

EXAMINER'S REPORT**AA3 EXAMINATION - JANUARY 2020****(AA35) CORPORATE AND PERSONAL TAXATION**

Question No. 01**What Was Tested?**

The knowledge on Final Withholding Payments was tested by this question. It was required to explain the meaning of the same and to identify two such payments under the Inland Revenue Act.

Observations:**Part (a):**

As per the act, once the relevant tax is deducted and paid to the Commissioner General of Inland Revenue (CGIR) as final withholding payment, such tax shall not be further liable for taxation. However, this was understood by only a limited number of candidates. Majority of the candidates had no idea as to what is meant by final withholding payments. Most of the answers were not applicable to the question and far away from the expected answer.

Part (b):

Following common mistakes were observed:

- More than half of the candidates have provided names of other taxes such as Economic Service Charges, Value Added Tax, Nation Building Tax, Stamp Duty etc.
- Considerable number of candidates have provided the answer interest and dividend without “resident” component.

Performance: *Overall performance for this question is not satisfactory.*

Question No. 02**What Was Tested?**

Obligations of an employer under the PAYE scheme were tested by this question.

Observations:

Majority of the answers were not up to the standard of an AAT Finalist. Following common mistakes were identified:

- Time bars have been ignored by majority of the candidates provided the answers without respective due dates or incorrect dates.
- Considerable number of candidates has provided accounting treatment for PAYE.

In this contest, the time bars associated with PAYE scheme can be summarized as below:

- (1) To remit the taxes deducted to CGIR in any month - on or before the 15th of the following month.
- (2) To furnish annual declaration - on or before the 30th of April every year.
- (3) To issue withholding certificates (T10) to employees - on or before 30th April immediately succeeding the end of the year of assessment or within 30 days from the cessation of employment.

Performance: Overall performance for this question is not satisfactory.

Question No. 03

What Was Tested?

This question was required to decide the taxability of a special payment received by an employee in relation to medical expenses with relevant case law.

Observations:

Any gift received by an employee in respect of employment is taxable under section 5 of the act. (*Craib vs Commissioner of Income Tax*) However, the particular payment Rs. 1 million received as a result of his 20 years exceptional service rendered to the company. Further, employer has considered employee's medical treatment requirements when making this payment.

The long service rendered by the employee to the company was the **motive, but not the consideration** for the payment. Hence, it cannot be considered as income derived from employment.

Though, most of the candidates have referred to the correct case they had no clear idea regarding the decision of the case. Further, final conclusion of making this payment taxable, has not been reached by majority.

Performance: Overall performance for this question is satisfactory.

Question No. 04

What Was Tested?

This question was required to decide the residency of a foreign person who worked on contract basis as an engineer at a project office in Sri Lanka for two years.

Observations:

This was the question that majority of the candidates have scored full marks.

As per the facts provided in the question, the duration of stay in Sri Lanka was very clear. If someone knows the resident rule of aggregate to 183 days, this question could have been answered without any difficulty.

Majority had the awareness in relation to 183 days rule. However, they were unable to calculate 230 days correctly, due to lack of understanding regarding the number of days for each month.

Performance: Overall performance for this question is good.

Question No. 05

What Was Tested?

Partnership income for tax purpose, withholding tax payable by the partnership, share of partnership income of each partner, and withholding tax credit available to each partner were tested by this question.

Observations:

- Most of the candidates have secured the full 3 marks for ascertaining partnership income for tax purpose.
- Some candidates lost ½marks that was allocated to the rent paid to one partner, because they kept silence in this respect.
- Some candidates have not applied the correct withholding tax rate of 8%, instead they have applied 10%, 15% and 28%, etc.
- Considerable number of candidates have lost marks allocated for the share of partnership income of each partner, because they have taken into consideration the rent income of one partner in making the calculation.
- Marks allocated for the tax credit available to each partner were lost by the most of candidates due to incorrect application of share of profit. The reasons were,
 - (a) Taking the rent income in calculating share of partnership profit.
 - (b) Applying 8% rate directly to withholding tax Rs.1,000,640/- with respective profit sharing ratios.

Performance: *Overall performance for this question is satisfactory.*

Question No. 06

What Was Tested?

Part (a):

This part of the question was required to access the balance tax payable/ (over paid) of Value Added Tax (VAT) for the quarter ended 31st March 2019 by a company, which is engaged in providing management consultancy service to the clients in Sri Lanka.

Part (b):

It was required to state the due date for submitting the VAT return for the quarter ended 31st March 2019.

Observations:

- Nearly half of the candidates not recognized the income from conducting classes for professional examinations as exempt income. Some candidates treated this income as zero rated while some others have charged tax for the same.
- Disallowing input tax on printing tutorials for classes have not been adjusted by majority of the candidates.

