

**EXAMINER'S REPORT**

Level III EXAMINATION - JANUARY 2024

**(304) CORPORATE & PERSONAL TAXATION**

---

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

This question tested the residency status under Section 69 of the Inland Revenue Act No. 24 of 2017 (hereafter referred to as the act) of a company, which was incorporated in Sri Lanka, and engaged in a construction project. Further, the particular company was a subsidiary of a large construction company in India.

Accordingly, in terms of Section 69 (4), a company shall be resident in Sri Lanka for a year of assessment (Y/A) if,

- (a) It is incorporated or formed under the laws of Sri Lanka,
- (b) It is registered or the principal office is in Sri Lanka; or
- (c) At any time during the year, the management and control of the affairs of the company are exercised in Sri Lanka.

**Observations:**

- (1) Almost all candidates have attempted the question.
- (2) The majority of candidates have applied the 183 days rule, which is applicable to determine the residency of an individual. Hence, the majority has completely misunderstood the facts given in the question itself when answering the question.

**Performance:** The performances were not in a satisfactory level.

**Part (b)**

This part of the question required to list the four principles of taxation.

**Observations:**

- (1) Many candidates misunderstood facts of the question by providing irrelevant answers.
- (2) Some candidates provided such objectives of taxation but not principles in taxation without proper understanding.
- (3) Only a lesser number of candidates provided correct answers as demand by the question.

**Performance:** The performances were not in a satisfactory level.

## Question No. 02

### Part (a)

#### What was tested?

This part tested the fundamental knowledge of Capital Gain Tax (CGT), which was imposed under Section 7 (2) (b) of the act. Further, calculation of gain from realization of investment assets under Section 35 to 51 of the act, was also tested.

#### Observations:

- (1) Many candidates got a poor knowledge on CGT as they applied different rates rather than correct rate of 10%.
- (2) It was further observed that the same answer for capital gain was taken by many candidates by applying incorrect formula  $(6,500,000 - (5,000,000 + 200,000)) = 1,300,000$  [Market Value - (Cost + Broker Fee)]. The formulation of calculating capital gain is very clear and consistent in the act itself.
- (3) The reason for such mistake was those candidates have taken into account the market price of the land instead of consideration received on disposal.
- (4) Almost all the candidates have correctly recognized the cost of the land for capital gain.
- (5) Most of the candidates were not aware of the correct date for CGT return submission.

**Performance:** The performances were not at a satisfactory level.

### Part (b)

#### What was tested?

This part of the question required to state the obligations of an employer under Advanced Personal Income Tax (APIT) scheme.

#### Observations:

- (1) The expected answers were not provided by many candidates.
- (2) Most of the candidates have stated about obligation that come under Employees' Provident Fund (EPF) and Employees' Trust Fund (ETF) schemes instead of obligation under APIT scheme.

**Performance:** The knowledge on APIT scheme was very poor. Therefore, the performance was not satisfactory.

### Question No. 03

#### What was tested?

This question was based on the case law that emerged from **D. S. Mahavitharana vs. Commissioner of Inland Revenue** in 1962. As per the judgment of the case, the Assessee Mahavitharana and another acquired an option to purchase a tea estate of 583 acres by paying an advance and agreed to complete the truncation within a short time period. But, they did not have sufficient funds to complete the truncation, and also no intension to purchase the entire land with their own funds or with borrowed funds. Even though the Assessee argued that they agreed to purchase the land as a source of green leaf to their tea factory, it was clear that they did not secure the option to purchase the land themselves.

The court held that the transactions were an adventure or concern in the nature of trade. Further held that the intension of the Assessee at the time of entering to an agreement was to embark on a venture in the nature of trade.

The given facts of the question were very similar to the facts of the above decided case. Hence, the profit earned by Assessee is liable to Income Tax.

On the other hand, in terms of Section 8 of the act, *“a person’s income from other sources for a year of assessment shall be that person’s gains and profits from any source whatsoever for the year, not including profits of a casual and non-recurring nature.”*

Moreover, in terms of Section 195 of the act, the definition of the term “business” include, a trade, profession, vocation or isolated arrangement with a business character however short the duration of the arrangement; and a past, present or prospective business; but excludes an employment.

#### Observations:

- (1) Majority of candidates had no idea as to how to apply the facts of a decided case to an answer.
- (2) Even though the question required to answer with reference to the decided case, the most of the candidates were failed to do so.
- (3) The majority of candidates have not described adequately the given case.
- (4) Many of them simply repeated the question rather than providing a comprehensive 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.
- (5) Some candidates have concluded that the particular profit is taxable without proper justification or explanation.

