considered 100% of the telephone bill re-imburement as taxable.
- Lottery prize of Rs. 400,000/- is exempted from tax due to less than Rs. 500,000/-. However, some candidates have considered that income as taxable.
- Interest of Rs. 20,000/- received from a friend for a loan obtained is also taxable. However, majority of the candidates have not considered this as taxable.
- Some candidates have erroneously considered capital repayment on house repair loan and the cost of repairs borne by **Ramya** as qualifying payments. Further, since this loan has not obtained for the construction or purchase of a house interest paid also cannot be deducted.
- Some candidates have not deducted the additional allowance on employment income of Rs.250,000/- in arriving at the taxable income.
- Value of the 1300cc motor car with a driver is Rs.35,000/- per month which is less than the exempted amount of Rs. 50,000/- per month, hence the value of the conveyance is exempted from tax. However, this has not been correctly identified by majority of the candidates.
- There were fewer number of candidates who have applied corporate income tax rate (28%) to compute the tax liability of **Ramya**.
- Some candidates have forgotten to deduct self-assessment tax payments and PAYE in arriving at the balance tax payable.

Overall performance for this question was at a satisfactory level. If the candidates have read the facts given in the question very carefully, they would have earned more marks.

The performance for this question was at a very satisfactory level.

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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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