

**EXAMINER'S REPORT****Level III EXAMINATION - JANUARY 2023****(304) CORPORATE & PERSONAL TAXATION**

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**Question No. 01****What was tested?**

This question was tested the residency rule under Section 69 of the Inland Revenue Act No. 24 of 2017 in relation to an individual who was appointed as an officer of the embassy of Sri Lanka in Japan for a period of two years.

Accordingly, in terms of Section 69 (1) (c) of the Act, an individual shall be a resident in Sri Lanka for a Year of Assessment (Y/A) if such individual is an employee or an official of the Government of Sri Lanka and his spouse is posted abroad during the year.

**Observations:**

- (1) Almost all candidates have attempted the question.
- (2) The most of candidates have misunderstood the question and provided a wrong answer, based on 183 days rule, which is not applicable for an individual who is a government employee is posted abroad during the year.

**Performance:** The performance was not in a satisfactory level.

**Question No. 02****What was tested?**

This question was tested the knowledge of Capital Gain Tax (CGT), which is charged under Section 7 (2) (b) of the act as gain from realization of investment assets as calculated under Section 35 to 51 of the act.

**Observations:**

- (1) The knowledge of the most of candidates in calculating CGT was in a satisfactory level and applied the 10% tax rate on capital gains.
- (2) Majority of the candidates have incorrectly mentioned the selling price of the land as consideration instead of the market value.
- (3) Most of the candidates have correctly recognized the cost of the land for capital gain.
- (4) Most of the candidates were not aware about the due date to submit the CGT return.

**Performance:** The performances were in a satisfactory level.

### Question No. 03

#### What was tested?

This case law question was based on the facts of the case held by the Court of Appeal in **Craib vs. Commissioner Income Tax (1939) 1 CTC 156**. As per the judgment given in the case, a special payment provided to Mr. Craib to undergo medical treatment as a recognition of exceptional service was considered as a personal gift, and it was not taxable under employment income. Further, it was held that mere fact that special bonus paid to an employee in recognition of his exceptional service, rendered to the company to undergo medical treatment was not a profit from employment.

According to the decision of the above case, the loyal service rendered by **Mr. Anura** to the company is a motive, but not the consideration for the payment. Further, this special payment was a personal gift, which could not be considered as profit from employment. Hence, it is not form part of his taxable income for Y/A 2021/2022.

However, In terms of Section 5 (2) of the act, this special medical bill reimbursement is a part his of Taxable Income because of it is not available for the all employees of the company on equal terms as provided in the Section 5 (3) (c) of the act.

#### Observations:

- (1) The most of the candidates still not understand how to apply the facts of a given question to a decided case law.
- (2) Even though the question was required to answer with reference to the decided case and provisions of the Act, the most of candidates were failed to do so.
- (3) Certain candidates have concluded that the particular profit is taxable without proper justification or explanation.
- (4) Only very few candidates have correctly identified the facts of the case and provided the expected answer.
- (5) The majority of candidates have answered that it was a gift, and not given for everyone in the same grade.
- (6) Some candidates have written long paragraphs and question repeatedly, but the important points that should be included in the answer were completely omitted.

**Performance:** The case law knowledge of the candidates was in an average level.

### Question No. 04

#### Part (A)

#### What was tested?

This particular question was based on the Tourism Development Levy (TDL), which has been imposed under Section 13 (a) of the Finance Act No. 25 of 2003.

**Observations:**

- (1) Majority of the candidates still did not aware the correct tax rate of 1%, applicable in calculating TDL.
- (2) The most of the candidates have incorrectly included the service charges when calculating the gross turnover, liable for TDL.
- (3) Few candidates have taken only 10% of the service charges correctly.

**Performance:** Performances were in average level.

**Part (B)****What was tested?**

This part of the question was tested the fundamental knowledge pertaining the Share Transaction Levy, which was enacted under Finance Act No. 5 of 2005 with effect from 01.01.2005 to charge a levy on share transactions taking place in the stock exchange. The rate applicable is 0.3% on the seller on disposal value of the share and the 0.3% on the buyer on the purchase value of the share with effect from 01.01.2011.

**Observations:**

- (1) Majority of the candidates have correctly calculated the tax base for Share Transaction Levy by multiplying number of shares by price per share.
- (2) Only few candidates have correctly calculated the Share Transaction Levy by applying 0.3% tax rate.

**Performance:** The performances were in average level.

**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 31.03.2022 by an entity, which was engaged in advertising and event organizing services.

**Observation:**

- (1) The majority of candidates have secured at least five to six marks allocated for the question whereas, some candidates have displayed a good knowledge on VAT by securing above eight marks. A very few candidates scored below three marks due to inadequate knowledge on VAT due to just adding and deducting the figures given in the question itself.
- (2) Even though 8% is the applicable tax rate in calculating tax liability has been provided in the question itself, some candidates calculated the tax liability at the rate of 15%.

