

**EXAMINER'S REPORT****Level III EXAMINATION - JANUARY 2022****(304) CORPORATE & PERSONAL TAXATION**

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**Question No. 01**

This question tested the residency of Sri Lankan individual who has migrated to Australia under the provisions of Section 69 (1) (b) of the Inland Revenue Act No. 24 of 2017. He has frequently visited Sri Lanka for business purposes.

In terms of Section 69 (1), an individual shall be a resident in Sri Lanka for any year of assessment, if he or she 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.

**Observations:**

- (1) Almost all candidates have attempted the question and correctly identified the given facts of the question.
- (2) Majority of candidates have correctly applied the 183 days residency rule to conclude that the individual is a non-resident for tax purpose in Sri Lanka.
- (3) Even though the correct duration of stay in Sri Lanka was 133 days, certain candidates provided answers such as 131, 132, 134, 135 and 136 days due to failure in calculating correct number of days for each month.
- (4) Certain candidates concluded that the particular individual is a resident of Sri Lanka due to being a Sri Lankan citizen without applying the residency rule.
- (5) Some candidates have written long paragraphs and the question repeatedly without showing calculation and conclusion.

**Performance:** The overall performance was good.

**Question No. 02**

This question tested the knowledge on the Withholding Tax deductible from employees who have given their consent to deduct Advance Personal Income Tax (APIT) from their remuneration. The question required to;

- (a) State three obligations of an employer under APIT scheme, and
- (b) State two items that have to be included in the Certificate of Tax Deduction.

**Observations:**

- (1) The knowledge on the APIT scheme of majority of the candidates was not at a satisfactory level.
- (2) The candidates who have secured full marks for the question was a minimum number even though the expected answers were very clear-cut.
- (3) Most of the answers provided by the majority of candidates were not relevant to the question.

**Performance: The overall performance was not at a satisfactory level.**

**Question No. 03**

This question tested the fundamental knowledge of candidates on Tourism Development Levy (TDL), which is charged under the Tourism Development Act No. 14 of 1968 at 1%, if the annual turnover of a registered institution exceeds 12 million (3 million per quarter) or at 0.5%, if the annual turnover does not exceed 12 million.

**Observations:**

- (1) Majority of candidates were not aware of the correct tax rate of 1%, which was applicable for the given facts of the question.
- (2) Considerable number of candidates have not eliminated service charges included in the income from rooms when calculating the turnover.
- (3) Some candidates have included dividend income in the turnover, which has to be eliminated when calculating turnover.

**Performance: The overall performance was not satisfactory.**

**Question No. 04**

This case law question was based on the facts of decided case *Ram Ishwara Vs. Commissioner of Inland Revenue* (1962) 3 CTC 184. This decided case is known as a landmark decision held by the Supreme Court of Sri Lanka, pertaining to the isolated transaction or adventure in nature of trade. The assessee has made a pre-arrangement for the transaction to escape from the tax net by reselling a land near the St. Bridget's Convent in Colombo 7.

The court decided the case in favour of both revenue officials and Board of Review on the following grounds:

- (1) The Assessee had no money to pay even an advance to the landlord.
- (2) The transaction was concluded within a short period of time.
- (3) There was a pre-arrangement of activities to carry out the transaction.
- (4) The extent of the entire land was far in excess of the requirement of the Assessee.
- (5) Within a short period of time the Assessee had made a considerable profit.

Those grounds can be observed in the given facts of the question and hence, the profit earned by the assessee should be liable to tax as an isolated transaction or adventure in the nature of trade.

**Observations:**

- (1) Poor attempt in answering the question as most of the candidates did not have a fair knowledge with regard to how to apply the facts of a given case to the decided case by the court.
- (2) Most of the candidates have mixed up the given facts of the case with another similar case in which facts were totally different.
- (3) Many of the candidates have misunderstood the facts of the question with the Capital Gain Tax as the subject matter in issue was a land disposal and due to lack of attention to the requirements of the question.
- (4) Certain candidates have concluded that the particular profit is taxable without proper justification or explanation.
- (5) Some candidates have written long paragraphs and question repeatedly, but the important points that should be included in the answer were completely missing.

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

**Question No. 05**

This question was based on furnishing of the return of Income Tax for the year of assessment (Y/A) 2020/2021 by a limited liability company, which was incorporated on 01.04.2020. Further, the company had a Taxable Income as per the draft tax computation for Y/A 2020/2021.

The question was required to:

- (1) State whether the company has to furnish return of income for Y/A 2020/2021 with relevant reasons.
- (2) State the due date to furnish such return of income, and
- (3) State penalties, which are applicable for non-submission of such return of income as per the act.

**Observations:**

- (1) Majority of the candidates failed to answer all three parts of the question.
- (2) Some candidates have provided completely irrelevant answers for reasons for furnishing a return of income.
- (3) Majority of the candidates were not aware of penalties that are applicable for non-submission of return of income on due date.
- (4) It was very clear that the majority had not paid enough attention on Administrative Provisions such as “payment of Income Tax, furnishing of returns, assessments, appeals, tax in default, refunds, and penal provisions included in Chapter 5 of the self-study text.