**Performance:** The case law knowledge of the candidates was poor. Therefore, the performance was not satisfactory.

## Question No. 04

### Part (a)

#### What was tested?

This part required to list two criteria to be fulfilled by a tourist to be eligible for Tourist VAT Refund Scheme (TVRS), which introduced under Value Added Tax (amended) Act No. 25 of 2018.

#### Observations:

- (1) Majority of the candidates have inadequately responded to this part of the question.
- (2) Even though the question tested the knowledge on “*eligibility for tourist VAT refund*”, majority have not understood it properly.

**Performance:** The knowledge on TVRS was very poor and therefore, the performance was also very poor.

### Part (b)

#### What was tested?

The knowledge pertaining to Social Security Contribution Levy (SSCL) was tested by this part of the question. Accordingly, the question was required to calculate the SSCL for the quarter ended 31.03.2023.

#### Observations:

Most of the candidates did not had a proper knowledge on the SSCL rate, even though they answered the question.

**Performance:** The performance was poor.

## Question No. 05

### What was tested?

This question required to calculate the balance Value Added Tax (VAT) payable/ (over paid) for the quarter ended 31.03.2023 by an entity, which was engaged in preparing Sri Lankan sweets and selling them in the local and foreign markets.

#### Observation:

- (1) Most of the candidates have attended the question, and the majority have earned considerable percentage of the total marks allocated for the question.
- (2) Some candidates have used ledger accounts (Debit/Credit) to estimate the tax liability rather than using the correct format given in the VAT return.

- (3) Majority has correctly charged tax on SVAT supplies when computing output tax but did not claimed the SVAT Credit Vouchers (SVCV) as a tax credit at the end.
- (4) The company has paid Rs.50,000/- as monthly installment. But considerable number of candidates have interpreted this as Rs.50,000/- being paid for one month, and thus, the quarterly payment should be (Rs.50,000/- x 3) Rs.150,000/-. This was completely misunderstood by the candidates. Additionally, some candidates have erroneously added the installment payments to tax payable instead of subtracting them.
- (5) Some candidates have not understood the disallowable expenses such as repair of a motor car used by the Managing Director. Some have included those under input tax but have not stated as disallowed. Additionally, some were erroneously mentioned as exempt.
- (6) Some candidates have just mentioned figures, but not mentioned as to how they have arrived at the calculations.
- (7) The excess input tax brought forward from the previous quarter and installment payment were deducted by the majority of candidates.
- (8) 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 of the act. The question was required to calculate the Income Tax payable by a partnership for the Y/A 2022/23, which included partners' salaries, professional fees paid to a partner, allowance paid to a wife of a partner for working as the Coordinator, donation, and interest and rent income.

### **Observation:**

- (1) Candidates were consistently misled by business profit adjustments. They consistently added income that should be deducted and subtracted expenses that should be added back to the profit.
- (2) Partner's salary have correctly added back to the accounting profit when arriving at the business profit of the partnership by the majority.
- (3) Professional fees paid to a partner has been correctly disallowed by majority.
- (4) Allowance paid to a wife of a partner for working as the Coordinator was erroneously added back to the profit by many candidates.
- (5) Interest income and rent income were removed from business income by many candidates.
- (6) Some candidates made mistakes in computing capital allowances by adding back depreciation to profit, but deducting incorrect amount as capital allowance from the profit.

- (7) However, some candidate forgot to claim donation under qualifying payments and relief in arriving at Taxable Income.
- (8) 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 (individual tax rates) to tax the partnership. Furthermore, some candidates have applied the tax rate as 30% and certain candidates failed to tax the 1<sup>st</sup> Rs.1,000,000/- at 0%.
- (9) Some candidates have incorrectly claimed Rs.1,000,000/- as partnership allowance without taxing at 0%.

**Performance:** The performance in relation to partnership taxation were at a satisfactory level.

### **Question No. 07**

#### **What was tested?**

This question tested basic knowledge in relation to tax administration, which included installment payments, return submission and time bar for issuing amended assessment for the Y/A 2022/23.