- Adjusting common input tax on office expenses on pro-rata basis was not performed by most of the candidates. Some candidates have totally disallowed this input tax.
- Disallowing input tax on insurance premium on travelling car was not correctly performed by majority.
- Considerable number of candidates has mentioned the due date as 20th April 2019.

Performance: Overall performance for this question is satisfactory.

Question No. 07

What Was Tested?

This particular question was required to provide answers in relation to:

- (a) Income Tax return submission date,
- (b) Penalty that can impose in the case of failure,
- (c) Time bar for the assessment if the return furnished on or before due date, and
- (d) Meaning of tax in default assessment.

Observations:

Unfortunately, except a handful of candidates, all other candidates have not attempted **part (a), (b) and (c)** of the question.

However, **part (d)** had been attempted by majority, but they had no idea as to what is tax in default. They have mentioned regarding default assessment.

Performance: Overall performance for this question is not satisfactory.

Question No. 08

What Was Tested?

This question was tested the basic theoretical knowledge of the candidates with regard to corporate taxation to review the ability to assess the Total Assessable Income, Taxable Income, gross income tax payable and balance tax payable of a resident company when there were sources of business income and investment income,

Observations:

- Though the land is not entitled for the capital allowances, some candidates have not stated it. Some others have computed capital allowances for the land as well. Considerable number of candidates has failed in adjusting assessable charge on machinery disposal (balancing amount).
- Considerable number of candidates has faced difficulties in adjusting the brought forward tax loss correctly. Some candidates have considered this amount as a qualifying payment or tax credit while some others have correctly applied 35% rule, which comes under Inland Revenue Act No. 10 of 2006.

- Correct recognition of investment income was not performed by majority. Considerable number of candidates have included net dividend income of Rs.500,000/- again as investment income to reach the Total Assessable Income.
- Though, donation in cash or otherwise to an approved charity or government is not a Qualifying payment, it was allowed as a qualifying payment by majority.
- Individual slab rates of 4% to 24% were applied by substantial number of candidates instead of 28%.
- Recognition of WHT on fixed deposit as a tax credit was not performed by majority.
- Some candidates have obtained certain figures in relation to disposal of assets and investment income without proper workings. In such a scenario, when the answer is incorrect there was no way to give pro-rata marks for any correct parts of the adjustments.
- Lack of understanding of “allowable” and “disallowable” (**Plus and Minus**) when arriving at business income from the accounting profit was observed from the answers of few candidates.
- Few candidates have aggregated child’s income when arriving at Total Assessable Income.

Performance: Overall performance for this question is satisfactory.

Question No. 09

What Was Tested?

This question was required to compute the personal Income Tax for the year of assessment 2018/2019 of a resident individual who is a software engineer by profession. The sources of income included: employment and investment.

Observations:

- Recognition of the correct vehicle benefit has not been correctly understood by considerable number of candidates.
- Some candidates have considered the actual of medical expenses as employment benefit.
- Less number of candidates has considered ETF 3% of gross salary as an employment income.
- Foreign currency earnings were taken as employment income by majority. Also some candidates have eliminated this income as exempt and marks were awarded accordingly. However, this was not taken as a tax relief even though the same amount was included in the employment income.
- Dividend from listed companies and interest on RFC account have been correctly recognized as final tax under investment income by many candidates.
- Profit from sale of listed company shares was also correctly recognized as exempt income under investment income by the majority.
- Personal allowance of Rs.500,000/- and allowance for employment of Rs.700,000/- have taken correctly as tax relieves by the majority.
- Noticeable number of candidates has forgotten to claim foreign currency earnings and 25% of gross rent as tax relieves.

- Claiming the value of computers donated to the University of Moratuwa (government) was not recognized as a qualifying payment by many candidates.
- The application of 4% to 24% slab rates was adopted by many candidates correctly.
- Claiming PAYE and WHT on secondary employment as tax credits have also performed in a satisfactory level. However, a handful of candidates have forgotten to claim WHT on rent as a tax credit.

Performance: *Overall performance for this question is satisfactory.*

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Hints to improve performance:

- (1) Paying more attention on time management before answering questions.
- (2) Summarizing answers as much as possible depending on the requirement of the question and marks allocated.
- (3) Answering the past question papers and check with model answers to improve the examination skills and answering speed before sitting for the examination.
- (4) Focusing on basic fundamental principles of taxation rather than arithmetical accuracy of calculations.
- (5) Making clear and realistic assumptions that need to answer questions.
- (6) Answering the question paper with legible handwriting that will enable the marking examiner to understand the facts.
- (7) Providing appropriate workings for each and every calculations if necessary and link them with the answers.

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