**Performance: Overall performance for this question was poor.**

### **Question No. 06**

This question required calculation of the balance Value Added Tax (VAT) payable/(over paid) for the quarter ended 31<sup>st</sup> March 2021 by a company, which was engaged in manufacturing of handmade greeting cards and other gift items for both foreign and domestic markets.

#### **Observations:**

- (1) Most of the candidates have secured at least above the average marks allocated for the question.
- (2) The majority has applied correct VAT rate of 0% for the export sales and 8% for local sales.
- (3) Considerable number of candidates have mixed up suspended supplies (SVAT) and exempt supplies as they have considered the local sales to SVAT registered persons as exempt supplies.
- (4) Input tax on imported and locally purchased raw material, and repair expenses on motor lorry used to deliver goods were properly claimed by many candidates.
- (5) Some candidates have recalculated VAT at 8% for input tax even though it was clearly stated "input tax" in the question itself.
- (6) Claiming brought forward excess input tax and installment payment were properly deducted by the majority of candidates when arriving at the balance tax payable.
- (7) The knowledge pertaining to input-output mechanism of VAT was understood by the majority.

**Performance: Overall performance for this question was good level.**

### **Question No. 07**

This question was based on partnership taxation in terms of Section 53 to 56 of the Inland Revenue Act. The question required calculation of the income tax payable by a partnership for the Y/A 2020/2021, which included partners' salaries, interest on loan paid to a partner, salary paid to the partner's daughter as expenses, and interest from fixed deposit and profit from disposal of a land as income.

#### **Observations:**

- (1) Most of the candidates have secured a considerable number of marks allocated to the question.
- (2) Partner's salary and interest paid to a partner's loan were added back to the accounting profit when arriving at the business profit by the majority of candidates.
- (3) Further, considerable number of candidates were struggling to make the relevant adjustment for the salary paid to a partner's daughter when ascertaining the business profit. Some candidates have added back this amount to the book profit as well.
- (4) Interest income and profit from disposal of land have been eliminated from book profit to reach business income by many candidates.

- (5) Most of the candidates did not know how to calculate Capital Gain Tax. The majority have ignored the market value of the land as at 30<sup>th</sup> September 2017 when calculating capital gain. The common adjustment was deducting acquisition cost of the land from the sale proceeds. Small number of candidates secured full marks allocated for this adjustment.
- (6) Claiming Rs.1,000,000/- at 0% and balance at 6% when calculating partnership tax was accomplished by more than half of the candidates.
- (7) Some candidates have included Capital Gains Tax on land disposal in the partnership Income Tax.

**Performance: Overall performance for this question was good level.**

### **Question No. 08**

The fundamental theoretical knowledge on corporate taxation for the Y/A 2020/2021 was tested by this question. Accordingly, the candidates were required to:

- (1) Assess the Assessable Income, Taxable Income, Gross Income Tax payable, and Balance Tax Payable of a resident fully owned subsidiary company the parent company of which is situated in India.
- (2) To decide the Income Tax rate when the company is engaged in the business of manufacturing with annual turnover more than 500 million.
- (3) To evaluate the practical aspect of applying general deductions (Section 10), main deductions (Section 11), and specific deductions (Section 12 - 19) of the act in ascertaining the business profit.

#### **Observations:**

- (1) **Average marks secured:**

Almost all candidates attempted the question, and more than half of the candidates have secured at least average marks for the question.

- (2) **Presentation format:**

The presentation and identification of statutory contents of the corporate Income Tax computation have been accomplished by the majority of candidates. However, some candidates failed to keep up with statutory contents and presentation of corporate Income Tax computation.

- (3) **Other income:**

Almost all candidates have eliminated sale of shares and interest income on fixed deposits from book profit when arriving at the business income.

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

Book depreciation and loss on asset disposal have been added back to the accounting profit by the majority of candidates. Further, most of the candidates have correctly applied the respective rates for capital allowances as stipulated by the act. However, some candidates have failed to calculate the balancing allowance for assets disposal. Moreover, considerable number of candidates still failed to understand the capital allowance rates stipulated in the current law and previous law.

(5) **Disallowable expenses:**

Gratuity provision, entertainment expenses, and donation have been added back to the accounting profit by almost all candidates. However, majority of candidates failed to accomplish the correct adjustment for the maximum claimable finance cost. Even though some candidates have applied the correct formula to calculate the allowable finance cost, which they deducted fully by disregarding the earlier deduction in the accounts.

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

Donation to the COVID-19 Relief Fund was fully claimed by most of the candidates. However, some candidates have fully claimed the amount paid to the COVID-19 affected employees of the company while some candidates claimed subject to limitation of Rs.500,000/- or 1/5 of Taxable Income. Only few candidates disallowed the entire amount that was expected as the correct answer.