- (3) The common mistake done by candidates was to charge VAT on income received from foreign clients. Some candidates did not state that supply to foreign clients for services provided to be utilized outside Sri Lanka whether zero rated in their answers.
- (4) Considerable number of candidates have incorrectly claimed the insurance premium for car used for travelling purpose in arriving at the balance VAT payable.
- (5) Most of the candidates have not scored marks allocate for headings (Total Input Tax and Balance Tax Payable), and they have done calculations, but not mentioned that how they have arrived at the calculations.
- (6) Handful number of candidates have correctly charged tax on SVAT supplies, and claimed the SVAT Credit Vouchers (SVCV) as a tax credit at the end.
- (7) The excess input tax brought forward from the previous quarter and installment payment were deducted by the majority of candidates.
- (8) Some candidates have continuously applied the accounting ledger approach (debit/credit) instead of output-input mechanism of VAT return in calculating tax liability, which was not accepted by examiners based on the format in VAT return.
- (9) The knowledge pertaining to input-output mechanism of VAT was understood by the majority.

**Performance:** The performances were good.

## **Question No. 06**

### **What was tested?**

This question was tested the fundamental knowledge of candidates in relating to the submission of the Statement of Estimated Tax payable (SET) for Y/A 2021/22 under the Section 90 of the Act. Accordingly, the question was required to,

- (1) Calculate the amount payable as the third installment payment for the Y/A 2021/22,
- (2) State the due dates of income tax installment payments for the Y/A 2021/22,
- (3) State a step that could be taken by the company to avoid penalties on late payment, and
- (4) State two methods available to recover the taxes in default by Inland Revenue Department.

### **Observations:**

- (1) Most of the candidates have stated the correct amount which was payable as the third installment and due dates of income tax installment payments for the Y/A 2021/22.
- (2) Majority of candidates have correctly stated the step that could have been taken by the company to avoid penalties on late payment.
- (3) The most of candidates have correctly mentioned the methods available to recover the taxes in default by Inland Revenue Department.

**Performance:** The knowledge pertaining to tax administration was good.

## Question No. 07

### What was tested?

This question was based on the partnership taxation in terms of Section 53 to 56 of the Act. The question was required to calculate the Income Tax payable by a partnership for the Y/A 2021/22, which included partners' salaries, loan provided by a partner to the partnership, payment of allowance to a partner's daughter, donation, and interest on the saving account.

### Observation:

- (1) Most of the candidates have secured at least 5 to 7 marks allocated for the question.
- (2) Partners salary have correctly added back to the accounting profit when arriving at the business profit of the partnership by majority of candidates.
- (3) Interest paid to a partner is disallowed by average number of candidates.
- (4) Allowance paid to a partner's daughter is allowed by the majority.
- (5) Business income and interest income were separately ascertained by many candidates in arriving at Assessable Income of the partnership.
- (6) However, some candidate forgot to claimed donation under qualifying payments and relief in arriving at Taxable Income.
- (7) Taxing first Rs.1,000,000/- at 0% and balance at 6% were correctly done by many candidates.
- (8) Some candidates have incorrectly claimed Rs.1,000,000/- as partnership allowance without taxing at zero rate.

**Performance:** The performances were good.

## Question No. 08

### What was tested?

The basic theoretical knowledge on corporate taxation for the Y/A 2021/22 was tested by this question. Accordingly, the question was required to,

- (1) Compute the Assessable Income, Taxable Income, Gross Income Tax Payable, and Balance Tax Payable by a resident company, which was engaged in the manufacturing of handicrafts.
- (2) To decide the Income Tax rate when the company is engaged in the business of manufacturing and exports.
- (3) 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 more than 60% of candidates have secured at least 50% marks.

### **(2) Presentation format:**

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

### **(3) Other income:**

Almost all candidate have eliminated the gain from disposal of quoted company shares, 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 correctly applied the respective rates in claiming capital allowances.

However, considerable number of candidates failed to calculate the assessable charges on assets disposal. Even though some candidates have correctly calculated the assessable charges on assets disposal, but the same amount was not added to the accounting profit in arriving at the Assessable Income.

### **(5) Disallowable expenses:**

Provision for gratuity, donation, and entertainment expenses have been correctly added back to the accounting profit by most of the candidates.

### **(6) Allowable expenses:**

Allowing building repair and advertising in arriving at the Assessable Income were in a satisfactory level. However, claiming an addition 100% for research expenses was not in a satisfactory level. Even though some candidates have written those expenses are allowable, they were incorrectly deducted from the accounting profit again.

### **(7) Qualifying payments and reliefs:**

The donation of educational equipment to the University of Colombo has been claimed by the majority without restriction. However, certain candidates have been incorrectly claimed this educational equipment donated, subject to limitation of Rs.500,000/- or 1/5 of Taxable Income without considering that it was in goods to the government.