#### **Observation:**

- (1) This is the question for which many candidates secured the lowest marks. Only a handful of candidates answered this important question in tax administration successfully.
- (2) Most of the candidates did not know how to calculate the installment payment, due date for filling return of income and making payment for such installments.
- (3) Majority did not attempt part (d) of the question (due date for payment of 3<sup>rd</sup> installment for the Y/A 2022/23).
- (4) Almost all the candidates did not know legal provisions, applicable for the “time bar” in the act.

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

### **Question No. 08**

#### **What was tested?**

The fundamental knowledge on corporate taxation for the Y/A 2022/23 was tested by this question. Accordingly, the question required to,

- (1) Compute the Assessable Income, Taxable Income, Gross Income Tax payable and balance tax payable by a resident company engaged in importing and selling ready-made garments in the domestic market.
- (2) Identify the Income Tax rate applicable when the company is engaged in the business of import and selling.

- (3) 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 the candidates attempted the question and majority of candidates have secured considerable marks for this question.

(2) **Presentation format:**

The presentation and identification of statutory contents of the Corporate Income Tax computation have been understood by many candidates. However, few candidates were unable to keep up with statutory contents and presentation of Corporate Income Tax computation.

(3) **Other income:**

Majority eliminated the gain from 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 the 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, that amount was not added to the accounting profit in arriving at the Assessable Income from business.

(5) **Disallowable expenses:**

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

(6) **Allowable expenses:**

Foreign travel expenses are allowed by many candidates. Further, payment of gratuity was claimed by the majority. Even though, some candidates have written those expenses as allowable, they were incorrectly deducted from the accounting profit again.

(7) **Investment income:**

The dividend income out of dividend received was not exempted by many candidates. Including interest income under investment income was correctly done by many candidates. However, some candidates have erroneously included the profit on disposal of vehicle under investment income.

**(8) Qualifying payments and reliefs:**

The donation made to the flood victims was incorrectly claimed by many candidates. Further, claiming donation to the children's home subject to the condition of 1/5 of Taxable Income or Rs.500,000/-, whichever is lower was not applied by the majority.

**(9) Identification of tax rate:**

Identifying the correct tax rate of 30% was done by the majority. However, few candidates 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.

**Performance:** The performance was good.

## **Question No. 09**

### **What was tested?**

This question required to ascertain Personal Income Tax for the Y/A 2022/23 of a resident individual who worked as a full-time Teacher in a private school. 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 considerable marks. The observations are listed below.

**(a) Employment Income:**

- (1) Salary was included under the employment income by the majority. However, some candidates have taken into account the monthly salary and fuel allowance as employment income instead of multiplying monthly amount by 12.
- (2) Many candidates have failed to identify the foreign travel and medical benefit provided under private medical insurance scheme for all employees as not liable when computing the employment income.
- (3) Resident and fuel allowance were correctly treated as employment income by many candidates.

**(b) Business Income:**

- (1) Staff salary and cost of tutorials were treated as allowable expenditure by majority in arriving at profit from business.
- (2) Capital allowance on furniture has been claimed correctly.



- (3) Some candidates have incorrectly deducted personal telephone cost in arriving at business profit even though it was clearly mentioned.

**(c) Investment income:**

- (1) Interest on fixed deposits and treasury bills have been treated as investment by many candidates.
- (2) However, considerable number of candidates have not exempted QPC shares and net dividend income, which are not liable to tax.

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

- (1) Most of the candidates had no idea the difference between the donation made to approved charity and donation made to the government.
- (2) Claiming Rs.1,200,000/- as personal relief was not performed satisfactorily.
- (3) Even though, most candidates have applied the correct tax rates with correct slabs to tax the Taxable Income, some candidates have applied tax rates and slabs according to the old Inland Revenue Act No. 10 of 2006. Certain candidates have applied progressive rate ranging from 6% to 60%, and some candidates have combined progressive rates with 30% for business profit. Some candidates have incorrectly calculated capital gain tax for share disposal separately.
- (4) Certain candidates incorrectly claimed tax credits from Taxable Income directly without computing the tax liability.
- (5) 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.
- (6) Some candidates have stopped tax computation at Taxable Income without completing the rest of the answer.

**Performance:** The performance was good.

- - - -

### **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 subsequent amendments to such laws.
- (3) Poor attention to read the question paper 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 a lesser marks.
- (7) Certain realistic assumptions were missing while unrealistic assumptions were made.
- (8) Failing to understand properly the actual requirement of each question that permits candidates 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) 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.
- (11) Some candidates did not show the proper workings to support their figures, which they have arrived in the process of calculation.

- \* \* \* -