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

The company was engaged in the business of manufacturing and selling goods to foreign customers. Hence, reduced tax rate of 14% must be applied for the export turnover while 24% for investment income. Only small number of candidates have applied both tax rates to estimate tax liability of the company. However, most of the candidates have applied the standard rate of 24% for the whole profit by not understanding export business. Some candidates have applied individual slab rates for corporate taxation.

(8) **Identification of tax credit:**

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

**Performance: Overall performance for this question was good level.**

**Question No. 09**

The question is based on the computation of personal Income Tax for the Y/A 2020/2021 of a resident individual who is a software engineer by profession. The source of income included income from employment business, and investment.

**Observations:**

The question was attempted by almost all candidates, and the fundamental knowledge in relation to individual taxation was at a satisfactory level. Average number of candidates secured at least average marks allocated for this question.

The common mistakes observed during the process of evaluation are summarized as follows:

**(a) Employment Income:**

- (1) Considerable number of candidates have taken month salary as gross salary for the entire year without multiplying by 12 months to get the total benefit of employment.
- (2) Some candidates have ignored the bonus paid out of profits of previous year as a benefit of the current Y/A.
- (3) Only few candidates correctly computed the value of motor car benefit and its fuel allowance separately.
- (4) Some candidates have taken the entire amount of telephone bill reimbursement without taking into consideration 50% of it.

**(b) Income from investment:**

- (1) Interest income from fixed deposit correctly treated as an investment income by the majority.
- (2) Average number of candidates treated the interest income from Foreign Currency Banking Unit (FCBU) as an investment income instead of exempt income.

**(c) Business income:**

- (1) Considerable number of candidates had treated the apartment rental business as a rental income under investment income, and also they claimed 25% deduction under rental relief.
- (2) The majority has correctly identified penalty paid to municipal council as a disallowable expenses. However, lawyer fees paid to get advice in the case against municipal council was incorrectly treated as an allowable expenditure.
- (3) Some candidates had taken the net profit provided by the question itself as the business income without adding back disallowable expense.

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

- (1) Claiming the entire cash donation of Rs.100,000/- to approved charity by disregarding the maximum limitation of Rs.75,000/- or 1/3 of Taxable Income.
- (2) Ignoring to claim the individual tax free allowance of Rs.3,000,000/- under tax reliefs.

- (3) Disregarding the maximum expenses relief of Rs.1,200,000/- while claiming expenditure relief. The majority have fully claimed wife's hospital bill of Rs.445,000/- that was disallowable.
- (4) Application of old individual tax rates stipulated by the Inland Revenue Act No. 10 of 2006.
- (5) Some candidates have not applied the correct flow when calculating the 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: Overall performance for this question were good level.**

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**The Overall Performance:**

The standard of the question paper was neither easy nor difficult to answer if candidates had properly planned and studied for examination. The majority of candidates have secured at least average marks allocated for questions pertaining to residency rule, VAT, partnership taxation, corporate taxation, and individual taxation. However, most of the candidates have displayed poor performance in the case of APIT, TDL, and Income Tax Administration (return submission, payments, defaults, assessments, appeals, penalty, and recovery actions) due to lack of attention to self-study text. Particularly, the fundamental knowledge in relation to tax administration was not at an acceptable level at all.

**As a whole, common reasons for Poor Performances of question paper by some Students:**

- (1) Ignoring fundamental principles in taxation, and devoting too much attention on arithmetical calculation.
- (2) Lack of awareness on relevant taxing laws such as TDL and the new Inland Revenue act and its subsequent amendments.
- (3) Poor attention to read the question paper properly before starting to answer the questions, which result to omit certain important requirements of the question due to misunderstanding.
- (4) Not devoting enough attention to past question papers and model answers that helps to improve the examination skills.



- (5) Less attention on the study pack in which most of the fundamental principles and rules are properly explained with subsequent updates.
- (6) Poor time management in answering the question paper, and some candidates have written lengthy answers for law marks. For example, answer for the question in relation to residency rule and case law.
- (7) Some candidates failed to grab the requirements of the new law Inland Revenue Act No. 24 of 2017, and still provided answers based on the old law 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 Marking 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, resulting Marking 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 to improve the performance at future examinations:**

- (1) Paying attention on time management before answering the question paper, which allows candidates to understand the important requirements of the question paper. It is of cardinal importance to summarize the answer as much as possible based on the requirements of the question and marks allocated.
- (2) Answering the past question papers and check with model answers in order to improve the examination skills.
- (3) Devoting full attention to the study pack as all areas in the question paper are covered in in the study pack. 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 answering questions. It is important to bear in mind that candidates cannot 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 calculation whenever necessary and properly link them with relevant answers.
- (8) Answering the question paper with legible handwriting that allows the Marking Examiners to understand the facts clearly if there is ambiguity in answers.
- (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 waste valuable time of both candidates and Marking Examiners.
- (11) Always use the reading time 15 minutes to read the question paper fully and then start to answer questions based on a confident level. This will allow candidates to secure more marks even though the certain their knowledge on certain parts of the question paper may be poor.

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