**(8) Investment income:**

The dividend income out of dividend received has been exempted from tax by many candidates. But, considerable number of candidates have incorrectly included quoted company dividend in the investment income. Taxing interest income under investment income was in a satisfactory level.

**(9) Identification of tax rate**

The company was engaged in the business of manufacturing and export for which 14% tax rate is applicable. On the other hand, the company has received an interest income from fixed deposit for which 24% tax rate is applicable.

However, only very few candidates have recognized both scenarios to estimate the tax liability of the company. The most of candidates have incorrectly applied the 24% tax rate for the entire profit by ignoring the exports. Unfortunately, certain candidates were still applying the individual slab rates to ascertain the tax liability of a company.

**(10) Identification of tax credit**

Quarterly installment payment was claimed as a tax credit by the majority.

**Performance:** The performances were good.

## **Question No. 09**

### **What was tested?**

Ascertainment of personal Income Tax for the Y/A 2021/22 of a resident individual who works as the Chief Financial Officer in a company in Sri Lanka. 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 the candidates secured at least 50% of allocated marks, and considerable number of candidates have been secured over 20 marks. The observations are listed below:

**(a) Employment income:**

- (1) Salary and bonus are included in the employment income by the majority.
- (2) The computation of the motor car benefit provided by the company with fuel has not been accomplished by many candidates.
- (3) Rent reimbursement made by the company has been included in the employment income by the most of candidates.
- (4) The foreign tour expenses reimbursement has been incorrectly included in the income by considerable number of candidates.

**(b) Business income:**

- (1) The salary to assistance and stationery expenses have been deducted from revenue by many candidates in arriving at profit from business.
- (2) Claiming the capital allowance (5 years) on computers was in a satisfactory level.

**(c) Investment income:**

- (1) The gross rent has been treated as investment income by the majority.
- (2) Average number of candidates have correctly treated the interest on Resident Foreign Currency Account (RFC) as an exempt income. However, some candidates included it in the Assessable Income.
- (3) The interest on fixed deposit has been correctly included in the investment income by the majority.

**(d) Common omissions, mistakes, and remarks:**

- (1) The most of candidates have incorrectly claimed the 25% of repair allowance from Assessable Income from investment instead of claiming it under qualifying payments and reliefs. Some candidates ignored the 25% repair allowance under qualifying payments and reliefs.
- (2) The donation made to the Buddhist and Pali University in goods has been claimed under qualifying payments by many candidates. However, the donations made to an approved charity in goods also incorrectly claimed by some candidates by ignoring that it was in goods.
- (3) Personal relief of Rs.3,000,000/- has been claimed by the majority under relief. However, claiming educational expenses and medical insurance subject to Rs. 1.2 million threshold have not been accomplished by many candidates.
- (4) Most of the candidates have applied the correct tax rates with correct slabs to tax the Taxable Income. Unfortunately certain candidates are still applying tax rates and slabs in the old Act, Inland Revenue Act No. 10 of 2006.
- (5) The APIT and installment payment have been correctly claimed by the majority as tax credits. However, certain candidates incorrectly claimed tax credits from Taxable Income directly without computing the tax liability.
- (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 installment 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 at least 50% marks allocated for questions in relation to CGT, VAT, partnership taxation, corporate taxation, and individual taxation. However, certain poor performances have been observed in the areas of residency rule, case law, TDL, and tax administration as a result of paying less attention to the study pack.**

## **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 such as CGT, TDL, the new Inland Revenue Act 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 which helps to improve the examination skills.
- (5) Less attention on the study pack in which the most of fundamental principles and tax 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) Some candidates failed to understand the requirements of the Inland Revenue Act No. 24 of 2017 and subsequent amendments. Some answers provided based on the previous Inland Revenue Act No. 10 of 2006.
- (8) Certain realistic assumptions were missing while unrealistic assumptions were made.
- (9) Failing to understand the actual requirement of each question properly that permits candidate to organize the answer including the format and presentation.
- (10) 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.
- (11) Lack of relevant workings for answers or workings were properly not linked with the computations, resulting Examiners were not able to grant full marks allocated for the questions.
- (12) 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 study pack because of all areas in the question paper are covered by the study pack. It is important to bear in mind that there is a possibility of testing different areas in the study pack.
- (4) Referring subsequent amendments to the Inland Revenue Act No. 24 of 2017 published by the Department of Inland Revenue by way of gazette notifications and paper notices.
- (5) 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.
- (6) Focusing on basic fundamental principles of taxation rather than arithmetical accuracy of calculations.
- (7) Providing appropriate workings for each and every calculations whenever necessary and link them properly with relevant answers.
- (8) Answering the question paper with legible handwriting that allows the Examiners to understand the facts clearly.
- (9) Answering a new question on a new page of the answer booklet.
- (10) Candidates are advised to read the question paper more than once and avoid writing irrelevant answers and calculations that will save time.
- (11) 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.